

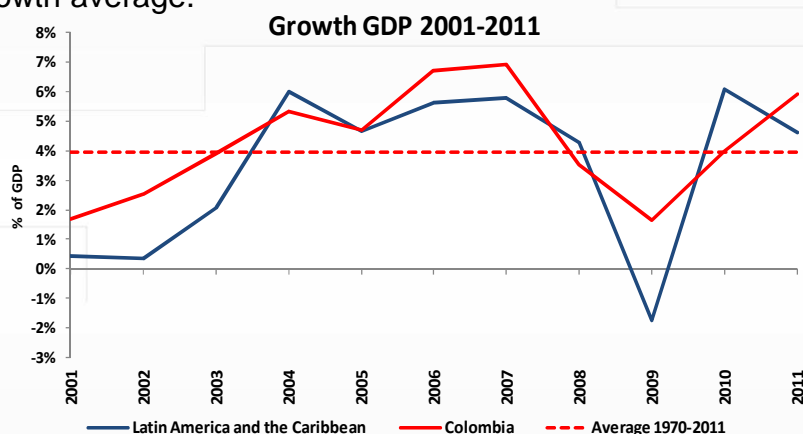
# COLOMBIA'S RECENT PERFORMANCE AND OUTLOOK

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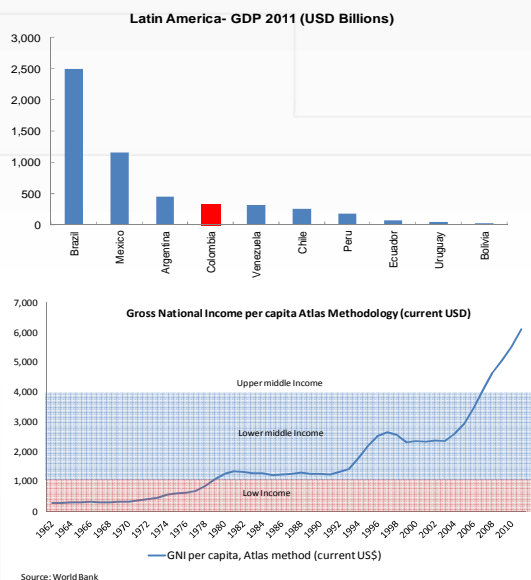
During the last decade economic growth in Colombia exceeded both its historical record and the Latin Average growth average.



Source: DANE-IMF

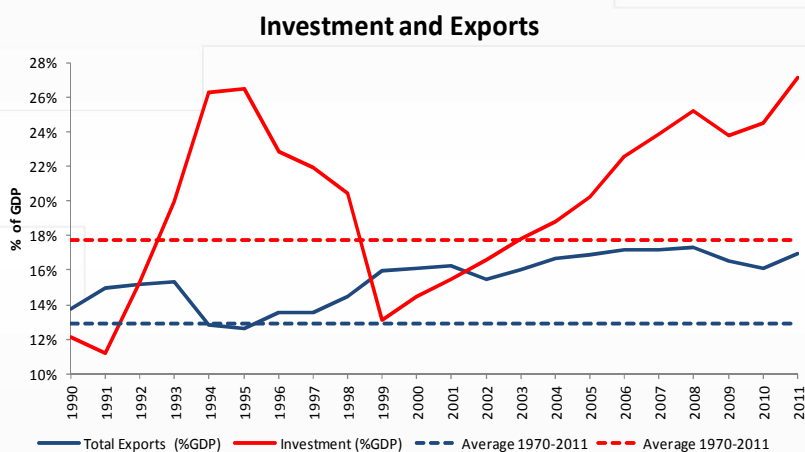


As a result, Colombia has become the fourth largest economy in Latin America, and now belongs to the group of upper middle income countries.



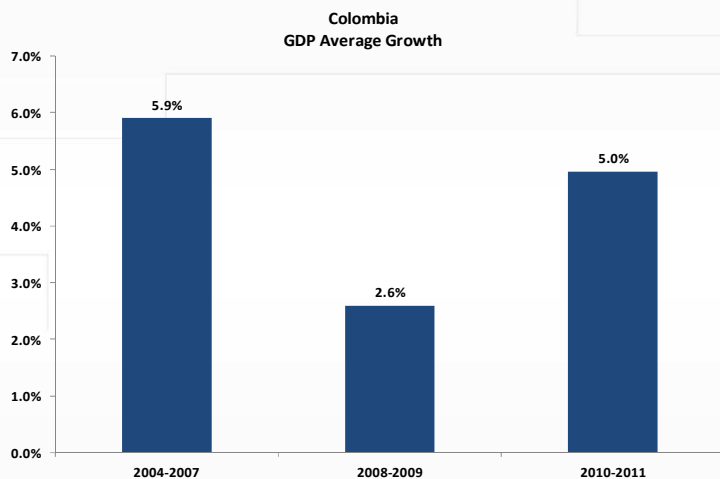
Source: IMF – World Bank

Satisfactory growth performance has been supported by the increasing share of exports and investment within GDP.



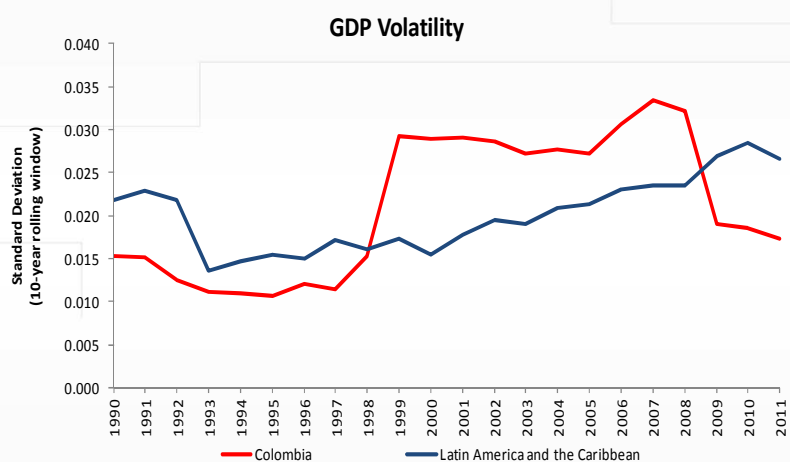
Source: DANE

The Colombian economy has also shown a remarkable resilience in the face of adverse external shocks



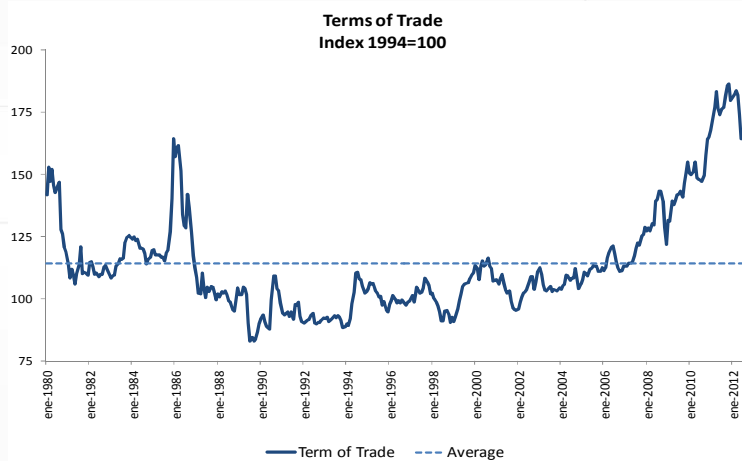
Source: DANE

As a result, the volatility of growth has been substantially subdued and is below the average for Latin America today.



Source: Banco de la Republica and IMF

The persistence of high terms of trade has also helped to moderate the effects of the global financial crisis on the Colombian economy.



The improvements in the Colombian macroeconomic policy framework were central to driving the economy along a higher growth path as well as to increasing its resilience in the face of adverse shocks.

The role of the Banco de la República's monetary policy strategy has been crucial for achieving these results.



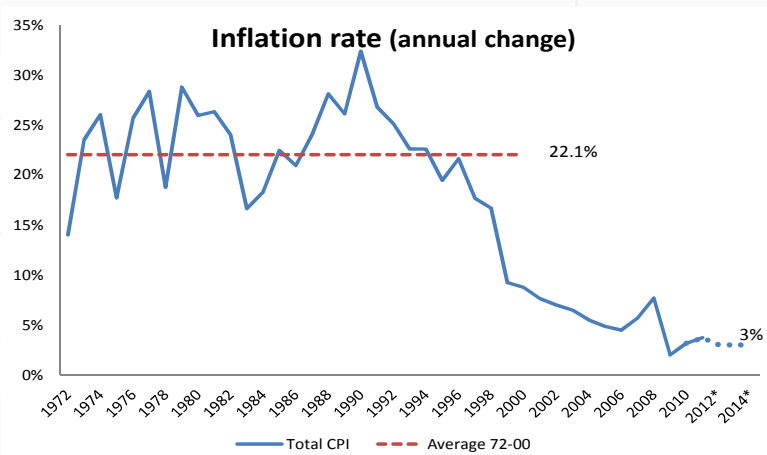
Since 1999, Banco de la República adopted a flexible Inflation Targeting strategy for managing monetary policy.

The policy objectives in this strategy are

- (i) the maintenance of a low and stable inflation (3% +/- 1%);
- (ii) the smoothing of output fluctuations around a sustainable growth path; and
- (iii) the contribution to financial stability.

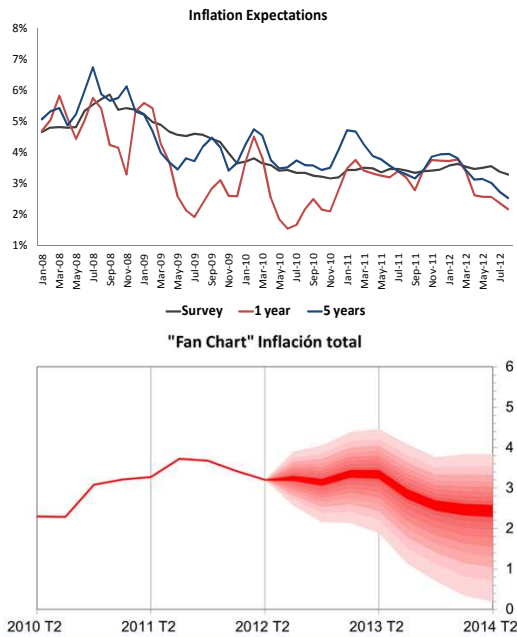


In Colombia, inflation converged to its long term target (3% +/- 1%) throughout the first decade of the century.



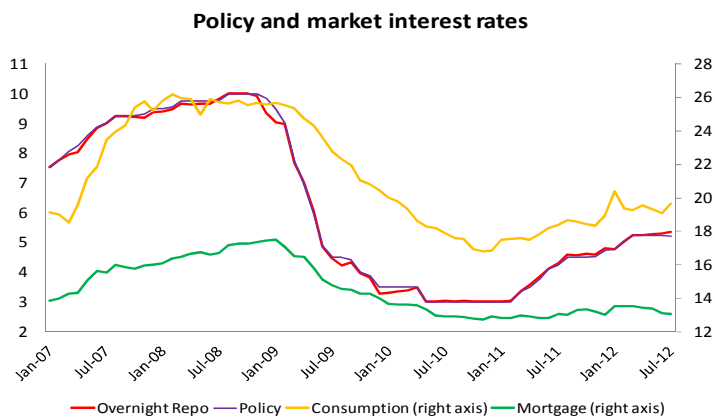
Source: DANE. \*Projected

The long term target has been met every year since 2009 and have provided a sound anchor for inflation expectations.



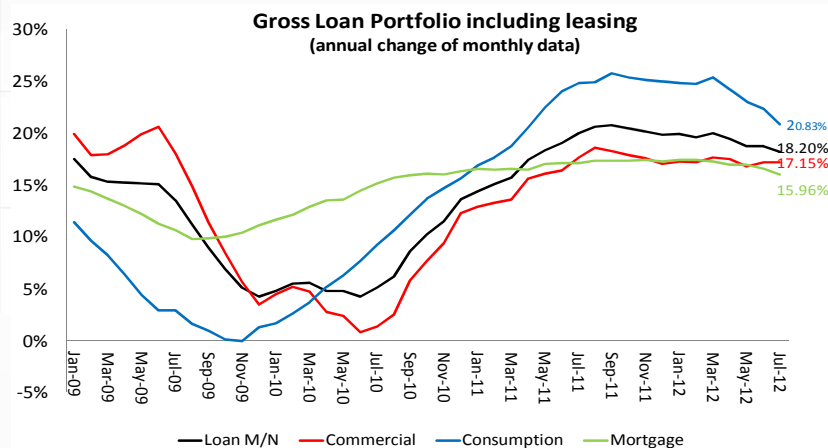
Source: MEC, SEN and Banco de la República.

The main instrument of the monetary policy strategy is the short term interest rate. Following the Lehman shock the policy interest rate was rapidly decreased, which induced a quick reduction of market interest rates.



Source: Superfinanciera and Banco de la República

As a result, financial system credit rebounded and supported economic growth.



Source: Superfinanciera and Banco de la República

A key element of the monetary policy strategy in Colombia is exchange rate flexibility. After the Lehman shock, the exchange rate was allowed to act as a buffer that protected export sectors from falling prices.



Source: Banco de la República.

In summary, the monetary policy strategy adopted in Colombia in 1999 has been successful by bringing macroeconomic stability that has enhanced productivity, investment and welfare, and has made the economy more resilience to external shocks.

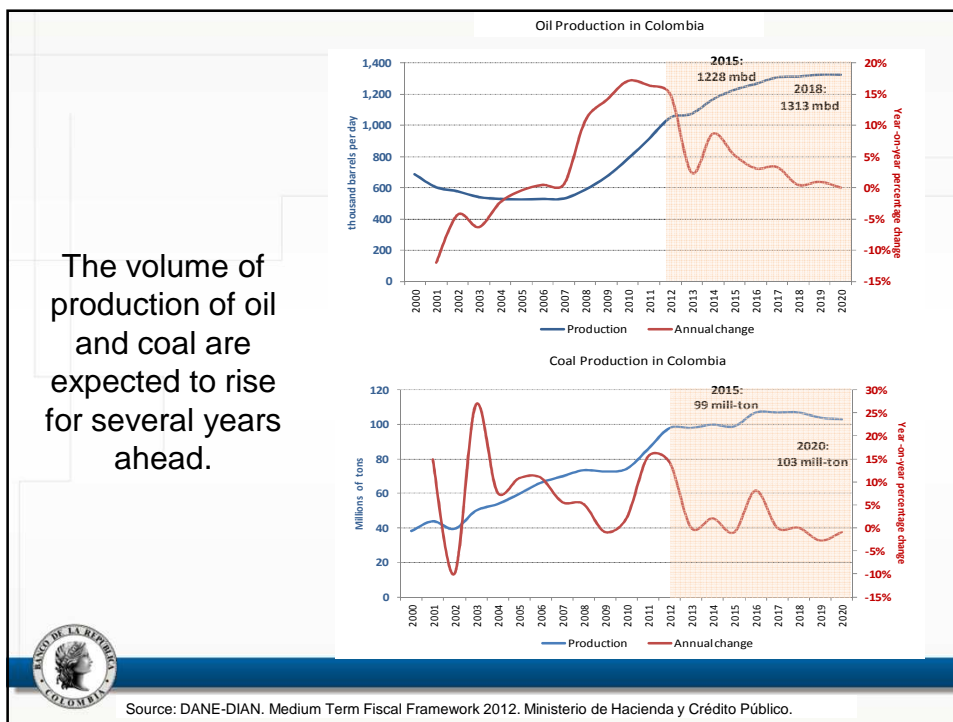
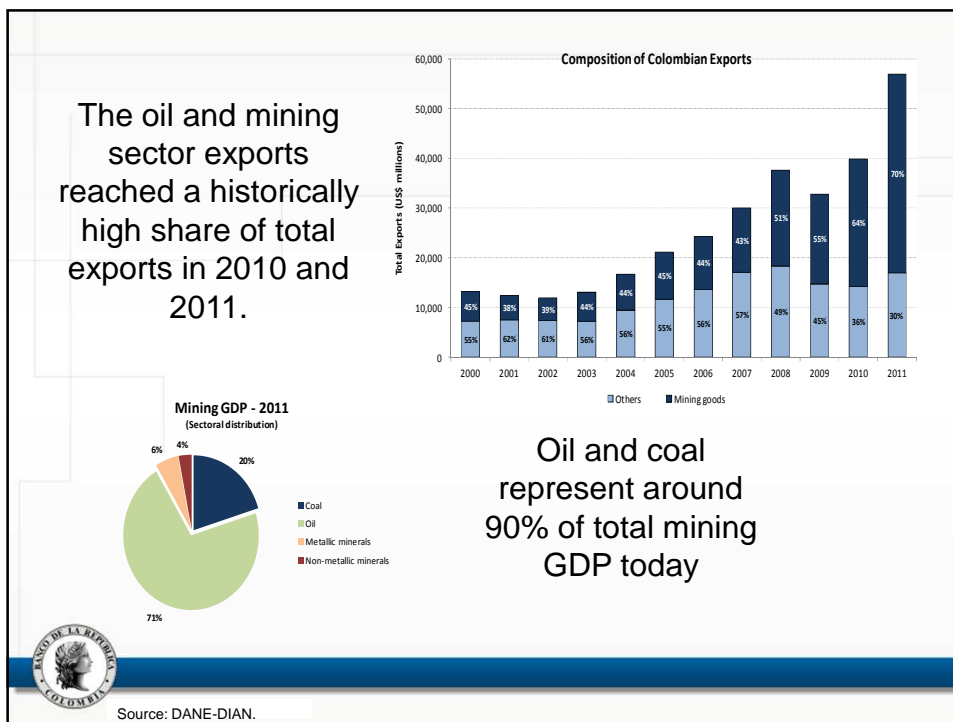
This is an essential component of the policy framework that the country needs in order to take full advantage of the opportunities in the future and to confront the challenges ahead.



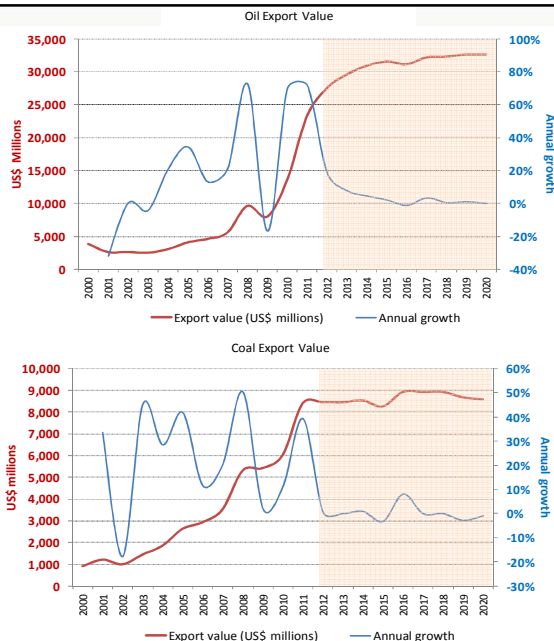
Colombia, a commodity exporter, has benefitted from the changing structure of the global economy since 2004. The strong demand and high prices for commodities have implied high terms of trade, a positive impact on national income and large FDI inflows into the oil and mining sectors.





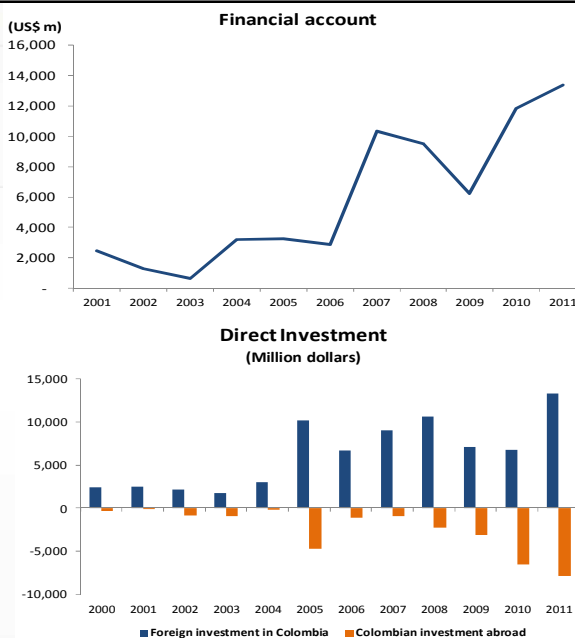


If international prices remain high, windfall income resulting from increasing exports of oil and coal will be large.



Source: DANE-DIAN. Medium Term Fiscal Framework 2012. Ministerio de Hacienda y Crédito Público.

In addition, high terms of trade and a improved risk perception of the country may continue attracting large capital inflows in the years to come.



Source: Banco de la República

**But the external environment is highly uncertain:**

- If favorable the main challenges will be maintaining macro stability in the face of an expanding energy exporting sector; and maximizing the returns on large (volatile) capital flows.



- If unfavorable the main challenge will be to absorb the external negative shocks at a minimum cost.

Interestingly,

In both cases what is crucial is to have a macro framework suited to respond to any kind of shocks,

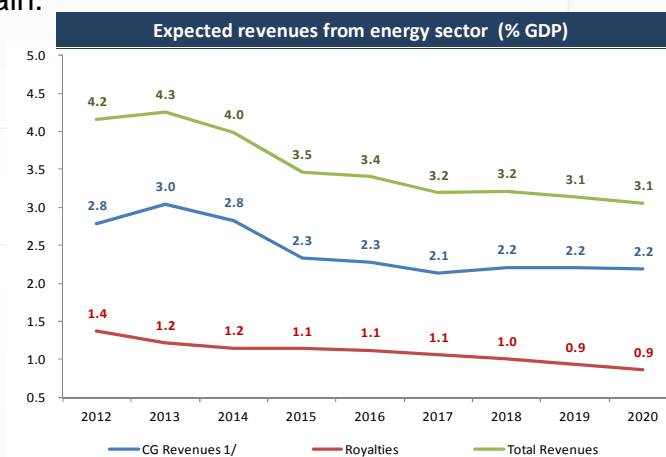


## The macroeconomic frameworks response is based on three “pillars”:

- Inflation targeting and exchange rate flexibility.
- Sound fiscal policy based on a fiscal rule and a new system for saving and distributing royalties.
- Micro and macro-prudential supervision and regulation to preserve financial stability.

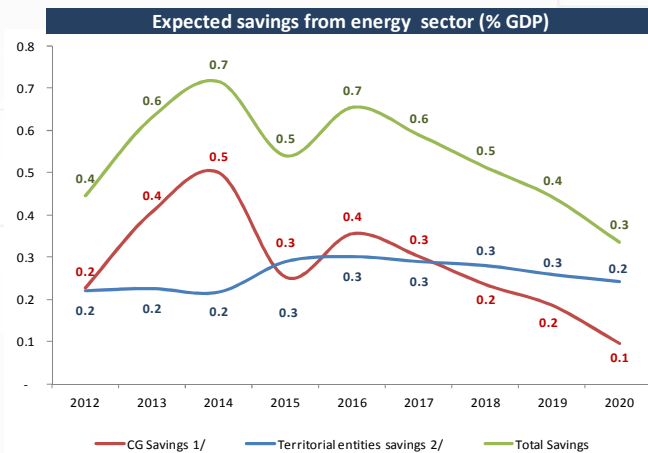


So far, fiscal revenues resulting from the expansion of the energy sector are expected to be significant, but are highly uncertain.



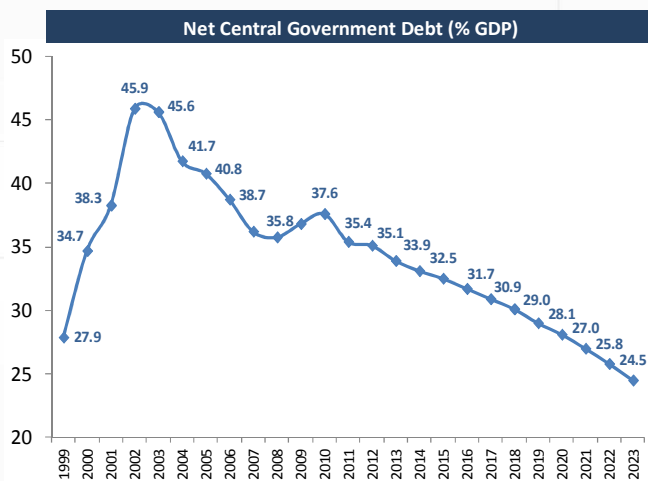
Source: Medium Term Fiscal Framework 2012. Ministerio de Hacienda y Crédito Público.  
1/ Includes revenues generated by Income tax and Ecopetrol profits

The fiscal rule and royalties distribution system are designed for the public sector to save a significant portion of the energy-related revenue windfall.



Source: Medium Term Fiscal Framework 2012. Ministerio de Hacienda y Crédito Público.  
1/ Savings generated by the fiscal rule. 2/ Saving and stabilization fund - FAE

As a result, the Government may achieve an important reduction in its debt to GDP ratio.



Source: Medium Term Fiscal Framework 2012. Ministerio de Hacienda y Crédito Público.

***To conclude:***

- The outlook for the colombian economy looks promising.
- The policy challenges are also huge. To face them properly, Colombia has an adequate macroeconomic policy framework.

