The Report to Congress by the Board of Directors of the Banco de la República

July 2001

Banco de la República
(The Central Bank)

Contents

31 July 2001
Bogotá D. C. (Colombia)

Honorable Chairman and Members of the
Third Standing Constitutional Committees of
the Senate and House of Representatives
Bogota, Colombia

Dear Sirs:

Pursuant to Article 5 of Law 31/1992, the Board of Directors of the Banco de la República hereby submits to the Congress of the Republic of Colombia a report on the macroeconomic results of the year 2001 to date, together with a description of the goals adopted by the Board of Directors for the current year and the prospects for the different macroeconomic variables. The last section of the report contains information on the composition of international reserves and forecasts for the financial position of the Banco de la República during the year 2001.

Sincerely,

Miguel Urrutia Montoya
Governor, Banco de la República

I

Introduction

The following report, presented to the Colombian Congress, offers a detailed look at recent economic performance and macroeconomic policy implemented during the year 2001 to date. Annual inflation, measured by the consumer price index (CPI), declined gradually in the first six months of the year due to the monetary policy applied up until then and the existence of unused installed capacity in various sectors of the economy. With respect to the balance of payments, the current account showed a deficit in the first quarter of 2001, following equilibrium in the year 2000. This was due to considerable growth in imports, the downturn in oil export volumes, and lower prices for coffee on the international market. Unemployment continued to be the most serious problem in the Colombian economy, in spite of having declined slightly during the year to date. On the other hand, following the drop in product registered in 1999, the economy recovered during the year 2000 and registered moderate growth rates. Economic activity continued to increase throughout the first quarter of 2001, although not as dynamically. This was due, in part, to factors associated with supply, such as the strike in the beverage industry and the slump in oil production, and, in part, to factors related to domestic demand sparked by uncertainty over the future of the economy and the persistence of high unemployment. The slowdown in the Colombian economy is not entirely different from the situation in a number of Latin American countries. This suggests the presence of shocks common to the region's economies, as discussed in detail in Chapter III of this report.

The similarity between performance of the Colombian economy throughout the nineties and that of the Latin America countries as a whole is illustrated in Chapter III. Capital flows to the Latin American countries are particularly important to explaining the so-called "Latin American economic cycle." Their presence limits the extent to which national authorities are able to implement counter-cyclical policies, particularly if there have been serious imbalances in the economy for some time.

As is customary, the report offers a detailed description of the macroeconomic policy applied during the first half of 2001 with respect to monetary, exchange, financial and fiscal matters. A coherent macroeconomic policy has helped the economy to recover and contributed to lower inflation. Decisions on monetary policy were intended to aid economic growth and to make sure the inflation target would be met. There has also been important progress towards lowering the fiscal deficit. This, in turn, has boosted the confidence of domestic and international investors alike. The major indicators in the financial system point to a substantial improvement in the sector.

The fifth section of the report outlines macroeconomic prospects for 2001, specifically in terms of inflation, the balance of payments, economic growth and the fiscal deficit. The gradual decline in inflation continues to be the result of a carefully implemented monetary policy. Accordingly, the Board is confident the target of 8% inflation for 2001 will be met. As to the balance of payments, the current account deficit is expected to be 3.0% of GDP in the year 2001, thanks to a decline of 6.5% in goods exports and a 12.1% increase in goods imports. The weak growth in product observed in the first quarter of 2001 prompted the government to revise its projections for the year as a whole. The new projections point to 2.4% economic growth. The consolidated public sector deficit will be around 2.8% of GDP by the end of the year, with a variation close to 0.6% of GDP in relation to the size of the deficit during the year 2000.

The report ends with a description of international reserves and the financial position of the Banco de la República.

II

Recent macroeconomic performance

Following the downturn in product observed in 1999, the Colombian economy recovered during 2000 and registered positive but moderate growth rates. However, this increase has slowed since the fourth quarter of last year, as has been the case in a number of Latin American countries, suggesting shocks common to the region's economies.

The economic slowdown observed in Colombia during the first quarter of 2001 was due to factors associated with supply, such as the strike in the beverage industry and the slump in oil production brought on primarily by attacks on oil facilities, and to factors associated with domestic demand sparked by uncertainty over the future of the economy and the persistence of high unemployment.

On the other hand, annual inflation, measured by the consumer price index, declined gradually during the first six months of the year, thanks to the monetary policy applied up until then and the existence of unused installed capacity in various sectors of the economy. This is coherent with the target of 8% inflation set by the Board of Directors of the Bank for 2001.

Following equilibrium in 2000, the balance of payments showed a current account deficit in the first quarter of 2001. This was due to high import growth, lower volumes for oil exports, and falling coffee prices on the international market. The trend in the major macroeconomic variables during the year to date is outlined in the following section.

A. Inflation Results and Basic Trends

1. General Considerations

Annual inflation at June was 7.9%, according to the CPI. This figure marks four consecutive months of annual consumer inflation equal to or below the target of 8% set by Board of Directors of the Banco de la República for 2001. Throughout the first half of this year, annual inflation continued the downward trend observed in the second half of 2000 and was 1.8 percentage points below the level registered for the same period in 2000. In contrast with the second half of 2000, when less pressure from food prices was crucial to lowering inflation, the decline in prices during the course of 2001 was due more to a positive trend in the cost of housing, culture and recreation, transportation and miscellaneous expenses than to good performance in food prices.

As was the case during 2000, the gradual decline in inflation during this period, in keeping with the target, was also the result of a carefully managed monetary policy, as suggested by the level of basic inflation. During the course of 2001 to date, basic annual inflation, calculated as the average of the two most reliable indicators obtained by the Banco de la República (core inflation and CPI without food), registered a slow drop to 7.9% at June, the lowest in history for these series. Specifically, basic inflation, measured by the CPI without food, was 7.7% at June; core inflation measured on the nucleus was 8.2% (Figures 1 and 2)[1]. As explained in previous reports, core inflation is the component of consumer inflation that excludes price variations associated with shocks in supply and, therefore, can be attributed to the position inherent in the country's monetary policy.

According to surveys on expectations conducted regularly by the Banco de la República, the decline in inflation during the course of 2001 has been accompanied by additional reductions in the inflation expectations of economic agents. The survey in January showed inflation was expected to be 8.9% by the end of the year; the one in April showed 8.5% anticipated inflation. Inflation expectations declined throughout 2000, helping to accomplish the inflation target for that year (Figure 3). This reflects the increased credibility of the Bank's anti-inflation policy which, if maintained, will significantly reduce the cost of lowering inflation.

2. The Consumer Price Index (CPI)

The course of consumer inflation in early 2001 was in keeping with the predictions presented by the Bank in its two previous reports to Congress. Considering past inflation and inflation expectations for 2001, the year to date has seen rather sizable adjustments in prices for many items, such as education, health and public utilities. There were also important adjustments in food prices, especially for basic foods, due to the seasonal decline in commodity supply.

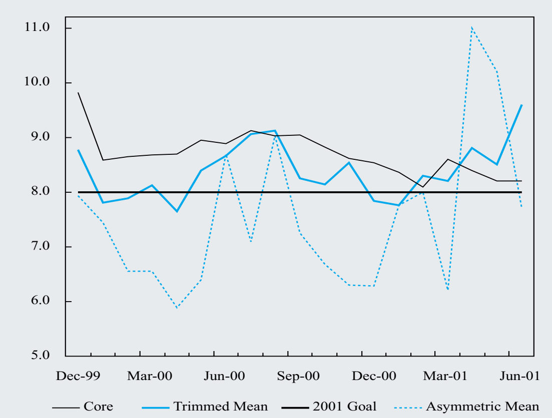
Inflation in Colombia has a strong seasonal component, with the first half of the year being the time when most prices change. For this reason, the coming months can be expected to see fewer and less sizable price variations, and more moderate changes in the CPI. This allows for optimism with respect to inflation performance in the current year.

[1] The other two indicators usually included in this report (the asymmetric mean and the trimmed mean) have been far too variable in recent months to qualify as core inflation indicators. Therefore, they will not be included in the next report to Congress.

Figure 1
Core inflation indicators
CPI without food
(Annual percentage change)

Source: DANE and the Banco de la República, SGEE

Figure 2
Core inflation indicators
(Annual percentage change)

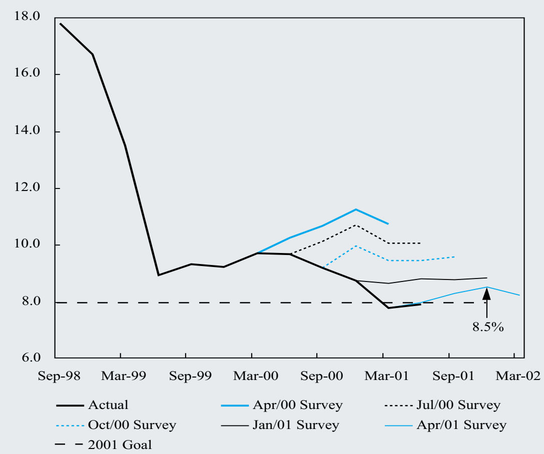


Source: Dane and the Banco de la República, SGEE.

Annual inflation at June, measured by the CPI, was 6.2%, having been 7.0% during the same period in 2000. As noted earlier, less price variation in the year to June has lowered annual inflation.

As to items, the trend in inflation was particularly favorable for housing, culture and recreation, transport and miscellaneous expenses, which registered less of

Figure 3
Actual inflation and changes in expectations of inflation
(Annual inflation)



a price change than was observed during the same period the year before. (Table 1).

A highlight between January and June was the low increase in housing prices (annual variations of two and three percent). This was due to virtually no rise in rents, and more than offset the sizable hike in public utility rates, which was occasioned by factors such as the elimination of consumer subsidies. However, recent months have seen a slowdown in the increase in public utility rates, as confirmed by the annual change in prices for this item at June 2001 (18.6%) compared with December (25.0%) and June 2000 (25.1%) (Figure 4).

The annual change in transport prices (including communications) surpassed overall consumer inflation, but has slowed in recent months because of smaller increases in the price of telephone service and fuel, compared with those registered the year before. The more moderate rise in fuel prices during the current year was predicted in the last report to Congress. The annual increase in fuel prices at June was 16.3%, which is well below the rates observed in December (30.3%) and June (29.6%) of last year.

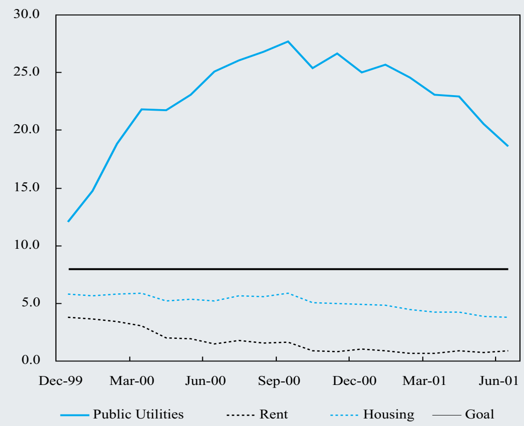
There was also a substantial slowdown in price changes for "miscellaneous expenses". The annual variation in prices for these items was 15.2% at December 2000 and only 9.7% at June. This is attributed to financial services (handling fees for debit and credit cards,

Table 1
Change in the CPI by major groups
(percentages)

	Change in year to date		Change in entire year			
	At Jun/2000	**At Jun/2001**	**Jun/2000**	**Dec/2000**	**Mar/2001**	**Jun/2001**
Total	7.0	6.2	9.7	8.7	7.8	7.9
Food	7.9	9.0	9.9	7.4	7.1	8.5
Housing	3.6	2.5	5.2	4.9	4.2	3.8
Clothing	1.7	1.9	2.8	3.6	3.5	3.7
Health	7.2	7.5	11.2	10.3	11.1	10.7
Education	7.9	9.0	9.7	9.4	8.2	10.6
Culture and recreation	6.0	5.7	3.0	11.7	11.1	11.3
Transport	10.7	7.5	18.4	16.2	15.2	12.9
Miscellaneous expenses	12.4	7.0	17.4	15.2	9.3	9.7

Source: DANE.

Figure 4
Annual Change in the Housing CPI
(Percentages)



Source: DANE.

among others), which registered an annual increase of 8.4% as opposed to 22.2% in December 2000.

Two items registering less than positive price performance in first five months of 2001 were education and health. Expectations for this year point to a variation in the price of education close to last year's rate of inflation and not far from the target of 8%. Among other reasons, this is due to regulations on the price of education, which tend to link changes to the rate of inflation for the previous year. Given the weakness anticipated for internal demand this year and the decline in available family income, major increases in this area were unlikely.

Nonetheless, annual inflation in education at June was 10.6%, which is well above the inflation target and surpassed previous-year inflation in the sector (9.4%). (Table 1). Considering an accumulated increase in prices of 9.0% during the first half of the year, and the price adjustments expected in the third quarter, which coincides with the start of the academic year at calendar B schools, inflation in education will exceed 8% this year and is likely to surpass last year's adjustment in price.

As to health, the annual variation in prices rose slightly at the end of 2000, after having declined throughout the year (Table 1). This was due primarily to increased inflationary pressure exerted by health services (check-ups, hospitalization, etc.), which saw a considerable drop in prices throughout the year as a result of weak demand. The new upswing in these prices signals a more dynamic demand in the sector.

Devaluation, which normally has considerable impact on inflation in health because of the price of medicine, continues to explain the fast pace at which the price of medicine has changed during the year to date. No additional inflationary pressure was observed in the first half of the year, as indicated by the fact that the annual variation in medicine prices at June (13.7%) was below that registered at the end of last year. This is surprising, given the important pace of devaluation in the first four months of the year and might imply the possibility of additional increases in the price of medicine during the coming months.

The annual variation in food prices experienced an upturn in April of this year, after declining in the 10 previous months. The last report to Congress anticipated some acceleration in annual inflation for this item during the first half of the year, due in part to the excellent trend in food prices during the last quarter of 2000, which would have been difficult to repeat. With the exception of a highly favorable figure for June (-0.6%), price adjustments in recent months surpass those anticipated originally. The annual variation in food prices at June was 8.5%, which is an increase of one percentage point compared with the variation observed at December.

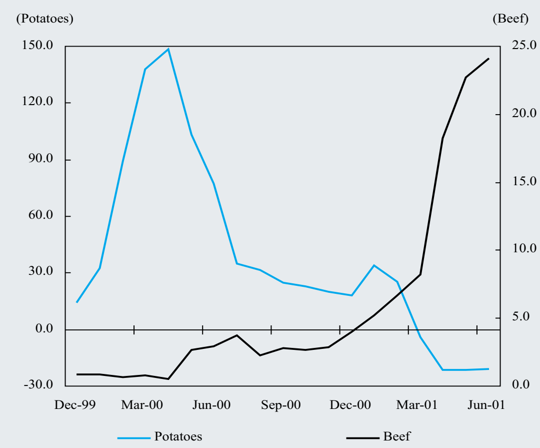
There are two important aspects of the trend in food prices during the year to date. As usual, the first quarter saw a major increase in the price of most commodities, particularly tubers, which have considerable bearing on the cost of living. These increases, including a 63.9% rise in potato prices between December and March, began to reverse gradually as of April. For example, the price of potatoes has fallen by almost 20.0% in the last three months. At the end of June, its variation for the year to date was 30.2% and the price was below that of the same month in 2000 (Figure 5).

Food prices in the first five months of the year were influenced primarily by the substantial increase in beef prices. At June, the variation in beef prices for the year to date was 22.5%, with most of this increase occurring in the last three months (Figure 5). Although seasonal factors contributed to the upswing, as did a shortage of rain in early 2001, which affected the quality of grass and delayed efforts to fatten the herd, there are also a number of long-term factors related to the cattle-raising cycle.

Cattle ranching in Colombia involves a five-year cycle, on average, including a liquidation stage and a holdback stage. The last segment of liquidation, during which slaughter exceeds calving, occurred between 1993 and 1999. It was a particularly long stage in the history of the series, probably because of problems with law and order in the cattle regions and the standstill in the demand for beef, which slowed investment in the sector.

The end of the sacrifice stage and the onset of holdback, expected as of mid-2000, appears to have begun in earnest in early 2001. During holdback, ranchers try to replenish their herds by reducing the number of cattle slaughtered in proportion to number of calves born. This diminishes the supply of meat and raises prices, as was the case in recent months. Added to this situation are expectations of an upswing in beef exports, inasmuch as northern Colombia was declared free of hoof-and-mouth disease. Moreover, beef prices in Venezuela are high. This bolsters livestock exports from border regions. These last two factors may have aggravated the rising trend in beef prices during the current holdback stage, which makes it impossible to rule out additional increases in the price of this product during the months ahead.

FIGURE 5
ANNUAL CHANGE IN POTATO AND BEEF PRICES
(PERCENTAGES)



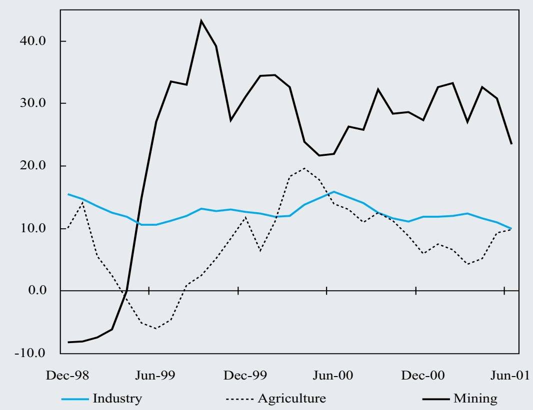
Source: DANE.

3. The Producer Price Index

Annual inflation measured according to the producer price index (PPI), was 10.2% at June, which is inferior to the rate observed in December 2000 (11.0%) and well below that registered at June 2000 (15.6%). The last six months have seen a slight downturn in producer inflation, which gained forced with a reduction of almost one percentage point in June occasioned by the highly favorable trend in prices for imported goods, as indicated later.

Nonetheless, some inflationary pressure on producer prices for specific items was observed in these six months. As with the CPI, most of the adjustments in the PPI pertain to cattle and beef. An analysis of the PPI by economic destination shows the increase in cattle prices to be largely responsible for the acceleration in annual price variations for farm products as of December. Added to this situation is the annual change in prices for other agricultural items such as vegetables, fruits and parchment coffee. This, as a whole, explains the higher annual variation in the agricultural PPI at June (9.8%) in comparison with the rate in December 2000 (6.0%) (Figure 6).

Figure 6
Producer price index, by economic destination
(Annual percentage change)



Source: Banco de la República.

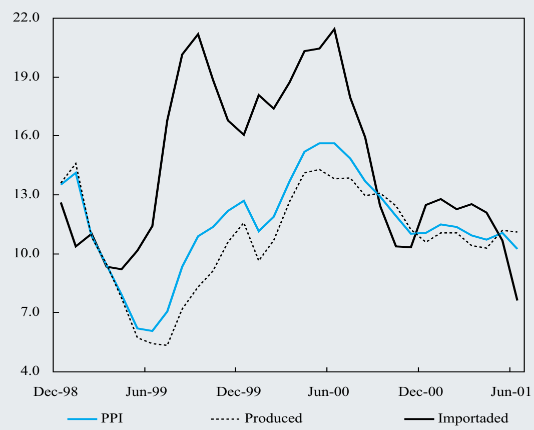
In the first half of the year, the rise in prices for agricultural goods was partially offset by the positive trend in the PPI for industrial goods and mining products. The annual variation in industrial prices at June was 10.0%, which was less than in December 2000 (11.9%) and well below the variation observed by June of that year (15.9%) (Figure 6).

The slowdown in inflation in the industrial and mining sector during the year to date was largely the result of a drop in coffee threshing prices, which are tied to the international price of coffee and account for a sizable share of the PPI. This compensated for the larger increase in prices on several other industrial items, such as automobiles, compared with the year 2000. The annual variation in the PPI for imports fell noticeably in June, thanks to a decline in the price of certain fuels.

As to changes in producer prices by origin, the index of goods produced and consumed in the country pushed producer inflation up from 10.6% annual growth at December 2000 to 11.1% at June 2001. This was due to a major change in the price of agricultural goods such as livestock, beef and parchment coffee, as mentioned earlier, and compensated for less inflation in the price of manufa-ctured goods. The larger variation in prices for goods produced and consumed in the country did not lead to a major increase in producer inflation during the first half of 2001, thanks to the positive trend in import prices. Their annual variation went from 12.5% at December to 7.6% at June 2001 (Figure 7).

The slowdown in import prices seems surprising at first glance, considering the extent to which the peso devaluated during the past year and the accelerated speed of devaluation in early 2001. To a large degree, and in a relatively short period of time (two quarters), prices for these goods tended to reflect movement in the exchange rate. However, during the past 18 months, the transmission of devaluation to import inflation and to overall inflation has been low because prices in foreign currency for most imported goods have declined, as illustrated in Figure 8. This is due to a slowdown in demand worldwide, led by less growth in the United States economy and by devaluation of the euro, the yen and other currencies of countries from which Colombia imports, such as Brazil. In the case of automobiles, which have not experienced this reduction, adjustments in peso prices have been more frequent. Furthermore, revaluation in June of this year allowed for significant, additional reductions in the pace at which peso prices for certain imports

Figure 7
Producer price index by origin
(Annual Percentage Change)

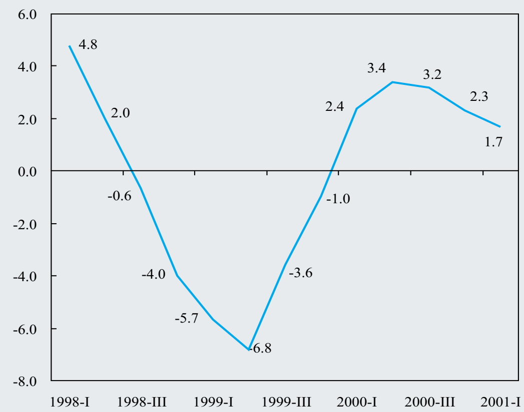


Source: Banco de la República.

Figure 8
Import price index in foreign currency (PPI/TRM) base June 1999 = 100
(January 1991 - June 2001)

Source: Banco de la República, Calculations by SGEE with information from the PPI.

Figure 9
Annual growth in quarterly GDP
(percentage)



Source: DANE.

changed, so much so that annual inflation for imported goods fell by 3.1 percentage points in the last month alone (Figure 7).

B. Economic activity and employment

1. Economic Activity

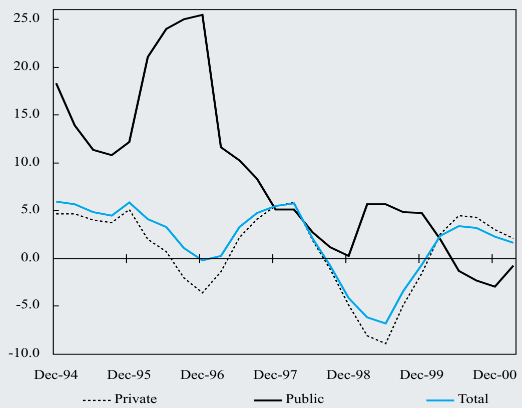
Growth in the Colombian economy was positive throughout the year 2000, following six quarters of consecutive decline. Annual economic growth in each quarter of the previous year was 2.4%, 3.4%, 3.2% and 2.3%, respectively. In other words, expansion during the year as a whole was 2.8%, which is close to the government's target of 3.0%. According to the latest figures from the National Bureau of Statistics (DANE), economic growth in the first quarter of 2001, compared with the same quarter the year before, was 1.67% (Figure 9).

Economic growth has been close on the heels of private economic activity. This means that economic recovery has been generated, as a whole, by more expansion in the private sector and not by increased public spending (Figure 10). Nevertheless, growth in the private sector during the first quarter of 2001 was less than in the three previous quarters. More of an increase in the private sector would have led to greater expansion of the economy overall.

Less of an increase in private production during the first quarter of 2001 was due, in part, to supply shocks stemming from the strike in the beverage industry, attacks on the nation's oil facilities and the drop in international investment in the oil sector. According to the Ministry of Finance and Public Credit, had these events not occurred, gross domestic product (GDP) overall would have grown by almost 2.2%. The impact of these shocks is calculated as an approximate loss of 0.5 percentage points in GDP growth (Figure 11). Not counting the effects of supply shocks, economic growth in the first quarter of 2001 was similar to that of the same period the year before.

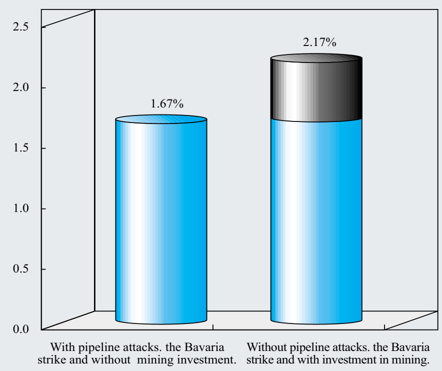
As to sectors (Table 2), the first quarter of 2001 saw a considerable slowdown in industrial growth compared with 2000. An annual cutback of 10.8% in beverage production (because of the strike in this sector), negative growth in the wood industry (-9.9%) owing to problems with the supply of raw materials, and a slowdown in industries such as petroleum by-

FIGURE 10
ANNUAL GROWTH IN PUBLIC, PRIVATE AND TOTAL QUARTERLY GDP
(PERCENTAGES)



Source: DANE.

FIGURE 11
ANNUAL GROWTH IN QUARTERLY GDP, WITH AND WITHOUT SUPPLY SHOCKS
(PERCENTAGES)



Source: DANE. Calculations by the Credit General Macroeconomic Policy Division of the Ministry of Finance and Public Credit (DGPM)

products (-3.2%), foodstuffs (-3.0%), meat and fish (-3.0%) and sugar (-0.5%) are some of the more important reasons for this situation. Nevertheless, industry as a whole registered an annual increase of 2.2% in the first quarter of the year, primarily because of growth in the production of transport equipment (31.6%), leather (28.1%), tobacco (16.8%), paper and cardboard (13.7%), machinery and equipment (10.2%), and rubber products (8.4%).

The rate of growth in agriculture was 3.4% in the first quarter of the year. This exceeds the rate observed for the same period the year before, but is below average economic growth for the year 2000 (5.2%).

TABLE 2
GROSS DOMESTIC PRODUCT (GDP) BY BRANCH OF ECONOMIC ACTIVITY (1994=100)
ANNUAL PERCENTAGE GROWTH
(UNSEASONALIZED SERIES)

Area of economic activity	**2000 (e)**					**2001(e)**
	I	**II**	**III**	**IV**	**Total**	**I**
GDP	2.4	3.4	3.2	2.3	2.8	1.7
Agriculture. forestry. hunting and fishing	1.9	7.5	3.5	7.9	5.2	3.4
Mining and quarrying	(0.9)	(7.3)	(7.5)	(5.8)	(5.4)	(4.0)
Electrical power. gas and water	3.6	1.7	1.0	2.9	2.3	1.8
Manufacturing industry	8.6	11.5	13.0	6.4	9.8	2.2
Construction	(6.7)	(1.8)	0.3	5.1	(1.0)	(3.4)
Commerce. repairs. restaurants and hotels	3.9	7.3	6.2	3.0	5.1	3.1
Transport. storage and communications	3.4	4.0	3.9	3.2	3.6	2.6
Financial establishments. insurance. real estate and business services	(1.3)	(0.0)	1.1	(0.7)	(0.3)	1.0
Servicios sociales. comunales y personales	0.6	(2.1)	(1.1)	(1.6)	(1.0)	(0.4)

(e) estimate

Farm sector performance, positive as of last year, is the primary reason for the increase in agricultural output. Coffee production rose by 20.5% in the first quarter of the year, despite the crisis generated by the sharp drop in prices. The same period saw an increase of 3.4% in other farm products, but livestock and animal products fell by 1.5% after registering positive growth the year before.

Items such as commerce and transport , which are tied to the trend in marketable supply, registered respective increases of 3.1% and 2.6% during the first quarter of the year. This is below the variation observed during 2000 (5.1% and 3.6%, respectively).

The positive trend in building construction, which rose by 9.0% in the first quarter, was offset by a decline in civil engineering works (-12.7% annual growth), particularly those associated with government contracts and facilities for the oil industry. The construction sector felt the effect this situation and declined by 3.4% in the first quarter of the year, after two consecutive quarters of positive growth.

Attacks on the Caño Limón-Coveñas Oil Pipeline, which made it impossible to pump and export 100,000 barrels of oil per day throughout most of the quarter, coupled with natural depletion of the country's principal oil fields, have produced negative annual growth rates for the mining sector since the fourth quarter of 1999.

As to demand, the change in GDP during the first quarter of 2001 showed growth rates for end consumption and gross fixed capital formation similar to those of the previous year and growth in total imports, in real terms, superior to the increase in total exports (Table 3).

The rise in end consumption during the first quarter of the year (1.2%) is largely explained by an increase of 1.9% in household consumption, which was below the increase observed for 2000 as a whole (2.6%). This was offset by less of a decline in government spending (-0.8%) compared with the entire 12 months of 2000 (-2.0%).

Civil works are the investment item reflecting the least growth, having declined by 12.7% in the first quarter of the year. Investment in transport equipment, machinery and equipment, and building construction increased at respective rates of 39.1%, 15.1% and 9.9%, thereby offsetting the negative effect of less investment in civil works. Consequently, the annual increase in gross fixed capital formation during the first quarter of 2001 (3.8%) was similar to that registered for the year 2000 as a whole.

2. Employment and Wages

According to the latest continuous home survey (ECH) by DANE, the unemployment rate (ratio of the number of unemployed to the economically active population) declined from 20.5% to 18.1% between January and May 2001 in the 13 metropolitan areas and from 16.4% to 14.3% nationwide (Figure 12)[2]. However, unemployment in the 13 metropolitan areas experienced a slight rebound of 0.3 percentage points between April and May.

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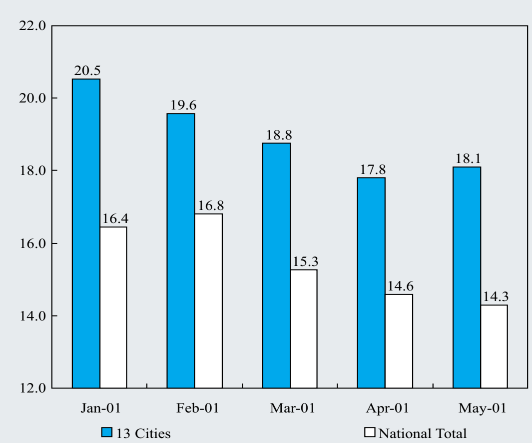
[2] The 13 cities and their metropolitan areas are Bogota D.C., Barranquilla, Cali, Medellín, Bucaramanga, Manizales, Pasto, Pereira, Cúcuta, Ibagué, Montería, Cartagena and Villavicencio.

FIGURE 12
UNEMPLOYMENT RATE
NATIONAL TOTAL AND 13 METROPOLITAN AREAS
(PERCENTAGE)



Source: DANE, ECH.

Table 3
GDP by spending component (1994 = 100)
Annual growth
(unseasonalized series)

Branch of economic activity	2000 (e)					2001(e)
	I	II	III	IV	Total	I
End consumption	2.4	2.2	1.1	(0.0)	1.0	1.2
Household	2.7	3.9	2.6	1.3	2.6	1.9
Non-durables	3.7	4.1	2.3	(1.1)	2.2	0.2
Semi-durables	4.8	8.2	7.5	8.1	7.2	5.1
Utilities	1.3	1.9	1.9	1.1	1.5	2.2
Durables	11.2	20.1	10.3	11.2	13.0	8.7
Government	1.3	(2.2)	(3.3)	(3.8)	(2.0)	(0.8)
Gross capital formation	8.7	20.1	17.0	4.6	15.3	7.2
Gross fixed capital formation	(1.2)	4.9	6.7	5.2	3.8	3.8
Machinery and equipment	10.7	14.9	19.8	10.7	13.9	15.1
Transport equipment	6.8	28.9	(9.9)	(15.7)	1.2	39.1
Buildings	(16.1)	(11.5)	10.9	7.2	(3.2)	9.9
Civil works	(2.0)	4.3	(4.2)	4.5	0.6	(12.7)
Variation in inventory	n.c.	n.c.	n.c.	n.c.	n.c.	n.c.
End internal demand	3.3	4.6	3.3	0.6	2.9	2.1
Total exports	3.8	2.9	6.0	7.2	5.3	6.6
Total imports	8.2	9.1	6.5	(0.3)	5.8	9.2
Gross domestic product (GDP)	2.4	3.4	3.2	2.3	2.8	1.7

(e) Estimate
n.c. not computable
Source: DANE

The decline in unemployment was due more to a reduction in the economically active population (EAP) and less to an increase in the employed population. As Figure 13 illustrates, the global participation rate (GPR = ratio of the economically active population (EAP) to the working age population) declined from 64.8% to 62.8% in the first five months of this year in the 13 cities and from 63.4% to 59.1% nationwide[3]. The employment rate (ER) remained near 51.0% in the 13 cities, and declined from 52.9% to 50.6% between January and May 2001 for the nation as a whole (Figure 14). Unemployment in Bogotá, Medellín, Bucaramanga, Manizales and their metropolitan areas was above 20.0% in the first quarter of the year. It was less in Cali, Barranquilla, Pasto and the surrounding areas[4].

Industrial employment, according to the DANE monthly manufacturing sample (MMS), rose by 2.2% in the first quarter of 2001 compared with the same period in 2000, thanks to less of a decline in permanent employment and an increase in temporary employment. According to the same survey, the downward trend in wage increases, which had been observed for some

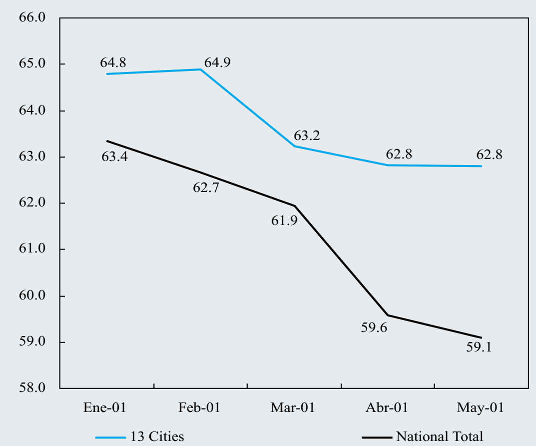
[3] In 2000, DANE revised and updated the methodology of its national home survey (ENH), now known as the continuous home survey (ECH), to include new concepts for measuring employment and unemployment, among others variables. Moreover, the survey is now monthly. In January 2001, ECH figures on the working age population (PET) began to be estimated on the basis of the 1993 census and not according to projections on the total population (PT). Therefore, as of that date, the figures are not comparable.

[4] Calculated by the Banco de la República Economics Research Division.

time, was interrupted by wage hikes in December of last year: 12.1% for workers and 14.8% for employees. This was a considerable increase, inasmuch as unemployment was 19.7% and inflation 8.7%.

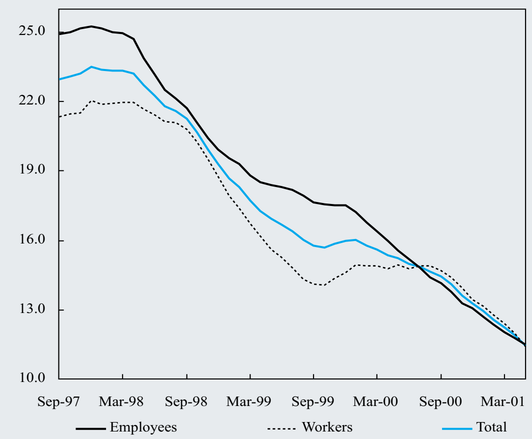
Wage increases during the first quarter of 2001 were below average increases for the previous year. Even so, they continued to be high with respect to the inflation target set by the Banco de la República for the current year (8%) and the public's expectation with respect to inflation, which takes that target into account (Figure 15). This nominal wage increase, coupled with the decline in inflation, led to a real wage increase of 1.4% in the first quarter of 2001 for the group of the people employed in industry (Figure 16).

Figure 13
Global participation rate
National total and 13 metropolitan areas
(Percentage)



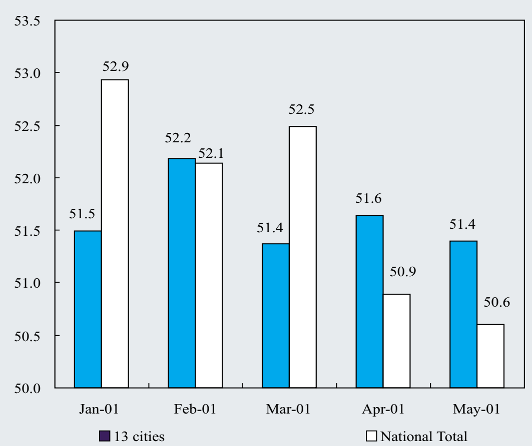
Source: DANE, ECH.

Figure 15
Nominal wage - manufacturing industry
(Percentage changes in the entire year)
(Figures at May 2001)



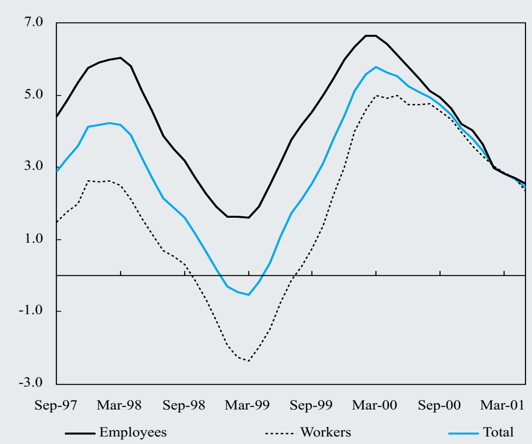
Source: DANE Monthly Manufacturing Sample

Figure 14
Employment rate
National total and 13 metropolitan areas
(Percentage)



Source: DANE, ECH.

Figure 16
Real wage - manufacturing industry
(Annual percentage changes, 12 month accumulated)
(Figures to May 2001)



Source: DANE, Monthly Manufacturing Sample.

Table 4
Colombia's balance of payments - quarterly
(millions of dollars)

	2000					2001	Difference I Qtr.
	I Qtr.	II Qtr.	III Qtr.	IV Qtr.	Total	I Qtr.	2001-2000
I. CURRENT ACCOUNT	(24)	(26)	58	33	41	(736)	(712)
Income	4,261	4,319	4,656	4,692	17,929	4,150	(111)
Outlays	4,284	4,345	4,598	4,660	17,888	4,886	601
A. Nonfactor goods and services	265	237	446	320	1,268	(289)	(554)
1. Goods	542	545	767	689	2,543	33	(509)
Exports	3,238	3,313	3,534	3,534	13,620	3,091	(147)
Imports	2,696	2,768	2,768	2,845	11,077	3,058	362
2. Nonfactor services	(277)	(308)	(321)	(369)	(1,275)	(322)	(45)
Exports	465	476	519	558	2,018	486	21
Imports	742	784	840	927	3,293	807	65
B. Factor income	(605)	(558)	(707)	(609)	(2,479)	(769)	(164)
Income	202	198	210	240	850	205	3
Outlays	807	756	917	849	3,329	973	166
C. Current transfers	316	295	319	322	1,252	322	5
Income	356	332	393	360	1,441	369	13
Outlays	40	37	74	39	189	47	7
II. CAPITAL AND FINANCIAL ACCOUNT	171	89	185	682	1,127	619	448
A. Financialaccount	171	89	185	682	1,127	619	448
1. Long-Term Financial Flows	534	(110)	923	766	2,112	909	375
a. Assets	70	153	6	76	306	25	(45)
i. Colombian direct investment abroad	70	153	6	76	306	25	(45)
ii. Loans **1/**	0	0	0	0	0	0	0
iii. Other assets	0	0	0	0	0	0	0
b. Liabilities	604	43	929	841	2,418	934	330
i. Foreign direct investment in Colombia	396	575	853	791	2,615	394	(3)
ii. Loans **1/**	208	(532)	77	50	(197)	540	332
Public sector	589	(108)	340	369	1,189	552	(37)
Private sector	(381)	(424)	(263)	(318)	(1,387)	(12)	369
iii. Other liabilities	0	0	0	0	0	0	0
Public sector	0	0	0	0	0	0	0
Private sector	0	0	0	0	0	0	0
c. Other long-term financial movement	0	0	0	0	0	0	0
2. Short-term Financial Flows	(363)	200	(738)	(83)	(985)	(290)	73
a. Assets	(19)	84	686	513	1,263	359	378
i. Portfolio investments	138	300	336	250	1,025	440	302
Public sector	81	(166)	(6)	191	100	101	20
Private sector	57	466	343	59	925	339	282
ii. Loans **1/**	(158)	(217)	349	262	238	(81)	76
Public sector	(71)	44	(32)	(2)	(61)	14	85
Private sector	(87)	(260)	381	264	299	(95)	(9)
b. Liabilities	(382)	283	(52)	429	278	69	451
i. Portfolio investments	23	(5)	(6)	5	17	5	(19)
Public sector	0	4	(4)	0	0	0	0
Private sector	23	(9)	(2)	5	17	5	(19)
ii. Loans **1/**	(405)	288	(46)	424	261	64	469
Public sector	(419)	67	(130)	9	(473)	(16)	403
Private sector	13	222	84	415	734	80	67
B. Special Capital Flows	0	0	0	0	0	0	0
III. NET ERRORS AND OMISSIONS	67	39	74	(477)	(298)	428	361
IV. CHANGE IN GROSS INTERNATIONAL RESERVES 2/	214	102	316	238	870	310	96
V. GROSS INTERNATIONAL RESERVES	8,257	8,355	8,596	9,006	9,006	9,285	1,028
VI. NET INTERNATIONAL RESERVES	8,255	8,355	8,595	9,004	9,004	9,283	1,028
VII. CHANGE IN NET INTERNATIONAL RESERVES	215	102	316	236	869	310	95

1/ Includes portfolio investment, leasing, direct loans and commercial credit.
2/ According to the balance-of-payments methodology.
Source: Banco de la República.

C. Balance of payments

At the end of the first quarter of 2001, the balance of payments showed a current account deficit of US$736 million (3.7% of quarterly GDP). This was US$712 million more than the deficit registered for the same period in 2000. The capital and financial account registered US$619 million in net receipts or US$448 million more than in the first quarter of 2000. This movement increased gross international reserves by US$310 million to a balance of US$9,285 million at the end of the quarter (Table 4)[5].

1. Current Account

Growth in the current account deficit during the first quarter of 2001 is explained primarily by less of surplus in the goods account, which dropped from US$542 million in the first quarter of 2000 to US$33 million between January and March 2001. This decline is attributed to less income from oil and coffee exports (US$309 million and US$47 million, representing respective annual reductions of 26.8% and 21.2% in the quarter) and increased outlays for imports (US$362 million, which is equivalent to 13.4% annual growth in the quarter).

Table 5 summarizes the trend in exports, by product, during the first quarter of 2001[6]. The country registered US$844 million in hydrocarbon exports, mainly because of a reduction in the volume of crude sold internationally, which declined from 398 thousand barrels per day (MBD) in January - March 2000 to 331 MBD during the same period this year (equivalent to a drop of 21.8%). The export price of crude suffered an annual decline of 7.3%, from US$28.09 per barrel in the first quarter of 2000 to US$ 26.03 per barrel in January-March 2001. Coffee receipts fell by US$47 million, from US$223 million in January-March

5 The accumulation of reserves is the sum of the current account plus the capital account plus errors and omissions. The latter came to US$428 million in the first quarter.

6 The figure for import growth listed in Table 4 differs from the rate mentioned herein by 13.4%, as it does not include special trade operations. The same is true of exports. In the table on the balance of payments, goods exports include these operations; Table 5 does not.

Table 5
Exports, according to principal products and economic sectors (PR)

	January-March		Variation	
	2000	**2001**	**Absolute**	**%**
Total exports	3,122	2,978	(144)	(4.6)
Traditional exports	1,701	1,391	(309)	(18.2)
Coffee	223	176	(47)	(21.2)
Coal	239	274	34	14.4
Ferronickel	66	73	8	11.6
Oil and by-products	1,153	844	(309)	(26.8)
Gold	0	0	0	-
Emeralds	19	24	5	25.6
Non-traditional exports	1,422	1,587	166	11.7
Agricultural sector	310	318	8	2.5
Industrial sector	1,063	1,224	162	15.2
Mining sector	49	46	(4)	(7.2)

(pr) Preliminary estimate
Source: DANE and Banco de la República.

2000 to US$176 million during the same period in 2001. This was due to low international prices, which dropped by 37.5% during this period and offset the 34.3% rise in export volume. Non-traditional exports increased by 11.7% between January and March 2001 compared with the same period in 2000. Industrial exports grew the most (15.2%) during the same period and accounted for 41% of total exports and 77% of non-traditional ones. Mining exports, on the other hand, fell by 7.2%.

An important aspect was the reduction in total exports to the United States and Japan. These dropped by 14.2% and 36.5%, respectively, in relation to the same period in 2000. Also of significance was the increase in non-traditional exports to Venezuela and Ecuador between January and March 2001: 28.3% and 88.3%, respectively, compared with the first quarter of the previous year (Table 6).

The rise in imports during the first quarter of the year was the result of an increase in the purchase of capital goods, the dollar value of which rose by 21.0% thanks to more imports of transport equipment and capital goods for industry. Imports of consumer goods, mainly durables, rose by 17.8%. Imports of intermediate goods registered 7.0% growth because of additional purchases for industry and agriculture. These were offset, in part, by the drop in imports of fuel and lubricants (Table 7).

Table 6
Annual percentage growth in the dollar value of colombian exports
(January-March 2001)

	United States	Venezuela	Ecuador	Japan	Germany	Mexico	Others	Total
Totals	(14.2)	27.5	87.6	(36.5)	9.8	6.2	(4.5)	(4.6)
Non-traditionalexports	6.4	28.3	88.3	(8.4)	8.7	24.2	(2.4)	11.7
Agricultural Sector	10.7	15.0	1,379.7	26.3	13.1	(16.5)	(13.3)	2.5
Industrial Sector	6.5	29.4	85.5	(15.0)	2.2	24.6	0.2	15.2
Food. beverages and tobacco	(5.6)	38.6	57.3	(13.9)	(6.0)	67.2	3.4	11.9
Yarn and fabric	(33.4)	(5.2)	103.1	n.a.	(15.9)	(32.7)	(8.6)	(4.5)
Clothing	25.0	5.0	286.6	n.a.	(6.4)	39.7	(18.1)	14.5
Plastic and rubber products	(21.9)	22.7	105.0	n.a.	63.8	107.2	(4.0)	13.7
Leather and leather goods	29.9	26.5	1,038.9	(84.8)	(6.3)	(18.5)	46.9	39.9
Wood and wood products	(8.9)	83.5	151.6	n.a.	(47.3)	(11.5)	55.2	24.7
Graphic arts and publishing	78.9	58.6	17.4	10.3	5,543.3	34.3	21.7	36.2
Chemical industry	(25.5)	38.5	40.4	n.a.	97.2	37.6	1.2	2.9
Non-metallic minerals	(1.5)	61.1	56.6	n.a.	(18.3)	3.3	(3.7)	6.0
Common metals	4.3	37.3	91.8	1,308.9	135.6	39.4	0.4	18.2
Machinery and equipment	407.1	47.9	48.9	(78.0)	(85.7)	44.0	29.5	72.2
Transport material	174.1	6.3	1,707.8	n.a.	n.a.	472.4	(75.4)	14.5
Optical. cinema and other apparatus	(16.6)	113.0	104.6	(100.0)	67.3	(73.3)	(24.5)	(10.4)
Other industries	33.2	123.5	249.3	n.a.	45.1	(17.3)	(14.1)	40.0
Mining sector **1/**	(11.5)	0.4	159.5	(93.8)	9.6	(47.2)	25.5	(7.2)

n. a. Not applicable
1/ Not including emeralds
Source: DANE and Banco de la República

TABLE 7
IMPORTS, ACCORDING TO ECONOMIC DESTINATION (PR)

	January-March		Variationn	
	2000	2001	Absolute	%
Total imports	2,616	2,977	361	13.8
Consumer goods	451	531	80	17.8
Non-durables	315	339	24	7.7
Durables	136	192	56	41.0
Intermediate goods	1,250	1,338	88	7.0
Fuel and lubricants	78	43	(35)	(44.9)
For agriculture	93	117	24	26.1
For industry	1,079	1,178	99	9.2
Capital goods	916	1,108	193	21.0
Construction materials	40	43	3	7.1
For agriculture	5	6	1	30.1
For industry	555	637	82	14.8
Transport equipment	317	423	106	33.6

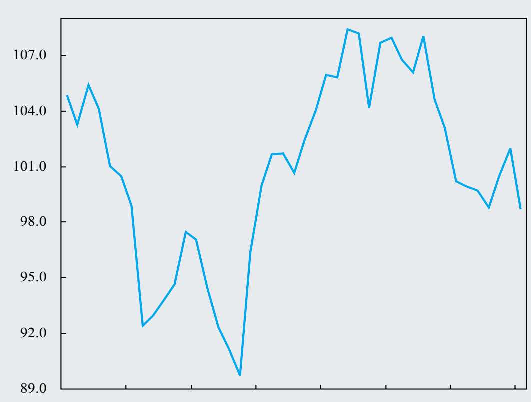
(pr) Preliminary
Source: DANE and DIAN

Between January and March of this year, terms of trade declined by 7.4%, on average, compared with the same period in 2000 (Figure 17). This was the result of a slowdown in growth of the PPI for export goods, due to the drop in export prices for traditional products, with the exception of coal (Table 8).

The current account is also affected by "factor income," which includes net interest payments on the external debt and remittance of profits and dividends on net foreign investment. This item showed a deficit of US$769 million in the first quarter of 2001 or US$164 million more than the deficit observed in January-March 2000, thanks to an additional US$156 million in foreign remittance of profits and dividends.

The balance of nonfactor services, which include net receipts from travel, transport and other services (communications, insurance, financial, etc.), registered a US$322 million deficit in January-March 2001; current transfers showed US$322 million in net income during the same period.

FIGURE 17
EVOLUTION IN TERMS OF TRADE 1/



1/ Measured by means of the PPI (PPI exports/ PPI imports) * 100.
Source: Banco de la República

Table 8
Export prices of traditional products
(January-March)

	Prices 2000	Prices 2001	Var. %
Coffee *(US$/pound ex-dock)*	1.20	0.75	(37.5)
Oil *(US$/barrel)*	28.09	26.03	(7.3)
Coal *(US$/ton)*	26.00	27.93	7.5
Ferronickel *(US$/ pound)*	1.83	1.34	(26.7)
Gold (US$/ troy ounce)	290.88	263.71	(9.3)
Emeralds (US$/carat)	12.51	12.24	(2.1)

Source: Preliminary balances of the Latin American and Caribbean economies -2000, ECLAC.

2. Capital Account

The capital and financial account registered US$619 million in net income during the first quarter of 2001, as opposed to US$448 million for the same period the year before. Essentially, this was the result of an increase of US$375 million in long-term external flows and a reduction of US$73 million short-term capital disbursements in comparison with the previous year.

As to long-term flows, foreign direct investment in Colombia (US$394 million) was similar to the level observed the year before. A highlight in terms of private debt flows was the reduction in net outflow of resources, which declined from US$381 million in the first quarter of 2000 to practically nil (US$12 million) during the same period in 2001. On the other hand, net borrowing in the public sector remained high, despite a US$37 million reduction from US$589 million in January-March 2000 to US$552 million in the first quarter of 2001.

The decline in short-term capital outflows was primarily due to performance of the public sector Net flows in the private sector were more negative between January and March 2001 than during the same months in 2000, mainly because of a US$282 million increase in portfolio investment abroad in comparison with the year before. A good portion of this investment was made through private pension funds.

The most recent figure on public and private external borrowing is for April (Table 9)[7]. As illustrated, the latter came to US$34,905 million. This is an increase of US$820 million with respect to March 2000, thanks primarily to an additional US$714 million in public borrowing.

3. Change in International Reserves

Movement in goods, services and capital during the first quarter of 2001 led to an accumulation of US$310 million in gross international reserves. The reserve balance was US$9,285 million, which is equivalent to 9.1 months of goods imports, 5.8 months of imports of goods and services, and 1.05 times the value of private and public debt amortization in one year.

This last indicator has become more important to determining the payment capacity of international reserves and, therefore, to limiting the market's vulnerability to international flows. According to a study by the International Monetary Fund (IMF), its value should be at least one (1.0) [8].

[7] Not including leasing or securitization by Ecopetrol.

[8] Bussier and Mulder (1999). "External Vulnerability in Emerging Market Economies: How High Liquidity Can Offset Weak Fundamentals and the Effects of Contagion," *IMF*, July.

Table 9
Balance of the colombian external debt /
(Millions of dollars)

Year	Montlhy	Private Sector 2/			Public Sector			Total
		Short-term	Long-term	Subtotal	Short-term	Long-term	Subtotal	Balance3/
1999	Oct.	2,315	11,793	14,108	747	17,917	18,665	32,772
	Nov.	2,370	11,670	14,039	785	18,640	19,425	33,464
	Dec.	2,317	11,555	13,872	672	19,081	19,753	33,625
2000 (p)	Jan.	2,318	11,358	13,676	360	18,980	19,340	33,016
	Feb.	2,380	11,284	13,664	306	19,317	19,624	33,288
	Mar.	2,331	11,216	13,546	254	19,499	19,752	33,299
	Apr.	2,453	11,147	13,599	229	19,272	19,502	33,101
	May.	2,600	11,044	13,645	311	19,288	19,599	33,243
	Jun.	2,552	10,867	13,419	320	19,404	19,725	33,144
	Jul.	2,598	10,770	13,368	248	19,496	19,744	33,113
	Aug.	2,553	10,750	13,303	218	19,617	19,835	33,138
	Sep.	2,636	10,661	13,297	190	19,607	19,797	33,095
	Oct.	2,679	10,504	13,183	186	19,921	20,108	33,291
	Nov.	2,815	10,440	13,256	172	20,081	20,253	33,509
	Dec.	3,051	10,451	13,502	199	20,051	20,250	33,752
2001 (pr)	Jan.	3,055	10,404	13,459	203	20,284	20,487	33,946
	Feb.	3,042	10,407	13,449	194	20,403	20,596	34,046
	Mar.	3,095	10,431	13,526	183	20,376	20,559	34,085
	Apr.	3,222	10,410	13,632	147	21,126	21,273	34,905

(p) Provisional
(pr) Preliminary
1/ Does not include leasing or securitization by Ecopetrol.
2/ The figures appearing in this bulletin may differ from those reported in the quarterly bulletin on the external debt and balance of payments, due to a review of private external debt statistics conducted by the International Exchange Department (DCIN).
3/ Statistics calculated with monthly closing. These do not necessarily coincide with those presented with the weekly cut-off.
Source: Banco de la República, SGEE and DCIN.

III

The latin american economic cycle and counter-cyclical policies

Recent performance of the Colombian economy is somewhat similar to that of other Latin American countries, which have also experienced slowdowns in recent quarters and where official and private forecasts for product growth during 2001 have been revised downward. However, these similarities are not new. They were present throughout the nineties and originated with factors common to development of the region's economies (Calvo, 2001)[9].

The present chapter explains how capital inflows in these countries have been important to the pattern of Latin American growth and how their fluctuations contribute to what can be called the "economic cycle of Latin America." Without ignoring the benefits to be gained from these inflows, it is also maintained that their presence imposes restrictions on the ability of national authorities to apply counter-cyclical policies. This phenomenon is more pronounced in economies with imbalances that have accumulated for prolonged periods or with serious structural weaknesses such as, for example, a financial system that is fragile or inflexible to an extent that makes it difficult to correct fiscal imbalances.

A. The Economic Cycle in Latin America during the Nineties

The Latin American countries witnessed major structural changes in their economies during the nineties. Trade was opened up and financial and capital markets were deregulated, all of which helped to attract foreign capital flows, increase exports, integrate the region economically and restrain inflation[10].

Figure 18 shows annual GDP growth in a sample of Latin American countries and the average for the region during the nineties. As illustrated, the economic cycle in Colombia was highly similar to that of Latin America as a whole, but with sharper upswings and recessions, particularly this last one. All these countries have experienced the growth, slowdown, recession and recovery that characterized the decade. The question is: Why do countries with different domestic policies generally behave the same in terms of their economic cycle? Part of the answer is that external factors influence their behavior. In other words, the Latin American economies share the external shocks that prevent their economic cycles from being different from the average cycle in the region[11].

In the eighties, as a result of the external debt crisis that marked the start of the so-called "lost" decade, the flow of foreign capital to Latin America was limited at best. However, foreign capital began to return to the region in the early nineties. On that occasion, the volume of capital compared with the size of the economy was significant[12]. For example, between 1991 and 1994, net capital inflows in Latin America accounted for nearly

[9] Calvo, G. et al. (2001). "Growth and External Financing in Latin America," Mimeograph, IDB, Research Department.

[10] For further details, see Ocampo J.A. (2001). *Una década de luces y sombras: América Latina y el Caribe en los años noventa*, ECLAC.

[11] See Calvo, G. Et al. (2001) *Op Cit.*

[12] See Agosin M. and French-Davis R. (1996). "Managing Capital Inflows in Latin America," *in The Tobin Tax: Coping with Financial Volatility*, edited by M. ul Haq, I. Kaul and I. Grunberg, Oxford.

FIGURE 18
ANNUAL GDP GROWTH IN LATIN AMERICA
(PERCENTAGE)

Source: Preliminary balance for the Latin American and Caribbean economies. 2000-ECLAC

6.0% of GDP, on average, as opposed to approximately 3.75% of GDP in the seventies and less than 1.0% in the eighties[13].

The new influx of capital was due, in part, to developments in the financial markets, to the positive expectations of international investors with respect to the emerging economies, and to the trend in interest rates worldwide. Consequently, an important part of what determined the influx of capital depended on factors that were entirely exogenous to the economies of Latin America.

Figure 19 shows the close relationship between the volume of net capital flow and growth of the Latin American countries. As illustrated, during the nineties, this relationship was positive in most Latin American countries, with significant rates of correlation between GDP and foreign capital. As such, the entry of capital helped the region to develop during the first half of the nineties. In effect, between 1991 and 1994, it grew by nearly 4.0%, on average (Figure 18).

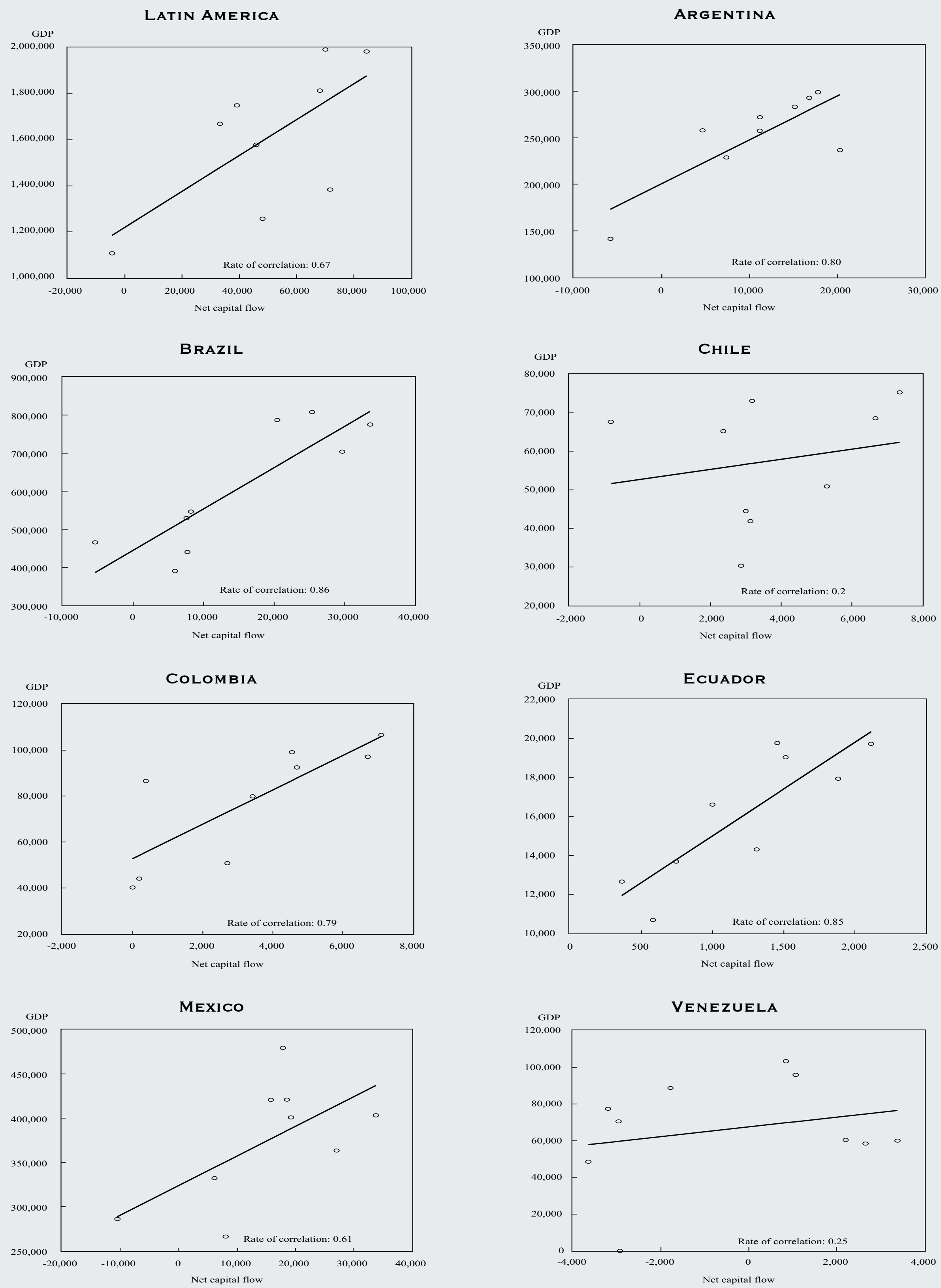
A sizable influx of capital allows countries to finance large current account deficits without having to use international reserves. As a result, economies are able to invest resources in amounts superior to national savings. Net capital income is, therefore, associated with high current account deficits, large investments and low levels of saving. Figure 20 shows the Latin American economies incurred huge current account deficits during 1993-1994, close to 3.0% of GDP, on average, financed largely with outside resources. In most countries, these large deficits were generally accompanied by an appreciation in real exchange rates.

Capital inflows affect economies by reducing domestic interest rates, raising the price of assets (Table 10), and elevating debt in the public and private sectors. This last factor made for a fragile financial system, which was evident even before the reversal of these flows to the region. Under these circumstances, influxes of capital make the economy more vulnerable to a reduction in capital flows.

Fiscal deficits increased considerably as capital flows were channeled more towards consumption than investment (Figure 21). In addition, the weakness of certain macroeconomic fundamentals, the large current account deficits and weak domestic saving made the Latin American countries even more vulnerable to the unexpected interruption in the flow of foreign capital.

[13] See Gavin, M., Hausmann, R. and Leiderman, L. (1996) "The Macroeconomics of Capital Flows to Latin America," *in Volatile Capital Flows: Taming their Impact on Latin America*, edited by Hausmann, R. and Rojas-Suárez, L. IDB.

Figure 19
The connection between net capital flow and GDP in Latin America (1990-1999)
(millions of dollars)



Source: Calculations by the Banco de la República

Figure 20
Current account balance in Latin America
(percentage of GDP)

Source: Preliminary balance for the Latin American and Caribbean economies. 2000-ECLAC.

Figure 21
Performance of the non-financial public sector in Latin America
(percentage of GDP)

Source: Preliminary balance for the Latin American and Caribbean economies. 2000-ECLAC.

This was precisely the case at the end of the nineties. While the crisis in Mexico (1994) and the one in Asia (1997) had a local impact and some repercussion worldwide, the Russian crisis had enormous global repercussions, causing serious capital flight in Latin America. The so-called Tequila crisis, which began in Mexico, had an important effect on Argentina but not on the rest of the world[14]. Similarly, the Asian crisis, which began in Thailand and spread throughout Asia, had no serious repercussions on capital flows to Latin America, although it did have a negative effect on terms of trade (Table 11). Surprisingly, the Russian crisis had more of a negative impact on capital flows to the emerging countries. This was due to the behavior of foreign investors and to short-comings in the international capital market.

The Russian crisis of 1998 seriously interrupted the flow of foreign capital to Latin America (Figure 22) and coincided with a decline in certain domestic

14 According to Calvo and Reinhart (1996), Colombia was one of the Latin American countries relatively unaffected by the Mexican crisis.

Table 10
Indexes of prices in dollar on latin america stock exchanges 1/
(Indexes, June 1997 = 100)

Country	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000 2/
Latin America	**49.0**	**51.0**	**77.4**	**76.2**	**62.5**	**72.5**	**90.6**	**56.0**	**81.0**	**74.7**
Argentina	70.0	50.7	84.9	63.6	69.1	82.1	96.3	68.9	91.3	68.6
Brazil	20.2	20.0	38.2	64.0	49.8	64.9	78.3	44.9	63.0	66.5
Chile	46.7	52.4	67.8	95.8	93.0	77.0	79.6	55.7	71.4	64.8
Colombia	45.5	62.0	81.6	103.5	77.1	80.5	99.9	56.4	44.3	25.1
Mexico	88.5	106.2	156.0	91.1	66.5	77.3	114.1	69.5	120.3	104.1
Peru	n.d.	32.6	43.9	66.8	73.1	73.6	83.8	50.5	61.1	43.9
Venezuela	128.0	73.3	65.6	47.8	32.7	75.7	93.3	44.9	37.8	48.6

n.d. Not available
1/ end of month values, global index
2/ at mid-december.
Source: eclac, based on figures from the international financial cooperation

macroeconomic factors throughout most of the region, aggravating the consequences of this external shock. The speed at which the "contagion" spread was due to the fact that foreign investors decided to treat all of Latin America equally and to interrupt capital flows to every economy in the region.

One of the primary consequences of the Russian crisis was a considerable increase in Latin American external debt margins (Figure 23) and, as a result, the restriction on access to external financing for these countries. In addition to the unexpected flight of capital from the region, the crisis in so-called emerging markets impaired terms of trade, which fell by 6.0%, on average, in 1998 (Table 11)[15]. This substantially reduced the value of Latin American exports, sending countries that were heavily in debt into a recession. Investment turned negative, savings declined, the price of assets fell, financial sectors were plunged into crisis, and unemployment rose (Figure 24)[16]. Growth of the region's economy as a whole dropped from 5.2% in 1997 to 2.3% in 1998 and 0.3% in 1999 (Figure 18).

Colombia was not an isolated case in Latin America. This negative external shock had a similar effect on every economy in the region. However, macroeconomic imbalances in Colombia made the country particularly vulnerable to changes in the international environment[17]. As a result, the external shock brought down prices for the country's primary exports, made external borrowing more expensive and reduced capital inflows, all of which raised domestic interest rates and caused a slowdown in the economy.

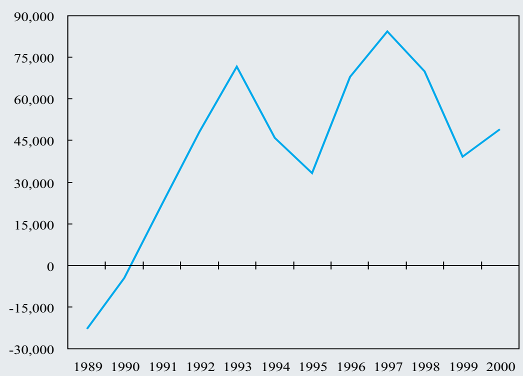
The recovery phase in Latin America began during the third quarter of 1999, in synchronized fashion, in every country of the region. Besides the adjustment

[15] The Latin American countries that experienced the sharpest decline in terms of trade were Chile (-11.7%), Colombia (-8.2%), Ecuador (-11.0%), Peru (-13.1%) and Venezuela (-27.9%).

[16] According to Calvo et al. (2001), the slowdown-recession that began in the third quarter of 1997 implied a change in the tendency of product growth rates. This was a highly synchronized circumstance and affected the seven largest economies in the region, without exception.

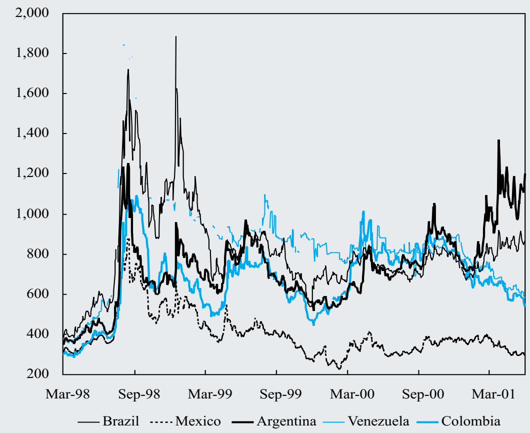
[17] Among others, these changes included the current account decline registered in the balance of payments, which made the economy vulnerable to any change in market conditions, and the fiscal deficit, which tended to displace the private economy through higher interest rates.

Figure 22
GDP by major branches of activity
(percentage of real growth)



1/ Include: Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Mexico, Paraguay, Peru, Uruguay and Venezuela
Source: IFM, to the period 1989-1997 and "Balance preliminar de las economías de América Latina y el Caribe 2000". CEPAL to 1998-2000, with base information from the IFM.

Figure 23
Spreads of Latin Americana 10 years bonds
(Basic points)



Source: Bloomberg.

Table 11
Terms of exchange in Latin America
(Index 1995=100)

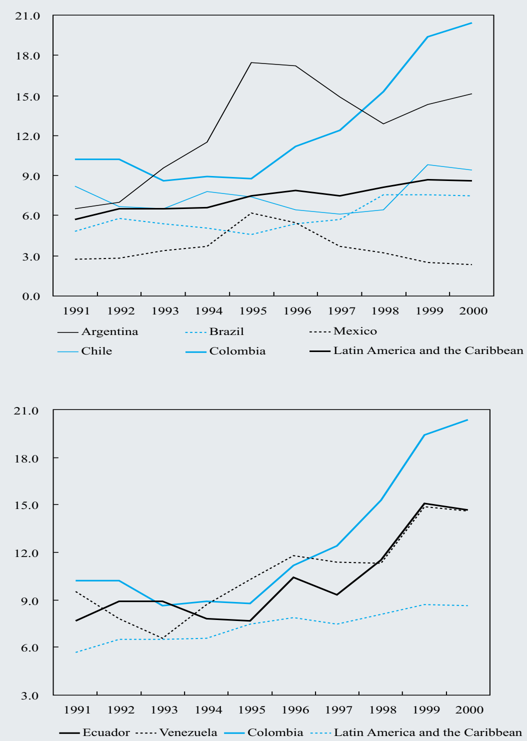
Country	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000 (*)
Latin America	**94.5**	**94.6**	**94.3**	**98.9**	**100.0**	**101.4**	**103.5**	**97.5**	**97.8**	**101.5**
Argentina	103.9	100.7	104.8	105.6	100.0	108.5	108.9	103.9	98.5	104.7
Brzsil	71.2	74.2	79.9	91.5	100.0	101.0	106.8	104.6	94.4	87.5
Chile	83.5	81.2	74.2	84.1	100.0	80.7	83.0	73.3	73.5	74.9
Colombia	99.1	87.4	91.0	104.9	100.0	103.7	104.4	95.8	102.6	118.9
Ecuador	121.7	116.3	106.4	108.9	100.0	109.6	111.9	99.6	106.2	121.4
Mexico	102.4	105.0	104.9	103.3	100.0	102.8	104.0	100.4	102.3	104.9
Peru	86.8	95.0	89.1	95.7	100.0	96.5	103.2	89.7	83.3	82.5
Venezuela	116.0	108.0	101.9	101.0	100.0	115.6	110.8	79.9	106.5	153.4

(*) Preliminary.
Source: CEPAL.

policies adopted by most of these nations, external factors such as growth of the United States economy and reactivation of the Asian economies played an important role in the region's economic recovery. Colombia has not been an exception in this respect[18]. Product and investment showed positive growth during the year 2000, and important adjustments were obtained in the current account balance and in fiscal accounts. For example, the current account deficit declined from

18 For a detailed explanation of the adjustment program carried out in Colombia, see the March 2000 Report to Congress by the Board of Directors.

Figure 24
Urban unemployment in Latin America
(average annual rates)



Source: Preliminary balance for the Latin American and Caribbean economies

Table 12
Annual growth rates and forecasts
(percentage)

	2000	2001	2002
World 1/	**4.1**	**2.3**	**3.0**
United States	5.0	1.9	3.0
European Union	3.3	2.5	2.7
Japan	1.7	0.9	1.5
Latin America 2/	**4.0**	**2.6**	**3.7**
Argentina	-0.5	1.6	4.5
Brazil	4.5	2.9	3.8
Chile	5.5	4.0	5.0
Ecuador	1.9	3.5	3.6
Mexico	6.9	3.0	1.3
Peru	3.1	0.9	2.5
Venezuela	3.2	4.4	3.5

1/ Forecasts developed in June 2001 and published by www.consensuseconomics.com.
2/ Source of forecasts: Idea Global, June 2001.

5.3% of GDP in 1998 to 0.05% of GDP in 2000, while the consolidated public sector deficit was reduced from 5.4% in 1999 to 3.4% in 2000. Nevertheless, as mentioned in the last report to Congress, unemployment has been on the rise since 1995 and continues to be the main problem in the Colombian economy.

The pace of recovery in Latin America slowed in the second quarter of 2000 and is not expected to improve during 2001. This is due to the slowdown in the world economy, as reflected in less than expected growth for the United States, continuation of the crisis in Japan, and disruptions in the international capital market because of economic problems in Argentina and Turkey. These external factors are compromising Latin American growth again this year (Table 12)[19].

[19] For additional details, see Calvo et al. (2001).

In conclusion, lifting controls on foreign capital has enormous advantages for the emerging countries and facilitates increased economic growth. However, the benefits of larger capital inflows must be complemented with firm fiscal and financial policies to offer international investors a stable macroeconomic environment in which long-term commitments are attractive.

The fact that most Latin American economies followed a pattern similar to the regional average during the nineties, suggests that an important part of the economic cycle in these countries is due to external factors, which could not be offset by counter-cyclical macroeconomic policies[20].

[20] See Uribe, J. D. (2001), "Las economías y su dificultad para adoptar políticas macroeconómicas anticíclicas," *Reportes del Emisor*, July No. 26.

B. Counter-cyclical policies in emerging countries and the Colombian case

In its upward phase, the economic cycle in emerging countries is marked by a current account deficit, an influx of external savings that allows for investment in excess of domestic savings, and higher economic growth rates. The increased availability of foreign credit is reflected in lower costs for external borrowing. This is a common trend throughout Latin America and in other emerging countries. When the situation in international financial markets is turbulent, capital moves to safer markets in the developed countries. Capital outflow coincides with the downward phase of the cycle, a time when all emerging countries are treated equally and growth in external credit is generalized.

Economic cycles of the magnitude observed in Latin America in the nineties are difficult to manage. At first glance, the solution would seem to be a question of applying counter-cyclical policies on the fiscal or monetary fronts. Policies of this sort are possible in the developed countries. When faced with a cutback in demand, these countries reduce interest rates or adopt expansive fiscal policies. However, in the emerging countries, counter-cyclical policies are not a trouble-free alternative. Because these economies are extremely sensitive to sharp fluctuations in capital flows, the convenience and effectiveness of such policies resides with their impact on flows of this type, which is determined by imbalances accumulated in the past or by serious structural weaknesses.

For example, a country with a history of high fiscal or external deficit, or with high levels of public or external borrowing, will find it difficult to implement counter-cyclical policies, as they might affect perceptions on the sustainability of public finances and the foreign balance and, therefore, provoke a drastic cutback in capital flows.

Counter-cyclical policies can create other problems for emerging countries. A reduction in interest rates, which can spark depreciation of the exchange rate in a floating system, jeopardizes compliance with the inflation target and aggravates the financial weakness of agents who are exposed to the risk of devaluation. Therefore, in a situation where the economy is vulnerable to shocks or fall outs in capital flows, experimenting with counter-cyclical policies can lead to a turnabout in macroeconomic policy; that is, to even more pro-cyclical policies.

Uncertain and unstable macroeconomic situations of this nature are characterized by volatile interest and exchange rates, and by a shortage of external financing. These factors do even more to aggravate problems with sustaining the public and external deficit.

In fact, most Latin American countries adopted pro-cyclical fiscal policies during the nineties. According to the information in this chapter, during periods of expansion, governments increase their consumption and investment, generating greater fiscal deficits as a result. On the contrary, in times of crisis, governments are forced to undertake fiscal adjustment programs as a way to generate confidence and credibility in international markets.

At present, the international economic situation is one of slowdown and uncertainty. The slowdown includes both the developed countries and emerging markets. The uncertainty is associated primarily with circumstances in Argentina and Turkey.

This environment diminishes possibilities for emerging countries to carry out counter-cyclical policies.

In spite of these limitations, fiscal and balance-of-payment adjustments make room for adopting counter-cyclical policies. Colombia and Chile are examples. In a context of weak aggregate demand, the Board of Directors of the Banco de la República adopted a looser monetary policy as of 1999, but without compromising the inflation target. This was possible thanks to the existence of unused installed capacity in various sectors of the economy and to the program agreed on with the IMF. The latter is designed to correct the fiscal deficit and to provide for structural reforms that will guarantee the long-term viability of public finances. This has facilitated the country's access to international capital markets in the last two year.

Consequently, the Banco de la República lowered its intervention rate on 15 occasions between December 1998 and March 2001, at times placing real interest rates on transactions in monetary expansion auctions at levels near zero[21].

In addition, reserve requirements were reduced, on average, from 8.7% at the end of 1997 to 5.8% at the end of 1998, where they have remained ever since. This freed an important volume of bank reserves and improved the cash position of the banking system.

On the other hand, conditions to support liquidity in the financial system were made more flexible in 1999, thereby reducing the risk of illiquidity and facilitating access to exceptional resources from Banco de la República. A more open monetary policy is evident in growth of the monetary base, which rose from -16.5% in December 1998 to 13.2% in June 2001[22].

Chile has implemented a counter-cyclical policy as well. The country's macroeconomic situation is highly resistant to shocks in the international economy. For years, central government finances showed a surplus, the current account deficit was moderate, and external debt margins were low in comparison with the rest of Latin America. This solid financial situation has enabled the country to deal with the international crisis through a more counter-cyclical monetary policy. In effect, during the current year, the interest rate according to monetary policy has declined in real terms from 5.0% to 3.75%[23].

Therefore, emerging countries that may some day be in a position to adopt counter-cyclical policies will have to reinforce their macr oeconomic foundation by improving their public debt and balance-of-payment indicators and by lowering inflation. This requires policies that guarantee macroeconomic stability. It also implies the design of a cautious regulatory framework for the financial system.

Although most Latin American countries are recovering from the crisis, the recession at the end of the nineties had high economic and social costs. As analyzed in Panel 1, income distribution in most of the countries worsened and poverty increased. Accordingly, one of the biggest challenges to economic policy is to place the economy on a path of sustained growth that encourages employment and reduces poverty.

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21 See the section on monetary policy (Chapter IV).

22 Part of the increase in the monetary base is, however, the result of a policy designed to satisfy increases in demand on the base, due to introduction of the tax on financial transactions and its subsequent modification. Given their nature, these changes in monetary base demand are not inflationary.

23 In Colombia, the interbank deposit rate, in real terms, was 3.2% in 2001.

The recent trend in income distribution and poverty in Colombia and Latin America

The Colombian economy has not been immune to the economic cycle in Latin America. Consequently, its social indicators would be expected to follow the pattern set by the region as a whole. Problems within inequitable income distribution have been observed and known for decades. As noted by ECLAC, the inequity characterizing the Latin American countries is a result of the economic and social structures prevailing throughout the region.[1]

Due to these structures, income distribution in Latin America is among the most inequitable in the world (Table 1). Latin America has some of the highest Gini coefficients, on average, in comparison with other regions. [2] While inequality in the Middle East and Africa has declined notably, and has remained relatively constant in the developed countries, it is persistently high in Latin America, having declined only slightly in the seventies to the point where it has stayed ever since.

Income distribution in Latin America in the eighties was aggravated by the debt crisis. Some progress in towards better income distribution and less poverty was observed in the first half of the nineties, thanks to structural reforms and rapid economic growth during that period. However, the recession experienced by most countries at the end of the decade has impaired the region's social indicators.

The trend differs considerably from one country to another. In some countries, such as El Salvador, Honduras and Peru, income distribution has gotten better. Despite extreme inequality, their situation in this respect improved during the nineties. Costa Rica and Uruguay have reached levels similar to those of the developed countries. However, according to Morley (2000), 75% of the total population in Latin America is located in countries where income distribution is extremely inequitable, even though there are signs of improvement. These countries include Argentina, Brazil, Chile and Mexico, the largest economies in the region, where inequality in income

Table 1
Gini coefficients, average by region and decade

Region	Sixties	Seventies	Eighties	Nineties 1/
Eastern europe	0.25	0.25	0.25	0.29
Southern asia	0.36	0.34	0.35	0.32
Oecd & high income countries	0.35	0.35	0.33	0.34
Far east and the pacific	0.37	0.40	0.39	0.38
Middle east and northern africa	0.41	0.42	0.41	0.38
Africa south of the sahara	0.50	0.48	0.44	0.47
Latin america	**0.53**	**0.49**	**0.50**	**0.49**

1/ average for the first half of the decade.
Source: klaus deininger & lyn squire, "a new data set measuring income inequality," world bank economic review, vol. 10, no. 3 (1996).

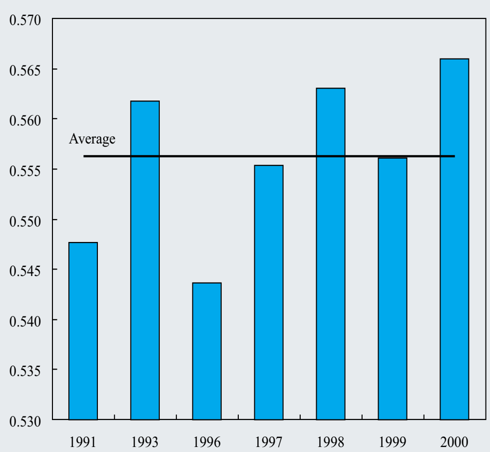
distribution increased in the eighties and has remained high since 1990. In Colombia and Venezuela, the level of inequality rose during the nineties. It is also high in Bolivia, Ecuador and Paraguay, which began to report statistics only recently.

Historically, Colombia has been one of the Latin American countries where income is most concentrated. Early studies on the topic showed a high concentration of income in Colombia during the fifties and sixties, due to lack of education and poor distribution of land ownership.[4] Nevertheless, there was considerable progress in the seventies and eighties. In effect, between 1971 and 1988, the Gini coefficient for the national total declined from 0.53 to 0.45, implying a notable improvement in income distribution[5].

However, in the nineties, the Gini coefficient was 0.56, on average, exceeding the coefficient for Latin America (0.52).[6] This indicator declined in Colombia to 0.54 between 1993 and 1996, before reaching to 0.57 in the year 2000 (Figure 1). The deterioration in income distribution was evidenced by the fact that the poorest 40.0% of the population reduced its share of the country's total income from 9.8% to 8.7% between 1991 and 2000 (Table 2).

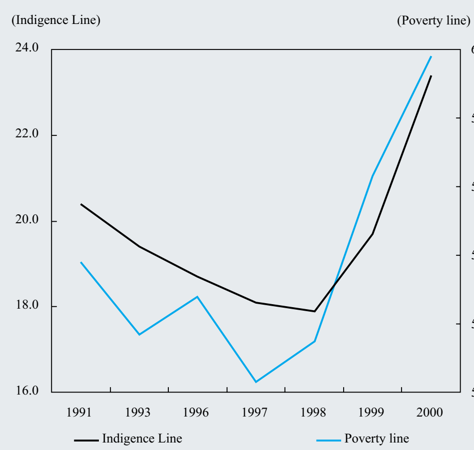
As to poverty indicators, the indigence line and the poverty line improved substantially at the start of the decade.[7] The portion of the Colombian population living in abject poverty declined from 20.4% to 17.9% between 1991 and 1998. The population living below the poverty line declined by 3.5 percentage between 1991 and 1997, from 53.8% to 50.3% (Figure 2). However, less favorable conditions in the national and international economy at the end of the nineties pushed the unemployment rate up and reversed the decline in poverty.[8] In fact, poverty at the end of the nineties was above what it had been at the start of the decade. In 2000, it was estimated that 23.4% of the population was below the indigence line and 59.8% was below the poverty line.[9]

FIGURE 1
GINI COEFFICIENT OF INEQUALITY IN COLOMBIA - NATIONAL TOTAL



Source: DNP-UDS-DIOGS. Information provided by the DNP Social Mission.

FIGURE 2
THE POVERTY LINE AND THE INDIGENCE LINE PERCENTAGE OF THE TOTAL POPULATION NATIONWIDE



Source: DNP-UDS-DIOGS. Information provided by the DNP Social Mission.

Table 2
Share of total national income (*) corresponding to each quintile of the population

Year	Quintile 1	Quintile 2	Quintile 3	Quintile 4	Quintile 5
1991	3.0	6.8	10.8	17.4	62.0
1993	2.5	6.0	10.0	16.6	64.9
1996	2.6	6.7	10.9	18.2	61.6
1997	2.6	6.8	11.4	19.1	60.1
1998	2.6	6.5	10.6	17.7	62.6
1999	2.5	6.6	11.0	18.5	61.6
2000	2.4	6.3	10.5	18.2	62.7
Average	**2.6**	**6.5**	**10.7**	**18.0**	**62.2**

(*) based on the income of the spending unit (all members of the household who perceive an income, with the exception of domestic service and pensioners). Each quintile represents 20% of the population. Quintile 1 is the poorest; quintile 5, the wealthiest.
Source: dnp-uds-diogs calculations based on the dane national home survey for september. Information supplied by the dnp social mission.

Chocó, Cauca and Nariño were the departments with the largest population below the poverty and indigence lines in the year 2000, followed by the various departments on the Caribbean Coast, Boyacá, Caquetá and Tolima. Although Bogotá has the fewest people below the poverty line and one of the lowest percentages of people below the indigence line, it is the place where these indicators increased the most between 1997 and 2000. This was due to the arrival of large numbers of displaced people (Table 3).

Figures on income distribution and poverty are based on the family income data in the home surveys. This information does not include subsidies or services provided by the state. An increase in social spending by the state may, therefore, improve the well being of the poorest groups without raising their share of total income. Hence, it can reduce the deficit of unsatisfied basic needs without generating any improvement in income distribution.

The nineties witnessed important progress in social conditions measured by the indicator of unsatisfied basic needs (UBN).[10] The poor declined from 37.2% of the population in 1993 to 22.9% in 2000, and the population living in abject poverty declined by more than eight percentage points during the same period (Table 4). Generally speaking, coverage of all basic needs has improved in recent years, primarily as concerns access to services. In the year 2000, Bogota had the lowest indicator of UBN with respect to poverty and indigence, while the departments on the Pacific coast, except for Valle, and those on the Caribbean coast had the highest (Table 5).

Table 3
National and departmental population below the indigence and poverty lines 2000
(Percentages)

Departaments	Poverty line			Indigence line		
	1997	1999	2000	1997	1999	2000
Total	**50.3**	**56.3**	**59.8**	**18.1**	**19.6**	**23.4**
Bogota	32.4	46.3	49.6	6.1	13.2	14.9
Antioquia	50.5	57.8	59.4	14.3	17.8	20.0
Atlantico	47.0	57.9	66.7	11.7	16.1	28.1
Bolívar	62.6	59.9	65.8	23.7	23.2	31.9
Boyaca	61.5	62.6	65.6	30.5	28.2	29.2
Caldas	54.9	53.9	61.3	16.7	15.3	20.7
Caqueta	57.5	59.9	69.2	15.3	19.3	28.7
Cauca	64.4	73.3	77.2	30.3	39.8	39.7
Cesar	55.9	53.7	61.4	18.4	13.5	16.4
Choco	70.5	78.0	78.0	44.8	46.7	47.4
Cordoba	70.8	72.6	69.4	41.1	37.1	36.7
Cundinamarca	43.5	50.9	59.0	15.0	16.8	28.1
Huila	53.3	62.5	62.4	24.1	21.9	26.8
La Guajira	59.0	50.2	56.6	25.6	18.8	23.6
Magdalena	58.9	62.6	59.5	24.1	17.0	18.4
Meta	38.6	52.4	55.5	10.1	15.9	17.5
Nariño	67.1	71.7	74.7	38.2	36.8	40.6
N. Santander	58.6	58.2	53.0	23.5	18.2	20.2
Quindío	47.1	50.8	50.6	13.1	11.8	11.5
Risaralda	45.2	51.1	58.2	16.0	18.0	23.2
Santander	44.2	54.9	57.7	18.5	21.6	23.1
Sucre	66.0	64.0	67.4	28.2	17.8	26.6
Tolima	60.7	57.3	66.4	26.0	21.7	31.0
Valle	42.9	47.6	52.3	9.4	13.9	15.8

Source: DNP-uds-diogs calculations based on the dane national home survey for september.
Information supplied by the dnp Social mission.

Table 4
Indicator of unsatisfied basic needs (UBN)
(percentage of the total population nationwide)

Year	Poverty (1 UBNI)	Indigence (More of 1 UBN)	Housing	Services	Overcrowding	School non attendance	Economic dependence
1993	37.2	14.9	11.6	10.5	15.4	8.0	12.8
1996	26.0	8.9	8.6	5.5	11.1	4.0	9.0
1997	25.9	8.6	8.0	5.4	11.3	4.2	8.9
1998	26.0	8.2	6.6	4.7	11.1	4.7	10.0
1999	24.9	7.3	6.7	4.0	11.2	3.9	8.8
2000 (*)	22.9	6.5	6.7	3.6	10.2	3.2	7.6

(*) corresponds to he latest dnp-usd-diogs calculations by the dnp social mission.
Source: dnp-uds-diogs calculations based on the 1993 dane census and the national home survey for september. Published in *coyuntura económica e indicadores sociales*, dnp, july 2000.

Table 5
National and departmental population with UBN and living in abject poverty
1997 - 2000
(Percentages)

Departaments	UBN, poverty			UBN, abject poverty		
	1997	1999	2000	1997	1999	2000
Total	**25.9**	**24.9**	**22.9**	**8.6**	**7.3**	**6.5**
Bogota	13.0	12.4	12.4	2.5	2.4	1.3
Antioquia	23.5	22.4	18.3	7.2	6.0	5.2
Atlantico	20.8	19.5	23.0	6.5	4.7	7.1
Bolívar	43.1	37.5	35.2	22.4	16.9	13.0
Boyaca	34.6	28.0	24.5	9.5	8.4	4.7
Caldas	21.6	20.4	15.4	4.9	2.9	3.6
Caqueta	42.0	27.5	22.2	16.0	7.7	6.6
Cauca	32.2	40.3	28.9	10.7	15.9	11.3
Cesar	35.5	32.1	36.3	17.2	10.1	13.2
Cordoba	53.5	49.0	44.1	25.6	22.9	18.1
Cundinamarca	21.8	23.0	23.4	5.7	3.2	5.1
Choco	49.1	64.9	60.6	14.3	23.2	17.6
Huila	24.1	26.6	28.6	7.2	8.0	6.6
La Guajira	34.2	37.7	32.6	17.2	17.7	11.7
Magdalena	40.9	40.6	34.0	17.7	15.3	16.3
Meta	29.5	25.7	26.2	7.2	6.0	7.5
Nariño	39.5	34.0	32.6	14.7	9.2	9.8
N. Santander	27.1	22.0	19.2	8.6	5.7	3.2
Quindío	20.0	21.1	18.1	4.7	6.4	3.4
Risaralda	14.9	15.1	16.7	2.0	3.5	4.0
Santander	18.4	20.3	20.8	5.4	3.6	4.1
Sucre	48.8	44.2	39.8	21.8	18.6	15.0
Tolima	29.9	28.9	27.3	9.2	8.2	8.7
Valle	15.7	17.1	15.7	2.5	2.6	2.6

Source: dnp-uds-diogs calculations based on the dane national home survey for september.
Information supplied by the dnp social mission.

According to other social indicators, such as the infant mortality rate, life expectancy at birth, illiteracy and the fertility rate, living conditions for the Colombian population have improved considerably in recent years. Furthermore, Colombia's social indicators surpass the average in Latin America. According to figures released by ECLAC, the infant mortality rate in Colombia declined from 48.4 in 1980 - 1985 to 30.0 in the five years between 1995 and 2000, and was below the regional average (Table 6).

Life expectancy in Colombia increased from 67 to 71 years between the first half of the eighties and the second half of the nineties, and was near the average for the Latin American countries (Table 7).

Latin America has also made significant headway towards combating illiteracy, which was reduced by almost 50.0% in the last two decades. However, despite important progress in this respect, Colombia continues to lag behind other countries. This indicator declined by 47.4%

Table 6
Infant mortality rates 1/
(Per 1,000 live births 2/)

Country	1980-1985			1985-1990		
	Total	**Males**	**Females**	**Total**	**Males**	**Females**
Argentina	32.2	35.5	28.8	27.1	30.0	24.1
Bolivia	109.2	116.0	102.0	90.1	96.0	84.0
Brazil	64.4	71.5	57.0	55.0	62.0	47.7
Chile	23.7	25.8	21.6	18.4	19.9	16.7
Colombia	48.4	53.4	43.1	41.4	46.2	36.4
Ecuador	68.4	75.5	61.1	57.1	63.5	50.5
Mexico	47.0	52.9	40.9	39.5	43.0	35.9
Peru	81.6	87.9	75.1	68.0	74.7	61.0
Venezuela	33.6	37.6	29.4	26.9	30.3	23.4
Average	**56.5**	**61.8**	**51.0**	**47.1**	**51.7**	**42.2**
Total 3/	**58.3**	**63.7**	**51.8**	**48.6**	**53.4**	**42.9**

Country	1990-1995			1995-2000		
	Total	**Males**	**Females**	**Total**	**Males**	**Females**
Argentina	24.3	27.0	21.5	21.8	24.5	19.0
Bolivia	75.1	79.2	70.8	65.6	70.0	61.0
Brazil	47.2	54.0	40.0	42.2	48.5	35.6
Chile	14.0	15.2	12.8	12.8	13.8	11.6
Colombia	35.2	39.5	30.6	30.0	34.0	25.8
Ecuador	49.7	55.4	43.7	45.6	50.8	40.1
Mexico	34.0	36.2	31.6	31.0	33.0	28.9
Peru	55.5	61.8	48.8	45.0	50.1	39.6
Venezuela	23.2	26.2	20.1	20.9	23.6	18.2
Average	**39.8**	**43.8**	**35.5**	**35.0**	**38.7**	**31.1**
Total 3/	**40.8**	**44.9**	**35.7**	**36.1**	**39.9**	**31.5**

1/ Deaths in the 0-to-1 age group per 1,000 live births.
2/ Rates implicit in the population projections.
3/ Does not include the countries of the english-speaking caribbean.
Source: *Anuario estadística de América Latina y el caribe*, United Nations, Eclac, 2000.

as opposed to an almost 55.0% reduction, on average, in countries such as Ecuador, Bolivia and Venezuela (Table 8).

The fertility rate is lower in Colombia than in most countries of the region. As of the eighties, it has displayed the same downward trend as the average for Latin America (Table 9).

In short, although there has been important progress towards creating better living conditions for the people of Latin America, and the Colombian population in particular, the rise in informal jobs and unemployment originating with the economic recession at the end of the nineties had a negative impact on what was accomplished in the early nineties in terms of reducing poverty and inequality.

Table 7
Life expectancy at birth
(Years, average)

Country	1980-1985			1985-1990		
	Total	Males	Females	Total	Males	Females
Argentina	70.2	66.8	73.7	71.0	67.6	74.6
Bolivia	53.7	51.9	55.6	56.8	55.1	58.6
Brazil	63.4	60.2	66.7	64.9	61.4	68.6
Chile	70.7	67.4	74.2	72.7	69.6	75.9
Colombia	66.8	63.6	70.2	67.9	64.2	71.7
Ecuador	64.5	62.5	66.7	67.1	64.7	69.5
Mexico	67.7	64.4	71.2	69.8	66.8	73.0
Venezuela	68.8	65.9	71.8	70.5	67.7	73.5
Average	**65.7**	**62.8**	**68.8**	**67.6**	**64.6**	**70.7**

Country	1990-1995			1995-2000		
	Total	Males	Females	Total	Males	Females
Argentina	72.1	68.6	75.7	73.1	69.7	76.8
Bolivia	59.3	57.7	61.0	61.4	59.8	63.2
Brazil	66.4	62.7	70.4	67.9	64.1	71.9
Chile	74.4	71.5	77.4	75.2	72.3	78.3
Colombia	68.6	64.3	73.0	70.7	67.3	74.3
Ecuador	68.8	66.4	71.4	69.9	67.3	72.5
Mexico	71.5	68.5	74.5	72.4	69.5	75.5
Venezuela	71.8	69.0	74.7	72.8	70.0	75.7
Average	**69.1**	**66.1**	**72.3**	**70.4**	**67.5**	**73.5**

Source: *Anuario estadística de américa latina y el caribe*, United Nations, Eclac, 2000.

Table 8
Illiterate population age 15 and over, by gender
(Percentage of the population age 15 and over)

Country	Both sexes			Males			Females		
	1980	1990	2000	1980	1990	2000	1980	1990	2000
Argentina	6.0	4.2	3.1	5.7	4.1	3.1	6.4	4.4	3.1
Bolivia	30.9	21.6	14.4	19.9	12.9	7.9	41.3	29.9	20.6
Brazil	25.4	18.3	14.7	23.7	17.9	14.9	27.2	18.8	14.6
Chile	8.5	6.0	4.3	7.9	5.6	4.1	9.1	6.4	4.5
Colombia	15.6	11.3	8.2	14.7	10.9	8.2	16.4	11.6	8.2
Ecuador	18.1	11.6	8.1	14.4	9.5	6.4	21.8	13.8	9.8
Mexico	17.0	12.3	9.0	13.8	9.6	6.9	20.2	15.0	10.9
Venezuela	15.1	9.9	7.0	13.3	9.1	6.7	16.9	10.8	7.3
Average	**17.1**	**11.9**	**8.6**	**14.2**	**10.0**	**7.3**	**19.9**	**13.8**	**9.9**

Source: *Anuario estadística de américa latina y el caribe*, Uunited Nations, Eclac, 2000.

TABLE 9
OVERALL FERTILITY RATE
(NUMBER OF CHILDREN)

Country	1980-1985	1985-1990	1990-1995	1995-2000
Argentina	3.2	3.0	2.8	2.6
Bolivia	5.3	5.0	4.8	4.4
Brazil	3.6	3.0	2.5	2.3
Chile	2.7	2.7	2.5	2.4
Colombia	3.7	3.2	3.0	2.8
Ecuador	4.7	4.0	3.5	3.1
Mexico	4.2	3.6	3.1	2.8
Venezuela	4.0	3.6	3.3	3.0
Average	**3.9**	**3.5**	**3.2**	**2.9**

Source: *Anuario estadística de américa latina y el caribe*, United Nations, Eclac, 2000.

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1 See Ocampo, José, A. (2000). "Equidad, desarrollo y ciudadanía," Eclac, August 2000.

2 The Gini coefficient is an index used to measure inequality. It is based on the assumption that, if income is distributed fairly, each member of the population would have the same share of income (equal distribution). This index measures the gap between actual distribution and equal distribution. The value of the coefficient ranges from 0 to 1. The higher the value, the greater the concentration.

3 Morley, Samuel (2000). "La distribución del ingreso en América Latina y el Caribe," ECLAC.

4 For a more detailed description of the trend in income distribution during 1970s, 1980s and 1990s, see "Distribución del ingreso y la pobreza en Colombia. Evolución reciente" in Revista del Banco de la República (Journal of the Banco de la República), Editorial Notes, August 1993.

5 See "Distribución del ingreso y la pobreza en Colombia. Evolución Reciente" in Revista del Banco de la República (Journal of the Banco de la República), Editorial Notes, August 1993, Chart 1.

6 Bulletin No. 26, "Coyuntura económica e indicadores sociales," National Department of Planning (DNP), July 2000.

7 The poverty line is calculated on the basis of household income, assuming that the shortage of other goods and services is proportional to the shortage of food. See Bulletin No. 26, "Coyuntura económica e indicadores sociales," National Department of Planning (DNP), June 2000.
The indigence line is calculated on the value of a standard food basket that meets the minimum requirements. Consequently, a household lacking the income to purchase this basket for all its members is considered to be in a state of indigence or abject poverty. For a more detailed definition of these indicators, see Bulletin No. 26, "Coyuntura económica e indicadores sociales." DNP, July 2000.

8 For further details on recent unemployment problems, see the March 2001 Report to Congress by the Board of Directors.

9 Information provided by the DNP Social Mission.

10 This method is used to measure the percentage of the population with at least one unsatisfied basic need. A household is considered poor if it does not have proper housing with adequate water and sanitation facilities, if it is subject to critical overcrowding, if it is highly dependent economically, or if it has at least one child between seven and 11 years who does not attend some type of educational establishment. Households in a state of misery are those with two or more unsatisfied basic needs. For details, see Bulletin No. 26, "Coyuntura económica e indicadores sociales." DNP, July 2000.

IV

Macroeconomic policy

A coherent macroeconomic policy has helped the country to recover economically and has reduced inflation. Decisions on monetary policy are intended to make sure the inflation target is met and to boost economic growth. For its part, monetary policy has helped to lower interest rates and to provide for adequate liquidity in the economy. There has also been progress towards reducing the fiscal deficit. This, in turn, has bolstered confidence in the nation's economy on the part of domestic and international investors. The principal indicators of the financial system point to an improvement in that sector as well.

A. Monetary policy

Pursuant to the mandate granted to the Board of Directors of the Banco de la República (BDBC) by the constitution, monetary policy in Colombia is designed to achieve increasingly lower targets for annual inflation, while encouraging a recovery in economic growth and aggregate demand. This has been possible thanks to the existence of surplus installed capacity in various sectors of the economy, to efforts aimed at correcting public and external imbalances, and to the adoption of structural reforms. With this in mind, the BDBC has developed a strategy that combines elements of the scheme for target inflation with reference values for monetary aggregates. Therefore, the approach taken by monetary policy is decided according to an evaluation of inflationary pressures, prospects for inflation and the trend in other macroeconomic variables, especially monetary aggregates and the monetary base. In this respect, an important element of the current monetary strategy is to develop a reference course for this aggregate, as a guide to supplying liquidity to the economy, one that is founded on target inflation and the premise of economic growth, and contemplates anticipated shocks in the demand for currency.

1. How Monetary policy operates

The Board of Directors defines the band for intervention rates on the Bank's open market transactions (OMT), based on a periodic evaluation of the situation with respect to inflation. The Bank offers primary liquidity at these rates, establishing quotas for daily expansion and contraction auctions. These quotas are set in light of the anticipated trend in supply and demand for liquidity, according to the reference line for the monetary base and estimates of the demand for reserves by the financial system to meet its reserve requirements.

The band applying to the reference intervention rates used by the Banco de la República to apply monetary policy fluctuates between: i) the maximum rate at which the Bank is willing to supply resources to the economy in any amount, known as the Lombard expansion rate (expansion window); ii) the minimum rate at which liquidity is supplied to the market through expansion auctions; iii) the maximum rate at which the Bank is willing to receive resources from the market through contraction auctions; and iv) the minimum rate at which resources are accepted from the market in unlimited amounts. The latter is known as the Lombard contraction rate (contraction window).

The Board of Directors, in Internal Resolution No. 1 of 18 January 2000, introduced several changes and specified the way net liquidity requirements in the economy are to be met. The Monetary Intervention and Exchange Committee (CIMC) was made directly responsible for setting expansion and contraction quotas in keeping with the reference line for the monetary base[24].

At the same time, the Internal Operating Committee (COI) was created expressly for the purpose of overseeing compliance with the new supply of liquidity defined by the CIMC. It is authorized to modify liquidity quotas set by the CIMC, but only in the event of changes not foreseen in the projections on monetary base supply[25]. Consequently, the COI has a passive monetary function. Exercise of its powers does not alter the focus of monetary policy[26].

Monetary policy decisions are, therefore, supported by a mechanism that makes it easier to interpret and separate the short and long-term shocks that influence supply and demand with respect to the monetary base. Accordingly, there should be no substantial fluctuations in the short-term interbank rate, which should remain at a level coherent with the targets established for inflation.

The trend in inflation, coupled with accomplishment of the target for 2001 and stability of the interbank interest rate in the first half of the year, is an indication that the new operational scheme for applying monetary policy in Colombia has achieved its purpose (Figure 25). Nevertheless, this was not easy. At the beginning of 2001, the Board of Directors faced shocks in the demand placed on the monetary base due to variations in the tax on financial transactions.

a. Revision of the reference line for the monetary base

As a preliminary measure, a new reference line for the monetary base in 2001 was adopted in March of this year by the Board of Directors. The new estimate includes changes in the demand for cash, which were brought on by an increase in the financial transaction tax to three per thousand at the beginning of the year, and corrected the M3 estimate, since the initial assumption of the constant speed of this aggregate was not being met[27].

A ruling issued in mid-March exempts withdrawals of up to $3.9 million pesos a month from certain types of savings accounts with savings and loan associations from the tax on financial transactions (3 x 1000). This influenced the trend in cash in the hands of the public, as well as the monetary base, and explains why, in recent months, both these aggregates have been below the level estimated in the reference line adopted last March. This factor, coupled with the revised figures and the course anticipated for M3, prompted a new estimate of the reference line for the monetary base, which was approved by the Board of Director on 28 June 2001. This line, illustrated in figure 26, shows 16.9% average annual growth and 8.1% at year end. The Board of Directors constantly examines the trend in demand on the monetary base and evaluates whether or not the reference line is coherent with the target for inflation.

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24 The members of the CIMC include the Minister of Finance and Public Credit or his delegate, the Governor of the Banco de la República, and all regular members of the Board of Directors of the Banco de la República.

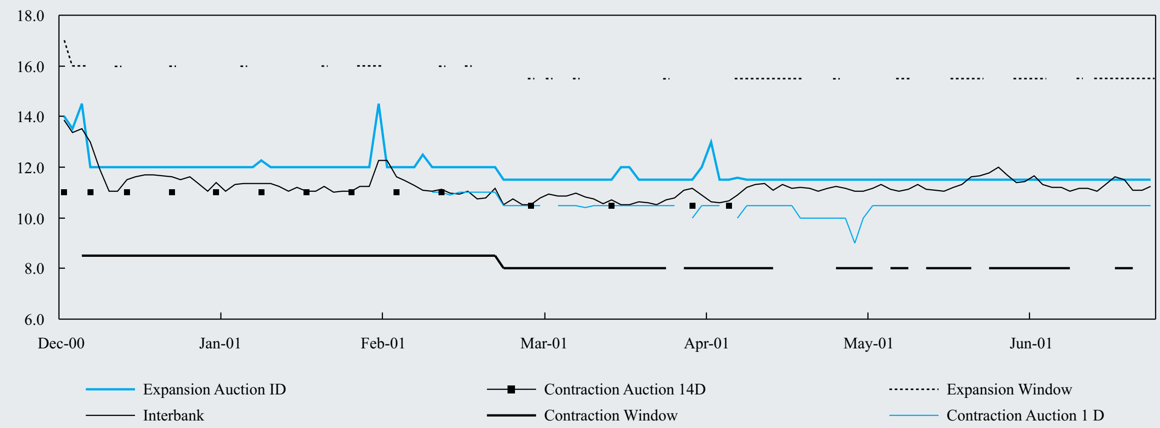
25 The COI is comprised of the Technical Director of the Banco de la República, the Director of Economic Research and the Director of Monetary Matters and Reserves.

The scheme described above is reinforced and supplemented by constantly updating estimates of cash and reserves on the basis of actual figures. The econometric models used to estimate short-term cash demand, which are updated with actual figures and estimates of the demand for bank reserves based on liabilities subject to the reserve requirement two weeks earlier, allow for a more precise estimate of demand than that implied by the reference line.

26 Prior to this operational change, the Board of Directors set expansion and contraction quotas directly and authorized the Monetary Intervention and Exchange Committee (CIMC) to modify them in the event of significant deviations from projections.

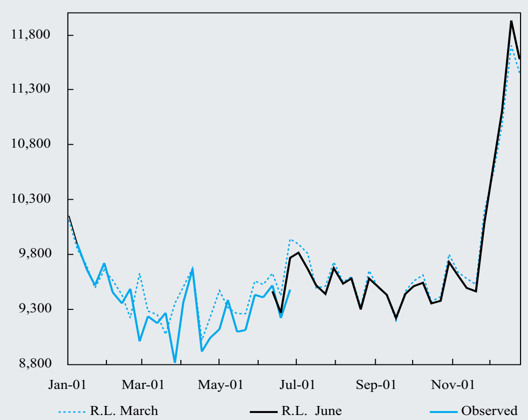
27 As a result of the revision, it was estimated that the base, M3 and cash would grow by 17.6%, 5.3% and 24.2%, respectively, on average for the year, and 6.9%, 7.8% and 14.2% by year's end.

Figure 25
Closing Rates for Intervention Auctions and Window Transactions
(Percentage)



Source: Banco de la República

Figure 26
Reference line for the monetary base - 2001
(billions of pesos)



Source: Banco de la República, SGEE.

b. Developments concerning intervention in the money market

Throughout most of 2001, expansion auctions have been held at the minimum expansion rate and only on extremely isolated occasions has the short-term auction rate been above this floor. Window transactions have been sporadic and in marginal amounts (Figure 27). The general mechanism used by the Banco de la República to supply liquidity allowed for a highly stable interbank rate, which fluctuated between the maximum contraction auction rate and the minimum expansion auction rate (Figure 25).

2. Monetary aggregates

The trend in monetary aggregates reflected the Board's decision on quotas and intervention rates, as described herein.

a. Monetary base

As of February 2001, annual growth in the average monthly monetary base dropped from a high of 24.1% in January to 15.4% in June. The hike in January, as opposed to 17.1% in December 2000, was the result of a rise in the demand for cash brought on by the increase in the financial transaction tax from two to three per thousand.

Annual growth in cash went from 26.7% in December 2000 to 32.7% in January 2001. After certain exceptions to this tax were established in March, the increase in the demand for cash slowed to 19.9% in June.

The trend in the demand for reserves at the beginning of the year showed a large surplus of reserves in the financial system. This was associated with the caution exercised by credit companies in managing their bank reserves in response to extension of the tax on cash withdrawals by financial agents from deposit accounts with the Banco de la República. The excess in reserves declined recently, perhaps because, as of April, the Banco de la República has allowed the financial system to extend intraday REPOs and to cover shortages in its deposit accounts with the Bank through semiautomatic REPO transactions.

Annual growth in the monetary base at the last week of June was 13.2%, which is $297 billion below the revised reference line. This is explained fundamentally by less demand for cash, the average annual growth of which declined from 24.1% in May to 19.9% in June (Table 13).

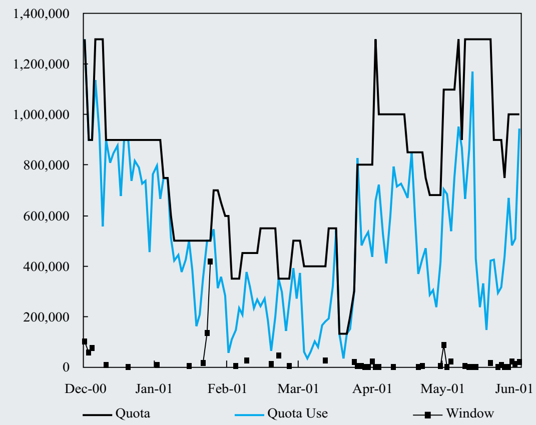
b. Money supply (M1)

During the year to date, the annual increase in average monthly M1 dropped from 32.1% in December 2000 to 13.8% in May and 10.2% in June. This is explained by a decline in annual current account growth, which went from an average of 36.7% in December 2000 to 6.1% in May and 2.7% in June. In other words, the pace of current account growth began to return to normal once the tax reform in December 2000 did away with the levy on financial transactions involving transfers between accounts held by the same customer (Figure 28).

c. Extended monetary aggregate (M3)

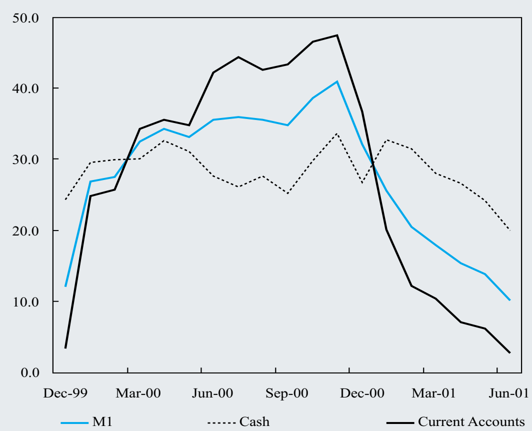
Annual growth in the average monthly extended monetary aggregate (M3) recovered substantially in the first half of the year, when it increased from a rate of 2.8% in January to around 6.0% between February and June (Figure 29). This tendency would appear to indicate that some of the factors responsible for keeping this element down in the year 2000, as discussed at length in the last report, are beginning to be overcome. Among others , these include the decline in the financial margin between assets in foreign and domestic currency and less growth in the net supply of public debt securities (TES) offered by the government and, consequently, a greater channeling of resources towards the financial sector. In effect, as illustrated in Table 14, annual growth in TES as part of the financial portfolio of the economy declined from 41.8% to 24.3%, while annual growth in the commercial bank portfolio rose from 4.3% at December 2000 to 7.0% at June 2001. Although pressure exerted by TES on structure of the financial portfolio in the economy has eased, their growth remains high and probably has prevented more expansion in M3 and credit.

FIGURE 27
LIQUIDITY QUOTAS AND ONE-DAY EXPANSION TRANSACTIONS DAILY OPERATIONS: 2-001
(MILLIONS OF PESOS)



Source: Banco de la República.

FIGURE 28
M1 AND ITS COMPONENTS
(ANNUAL RATE OF GROWTH IN THE AVERAGE MONTHLY BALANCE)



Source: Banco de la República, SGEE.

Table 13
Monetary base: actual cash and reserves
(Bgillions of pesos)

	Monetary base			Cash			Reserve		
	2000	2001	Var %	2000	2001	Var %	2000	2001	Var %
5-Jan.	8,091	10,157	25.5	5,420	7,100	31.0	2,670	3,058	14.5
12-Jan.	8,045	9,895	23.0	5,085	6,780	33.3	2,960	3,116	5.3
19-Jan.	7,620	9,669	26.9	4,896	6,627	35.4	2,725	3,042	11.7
26-Jan.	7,817	9,517	21.7	4,881	6,473	32.6	2,935	3,043	3.7
2-Feb.	7,639	9,724	27.3	5,064	6,670	31.7	2,575	3,054	18.6
9-Feb.	7,599	9,460	24.5	4,857	6,499	33.8	2,743	2,960	7.9
16-Feb.	7,765	9,359	20.5	4,792	6,384	33.2	2,972	2,976	0.1
23-Feb.	7,704	9,488	23.2	4,719	6,176	30.9	2,985	3,312	10.9
2-Mar.	7,676	9,013	17.4	5,010	6,493	29.6	2,666	2,520	(5.5)
9-Mar.	7,535	9,236	22.6	4,860	6,345	30.5	2,675	2,891	8.1
16-Mar.	7,640	9,177	20.1	4,878	6,267	28.5	2,762	2,910	5.4
23-Mar.	7,797	9,268	18.9	4,719	6,104	29.4	3,078	3,164	2.8
30-Mar.	7,132	8,819	23.6	4,922	6,263	27.3	2,210	2,556	15.6
6-Apr.	7,821	9,364	19.7	5,017	6,448	28.5	2,803	2,916	4.0
13-Apr.	7,812	9,668	23.8	4,939	6,380	29.2	2,873	3,289	14.5
20-Apr.	8,167	8,917	9.2	4,959	6,105	23.1	3,208	2,812	(12.3)
27-Apr.	7,436	9,045	21.6	4,912	6,167	25.6	2,524	2,877	14.0
4-May.	7,931	9,124	15.0	5,095	6,422	26.1	2,836	2,702	(4.7)
11-May.	7,769	9,386	20.8	4,995	6,289	25.9	2,774	3,097	11.6
18-May.	8,058	9,095	12.9	4,945	6,181	25.0	3,113	2,914	(6.4)
25-May.	7,519	9,116	21.2	4,962	6,162	24.2	2,556	2,954	15.5
1-Jun.	8,003	9,433	17.9	5,352	6,413	19.8	2,651	3,021	13.9
8-Jun.	8,002	9,409	17.6	5,240	6,354	21.3	2,762	3,055	10.6
15-Jun.	8,264	9,521	15.2	5,312	6,381	20.1	2,952	3,141	6.4
22-Jun.	7,963	9,221	15.8	5,227	6,296	20.5	2,736	2,925	6.9
29-Jun.	8,369	9,477	13.2	5,517	6,506	17.9	2,852	2,971	4.2
Average	7,814	9,368	20.0	5,022	6,396	27.5	2,792	2,972	6.8

Source: Banco de la República.

Figure 29
M3 and PSE
(annual growth in the average monthly balance)

Source: Banco de la República, SGEE.

In spite of the foregoing, one of the factors to influence slow M3 growth during this period was the tendency on the part of the non-financial private sector to increase its holdings in foreign assets. According to the balance of payments, foreign portfolio investments by this sector are estimated as having increased by US$338 million during the first quarter of 2001.

In short, although the M3 aggregate has seen some growth, it is important that agents maintain confidence in the process to reorganize the financial sector and trust the public sector to do more in terms of fiscal adjustment. To the extent that the government manages to cut back on its need for internal financing by reducing the deficit and to obtain adequate

Figure 14
Total credit and financial portfolio
(billions of pesos)

	Balance at Dec-30 2000	Balance at Jun-29 2001	Annual Variation December %	Annual Variation June %
I. Total credit	48,368	48,073	(8.6)	(2.7)
Commercial banks	22,620	23,102	4.3	7.0
Mortgage banks	16,217	15,634	(23.6)	(14.6)
Financial entities	7,964	7,764	(2.3)	(1.1)
Commercial finance companies	1,319	1,326	(9.7)	(4.7)
Cooperatives	75	73	34.8	65.4
Companies in liquidation	174	174	(52.3)	(28.9)
II. Total financial portfolio 2/	91,137	93,558	12.2	12.0
A. Financial sector	62,817	63,310	2.5	7.0
Extended money supply - M3	62,276	62,838	2.8	7.1
Money supply - M1	16,721	14,107	30.5	10.9
Quasimoney	39,458	42,755	(3.4)	6.2
Other liabilities subject to the reserve requirement **3/**	3,691	3,869	8.0	36.4
Bonds	2,128	1,852	(26.7)	(25.2)
Commercial banks	218	98	(26.8)	(59.9)
Mortgage banks	1,211	1,134	(25.2)	(15.3)
Financial entities	501	491	(16.4)	(17.6)
Commercial finance companies	197	128	(49.1)	(56.8)
Restricted deposits	278	255	(52.2)	(34.1)
Bankers acceptances in circulation	55	35	(14.7)	(18.1)
Assessable electrical sector securities	55	0	(86.0)	(99.8)
Fen savings securities	430	436	68.5	63.6
Other financial assets **4/**	1	1	0.0	0.0
B. Public sector	28,320	30,248	41.8	24.3
TES	19,457	20,635	16.2	15.7
TESb denominated in f/c	2,050	2,002	31.3	28.3
TES B UVR	4,973	5,538	199.9	64.0
TES law 546 of 1999 **5/**	1,839	2,071	...	31.5
Securities to support the coffee sector	2	2	(85.2)	(0.0)

1/ Includes the portfolio in d/c and f/c with the public and private sectors.
2/ includes financial assets held by the public and the private sector.
3/ includes deposits in escrow, sight deposits, repos with non-financial entities, and mortgage bonds.
4/ includes ter, exchange certificates and bank bonds
5/ tes issued by the government and delivered to mortgage companies as payment for portfolio reliquidations.
Source: banco de la república and the banking superintendent.

financing abroad, acquisition of public debt instruments, which now account for an important share of financial and private sector portfolios, will cease to be as attractive and accessible an alternative. This will help to channel the private sector's demand for financial assets to the financial system and to reorient the structure of the financial system's assets in the direction of credit.

3. Interest rates

As explained in Section 1, the monetary policy adopted by the Board of Directors has a direct impact on interbank interest rates and an indirect effect on interest on deposits, TES and credit. Nominal interest on 90-day time deposits (DTF) has declined by 0.6 percentage points during the course of the year, from 13.3% in

December 2000 to 12.7% at June 2001[28]. The real deposit rate rose by 0.3 percentage points during the same period and was 4.4% at June. This increase obeys the fact that the drop in inflation rates was greater than the reduction in the rate on time deposits (Figure 30).

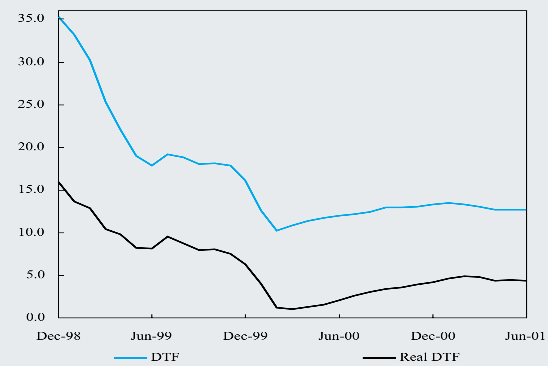
In June 2001, nominal and real investment rates on one-year TES were 12.9% and 4.6%, respectively (Figure 31). Their trend during the course of the year was similar to that registered for time deposits (DTF), declining by 0.3 percentage points in nominal terms and increasing by 0.5 percentage points, discounting inflation. As illustrated in Figure 32, the difference between the nominal cut-off rate in auctions of one-year TES and the DTF rate, which was three percentage points at June 2000, declined to less than one in the 2001 auctions. A comparison between the rate on one-year TES and the rate on fixed-yield commercial paper with the same maturity, such as a 360-day time certificate of deposit (TCD), shows the annual yield on the latter was above the annual rate on public debt securities. This contrasts with the situation throughout most of last year.

The downward trend in interest on TES was true for longer terms as well. Three-year TES issued by the government in June were marketed at 15.0%, on average, compared with 16.0% in December of last year. Five-year TES were marketed at 15.9%, which was also below the rate observed in December 2000 (17.0%) (Figure 33)

There is an important difference in lending rates, depending on the type of risk involved for the intermediary. Ordinary and consumer credit, which registered interest rates of 23.9% and 33.9% at June 2001, involved a higher risk premium than interest on treasury and preferred credit, which showed respective rates of 15.2% and 17.1%. The trend in interest on loans is also different, according to the type of credit. In the first half of the year, ordinary and consumer rates increased by 0.4 and 3.5 percentage points,

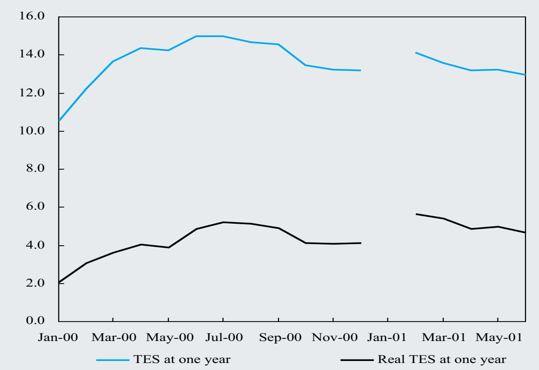
[28] The weighted average monthly rate based on the amount deposited with the financial system in 90-day time certificates of deposit.

FIGURE 30
NOMINAL AND REAL INTEREST RATES ON DEPOSITS 1/



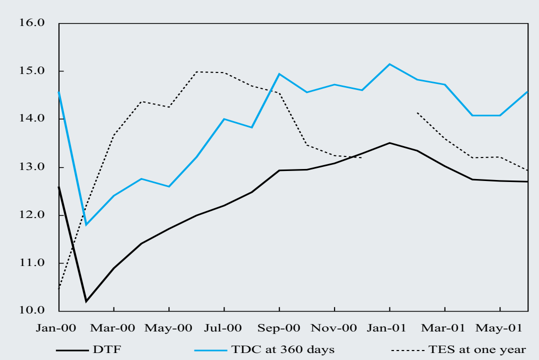
1/ Deflated with the CPI
Source:: Banco de la República and the Banking Superintendent.

FIGURE 31
REAL AND NOMINAL RATES ON ONE-YEAR TES 1/



1/ Deflated with the CPI
Source: Source: Banco de la República.

FIGURE 32
RATE ON TES AT ONE YEAR, DTF AND TDC AT 360 DAYS
(PERCENTAGES)



Source: Banco de la República and the Banking Superintendent.

respectively, while the cost of preferred loans declined by 1.5 percentage points and that of treasury loans by 0.8 percentage points (Figure 34). An analysis of the recent trend in interest spreads is presented in the section on the position of the financial system.

B. The foreign exchange market and foreign exchange policy

The representative market rate (TRM) closed at Col$2,298.90 on 30 June 2001. This implies 7.5% annual devaluation and 3.1% in the year to date. The TRM rose between January and April, slowed its upward trend at mid-May, and remained stable throughout June. The monthly average increased from Col$2,186.20 in December 2000 to Col$2.305.70 in June (Figures 35 and 36).

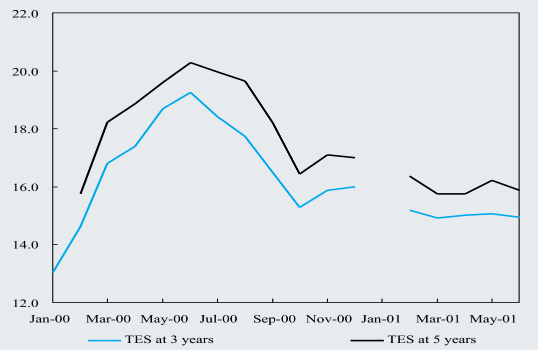
1. The foreign exchange market

The behavior of the exchange rate can be explained by analyzing the sources of foreign currency income or outlays on the exchange market.

Table 15 contains an estimate of surplus demand (the minus sign denotes net supply) for foreign currency on the exchange market by the main economic agents during the course of the year to June[29]. Net demand for foreign currency during this period originated primarily with the productive sector in an amount (US$341 million) superior to that observed during the same period the year before (US$ 251 million). On the other hand, the main supplier of foreign currency was the Treasury, which sold US$846 million, an amount far above that registered in the first half of 2000. The extent of the supply of foreign currency made available by the Treasury was not only sufficient to meet the demand in the productive sector, it also

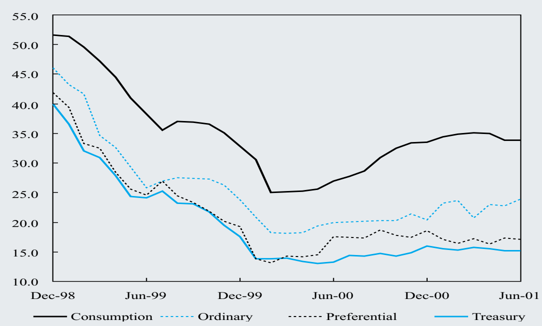
[29] The sum of net demand for foreign currency on the part of the various economic agents is equal to zero in each period, reflecting the fact that the exchange market must be balanced.

Figure 33
Rates on three and five-year TES
(percentages)



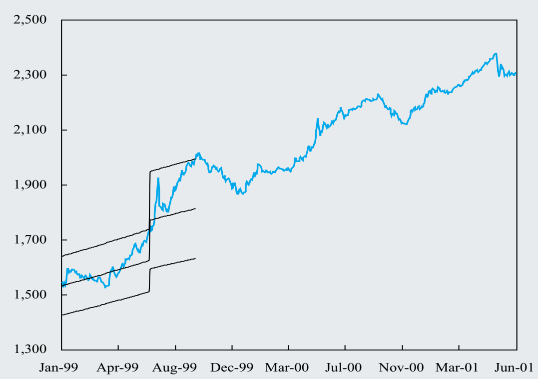
Source: Banco de la República and the Banking Superintendent.

Figure 34
Investment rates by credit type
(percentages)



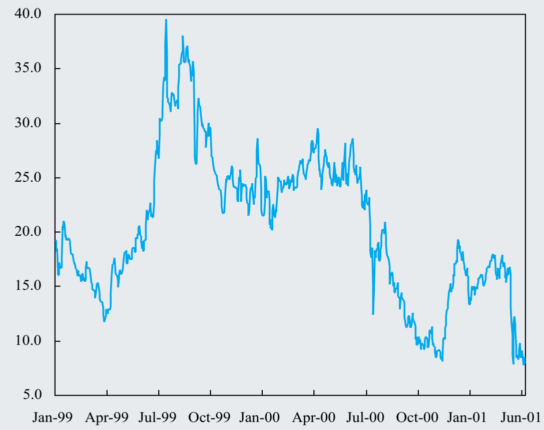
1/ Deflated with the CPI
Source: Banco de la República and the Banking Superintendent.

Figure 35
Trend in the representative market rate
(pesos per dollar)



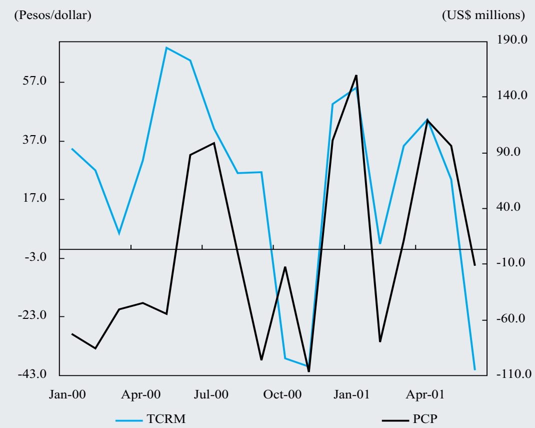
Source: Source: Banco de la República and the Banking Superintendent.

Figure 36
Annual Nominal Devaluation: 1999-2001



Source: Source: Banco de la República and the Banking Superintendent.

Figure 37
Monthly variation in average TCRM and the particular cash position of the financial system (2000-2001)



Source: Banco de la República and the Banking Superintendent.

Table 15
Net demand for foreign currency by the principal economic agents (millions of dollars)

	2000 Jun.	2001 Jan.	Feb.	Mar.	Apr.	May.	Jun.	Accum. Jun.
A. Productive sector	250.5	52.5	141.9	(11.5)	(34.1)	189.9	2.2	340.9
B. Monthly variation in financial sector PCP **1/**	(219.3)	160.0	(80.2)	11.5	119.1	96.6	(11.7)	295.3
C. Treasury	(117.2)	(292.5)	(131.0)	0.0	(85.0)	(316.5)	(20.5)	(845.5)
D. Intervention-Banco de la República	86.0	80.0	69.3	0.0	0.0	30.0	30.0	209.3

1/ Particular cash position - Banking Superintendent
Source: Banco de la República

enable the financial sector to accumulate US$295 million in its particular cash position and the Banco de la República to purchase US$209 million through options auctioned monthly.

Figure 37 shows the trend in net demand for foreign currency in the financial sector (particular cash position-PCP), together with the change in the average monthly TRM. It is interesting to see the close, positive relationship between these two variables, which suggests that, in the short term, the exchange rate responds significantly to the behavior of exchange market intermediaries. During the year to date, the TRM tended to depreciate with an increase in the PCP of exchange market intermediaries (IMC), as occurred in January, March and April. In February and May, the pace of TRM depreciation slowed and, in June, the tendency was towards considerable appreciation, coinciding with less accumulation or slowdown in the financial sector PCP.

Abrupt changes in the demand for foreign currency in the financial system are tied to expectations of devaluation or appreciation. For example, the following factors contributed to the shift in expectation from devaluation to appreciation during May and June: i) the increase in sales of foreign currency by the National Treasury, which amounted to US$316 million in May; ii) the announcement that resources to finance all the government's foreign currency needs during the year 2001 have been secured; iii) the Bank's approval of a request from the government to earmark resources for the year 2002; iv) congressional approval of the transfer reform bill; and v) steps taken by the Banking Superintendent to limit the extent to which the foreign currency investment portfolio of mandatory private pension and severance funds is exposed to exchange risk. These funds have been obliged to sell part of their portfolio under a futures agreement, which constitutes an additional factor of TRM appreciation.

2. Sale of foreign currency to the Banco de la República: Use of sale options

As reiterated in previous reports, the Banco de la República intervenes in the exchange market for two, well-defined purposes; namely, to accumulate international reserves and to control excess exchange rate volatility. It does not intervene to define a particular exchange rate. As to the first goal, the Board of Directors continued with auctions of foreign currency sale options to accumulate international reserves, in keeping with the 2001 macroeconomic program. As to the second, the Banco de la República has yet to intervene, since there has been no excess volatility in the exchange rate.

In terms of options for accumulating reserves (Table 16), the monthly quota was reduced from US$100 million in the January 2001 auctions to US$75 million in February, US$50 million in March and April, and US$30 million in the months of May and June, as there was less need to accumulate reserves[30]. In each month of 2001, all auctioned quotas were approved. These rights were not exercised by the market in March and April. In January and February, they were exercised in part: US$80 million and US$69 million, respectively. The options in May and June were exercised in full.

The closing premiums at which the exchange market has been willing to exercise options for sale to the Banco de la República fluctuated between $1,860 per US$1,000 in January and $9,550 in June, with a steady increase as of February. The premium for the June auction was the highest ever. This fact, coupled with full exercise of all assigned options, denotes a change in the course of expectations for devaluation as of May, once the government announced its intention to continue to play an active role in the supply of foreign currency on the domestic exchange market.

3. The exchange balance

Table 17 shows the origin of foreign currency movement from a different perspective, by examining developments in the domestic exchange balance during the year to date. This balance includes all foreign currency transactions conducted through authorized exchange market intermediaries and the Banco de la República[31].

The exchange balance registered a current account outlay of US$845 million at June, which is US$89 million less than during the same period in 2000. The increase in remittances for imports (US$2,446 million as opposed to US$2,175 million during the same period the year before) was more than offset by the increase in foreign currency remitted for exports, which rose from US$1,357 million to US$1,412 million, and by the trend in the balance of services. An important aspect of this last item is the income in foreign currency originating with transfers from Colombians abroad, which are estimated at

[30] The Banco de la República employs various indicators used internationally to estimate the level of international reserves considered prudent for the country.

[31] According to Board of Directors Resolution 8 of 2000, authorized exchange market intermediaries include banks and finance corporations, commercial finance companies, finance cooperatives, Bancoldex, FEN, stock brokers and exchange bureaus that meet the respective requirements, as set forth in the resolution.

Table 16
Auction of sales options to accumulate international reserves
(Millions of dollars)

	Auction date 1/	Amount		Quota	Premium			Quota exercised
		Presented	Approved		Mnimum	Maximum	Closing	
					(Peso/thousands of dollars)			
2000	Feb.	204.0	80.0	80.0	10.0	3,020.0	210.0	12.0
	Mar.	368.0	80.0	80.0	130.0	4,100.0	1,600.0	0.0
	Apr.	607.5	100.0	100.0	101.0	4,800.0	3,000.0	74.0
	May.	394.0	55.0	100.0	230.0	5,000.0	600.0	0.0
	Jun.	493.0	100.0	100.0	50.0	4,500.0	2,250.0	0.0
	Jul.	474.0	100.0	100.0	50.0	5,100.0	3,000.0	15.5
	Aug.	368.0	100.0	100.0	200.0	6,100.0	3,650.0	0.0
	Sep.	522.0	99.9	100.0	220.0	6,957.0	3,500.0	17.1
	Oct.	434.5	100.0	100.0	220.0	7,000.0	4,510.0	100.0
	Nov.	511.0	100.0	100.0	5.0	7,535.0	6,350.0	100.0
	Dec.	442.8	100.0	100.0	210.0	5,160.0	3,560.0	0.0
2001	Jan.	287.0	100.0	100.0	320.0	4,110.0	1,860.0	80.0
	Feb.	405.7	75.0	75.0	212.0	7,100.0	5,560.0	69.3
	Mar.	259.4	50.0	50.0	500.0	7,566.0	3,800.0	0.0
	Apr.	240.5	50.0	50.0	312.0	5,570.0	3,000.0	0.0
	May.	79.0	30.0	30.0	1.290.0	5,560.0	3,510.0	30.0
	Jun.	123.0	30.0	30.0	3.960.0	10,000.0	9,550.0	30.0

Note: the amount approved at the auction on april 28 was reduced from us$100 million to us$55 million because one institution failed to pay the premium.
1/ the auction is held the last working day of the previous month.
Source: Banco de la República

approximately US$945 million for the first half of the year[32].

The exchange balance showed a foreign currency deficit of US$309 million in the private capital account, which is US$135 million more than the balance registered during the same period the year before. As indicated in Table 17, the downturn in private sector accounts was primarily the result of increased foreign drafts for Colombian investment abroad, which came to US$1,007 million during the year to June. The trend in foreign currency investments by private pension and severance funds during this period is an important aspect. According to exchange declarations filed with the Banco de la República, net investments in foreign currency by these funds amounted to US$659 million by June, which is 65.4% of total investment registered in the exchange balance.

Net external borrowing in the private sector during the first half of the year remained negative by US$309 million. However, this was below the amount reported the year before, mainly because of less amortization. Foreign investment in Colombia, which came to US$1,216 million, was an important source of foreign currency for the exchange market during the first six months of the year.

The exchange balance showed US$1,172 million in net income in official capital between January and

32 Colombians transferred US$283 million in foreign currency to the country from abroad, and US$662 million in transactions were conducted and declared through exchange bureaus.

Table 17
Exchange movement in 2000-2001
(Millions of dollars)

	2000 Accum. Jun.	2001 Jan.	Feb.	Mar.	Apr.	May.	Jun.	Accum. Jun.
I. CURRENT ACCOUNT	(934.6)	(108.5)	(208.4)	(78.0)	(144.4)	(46.7)	(259.1)	(845.2)
Trade balance	(817.9)	(207.6)	(206.4)	(79.3)	(175.9)	(223.3)	(141.5)	(1.034.1)
Reimbursement for merchandise exports	1,357.1	206.3	198.9	322.2	208.6	242.4	233.6	1,412.0
Drafts for imports	2,175.0	413.9	405.3	401.5	384.5	465.7	375.2	2,446.1
Balance of services	(116.6)	99.1	(2.0)	1.4	31.5	176.5	(117.5)	188.9
Net yield on international reserves	105.6	39.9	70.2	31.0	29.7	55.0	10.8	236.8
Other net yields	(222.2)	59.2	(72.3)	(29.7)	1.8	121.5	(128.4)	(47.8)
II. CAPITAL ACCOUNT	1,137.2	588.2	17.5	130.8	531.0	92.5	(114.3)	866.8
Private capital	(173.9)	(69.2)	(122.5)	(119.4)	139.1	(260.4)	123.0	(309.4)
Net external debt	(780.1)	(85.5)	(106.4)	(62.3)	7.6	(72.2)	10.0	(308.8)
Outlays	255.1	17.6	25.8	58.9	125.1	38.8	119.5	385.8
Amortization	1,035.2	103.2	132.2	121.2	117.6	111.1	109.4	694.7
Hedged transactions	(4.3)	(2.1)	0.8	(2.1)	0.1	(1.9)	0.5	(4.6)
Net foreign investment	294.0	24.4	(37.9)	19.6	137.5	(63.3)	128.5	209.0
Foreign investment in Colombia	997.8	175.7	189.9	107.9	358.0	141.7	243.0	1,216.2
Colombian investment abroad	(703.9)	(151.3)	(227.8)	(88.3)	(220.5)	(205.0)	(114.4)	(1,007.2)
Special transactions	316.5	(6.0)	20.9	(74.6)	(6.0)	(123.0)	(16.2)	(204.9)
Official capital	852.1	586.0	(130.0)	241.3	540.0	160.1	(225.4)	1,172.1
Net external debt	(611.5)	299.4	96.8	164.1	675.4	604.6	(43.7)	1,796.6
Outlays	381.5	366.5	193.9	203.2	1,138.5	641.7	686.2	3,230.1
Amortization	993.0	67.1	97.1	39.2	463.1	37.1	729.9	1,433.5
Financial investments	(4.6)	0.0	(1.9)	0.5	(9.8)	(6.3)	4.5	(12.9)
Special operations	1,468.2	286.7	(224.9)	76.7	(125.6)	(438.2)	(186.2)	(611.6)
Banco de la República	(8.9)	4.6	2.0	22.7	(20.5)	(4.9)	0.3	4.1
Change in F/C liquidity	468.0	66.7	268.0	(13.7)	(127.6)	197.6	(12.2)	378.8
1. Exercise of options								
Banco de la República	86.0	80.0	69.3	0.0	0.0	30.0	30.0	209.3
2. Recovery external lines of credit								
Banco de la República	41.1	0.1	0.1	0.4	8.9	1.2	(25.2)	(14.5)
3. Others **1/**	340.9	(13.3)	198.6	(14.1)	(136.5)	166.4	(17.1)	184.0
III. VARIATION IN INTERNATIONAL CASH RESERVES (I + II)	202.7	479.7	(190.9)	52.8	386.6	45.7	(373.4)	400.5

1/ Variation in foreign currency liquidity in the financial system.
Source: Banco de la República, exchange balance

June. This is US$320 million more than the figure observed for the same period the year before[33].

At the end of May 2001, the non-financial sector registered a current account balance abroad of US$5,844 million, or US$732 million more than in the second quarter of 2000 and US$376 million more than the level observed in December 2000. The growth in this balance was due, in part, to external credit outlays for the national government that have yet to be monetized. This availability of foreign currency outside the country affected the exchange rate as of May, by being considered a potential supply of foreign currency. It also helped to temper growth in the nominal exchange rate and generated revaluation expectations.

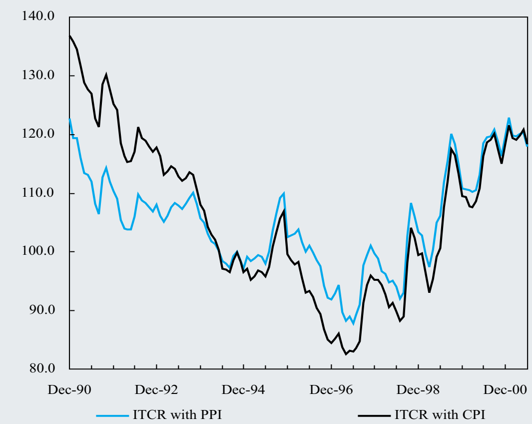
The trend in the exchange rate during the second half of the year will be determined by the difference between profitability at home and abroad. This difference has declined, mainly due to the combined effect of less expectation of devaluation and the reduction in interest rates set by monetary authorities in the United States.

4. The Real exchange rate

The trend in exchange market and inflation indicators has had a positive impact on the competitiveness of the external sector of the Colombian economy. Moderate nominal devaluation in recent years, coupled with declining inflation rates, have been good for exports. Traditionally, the real exchange rate index (ITCR), based on the equivalence of buying power, has been used as an indicator of relative prices to measure changes in the competitiveness of domestic goods[34].

Figure 38 illustrates the upward trend in the real exchange rate index (ITCR) as of June 1997, calculated with the consumer price index (ITCR-CPI) and the

Figure 38
Real exchange rate index in Colombia
Non-traditional commerce



Source: Banco de la República and the Banking Superintendent.

producer price index (ITCR-PPI). Between that date and June 2001, these two indicators showed respective real devaluation rates of 42.6% and 34.2%. Between December 2000 and June 2001, there was no significant change in the ITCR-CPI (0.04%). The ITCR-PPI, on the other hand, showed 1.5% real revaluation, primarily because growth in producer prices in Colombia during the year to date (6.84%) exceeded nominal devaluation during the same period (5.46%)[35].

C. Condition of the financial system

In 2001, the financial system continued on the path to recovery initiated the year before. The profitability of financial activity has been a highlight in this respect. The ex post spread, or brokering margin, stabilized at levels near 9.0%, breaking the trend observed in 2000. Credit grew at a faster pace, especially with respect to the non-mortgage portfolio, and performance remained good in terms of outlays on ordinary and consumer credit.

33 Access to the international capital market has benefited from less of a margin on the country's external debt, which dropped from 796 basis points in December 2000 to 443 basis points at the end of June 2001.

34 A TCR indicator is calculated as well, based on the record of tradable and non-tradable prices in the domestic economy.

35 Measured as the variation between the average nominal rates in June 2001 and December 2000.

1. The financial system continues to gain strength

The primary indicators for the financial system reflect a definite improvement during the course of 2001.

a. Solvency[36]

By April 2001, the indicator of solvency for the financial system as a whole was similar to that of the year before (around 14.0%). Solvency of the public financial system increased from 15.3% to 17.9% (Figure 39A), which is well above the minimum capital requirement in Colombia (9.0% of risk-weighted assets). This is primarily the result of progress towards putting Bancafe on a sound footing. Bancafe continued to eliminate doubtful transactions from its balance sheet, with an eye towards privatization. These efforts were reflected in a better level of solvency for the banking system (Figure 39B). In fact, with 8.2% of all assets in the banking system, Bancafe is now the second largest bank in terms of assets.

b. Profitability

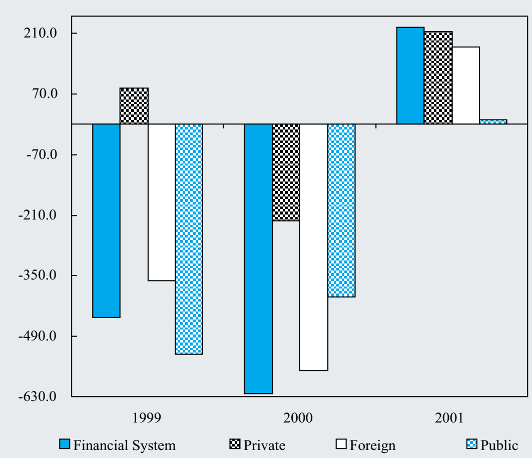
Losses reported by the Colombian financial system during the year to date declined considerably. All groups of organizations registered major improvements. The system accumulated $224 billion in profits between January and April 2001(Figure 40), basically by reducing administrative costs and expenditure on net provisions for recovery[37]. The private sector accounts for 71.3% of these profits, being the sector to recover the most provisions ($325 billion).

Asset profitability for the system as a whole went from -2.0% at December 2000 to -0.91% in April 2001. Asset profitability was -0.52 in the private sector and -2.37% in the public sector (Figure 41)[38].

FIGURE 39
SOLVENCY RATIO
(PERCENTAGES)

Source: Banking Superintendent and the Banco de la República.

FIGURE 40
FINANCIAL SYSTEM PROFITS, APRIL



Source: Banco de la República and the Banking Superintendent.

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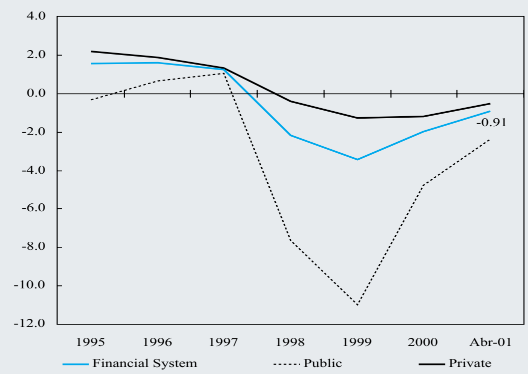
36 Risk-weighted equity/assets.

37 Financial intermediaries are in the process of recovering unproductive assets, either directly or through entities that manage assets of this type. When of these assets are recovered, expenditure for their provision requirement is less.

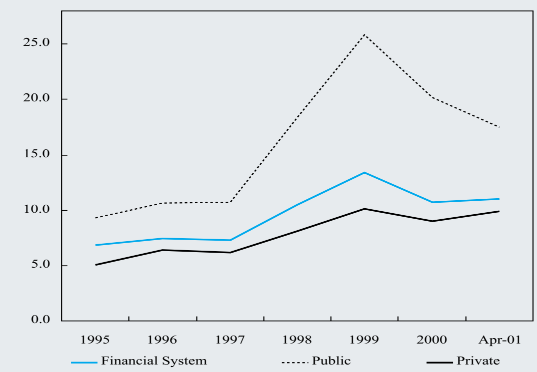
38 Asset profitability is measured as the ratio of assets accumulated in the last 12 months to average assets.

FIGURE 41
ASSET PROFITABILITY
(PERCENTAGES)



Source: Banco de la República and the Banking Superintendent.

FIGURE 42
OVERDUE PORTFOLIO/GROSS PORTFOLIO
(PERCENTAGES)



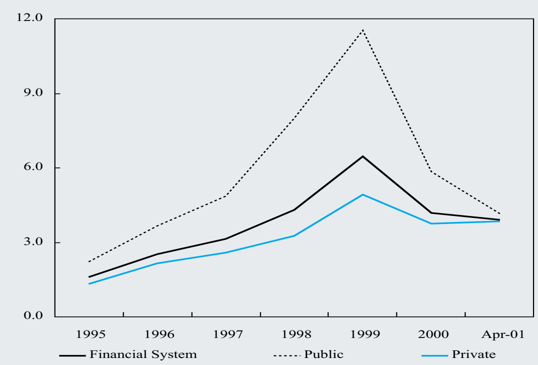
Source: Banco de la República and the Banking Superintendent.

c. Asset quality

The overdue portfolio/gross portfolio ratio remains at around 11.0% (Figure 42), fundamentally because this indicator is high for specialized mortgage institutions as a whole (22.0% in April 2001). The quality of the portfolio in the public financial sector improved, as indicated by the variation from 20.2% in December 2000 to 17.5% in April 2001. In the private financial sector, it stayed at around 10.0%.

The percentage of unproductive assets remained near 4.0% for the financial system as a whole. Banks reduced their share of unproductive assets to almost half the percentage registered in December 2000; that is, from 0.9% to 0.5% in April 2001 (Figure 43). This was due, in part, to steps taken by Bancafe in April 2001 to clean up its portfolio and, in part, to recovery of provisions in the non-mortgage financial sector.

FIGURE 43
PERCENTAGE OF UNPRODUCTIVE ASSETS
(PERCENTAGE)



Source: Banking Superintendent and the Banco de la República.

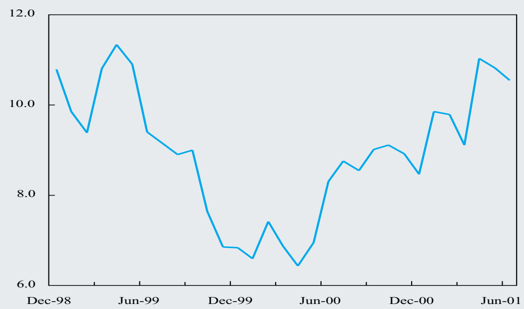
2. Interest rate spreads

The last report to congress contained a brief comparative analysis of ex ante and ex post spreads in the Colombian financial system. During the year 2000, the first grew considerably, while the latter increased only slightly. The result was an approximate 7.0% difference in spread at December 2000.

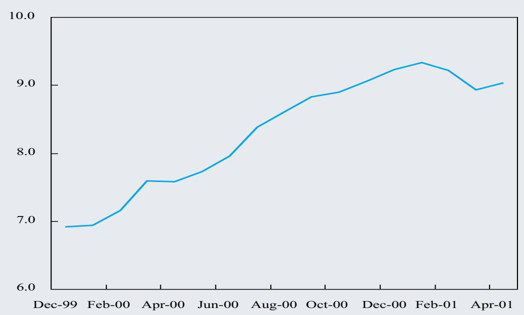
As illustrated in Figure 44A, if the interest rate on preferred loans is included in calculating the lending rate, the ex ante spread was 8.5% in December 2000, as part of an upward trend that continued to June 2001. This is explained by the recovery in ordinary credit (to small businesses) and in consumer credit (to households, etc.), which have above-average interest rates, and by smaller outlays on preferred loans (to large businesses) compared with the year before. The upswing in ordinary and consumer credit helped to place the ex ante spread at levels similar to those observed at the end of 1998.

Figure 44
Solvency ratio
(percentages)

(A)
Ex Ante
(Difference between the loan and deposit rate)



(B)
Ex Post
(Based on the balances and P & G of Intermediaries)



Source: Banking Superintendent and the Banco de la República.

Figure 44B shows the trend in the ex post spread calculated according to the financial statements of credit institutions[39]. As illustrated, that spread remained at around 9.0% in the first four months of 2001, halting the upward trend of the past year[40].

3. Credit in the financial system

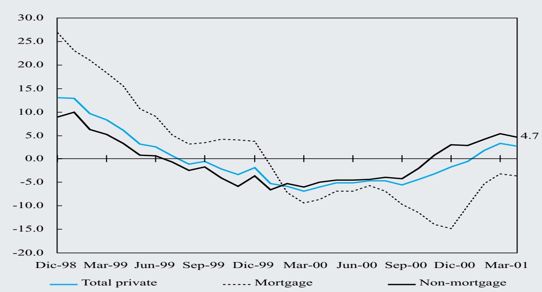
Growth in the loan portfolio increased, especially with respect to non-mortgage loans. The non-mortgage credit balance has seen positive annual growth since February 2001 and was 1.7% by April. The downward trend in the mortgage loan portfolio up to December 2000 was also reversed, although growth remained negative (-11.8% in April 2001).

Annual growth of credit in the private financial sector was 2.7% at April 2001. Non-mortgage loans increased by 4.7% and mortgage loans declined by 3.6% (Figure 45A). In contrast, the public financial sector saw major reductions in the balance of its loan portfolio; mortgage loans dropped by 30.5% and non-mortgage loans by 16.7% (Figure 45B).

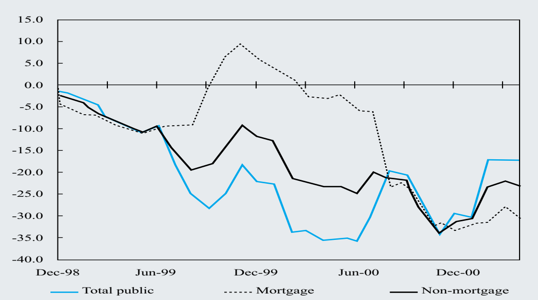
The negative growth in loan portfolio balances continues to be affected by efforts on the part of financial intermediaries to clean up their assets. One of the most important transactions of this type prior to

Figure 45
Gross loan portfolio growth
(percentages)

(A)
Private financial sector



(B)
Public financial sector



Source: Banking Superintendent and the Banco de la República.

39 The *ex post* spread is calculated as follows, based on the financial statements of intermediaries. The average return on lending is calculated as the ratio of financial income received in the last 12 months in the form of interest and discounts on the loan portfolio (including the adjustment for currency devaluation) to the total balance of the gross loan portfolio. The average cost of deposits and receivables is calculated as the ratio of financial outlays paid in the last 12 months on deposits and receivables (including the adjustment for currency devaluation) to the balance of current account deposits, simple deposits, time certificates of deposit, CDATS, savings deposits and savings certificates

40 For a detailed analysis of the trend in ex post spreads, see Michael Hanna, Ana María Loboguerrero, Adriana López and Santiago Muñoz - SGMR (June 2001). "Medición y evolución de los Márgenes de intermediación financiera para el caso colombiano, 1996 - 2001."

May 2001 occurred in April when Bancafé eliminated $350 billion from its portfolio, in the final stage of preparations for privatization. Mortgage loans accounted for nearly 45.0% of this amount. Table 18 shows the adjusted gross portfolio series resulting from these operations prior to April. In that month, the flow of credit in domestic currency should have increased by 3.7%. as opposed to a drop of 3.3%, because the portfolio withdrawn from the balances sheets came to $10,440 billion at April 2001. Accordingly , the flow of credit to the economy began to respond, although slowly, to the recovery experienced by the product as of last year.

Real credit in other countries was also slow to respond to the rebound in economic activity, especially after a recession[41]. There are several explanations for this fact. In terms of credit supply, resources may not be available or lending agencies may not be in a position to loan. This, however, does not appear to be the case in Colombia. As to the demand for credit, households and companies are at first reluctant to increase spending and borrowing. They and prefer to use part of their income to reduce their debt.

The Banco de la República surveyed the chairmen of Colombia's commercial banks and those of several finance corporations and commercial finance companies to determine if the drop in credit is due more to limited supply than weak demand[42].

The questions were designed to discover possible signs of a "credit squeeze" in the economy. i) The financial system has a special preference for debt instruments that are highly liquid and low in risk. ii) The financial system finds it particularly difficult to identify good customers. iii) Loans are accepted o rejected more on the basis of the customer's credit record than on the financial features of the project. iv) Requirements for access to credit have increased for the customer. v) The customer's willingness to pay higher interest rates or to receive a shorter loan

41 See the July 2000 Report to Congress.

42 Banco de la República, Technical Department, SGMR and SGEE (April 2001).

Table 18
Adjusted gross portfolio in the financial system
(In domestic currency)

	Balances (billions of pesos)				Annual variations %		
	Dec-98	Dec-99	Dec-00	Apr-01	Dec-99	Dec-00	Apr-01
A. Gross portfolio	46,734.9	47.230.7	44,026.6	43.550.7	1.1	(6.8)	(3.3)
B. Loans withdrawn from the balance sheet	4,169.5	7.231.9	10,266.1	10.440.2	73.4	42.0	35.0
Assets received as payment	1,623.8	2.160.7	2,171.3	2.128.2	33.1	0.5	(6.4)
Portfolio written off	1,369.1	2.840.1	4,520.1	4.250.3	107.4	59.2	30.7
Managed portfolio	930.0	1.271.3	2,565.8	3.040.9	36.7	101.8	150.5
Loans to liquidated entities (Caja Agraria)	0.0	709.8	709.8	709.8	0.0	0.0	0.0
Securitization and sales	246.6	250.0	299.1	311.0	1.4	19.6	8.4
C. TES law 546 (reduction in mortgage portfolio)	0.0	0.0	1,879.4	2.231.1	0.0	0.0	56.7
D. Adjusted balance (a) + (b) + (c)	53,681.5	54.462.5	56,172.1	56.222.0	1.5	3.1	3.7

Source: Banco de la República, SGEE.

does not influence the decision of the lending agency with respect to credit. vi) The country's financial intermediaries have decided to reduce their assets.

The following are the principal results of the survey. To begin with, 77.0% of those interviewed said an increase in economic activity would change the trend in credit. The other 23.0% cited factors such as legal stability, the 3 x 1000 tax on financial transactions, and capitalization of the mortgage sector. Secondly, in attempting to deal with the crisis, the financial sector has concentrated on capitalizing institutions and stepping up efforts to collect on loans. Policies that call for reducing loans and eliminating poor customers are not considered important in dealing with the crisis. When asked what they would do with resources from surplus short-term liquidity, 65.7% said they would extend some type of credit to the productive sector, 14.3% would purchase government bonds, and 8.6% would make loans to other financial entities. Therefore, it is possible to conclude that limited economic activity and a perception of high financial and institutional risk are the primary factors behind the recent trend in credit. Housing, agriculture and small business appear to be the sectors most affected by this phenomenon.

D. Fiscal policy

At the close of the first quarter of 2001, the consolidated public sector had accumulated a deficit of $855 billion, which is equivalent to 0.5% of annual GDP. This is within the terms of the country's agreement with the International Monetary Fund (IMF), which sets the target for the deficit in the same period at $1,000 billion. As illustrated in Table 19, fiscal performance in the public sector includes central government balances, the rest of the non-financial public sector, Fogafin, the cost of financial reorganization, and the balance reported by the Banco de la República[43].

The fiscal situation in the non-financial public sector during the first quarter of 2000 experienced a decline equal to approximately 1.0% of GDP. This was the result of a larger central government deficit and less of a surplus in the rest of the non-financial public sector. The reduction in the social security surplus and the decline in resources channeled to the Oil Savings and Stabilization Fund (FAEP) are examples.

The central government showed a quarterly deficit of $1,899 billion, which is equivalent to 1.0% of annual GDP. Compared with the same period in the previous year, income rose by 12.6% and expenses by 14.8%. A highlight was the increase in revenue from gasoline taxes, the financial transaction tax and the external VAT. These collections rose by 45.9%, 40.7% and 35.4%, respectively. The sizable increase in gasoline tax collections stems from the fact that contributions for decentralization and from hydrocarbons began to be recorded under this item as of the year 2001[44]. The tax on financial transactions was increased by one point, and tax authorities (DIAN) made an effort to exercise more control over the tax base (Table 20).

Income tax, internal VAT and customs revenue did not meet the targets set by DIAN, having increased by only 3.0%, 16.5% and 20.4% respectively. The slow growth in income tax is associated with difficulties in applying the tax reform and with problems of comparison generated by a reduction in the number of days banks are allowed to hold tax collections before transferring them to the General Treasury Account.[45]. Problems with implementing the reform were particularly important in terms of the benefits established for auditing and portfolio recovery. In this respect, the government fell $300 billion short of the quarterly targets.

VAT collections suffered from the decision to postpone the general rate increase stipulated in the tax reform (from 15% to 16%) until the end of January. This

43 Although the cost of realigning the financial system is presented as a separate item, it was funded by the central government.

44 Up until the year 2000, revenue from hydrocarbons was part of non-tax income and the contribution for decentralization was entered under the heading of special funds.

45 An additional $600 billion were collected during the first quarter of 2000 on account of this limit being reduced from 21 to 14 days.

Table 19
Consolidated public sector
First quarter deficit (-) or surplus (+)

	Billions of pesos		Percentage of PIB	
	2000	2001	2000	2001
Electricity	238.0	228.0	0.1	0.1
Carbocol	65.0	0.0	0.0	0.0
F.A.E.P.	410.0	238.0	0.2	0.1
Ecopetrol	607.0	701.0	0.4	0.4
Telecom	(100.0)	(112.0)	(0.1)	(0.1)
Other entities **1/**	(95.0)	(67.0)	(0.1)	(0.0)
Social security	482.0	129.0	0.3	0.1
Regional and local entities	308.0	(156.0)	0.2	(0.1)
National coffee fund	(1.0)	28.0	(0.0)	0.0
1. Sub-total: rest of the public sector	1,914.0	989.0	1.1	0.5
2. National government	(1,044.0)	(1,899.0)	(0.6)	(1.0)
A. Total non-financial public sector (spnf) (1+2)	870.0	(910.0)	0.5	(0.5)
B. Cash losses and profits - Banco de la República	226.0	452.0	0.1	0.2
C. Cash losses and profits - Fogafin	(171.0)	64.0	(0.1)	0.0
D. Cost of reorganizing the financial sector	(163.0)	(442.0)	(0.1)	(0.2)
E. Adjustments	(22.0)	(18.9)	(0.0)	(0.0)
F. Total sector público consolidado (A + B + C + D + E)	740.0	(854.9)	0.4	(0.5)

1/ Includes Epm and Emcali
Source: confis.

implied a sacrifice of resources[46]. Revenue from customs duties and external VAT was $113 billion below the government's goal, due to an increase in imports of duty-free items such as defense material and certain capital goods.

The central government made $8,991 billion in payments during the quarter; that is, 14.8% more than in the same period the year before. As to items, payments for interest increased by 11.5%, operations by 16.5% and investment by 13.5%. Payments for personal services rose by 26.2%, general expenses by 101.4% and transfers by 7.7%. The increase in personal services is associated with payment of the budget lag produced in the year 2000 due to wages. The rise in general expenses was due to an increase of $206 billion in payments on military equipment during the quarter.

The central government financed its deficit with credit and with earnings transferred by the Banco de la República. Net external borrowing came to $1,685 billion, as a result of $1,936 billion in disbursements and $251 billion in amortization. With $3,957 billion in disbursements and $3,275 billion in amortization, net internal borrowing increased by $682 billion. The Banco de la República transferred $1,452 billion in earnings, with $181 billion corresponding to the sale of assets. Moreover, $3,931 billion in TES were sold during the quarter: $2,688 billion through agreed or forced investments and $1,243 billion through auctions.

The rest of the non-financial public sector registered a first-quarter fiscal surplus equivalent to 0.5% of GDP, thanks to the favorable trend in Ecopetrol and FAEP finances. The surplus reported by Ecoptrol in the first

46 The delay was the result of a request from withholding agents who asked DIAN for more time to relabel price tags with the new rate.

Table 20
Effective central government operations
First semester
(Billions of pesos)

	2000	2001	Annual growth
I. Total revenue (A + B + C + D)	5,845.0	6,581.0	12.6
A. Tax revenue	5,240.0	6,043.0	15.3
Income tax	2,186.0	2,252.0	3.0
Internal vat	1,689.0	1,967.0	16.5
External vat	523.0	708.0	35.4
Customs	397.0	478.0	20.4
Gas tax	185.0	270.0	45.9
Tax on financial transactions	253.0	356.0	40.7
Others	7.0	12.0	71.4
B. Non-tax revenue	282.0	225.0	(20.2)
C. Special funds	72.0	54.0	(25.0)
D. Capital resources	251.0	259.0	3.2
Financial yields	134.0	183.0	36.6
Financial surpluses	28.0	61.0	117.9
Others	89.0	15.0	(83.1)
II. Total expenses (A + B + C + D)	7,830.0	8,991.0	14.8
A. Interest1.889.0	2,107.0	11.5	
External	557.0	753.0	35.2
Internal	1,332.0	1,354.0	1.7
B. Operating costs	5,303.0	6,141.0	15.8
Personal services	916.0	1,156.0	26.2
General expenses	277.0	558.0	101.4
Transfers	4,110.0	4,427.0	7.7
C. Investment	489.0	555.0	13.5
D. Net loan	149.0	188.0	26.2
III. Adjustments	941.0	511.0	(45.7)
IV. Cash deficit (-) or surplus (+) (I - II + III) 1/	(1,044.0)	(1,899.0)	81.9
V. Financing (A + B + C + D)	1,044.0	1,899.0	81.9
A. Net external credit	1,526.0	1,685.0	10.4
Outlays	2,351.0	1,936.0	(17.7)
Amortization	825.0	251.0	(69.6)
B. Net internal credit	2,098.0	682.0	(67.5)
Outlays	3,916.0	3,957.0	1.0
Amortization	1,818.0	3,275.0	80.1
C. Banco de la República earnings	516.0	1,452.0	181.4
D. Others	(3,096.0)	(1,920.0)	(38.0)
VI. Deficit as a percentage of GDP	(0.6)	(1.0)	63.5

1/ Not including the cost of restructuring the financial sector
Source: Confis.

quarter is partially the result of reduced payments and more income from national sales, which rose by 24.2%. Compared with the first quarter of 2000, the rest of the non-financial public sector showed a decline in surplus equivalent to 0.6% of GDP. This was due to deterioration in the finances of the social security system and the public sector at regional and local level.

E. Progress in the adjustment program

As is widely known, the Colombian government and the IMF agreed to a macroeconomic program based on maintaining monetary discipline, on restructuring the financial system, on reducing the fiscal deficit, and on a policy of external borrowing in keeping with the macroeconomic adjustment process. Quarterly performance criteria for a series of variables were established to accomplish these objectives and to guarantee compliance with the program. The quarterly goals set for 2001 concern I) net international reserves (RIN), II) inflation measured according to the accumulated CPI in the last 12 months, iii) the overall balance in the consolidated public sector, and iv) net disbursements on the short, medium and long-term external debt in the public sector. As illustrated in Table 21, all the goals of the macroeconomic agreement were met during the first half of 2001[47].

[47] Days before the end of the first half of the year, the government feared it would be short of dollars to meet the net external borrowing target established in the program with the IMF. Accordingly, as a precaution, it requested a sale of foreign currency by the Banco de la República, on the last working day of June, with the understanding that the bank would repurchase this currency on the first working day of July. Being conscious of how important it was for the country to comply with all the goals set forth in the program agreed on with the IMF, the Board of Directors approved the sale of dollars to the Colombian Treasury at the TRM on the day of the transaction, under the condition that the Treasury would sell the same amount of dollars back to Bank on the next working day (also at the TRM). In this way, the transaction was conducted at market rates and accounts were affected only from one day to the next. Later, when the final figures were available, it became clear that the government could have met this goal without having to purchase foreign currency from the Banco de la República. Consequently, the Board of Directors decided to reverse the operation. This is an entirely acceptable and common international practice in "good value" transactions. The operation implied almost no administrative cost.

Table 21
Criteria for fulfilling the program agreed on with the International Monetary Fund
(Millions of dollars)

Description	March 2001			June 2001		
	FMI Goal (a)	Actual (b)	Difference (c)	FMI Goal (a)	Actual (b)	Difference (c)
Rin floor	8,900	9,077	177	8,980	9,203	223
Target inflation	8.70	7.81	(0.89)	8.90	7.93	(0.97)
Ceiling applying to the global deficit in the consolidated public sector as of january 1, 2001 (in billions of pesos)	1,000	855	(145)	2,600	n.d.	n.d.
Ceiling applying to accumulated net disbursements on the medium and long-term external debt in the public sector as of january 1, 2001 de enero de 2001 (En millones de dólares) **1/**	460	437	(23)	1,210	n.d.	n.d.
Techo a los desembolsos netos acumulados de deuda externa de corto plazo del sector público desde el 1 de enero de 2001 (in millions of dollars) 1/	80	0	(80)	80	n.d.	n.d.

(c) + (b) - (a)
n.d. Not available
1/ net disbursements on the medium and long-term external debt in the public sector came to us$552 million. However, taking into account the clause according to which surplus external financing with this span (us$115 million) can be deducted from asset accumulation abroad, the end amount is us$437 million, as indicated in the table.
Source: Banco de la República.

V

The macroeconomic outlook for 2001

The following are projections for the major macroeconomic variables, inflation, the balance of payments, growth and the fiscal deficit in the year 2001. Given the gradual decline in inflation, the Board of Directors is confident the target of 8% inflation for 2001 and 6% for 2002 will be met. The current account deficit in 2001 is expected to be 3.0% of GDP, owing to a 6.0% decline in goods exports and a 12.1% increase in goods imports. On the other hand, weak growth in product during the first quarter of 2001 prompted the government to revise its forecasts for the year as a whole. The new projections point to 2.4% economic growth and a consolidated public sector deficit close to 2.8% of GDP by the end of the year, with an adjustment approaching 0.6% of GDP compared with the actual size of the deficit in the year 2000.

A. The outlook for inflation

The various projection models applied by the Banco de la República, with figures at June, indicate the target of 8% inflation will likely be met. This optimistic outlook is also based on the trend in core inflation during the first six months of the year, which was close to 8%, on minor changes in the price of important items in the consumer market basket, such as home rental and clothing, and on prospects for good harvests in the months ahead. Meeting the inflation target for this year will make it even more feasible to comply with the target of 6% announced by the Board of Directors for 2002.

Nevertheless, circumstances that could affect price stability in the coming months will have to be monitored closely. The greatest risk stems from recent anxiety on international markets, especially in Latin America, over the weak external situation in Argentina and Brazil. Until now, this uncertainty has had little impact on the Colombian economy. However, the country is not exempt from a contagious effect. If this were to happen, the resulting step up in devaluation could make it difficult to meet inflation targets.

The trend in certain foods could also be a source of uncertainty. Meat and meat substitutes are a case in point, They could exert upward pressure on consumer prices, given their important to the CPI basket, if the supply restrictions mentioned earlier continue and if there are negative surprises in the weather. However, the likelihood of the latter declined recently, judging from weather forecasts for the rest of the year.

B. The outlook for economic growth

Weak economic growth in the first quarter of 2001 prompted the government to revise its forecasts for 2001. The new projections point to an increase of 2.4%[48], which is consistent with the target of 8% inflation. It also is in keeping with the situation posed

[48] The figure of 2.4% appears in the Compes document dated July 26, 2001. However, this rate could change, depending on the situation with respect to law and order, the trend in consumption and private investment, exports, and the course of international economic conditions, particularly in Argentina.

by extremely low international prices for coffee, oil prices below what they were last year, growth in non-traditional exports similar to the first quarter of the year, and a fragile international economic environment.

A analysis of trends in the various sectors of the economy offers a more detailed view of what the rest of the year could hold in store (Table 22)[49]. Agricultural growth is expected to remain positive, due to available credit and good yields on crops associated with exports. Palm oil and flowers are two examples. However, this growth could be affected by low international prices for coffee and by the impact of adverse weather conditions on harvests and milk production.

Mining continues to suffer the effects of less oil production due to the natural depletion of oil reserves and to persistent attacks on oil facilities.

The slowdown in the industrial sectors, which was evident in the first months of the year, will be overcome if household consumption recovers and industrial exports continue the upward trend observed in 2000.

Growth in the construction sector would be led by building construction, which has developed favorably during the year to date. However, the reduction in civil works, due to cutbacks in government investment, could slow recovery of the sector.

On the other hand, the recent behavior of several economic indicators other than those referring to national accounts does not denote the likelihood of major changes in the pace of economic growth.

The indicator of energy demand rose by 1.06% in June compared with the same period the year before, implying average growth during the year to date above what was registered in 2000 (Figure 46).

[49] According to figures in the Compes document dated July 26, 2001.

Table 22
GDP by major branches of activity
(Percentage of real growth)

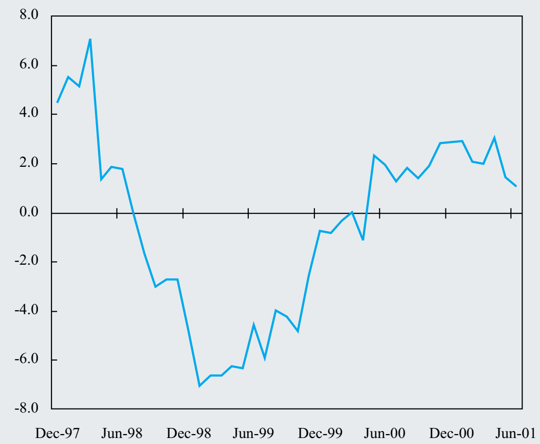
	2000	2001 (Proj.)
Agriculture, forestry, hunting and fishing	5.2	3.6
Mining and quarrying	(5.8)	(2.8)
Electrical power. gas and water	2.7	2.2
Manufacturing industry	9.7	3.4
Construction	(1.5)	3.2
Commerce. repairs. restaurants and hotels	5.2	4.1
Transport. storage and communications	3.7	2.9
Financial services	0.0	1.2
Social. community and personal services	(1.1)	(0.4)
Public administration services	(1.9)	(1.0)
Total PIB	2.8	2.4

(ProJ.) Projected
Source: for the year 2000: dane. For 2001: conpes document, july 26, 2001 - "balance macroeconómico a junio de 2001 y perspectivas para 2002," (macroeconomic balance at june 2001 and the outlook for 2002), DNP.

The indicator of nominal sales financed with credit cards has also been favorable for the year to date. Annual growth in credit card use was 15.1% at April, the highest in the first months of 2001. Despite less of an increase in May (6.6%), the trend in this indicator is still more positive than in 2000 (Figure 47).

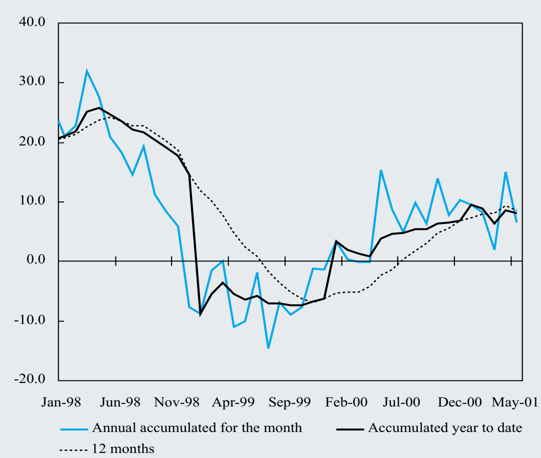
The Business Opinion Poll (EOE) conducted by Fedesarrollo shows stock and orders have declined since the beginning of the year. This trend has yet to change, as evidenced by the figures for May (Figure 48) and the preliminary results for June. Short and medium-term expectations among businessmen have also suffered a setback since January of this year, prompting a drop in the business climate indicator. However, this trend registered a change in May (Figure 49), which would have continued in June.

Figure 46
Annual growth in monthly energy consumption (MUTB/DAY)
(percentage)



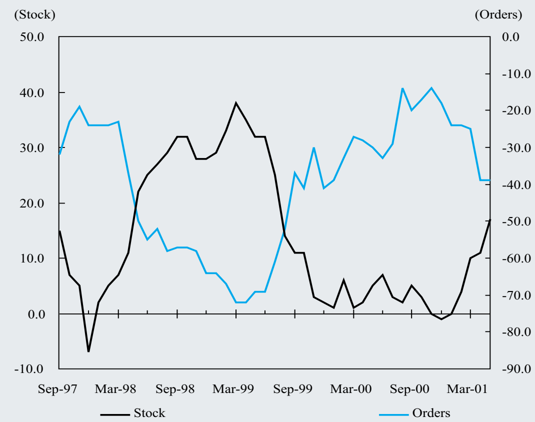
Source: ISA, Calculations by the Banco de la República.

Figure 47
Total credit card sales and advances at May 2001
(growth rates)



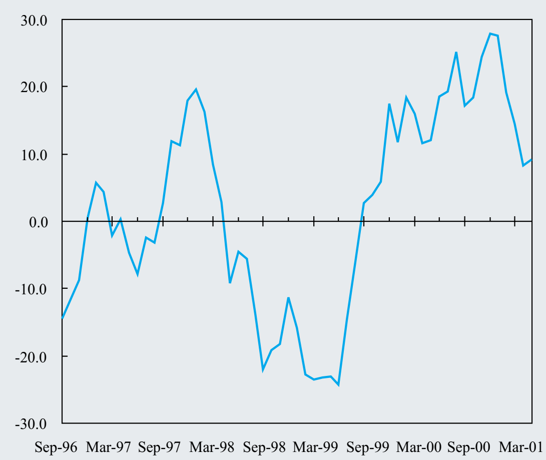
Source: Red multicolor.

Figure 48
Business opinion poll
(balances - figures at May 2001)



Balances: Percentage of companies responding positively to the poll, minus those with a negative response.
Source: SGEE, based on figures from the Fedesarrollo Business Opinion Poll (EOE).

Figure 49
Business climate
(Percentages - figures at May 2000)



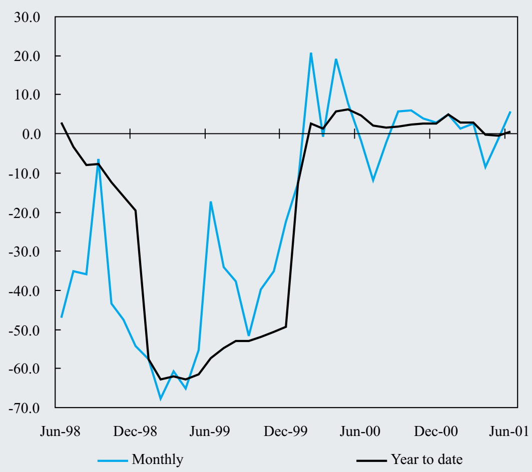
Source: Banco de la República, SGEE, based on EOE figures from Fedesarrollo.

Following a slight downturn in April and May, automobile sales, which are another indicator of economic activity, recovered in June, thanks to 5.6% growth compared with the same month in 2000 (Figure 50).

Growth in product during 2001 will ultimately be subject to changes in the economic conditions of Colombia's major trading partners (the United States, Venezuela and the Andean Community) and to variations in international prices for oil and coffee.

The international economy shows signs of weakening. Recent figures on growth of the world's three major economies confirm fears of a global economic slowdown, which have existed since the beginning of

FIGURE 50
AUTOMOBILE SALES
TOTAL AUTOMOTIVE INDUSTRY
(ANNUAL PERCENTAGE CHANGES)



Source: Colmotores.

the year. The United States economy grew by 2.5% during the first quarter of 2001. This is the lowest rate in the last four years. However, expectations of improved US economic performance during the second half of the year have increased as a result of several factors; namely, less inflationary bias on the part of the Federal Reserve Bank and its active policy of reducing interest rates, the Bush Administration's plan for a scheduled tax cut this year and during next 10 years, and the trend in household consumption. If these forecasts are confirmed, the US economy should grow by almost 1.9% in 2001 as a whole and by 3.0% in 2002.

Economic growth in the Latin American countries faces a number of domestic risks, including the critical situation in Argentina and its possible contagious effect on the region. The energy crisis in Brazil and political problems throughout the region are also important factors in this respect. On the external front, lower prices for basic exports and the slowdown in the United States economy continue to threaten good performance of the region's economy. The Latin American economies are expected to grow by 2.6%, on average, during 2001.

C. THE OUTLOOK FOR THE BALANCE OF PAYMENTS

The most recent projection on the balance of payments (Table 23) shows a current account deficit of US$2,394 million for 2001, which is equivalent to 3.0% of GDP.

Financing for this deficit will be met with US$2,619 million in anticipated capital receipts (3.2% of GDP). The current account estimate for the balance of payments contemplates an annual drop of 6.0% in goods exports, due to less income from petroleum and petroleum by-products, coffee, ferronickel and gold. This will be offset in part by increased exports of coal and non-traditional products[50]. The annual increase in goods imports is estimated at 12.1% and includes imports projected within the scope of Plan Colombia, which would amount to US$560 million in the year[51]. Without this last item, the value of imports in the year 2001 would increase by 7.0%.

The projection for the capital and financial account does not consider revenue from privatization[52]. Long-term capital flows should grow as a result of more medium and long-term net external borrowing by the public sector, which is expected to increase by US$2,848 million in 2001. Adding the projection on long-term net external indebtedness in the private sector would increase the total balance of the debt by US$2,567 million to US$38,865 million at the end of the year[53]. It is important to point out the central government's success in obtaining resources on the international market. During the year to June, US$3,344 million in external bonds were sold, in addition to a US$339 million bond issue in October of last year, which corresponds to the 2001 period.

50 Included in special commercial transactions.

51 Ibid.

52 This considers only the US$80 million in proceeds paid to the national treasury in January 2001 for the privatization of Carbocol in 2000.

53 Includes leasing and securitization transactions.

Table 23
Colombia's balance of payments - summary
(Millions of dollars)

	Millions of dollars			as a % of GDP		
	1999 (pr.)	2000 (pr.)	2001 (proj.)	1999 (pr.)	2000 (pr.)	2001 (proj.)
I. CURRENT ACCOUNT	98	41	(2,394)	0.12	0.05	(2.96)
Income	15,957	17,929	17,589	18.83	22.06	21.79
Outlays	15,858	17,888	19,983	18.71	22.00	24.75
A. Nonfactor goods and services	506	1,268	(867)	0.60	1.56	(1.07)
1. Goods	1,775	2,543	380	2.09	3.13	0.47
Exports	12,030	13,620	12,800	14.19	16.75	15.85
Imports	10,255	11,077	12,421	12.10	13,63	15.38
2. Nonfactor services	(1,269)	(1,275)	(1,246)	(1.50)	(1.57)	(1.54)
Exportaciones	1,865	2,018	2,004	2.20	2.48	2.48
Importaciones	3,133	3,293	3,250	3.70	4.05	4.03
B. Factor income	(1,460)	(2,479)	(3,278)	(1.72)	(3.05)	(4.06)
Income	791	850	846	0.93	1.05	1.05
Outlays	2,251	3,329	4,124	2.66	4.10	5.11
C. Current transfers	1,052	1,252	1,751	1.24	1.54	2.17
Income	1,271	1,441	1,938	1.50	1.77	2.40
Outlays	219	189	188	0.26	0.23	0.23
II. CAPITAL AND FINANCIAL ACCOUNT	17	1,127	2,619	0.02	1.39	3.24
A. Financial account	17	1,127	2,619	0.02	1.39	3.24
1. Long-term financial flows	2,262	2,112	3,627	2.67	2.60	4.49
a. Assets	121	306	304	0.14	0.38	0.38
i. Colombian direct investment abroad	116	306	304	0.14	0.38	0.38
ii. Loans **1/**	6	0	0	0.01	0.00	0.00
iii. Other assets	0	0	0	0.00	0.00	0.00
b. Liabilities	2,383	2,418	3,930	2.81	2.97	4.87
i. Foreign direct investment in Colombia	1,326	2,615	1,364	1.56	3.22	1.69
ii. Loans **1/**	1,057	(197)	2,567	1.25	(0.24)	3.18
Public sector	1,766	1,189	2,848	2.08	1.46	3.53
Private sector	(709)	(1,387)	(282)	(0.84)	(1.71)	(0.35)
iii. Other liabilities	0	0	0	0.00	0.00	0.00
Public sector	0	0	0	0.00	0.00	0.00
Private sector	0	0	0	0.00	0.00	0.00
c. Other long-term financial movement	0	0	0	0.00	0.00	0.00
2. Short-term financial flows	(2,245)	(985)	(1,008)	(2.65)	(1.21)	(1.25)
a. Assets	1,512	1,263	1,474	1.78	1.55	1.83
i. Portfolio investments	1,420	1,025	1,339	1.68	1.26	1.66
Public sector	586	100	774	0.69	0.12	0.96
Private sector	834	925	565	0.98	1.14	0.70
ii. Loans **1/**	93	238	135	0.11	0.29	0.17
Public sector	(61)	(61)	0	(0.07)	(0.07)	0.00
Private sector	153	299	135	0.18	0.37	0.17
b. Liabilities	(733)	278	467	(0.86)	0.34	0.58
i. Portfolio investments	(23)	17	150	(0.03)	0.02	0.19
Public sector	4	0	80	0.00	0.00	0.10
Private sector	(27)	17	70	(0.03)	0.02	0.09
ii. Loan **1/**	(710)	261	317	(0.84)	0.32	0.39
Public sector	(306)	(473)	14	(0.36)	(0.58)	0.02
Private sector	(404)	734	302	(0.48)	0.90	0.37
B. Special capital flows	0	0	0	0.00	0.00	0.00
III. NET ERRORS AND OMISSIONS	(434)	(298)	428	(0.51)	(0.37)	0.53
IV. CHANGE IN GROSS INTERNATIONAL RESERVES 2/	(319)	870	653	(0.38)	1.07	0.81
V. GROSS INTERNATIONAL RESERVES	8,103	9,006	9,591	9.56	11.08	11.88
VI. NET INTERNATIONAL RESERVES	8,101	9,004	9,589	9.56	11.08	11.88
Months of goods imports	9,5	9,8	9,3			
Months of imports of goods and services	6,2	6,1	5,8			
Nominal gdp in millions of dollars	84,752	81,290	80,739			
VII. CHANGE IN NET INTERNATIONAL RESERVES	(320)	869	653	(0.38)	1.07	0.81

(pr.) Preliminary
(proj.) Projection
Assumptions: export prices: coffee us$0.8/pound(exdock); oil us$26.6/barrel; growth in goods imports 12.2% (7.0% without plan Colombia).
1/ includes portfolio investment, leasing, direct loans and commercial credit
2/ according to the balance-of-payments methodology.
Source: Banco de la República.

As a result, the country would accumulate US$653 million in gross international reserves during 2001, for a balance of US$9,591 million at the end of December. This equals 9.3 months of goods imports and 5.8 months of imports of goods and services.

D. The fiscal outlook

The fiscal projections and targets presented in the March Report to Congress remain in effect for 2001. The report indicated the consolidated public sector deficit would be close to 2.8% of GDP by the end of the year, with an adjustment close to 0.6% of GDP compared with the size of the deficit in 2000. As noted in the same report, the central government's deficit might be slightly above 4.0% of GDP; the rest of the non-financial public sector would accumulate a surplus close to 1.6% of GDP (Table 24).

The trend in central government finances will depend largely on how successful the authorities are in applying the tax reform approved at the end of last year and the reforms adopted with respect to spending. According to the current projection, revenue would grow by more than 25.0% and expenses by 14.6%. Official figures point to a 30.0% increase in tax collections, including additional revenue derived from the tax reform, which is estimated at 1.2% of annual GDP. Expenses would increase by 13.5% for interest, 15.1% for operation and 20.6% for investment. The net loan is charted at $752 billion, with $420 billion for loans to cover debt service incurred by Urrá, Emcali and the Empresa del Metro de Medellín.

As to financing, projections point to the use of external and domestic credit resources in net amounts of $4,113 billion and $4,474 billion, respectively. TES B are the primary domestic debt instruments, with sales estimated at $11,900 billion. The government conducted a voluntary internal debt swap in June, via auction, in the amount of $5.6 trillion. This transaction eased pressure on the national budget and improved the profile of public borrowing, inasmuch as the average life of the central government's external debt portfolio increased from 3.4 to 4.5 years.

Efforts to restructure the government's internal debt consisted of swapping TES that are due to mature between 2001 and 2005 for securities redeemable in 2004, 2006 and 2011. Three and five-year government securities were issued at a fixed interest rate, and 10-year securities at a floating rate.

From a fiscal standpoint, the debt swap spelled important relief for government finances, by reducing the need for domestic credit in the years ahead. In 2001, 2002 and 2003, payments to retire the debt will decline by $875 billion, $2,820 billion and $1,140 billion, respectively. In terms of the economy as a whole, the internal debt swap represents less pressure from the public sector on aggregate savings, which should help to lower interest rates and make more room for private investment.

In closing, it is important to mention the recent approval of legislation that modifies the way transfers to the territories are calculated. This reform guarantees stability in resources for health and education. It also allows for more flexibility in managing the national budget, inasmuch as positive changes in current government revenue are not translated into spending on transfers.

The amount transferred annually between 2002 and 2008 will be pegged, in essence, to the trend in inflation and will be determined by actual growth in prices and respective real increases of 2.0 and 2.5 points for the 2002-2005 and 2006-2008 periods.

Table 24
Consolidated public sector
Deficit (-) or surplus (+)

Item	Billions of pesos 1999	Billions of pesos 2000	Billions of pesos 2001 (proj.)	Percentage of GDP 1999	Percentage of GDP 2000	Percentage of GDP 2001 (proj.)
Electricity	(412.0)	237.9	378.0	(0.3)	0.1	0.2
Carbocol	266.0	179.3	0.0	0.2	0.1	0.0
F.A.E.P.	533.0	1,622.4	642.0	0.4	1.0	0.3
Ecopetrol	808.0	1,272.2	570.0	0.5	0.7	0.3
Telecom	(70.0)	(41.2)	41.0	(0.0)	(0.0)	0.0
Other entities	280.0	389.1	616.0	0.2	0.2	0.3
Social security	1,254.0	808.9	687.0	0.8	0.5	0.4
Regional and local entities	(512.0)	(170.7)	344.0	(0.3)	(0.1)	0.2
National coffee fund	(43.0)	(274.6)	(205.0)	(0.0)	(0.2)	(0.1)
1. Sub-total - rest of the public sector	2,104.0	4,023.3	3,073.0	1.4	2.4	1.6
2. National government	(11,450.0)	(10,080.0)	(8,102.0)	(7.5)	(5.9)	(4.1)
A. Total non-financial public sector (SPNF) (1+2)	(9,346.0)	(6,056.7)	(5,029.0)	(6.1)	(3.6)	(2.6)
B. Cash losses and profits Banco de la República	608.0	877.0	995.0	0.4	0.5	0.5
C. Cash losses and profits - Fogafin	828.0	30.0	194.0	0.5	0.0	0.1
D. Cost of restructuring the financial sector	(10.0)	(666.0)	(1,672.0)	(0.0)	(0.4)	(0.9)
E. Statistical discrepancy	(351.0)	(4.0)	0.0	(0.2)	(0.0)	0.0
F. Total consolidated public sector (A + B + C + D + E)	(8,271.0)	(5,819.7)	(5,512.0)	(5.4)	(3.4)	(2.8)

(proj.) Projection
Source: Confis.

VI

International reserves and the financial position of the Banco de la República

A. International reserves

1. The international reserve balance

Colombia had US$9,270.4 million in net international reserves at June 2001. This represents an increase of US$266.3 million during the year to date[54]. The bulk of these reserves correspond to financial investments held abroad (US$8,136.1 million). The others are distributed as follows: US$621.8 million in the country's reserve position with the International Monetary Fund and the Latin American Reserve Fund, US$134.3 million in special drawing rights (SDR), US$266.9 million in demand deposits and cash, and US$116.5 million in gold, Andean pesos and positive balances from international agreements. Short-term external liabilities came to US$5.2 million (Table 25).

2. Criteria for managing international reserves

Security, liquidity and profitability are the three criteria defined by the Banco de la República for managing international reserves. Accordingly, and to ensure the country's external liabilities are met, reserves are invested in financial assets with a broad secondary market. A portion are kept as working capital as a guarantee of immediate availability.

During the current year, the bank has continued its policy of appointing international financial institutions to manage part of the country's international reserves. These organizations are subjected to a rigorous selection process based on their experience in the business, the size of the funds they manage, and the extent of their capability for management and risk control. They have improved the profitability of international reserves through specialized management, and have supported development of the bank's own internal capacity for management. A number of central banks use similar delegation schemes to allow first-rate institutions to manage a portion of their external assets. This enables them to benefit from the specialized expertise these firms have to offer[55].

In the year 2000, the portion of Colombia's international reserves managed by Barclays Global Investors registered a yield of 6.46%, as opposed to 7.08% on the portion managed by JP Morgan Investment Management and 6.80% on the portion delegated to Goldman Sachs Asset Management. These percentages compare favorably with 6.29% yield on the reference portfolio, which is used to measure the performance of these asset managers and to evaluate direct management by the bank itself[56]. During the course of the year to June, the yields on these portfolios were 1.61%, 1.21% and 1.40%, respectively. The yield on the reference portfolio was 1.18%. International asset managers are able to obtain higher yields than those on the reference portfolio,

[54] Total international reserves or gross reserves minus the external short-term liabilities of the Banco de la República. The latter are comprised of sight liabilities in foreign currency with non-resident agents.

[55] This scheme has been adopted by several Latin American countries, such as Argentina, Brazil and Chile.

[56] The reference portfolio is comprised of assets denominated in US dollars (80%), euros (15%) and yen (5%). These assets are invested in a combination of money market instruments at three months (25%) and one to five-year government bonds (75%), with two years average duration for the portfolio as a whole.

Table 25
Principal components of international reserves
(Millions of dollars)

Description	June 2000	Share %	Dicember 2000	Share %	June 2001 (p)	Share %
Cash	61.6	0.7	30.0	0.3	266.9	2.9
Vault	60.4	0.7	28.5	0.3	21.1	0.2
Demand deposits **1/**	1.2	0.0	1.5	0.0	245.8	2.7
Investments	7,407.4	88.7	8,083.2	89.8	8,136.1	87.8
Managed directly	4,626.1	55.4	5,173.0	57.5	5,184.6	55.9
Delegated management	2,781.3	33.3	2,910.2	32.3	2,951.5	31.8
Gold	94.9	1.1	89.4	1.0	88.6	1.0
Vault	0.0	0.0	0.0	0.0	0.0	0.0
Custody	94.9	1.1	89.4	1.0	88.6	1.0
International monetary fund	517.7	6.2	508.1	5.6	490.3	5.3
Special drawing rights	135.5	1.6	135.7	1.5	134.3	1.4
Reserve position	382.2	4.6	372.4	4.1	356.0	3.8
Latin american reserve fund	270.0	3.2	285.8	3.2	285.8	3.1
Contributions	250.0	3.0	265.8	3.0	265.8	2.9
Andean pesos	20.0	0.2	20.0	0.2	20.0	0.2
International agreements	3.8	0.0	9.7	0.1	7.9	0.1
Total gross reserves	8,355.4	100.0	9,006.1	100.0	9,275.6	100.1
Short-term liabilities	2.7	0.0	2.0	0.0	5.2	0.1
International agreements	0.0	0.0	0.0	0.0	0.0	0.0
Foreign banks	0.0	0.0	0.0	0.0	0.0	0.0
Latin american reserve fund-LARF	0.0	0.0	0.0	0.0	0.0	0.0
Amounts payable for investment purchase	0.3	0.0	0.0	0.0	0.0	0.0
Liability accrual and valuation	2.4	0.0	2.0	0.0	5.2	0.1
Total net reserves	8,352.7	100.0	9,004.1	100.0	9,270.4	100.0

1/ among other items, demand deposits include reversal of the transaction with the national treasury on 29 june 2001. See footnote 47 in chapter iv of this report.
Source: Banco de la República

because portions of their portfolios are invested in specialized management assets different from those of the index used as a reference by the Banco de la República.

The Banco de la República directly managed a portfolio of US$5,430 million (64.8% of the total). The other 35.2% (US$2,952 million) was managed by Barclays Global Investors, Morgan Investment Management and Goldman Sachs Asset Management[57].

To make sure the portfolio is in keeping with the country's external operations, its currency distribution at June was as follows: 82.9% in US dollars, 14.0% in euros, 3.1% in Japanese yen and 0.01% in other currencies[58]. Although this investment policy occasionally results in unexpected earnings or outlays, due to changes in the exchange rates for different currencies vis-à-vis the dollar, it does allow for a balance between international reserves and the make-up of the country's external payments.

[57] Includes demand deposits.

[58] Such as Canadian dollars, Swedish kronors and pounds sterling.

3. Safety, liquidity and portfolio yield

As to the investment portfolio, including the portion managed directly by the bank and that managed by other institutions, 69.8% is invested in securities issued by sovereign governments and 30.2% in banking institutions. The credit risk of these investments is as follows, according to their rating by specialized agencies: 75.8% AAA, 8.3% AA-, 7.3% AA, 7.1% AA+, 1.4% A+ and 0.1% A[59]. To ensure immediate availability of foreign currency, the Banco de la República maintains a stock of working capital in the form of financial assets with immediate liquidity. The balance of working capital was US$375.5 million at June 2001.

The Banco de la República obtained US$105.8 million in net yield on the investment portfolio of reserves in the first six months of 2001: US$236.8 million in cash revenues and -US$131 million in losses recorded as accrual and appraisal of international reserves at market prices. During the year to June, US$140.6 million in losses were registered as appraisal due to depreciation of the euro and the yen with respect to the dollar. However, these losses have been compensated, in part, by the trend in foreign interest rates. The downturn in these rates has translated into a recovery in the market value of the investment portfolio.

B. Financial position

Results in 2001

The Banco de la República reported $29,590.2 billion in assets on June 30 of this year; that is, $441.3 billion more than at December 2000 (Table 26). This increase is due primary to appreciation in international reserves ($1,696 billion) and contributions with international organizations ($210.4 billion). These factors were partly offset by a decline in the balance of repurchase agreement and liquidity support transactions ($765.3 billion) and the reduction in investments ($672.6 billion) and the portfolio ($102.3 billion).

The bank showed $14,294.7 billion in liabilities on the same date, with an increase of $473.2 billion in the first half of the year, and $15,295.9 billion in net worth, which is $31.9 billion less that in December 2000. The seasonal reduction in the monetary base ($1,233.4 billion), the increase in deposits by the Colombian Treasury ($1,559.2 billion) and the rise in the peso value of liabilities with international organizations ($116.7 billion) were important aspects of the change in liabilities. The variation in net worth is explained by a larger exchange adjustment stemming from appreciation in the peso value of international reserves ($1,062.2 billion). This was offset by the decline in accrued profits in March, when $1,452.8 billion in profits were transferred to the government.

The Banco de la República earned $358.6 billion in profits during the first half of the year as a result of $687.2 billion in total income and $328.5 billion in disbursements (Table 27). Interest and yields ($527.9 billion), including those on international reserves ($242.3 billion), and TES acquired through monetary expansion transactions ($168.3 billion) were the main components of these earnings. Other items of importance include the exchange difference originating with the appreciation of assets in foreign currency other than international reserves ($58.0 billion), commissions ($43.1 billion) and other operational income ($49.6 billion). The latter is attributed basically to the recovery of provisions from the loan portfolio.

The principal disbursements, in order of importance, include $92.6 billion in payment of reserve deposits, $76.2 billion in personnel expenses, $33.2 billion attributed to the exchange difference resulting from an increase in the peso value of liabilities in foreign currency, $30.6 billion for pension provisions, $23.1 billion in general expenses, $19.7 billion in non-operational expenses, and $15.8 billion in provisions,

59 Standard & Poors, Moody's and IBCA.

Table 26
General balance sheet - banco de la república 1999-2001
(Billions of pesos)

	December, 1999		December, 2000		June, 2001 (*)	
	Balance	Share %	Balance	Share %	Balance	Share %
Assets	24,542.4	100.0	29,149.2	100.0	29,590.5	100.0
Gross international reserves	15,170.5	61.8	19,689.9	67.5	21,386.2	72.3
Contributions with international organizations	2,059.6	8.4	2,268.6	7.8	2,479.0	8.4
Investments	2,395.5	9.8	3,248.7	11.1	2,576.1	8.7
Consolidated public debt	390.0	1.6	308.8	1.1	223.0	0.8
Public securities in keeping with monetary regulations	2,005.5	8.2	2,398.0	8.2	1,970.7	6.7
Public bank bonds - fogafin and others		0.0	541.8	1.9	382.4	1.3
Loan portfolio	392.6	1.6	323.9	1.1	221.7	0.7
National government-public sector	4.0	0.0	3.7	0.0	3.6	0.0
Banks	24.8	0.1	6.0	0.0	4.1	0.0
Financial corporations	79.0	0.3	154.1	0.5	146.9	0.5
Other loans **1/**	388.1	1.6	235.9	0.8	102.6	0.3
Less provisions	103.3	0.4	75.8	0.3	35.6	0.1
Repurchase agreements - temporary liquidity support	2,892.3	11.8	1,729.0	5.9	963.7	3.3
Accounts receivable	55.8	0.2	64.3	0.2	78.9	0.3
Other net assets	1,576.0	6.4	1,824.9	6.3	1,884.9	6.4
Liabilities and net worth	24,529.5	99.9	29,149.2	100.0	29,590.5	100.0
Liabilities	12,770.4	52.0	13,821.5	47.4	14,294.7	48.3
Foreign currency liabilities affecting international reserves	4.3	0.0	4.3	0.0	11.9	0.0
Monetary base	9,739.6	39.7	10,710.4	36.7	9,477.0	32.0
Notes in circulation	7,457.6	30.4	8,698.6	29.8	7,777.6	26.3
Treasury coins	319.4	1.3	344.2	1.2	338.0	1.1
Bank reserve requirement deposits	1,648.7	6.7	1,362.8	4.7	1,119.1	3.8
Current account deposits rest of financial sector	313.9	1.3	304.9	1.0	242.4	0.8
Other deposits	142.7	0.6	77.5	0.3	51.9	0.2
National government - national treasury	83.4	0.3	253.7	0.9	1,812.9	6.1
International agency liabilities	1,779.9	7.3	1,853.8	6.4	1,970.5	6.7
External credit liabilities	218.0	0.9	207.6	0.7	198.0	0.7
Securities regulating domestic and exchange liquidity	147.4	0.6	28.7	0.1	30.9	0.1
Reverse REPOS and central bank bonds	46.1	0.2	20.9	0.1	24.6	0.1
Foreign currency funding certificates & dep. Res. 5/97	100.6	0.4	6.9	0.0	5.4	0.0
Others	0.7	0.0	0.9	0.0	0.9	0.0
Accounts payable	38.7	0.2	31.4	0.1	51.2	0.2
Other liabilities	616.4	2.5	654.1	2.2	690.3	2.3
Total net worth	11,759.1	47.9	15,327.7	52.6	15,295.9	51.7
Capital	12.7	0.1	12.7	0.0	12.7	0.0
Reserves	360.1	1.5	345.9	1.2	321.2	1.1
Capital surplus	10,557.7	43.0	13,254.2	45.5	14,324.3	48.4
Special exchange account liquidation	453.5	1.8	453.5	1.6	453.5	1.5
Exchange adjustment: 1993 and thereafter & surplus	10,088.2	41.1	12,619.7	43.3	13,681.9	46.2
Others	16.0	0.1	181.0	0.6	188.9	0.6
Appreciation	320.9	1.3	279.1	1.0	279.1	0.9
Results	507.8	2.1	1,435.9	4.9	358.6	1.2
Previous year profits/losses	0.0	0.0	0.0	0.0	0.0	0.0
Current year profits/losses	507.8	2.1	1,435.9	4.9	358.6	1.2

(*) Figures subject to revision.
1/ includes the portfolio corresponding to the seizure of charged assets for default on liquidity quota credit.
Source: Banco de la República.

TABLE 27

INCOME STATEMENT - BANCO DE LA REPÚBLICA

	Performance Jan-Jun, 2000		Performance Jan-Jun, 2001 1/	
	Flow	share %	Flow	share %
I. Total income	877.5	100.0	687.2	100.0
1. Operating income	854.6	97.4	679.5	98.9
Interest and yield	640.4	73.0	527.9	76.8
Net international reserves	325.0	37.0	242.3	35.3
External credit lines	12.0	1.4	7.5	1.1
Tes "A" appreciation at market prices	13.3	1.5	19.7	2.9
TES appreciation through monetary expansion transactions	146.0	16.6	168.3	24.5
Appreciation public bank capitalization bonds	16.6	1.9	28.4	4.1
Temporary purchase of securities and quotas	81.1	9.2	29.2	4.2
Others	46.3	5.3	32.5	4.7
Commissions	34.8	4.0	43.1	6.3
Banking services and trusts	29.2	3.3	39.1	5.7
Foreign currency management	4.9	0.6	4.0	0.6
Others	0.7	0.1	0.0	0.0
Exchange difference	130.4	14.9	58.0	8.4
Issue of coins and precious metals	1.6	0.2	0.4	0.1
Securities redeemed in advance	21.7	2.5	0.5	0.1
Ohers	25.7	2.9	49.6	7.2
2. Non-operational income	22.9	2.6	7.7	1.1
II. Total disbursements	344.5	100.0	328.5	100.0
1. Operating disbursements	333.5	96.8	308.8	94.0
Interest and yield	109.2	31.7	103.5	31.5
Float in deposit accounts	66.3	19.2	92.6	28.2
Temporary sale of securities	35.4	10.3	5.8	1.8
External credit lines and exchangeable securities	7.5	2.2	5.1	1.5
Commissions and fees	9.6	2.8	8.6	2.6
Exchange difference	63.0	18.3	33.2	10.1
International organizations	20.7	6.0	5.7	1.7
External credit lines	28.9	8.4	12.0	3.6
Others	13.3	3.9	15.5	4.7
Cost of currency issue	2.8	0.8	8.6	2.6
Personnel expenses	74.1	21.5	76.2	23.2
Retirement pensions	19.6	5.7	30.6	9.3
General expenses	23.4	6.8	23.1	7.0
Taxes	1.0	0.3	1.5	0.5
Insurance	1.7	0.5	2.6	0.8
Cultural expenses	1.9	0.6	2.1	0.6
Provisions. depreciation and amortization	20.3	5.9	15.8	4.8
Other operating expenses	7.0	2.0	3.0	0.9
2. Non-operational disbursements	11.0	3.2	19.7	6.0
III. Fiscal year profit/loss. including depreciation	533.0	154.7	358.6	109.2

1/ Figures subject to revision
2/ projections
Source: Banco de la República.

Variation Jan-Jun 2001-2000		Performance Jan-Dec, 2000		Projection Jan-Dec, 2001		Variation Jan-Dec 2001-2000	
Absolute	%	Flow	Share %	Flow	Share %	Absolute	%
(190.3)	(21.7)	2,090.8	100.0	1,534.6	100.0	(556.2)	(26.6)
(175.1)	(20.5)	2,055.8	98.3	1,524.4	99.3	(531.4)	(25.8)
(112.5)	(17.6)	1,733.9	82.9	1,255.8	81.8	(478.1)	(27.6)
(82.8)	(25.5)	1,086.1	51.9	796.3	51.9	(289.8)	(26.7)
(4.5)	(37.6)	21.7	1.0	13.2	0.9	(8.5)	(39.1)
6.4	48.0	46.4	2.2	34.6	2.3	(11.8)	(25.4)
22.3	15.2	311.0	14.9	283.9	18.5	(27.1)	(8.7)
11.8	71.1	48.2	2.3	37.3	2.4	(10.9)	(22.6)
(51.9)	(64.0)	147.3	7.0	49.4	3.2	(97.9)	(66.5)
(13.8)	(29.8)	73.2	3.5	41.1	2.7	(32.1)	(43.8)
8.3	23.7	77.3	3.7	84.3	5.5	7.0	9.1
9.9	33.8	65.4	3.1	74.4	4.8	9.0	13.8
(1.0)	(19.6)	11.0	0.5	9.9	0.6	(1.1)	(10.0)
(0.6)	(96.4)	0.9	0.0	0.0	0.0	(0.9)	(100.0)
(72.4)	(55.5)	170.0	8.1	109.0	7.1	(61.0)	(35.9)
(1.1)	(72.9)	2.8	0.1	20.8	1.4	18.0	632.1
(21.2)	(97.9)	22.5	1.1	0.5	0.0	(22.0)	(97.8)
23.9	92.9	49.3	2.4	54.0	3.5	4.7	9.5
(15.2)	(66.3)	35.0	1.7	10.2	0.7	(24.8)	(70.8)
(16.0)	(4.6)	654.9	100.0	712.2	100.0	57.3	8.7
(24.7)	(7.4)	642.2	98.1	686.0	96.3	43.8	6.8
(5.7)	(5.2)	219.1	33.5	202.3	28.4	(16.8)	(7.7)
26.3	39.8	125.5	19.2	176.1	24.7	50.6	40.3
(29.6)	(83.5)	71.4	10.9	14.9	2.1	(56.5)	(79.1)
(2.4)	(32.2)	22.2	3.4	11.3	1.6	(10.9)	(49.1)
(1.1)	(11.1)	17.8	2.7	14.6	2.1	(3.2)	(17.8)
(29.7)	(47.2)	77.4	11.8	87.9	12.3	10.5	13.6
(14.9)	(72.2)	27.1	4.1	13.8	1.9	(13.3)	(49.1)
(17.0)	(58.6)	34.7	5.3	24.1	3.4	(10.6)	(30.6)
2.2	16.2	15.5	2.4	50.0	7.0	34.5	221.8
5.8	206.8	17.7	2.7	34.3	4.8	16.6	93.6
2.1	2.9	150.6	23.0	160.7	22.6	10.1	6.7
11.1	56.5	52.5	8.0	75.6	10.6	23.1	44.0
(0.3)	(1.1)	48.8	7.5	53.6	7.5	4.7	9.7
0.5	50.0	2.0	0.3	3.7	0.5	1.7	85.0
0.9	52.9	4.1	0.6	5.4	0.8	1.3	31.7
0.1	7.6	6.0	0.9	5.8	0.8	(0.2)	(3.7)
(4.5)	(22.2)	31.7	4.8	35.8	5.0	4.1	13.1
(4.0)	(57.5)	14.5	2.2	6.3	0.9	(8.2)	(56.5)
8.7	79.7	12.7	1.9	26.2	3.7	13.5	106.6
(174.3)	(32.7)	1.435.9	219.3	822.5	115.5	(613.5)	(42.7)

depreciation and amortization. Personnel expenses showed an annual increase of 2.9%, while general expenses declined by 1.1% compared with the same period the year before.

Approximately $822 billion in profits are anticipated for the year as a whole, based on $1,534.6 billion in income and $712.2 billion in disbursements. Earnings estimated for the year originate primarily with the projected yield on international reserves ($796 billion). This does not, however, include the possible impact of changes in exchange rates and interest on the reserve portfolio between June and December. In the first half of the year, these factors accounted for US$131 million less in the gross dollar yield on international reserves, which came to US$236.8 million. Accordingly, the projection is subject to uncertainty over the future of exchange rates and international interest rates.

The Banco de la República anticipates an increase of 8.7% in disbursements compared with the year 2000. The following are the major items in this respect: i) $202.3 billion for interest and yield, ii) $160.7 billion for personnel expenses, iii) $87.9 billion in exchange differences, iv) $75.6 billion for retirement pensions, and v) $53.6 billion to cover general expenses. With 6.7% annual growth, personnel expenses are an important factor. There is an entry of $109 billion to offset disbursements for exchange differences. Accordingly, the net effect on the income statement is positive.

The payment system

The payment system consists of a set of instruments, measures, standards and procedures used by economic agents to transfer funds and to make payments, whether associated with low-value goods and services or high-value financial transactions. The payment system is a fundamental component of the financial system and its primary function is to ensure efficient circulation of currency inside a country and internationally. Therefore, it is a crucial element of the infrastructure that supports economic activity in a market economy.

There is increased international awareness of the importance of a properly designed payment system as being crucial to the strength and efficiency of the financial market, particularly a system that is supervised and monitored regularly.

This subject is of particular interest to central banks because the problems of financial institutions in crisis first come to light in the payment system. Eventually, this can transmit one institution's instability to another (systemic risk). A payment system that is properly designed and regulated can help to contain these effects; a poorly designed system will only aggravate them. In this sense, the objective of central banks in to reduce credit, liquidity, systemic, legal, operational and other types of risk.

The measures adopted by central banks to implement monetary policy are carried out within the payment system. The effectiveness of monetary policy depends, therefore, on the measures through which policy signals are transmitted. This, in turn, requires a payment system that is efficient and reliable, since alterations in the system produce unexpected and undesirable changes in the speed of currency and the demand on bank reserves (balances in the accounts that financial institutions maintain with the central bank). The demand on bank reserves also depends on the design and features of the payment system, particularly the mechanisms adopted for settlement (final payment), be they multilateral or bilateral, net or gross, deferred or in real-time; on the policies central banks adopt to provide the payment system with liquidity (intraday, overnight or longer terms); and on the ways and means available to deal with the shortages and defaults of institutions in crisis, which ultimately influence the central bank's course of action as a lender of last resort and its approach to implementing monetary policy.

The effectiveness of mechanisms for transferring money helps to make the productive sector of the economy and financial markets more productive and contributes to the supply of new banking services for the entire community.

These considerations, coupled with the fact that market forces alone may not be enough to provide for efficiency and reliability, explain why central banks in almost every country are involved with the payment system to some extent, in order to fulfill their mandate to safeguard the stability of the financial system and to maintain confidence in domestic currency. Part of their job, in this respect, can be to provide a number of direct services for clearing and settling payments, in addition to overseeing the system.

As of the early nineties, the Banco de la República has made an important contribution to modernizing and reinforcing Colombia's payment system from an operational, regulatory and institutional standpoint. It does so by rendering electronic services designed to facilitate transactions for financial intermediaries and the capital market, and to make them safer, more efficient and economical. In this sense, the fundamental objective is to support the private sector in a way that enhances the efficiency and competitiveness of the productive apparatus in general.

Efforts during the first half of the nineties focused on replacing physical documents for payment (checks) with new payment instruments and means of channeling orders and instructions electronically for high and low-value interbank transactions and trading in government securities.

The Central Securities Depository (DCV) was established by the Banco de la República in 1992 to managed securities issued or administered by the bank itself and securities (other than shares) constituting forced or substitute investments on the part of institutions supervised by the Banking Superintendent. The impact of the DCV has been considerable in terms of helping to develop, modernize and advance the capital market in Colombia, and particularly the market for government bonds and securities. The fact that the DCV is connected automatically to the deposit accounts system has made it possible, from the beginning, to apply the principle of delivery versus payment in trading on DCV managed securities, and real-time gross settlement of these transactions as of 1998.

The electronic accounts deposit system of the Banco de la República (SEBRA) was implemented in 1993 to transfer funds and to conduct large-value interbank transactions electronically. It is available to a wide range of public and private institutions that do business with the Banco de la República (more than 150 credit establishments, capital market intermediaries and institutional investors, as well and the National Treasury Department and the Social Security Institute). The system is used for monetary policy transactions, payments by the Treasury Department, interbank money market transactions, fund settlement transactions involving securities deposited with the DCV and others, and to settle the balances of clearing house systems. Account coverage is nation-wide.

As of July 1998, all operations conducted through this system must adhere to the principle of real-time gross settlement (LBTR). In other words, the system automatically checks the payer's balance, on line, and if there are insufficient funds in the account, the payment order is rejected. This mechanism ensures immediate completion of the transaction and offers considerable security to those involved, in addition to preventing credit risks and the propagation of systemic risk. At present, only certain developed countries and a limited number of developing countries have taken this important step in the design of their payment systems.1

SEBRA was established as a vehicle for on-line connection with the Banco de la República, in real time. It is a remote entry portal to electronic applications that allows financial institutions and brokers to communicate with the Bank for quick, safe and efficient transactions without the need for instructions on paper.

The second stage of the Bank's plan to modernize the payment system was initiated in the latter half of the nineties. The goal was to enhance development and transparency in the government bond and securities market, in modernizing clearings, in implementing electronic systems for low-value payments, and in international exchange transactions. Accordingly, in 1998, the Banco de la República placed four new electronic systems in operation:

a) The Electronic Trading System (SEN) for secondary market transactions in government bonds and securities. Interconnected with the DCV and the accounts deposit system of the Banco de la República, it is used for delivery-versus-payment transactions.

b) The Electronic Check Clearing System (CEDEC) is an automated settlement facility to transmit clearing information electronically. It operates according to a series of net multilateral positions, automatically settling the value of documents presented for collection against the drawing accounts banks maintain with the Banco de la República, all on the same date.

c) The National Clearing House Interbank Payment System (CENIT) is an automated clearing and settlement facility based on multilateral netting of electronic transfers, both debit and credit, which are settled automatically for authorized institutions against drawing accounts maintained with the Banco de la República.

d) The International Transactions System (SOI) is used to process operations involving international agreements, drafts and repayments, and transactions with international organizations

The results of these efforts are evident. Financial institutions and capital market intermediaries now recognize that transferring funds electronically through SEBRA is the safest, most opportune and efficient way to settle interbank and security market obligations. As a result, the use of checks for this purpose is becoming more and more limited, and is restricted basically to low-value operations. However, even in this area, checks are losing ground to electronic payment systems (ACH, debit cards, audio response systems, etc.)

The number of transactions channeled through SEBRA to transfer funds and to settle trading through the DCV increased from 157 thousand in 1996 to 545 thousand in 2000, and rose by almost 50% in the first four months of 2001 compared with the same period in 2000. The value of these transactions increased from $291 billion in 1996 to $1,154 billion in 2000. So far in 2001, it has exceeded the amount transferred in the first four months of 2000 by nearly 20%. As to the DCV, the capital balance of deposited securities (which includes TES and other national government bonds, Finagro TDA and Fogafin bonds) rose from $1.3 billion in 1994 to $9.1 billion in 1996 and $38.1 billion in 2000. Moreover, the average monthly value of transactions with government bonds traded through SEN has grown exponentially from less than $0.5 billion in 1999 to 1.2 billion in 2000 and to more than $4 billion in the course of 2001.

As mentioned earlier, there has been a considerable reduction in the use of checks. In 1996, approximately 280 million checks were issued for a total of $644 billion; 130 million were issued in 2000 for nearly $443 billion. One hundred million of these checks (77%), valued at close to $340 billion, where cleared through the interbank payment system of the Banco de la República; the rest were cleared within credit institutions.

The use of electronic payment instruments for low-value transactions in the Colombian market continues to be limited, basically because they have been incorporated slowly into the portfolio of services offered by banks, although they have obviously gained a relative share of the market compared with checks. Even though the number of transactions conducted through the Colombian ACH (privately owned) and CENIT (owned by the Banco de la República) increased from less than one million in 1998 to nearly three million in 2000, other mechanisms of this type, such as debit and credit cards, the use of automatic teller machines (ATM), POS (sales points), etc. Are at a standstill in terms of transactions since 1998 and have declined sharply in terms of real value.

This is explained by the tax on financial transactions (currently 3 x 1000), which is one reason for the rapid increase in the demand for cash in recent years (as is the decline in nominal interest rates). The cash/GDP ratio was 3.5% in the three year period from 1990 to 1992, 3.4% in 1993-1995 and 3.3% in 1996-1998. It rose to 4.0% in 1999 and 4.2% in 2000.

In summary, the Banco de la República has clearly helped to develop and modernize the payment system in Colombia. This has facilitated monetary policy implementation, stabilized the demand for mediums of payment, and is an important contribution to the strength of the financial system and the public's trust in currency. It has also enhanced the efficiency and productivity of the financial system and given it the potential to render new services to its customers and to the general public, all of which should add to the competitiveness of the sector and reduce interest rate spreads.

1/ Although the real-time gross settlement mechanism has been decisive to reducing risks for the other party and to limiting the propagation of systemic risk, it is highly demanding in terms of managing intraday liquidity. To improve the way this mechanisms operates, the Banco de la República made several major adjustments in its policy on the payment system. For example, intraday REPOs were introduced at the end of 1998 and the Bank revised the sequence of its operations to provide more liquidity to the system and to improve the cash position with which financial institutions and capital market agents start the day. The inter-connection between the high-value payment system and other settlement and clearing facilities is also an important feature in this respect.

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The role of the Banco de la República

The role of the Banco de la República, as set forth in Article 371 of the Colombian Constitution, is to regulate currency, international exchange and credit, to issue legal tender, to manage the country's international reserves, to be a lender of last resort and a banker to credit institutions, and to serve as the government's fiscal agent. According to Law 31/1992, which indicates how these duties are to be performed, the Banco de la República shall continue its cultural activities, as conducted nationwide prior to adoption of the 1991 Constitution.

The organizational structure of the Banco de la República responds to these duties in the following way.

- As the monetary, exchange and credit authority, the Board of Directors fulfills its function with the support of several divisions within the Bank; namely those dedicated to economic studies, monetary matters and reserves. These divisions prepare the technical studies on which the Board bases its decisions. They also research long-term and short-term trends in the nation's economy. The Bank is well known for its efforts to develop a team of highly regarded economists trained in Colombia and abroad.

- As the issuer of legal tender, the Banco de la República has a mint in Ibagué and a plant in Bogota where paper currency is printed. The various forms of currency circulated in Colombia are produced at these installations. The quality of the paper currency and coins fabricated in Colombia is recognized internationally. In fact, the Banco de la República has produced currency for other countries, such as Ecuador and Costa Rica. In its capacity as the central bank, it is also responsible for guaranteeing the circulation of legal tender throughout the country. This it does primarily through its branches in Colombia's major cities. A cash center is currently being established in Bogota to offer the benefits of advanced technology and increased security measures to the currency printing plant and the treasury of the Bank.

- As a manager of international reserves, the Banco de la República has a special department to administer the country's international reserves. International agencies specialized in asset management are appointed to fulfill a portion of this responsibility, in strict compliance with guidelines established to this effect by the Bank.

- As a lender of last resort, the Banco de la República has a department to monitor the performance of credit institutions in general and those with liquidity problems that might require the support of the Bank.

- As the banker to banks, the Banco de la República has developed a number of electronic systems to expedite interbank operations. For example, there is the case of the Electronic Trading System (SEN), which facilitates government debt transactions, the Electronic Check

Clearing System (CEDEC) for interbank payment of checks, and the National Electronic Interbank Payment System (CENIT) to expedite the bank's transactions with third parties. The Central Securities Depository (DCV) is a fundamental tool for managing the country's public debt. The work of the Bank in this respect is crucial to guaranteeing Colombia' payment system and its transactions abroad.

- As a provider of cultural services, the Banco de la República continues to operate the Gold Museum in Bogota, the Luis-Angel Arango Library and the Coin Museum, which is housed at the Casa de Moneda. It also sponsors art exhibits organized in conjunction with the donation last year by Colombian artist Fernando Botero and exhibits of the Bank's permanent collection. Cultural activities outside Bogota center on libraries, concert halls and the Gold Museum.

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