The Report to Congress by the Board of Directors

March 2003

Banco de la República
(The Central Bank of Colombia)

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27 March 2003
Bogotá D. C. (Colombia)

Honorable Chairmen 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 Banco de la República hereby submits to the Congress of the Republic of Colombia a report on the macroeconomic results of the year 2002 and 2003 to date, together with a description of the goals adopted by the Board of Directors for the current year and prospects for the various macroeconomic variables. The last section of the report contains information on the composition of international reserves and projections concerning the financial position of Banco de la República in 2003.

Sincerely,

Miguel Urrutia

Miguel Urrutia Montoya
Governor, Banco de la República

I

Introduction

The following report, presented to the Congress of the Republic of Colombia, offers an analysis of the country's economic performance in 2002 and the macroeconomic policy implemented during that period. The Colombian economy faced in a particularly unfavorable international environment characterized by a combination of two negative shocks: a drop in external demand and less access to international markets for credit. Other Latin American countries were affected by these conditions as well, and their overall product rose by only 0.5% in 2002.

The Colombian economy, including illegal crops, grew at a rate of 1.50%. If these crops are excluded, the rate was1.90%, which is superior to the figure for 2001 (1.57%). Unemployment remained high. However, in the 13 major cities, it showed a tendency to decline and employment increased. The pace of annual inflation slowed during the first five months of 2002, but increased as of September and was 6.99% by the end of the year. This is above the target of 6.0% set by the Board of Directors of Banco de la República (BDBR) for 2002 and is less than inflation in 2001 (7.7%). The lag was essentially due to higher food prices brought on by supply problems. Core inflation was 5.6% at December, which is below the target. However, the speed at which the peso devaluated during the second half of 2002 implied high core inflation as of October.

* * *

Chapter II offers an analysis of the macroeconomic policy applied in 2002. Monetary policy remained oriented to increase economic growth and meet the inflation target. During the first half of the year, the favorable trend in exchange stability and prices permitted a decline in the intervention interest rates charged by Banco de la República.

The adverse change in conditions for external financing and the acceleration in devaluation during the second half of the year obliged the Board of Directors to adopt supplementary policy measures, without changing the stance of the country's monetary policy. While the intervention rates remained unaltered, US$540 million (m) in put options were auctioned to control volatility of the change rate; US$141 m of these options have been exercised. By mid-August, the external environment had deteriorated even further and there was considerable uncertainty as to fiscal prospects in the short and mid-term. These factors led to an increase in the country's risk premium and in interest rates on government bonds (TES). Under these circumstances, the BDBR decided to move up its standing purchases of TES on the secondary market and authorized stockbrokers and trust companies to conduct temporary expansion operations with Banco de la República. These provisions, adopted at a time when the new administration was defining its the fiscal and financing strategy, helped to restore calm to the government bond market.

The rebound in core inflation due to increased cost pressure originating with the rise in devaluation necessitated a change in the stance of the country's monetary policy in January 2003. Accordingly, the BDBR increased the Bank's intervention rate by one percentage point. These same reasons led the Bank to announce in February that it would auction up to US$ 1 billion in put options on international reserves. It is hoped these measures will help to stabilize the exchange market and mitigate possible inflationary pressure on costs and expectations, which could jeopardize the inflation targets. Even though the Bank's intervention interest rates have increased, they are still at a historically lowest level, in real terms, and are among the lowest of the major Latin American countries.

Low interest rates enabled households and companies to continue to clean up their financial balances on a sound footing and to begin to demand credit in larger proportions than in previous years. The result was an increase of almost 11% in the portfolio of the banking system during 2002. This was accomplished at a time when the financial sector also experienced an important recovery, as reflected in higher profits and a sizeable decline in overdue portfolio rates. In this way, monetary policy aided the recovery in economic growth.

The external shocks to the economy also meant fluctuations in the exchange rate throughout 2002. Up until the first fortnight in May, the tendency was for the peso to appreciate, as it had since the end of 2001 due to low external interest rates and the expectations generated by foreign pre-financing of public sector needs for 2002. However, as of that point and until October, there was strong pressure for devaluation, aggravated by the "contagion" effect in Latin America, by less access to international credit and by the uncertainty provoked by the country's fiscal position. The exchange rate revaluated between October and November, when calm returned to the financial markets and the national government announced its program of fiscal adjustment. December 2002 saw a new trend towards devaluation of the peso, this time in response to the political and economic crisis in Venezuela. The nominal exchange rate on December 31 was 25.01% higher than at the end of 2001. The real exchange rate index was 131.5 at the end of the year, which is a historic high.

From its onset, the Uribe administration has undertaken a series of initiatives to address the country's fiscal problem. The one-time payment of a tax to finance a national security strategy was decreed with declaration of a state of "internal unrest", as provided for in the country's constitution. This levy is equivalent to 1.2% of net worth reported by companies and individuals, if in excess of Col$170 m at December 31, 2002. The declaration of a state of internal unrest and creation of the new tax were deemed lawful by the Constitutional Court. The revenue from this levy was used to finance the military budget for 2002 and to increase spending on the military and police in 2003. Actual revenue from this item will total Col$2.4 trillion (t) when collection concludes at the end of April 2003. This amount is superior to 1% of GDP.

In September 2002, the government presented Congress with a reform bill to increase tax revenue. It included a change in the value added tax (VAT) as of 2003 and 2005, a surcharge on income tax for 2003 and several other changes in tax legislation. The bill was passed into law in December, allowing for a tax increase equal to approximately 1% of GDP in 2003, 1.7% of GDP in 2005 and around 2.0% of GDP as of 2006.

The law convoking a referendum, which also obtained Congressional approval, considers a number of provisions intended to reduce spending. If the required majority of voters approve the referendum, special pension systems will be eliminated and a freeze placed on the wages and retirement pensions of public servants. The operating expenses of state agencies would be frozen as well. The Finance Ministry predicts the subsequent fiscal savings would amount to 0.7% of GDP in 2003 and 0.6% in 2004.

A pension reform bill was approved during the regular legislative session in 2002, raising pension contributions gradually as of 2004 and up until 2008. The positive fiscal impact of the reform is calculated at 0.32% of GDP in 2004 and will increase to 2.79% of GDP by the year 2010. Congress also passed a labor reform act to create jobs and ease conditions for work contracts and the dismissal of employees. It granted the President of Colombia special faculties to modify the organizational structure of central government administration. Use of these faculties would generate permanent fiscal savings on the order of 0.4% a year.

The consolidated public-sector deficit in 2002 was 3.6% of GDP. This is 0.4% of GDP more than during the same period in 2001, when the deficit was 3.2% of GDP. It is also 1.0 percentage point above what the government had scheduled at the start of the year. This imbalance, nearly 0.8% of GDP, is explained by less tax revenue than expected, which was partially due to poor economic performance in the early quarters.

A Stand By agreement was signed with the International Monetary Fund (IMF) at the beginning of 2003. It gives Banco de la República access to US$2.1 b in IMF resources to deal with external imbalances and makes it easier for other multilateral agencies to continue to support the country with credit resources. The agreement also sends a signal to private investors about the commitment to prudent management of public finances and the quality of the country's general macroeconomic policy. In the first quarter of 2003, the central government met all external financing requirements for the year.

* * *

Chapter III of this report analyzes the trend in the major macroeconomic variables during 2002 and prospects for the current year. Low growth in the economy is associated with external and internal factors. The most important external factors include limited access to international financial markets during certain months of the year and the drop in external demand. The negative impact of these factors was magnified by internal ones, such as the slow growth in credit, persistent unemployment and the violence unleashed by criminal groups. Savings and investment are at extremely low levels, preventing an acceleration of economic growth in Colombia. According to government forecasts for 2003, the economy will grow by 2.0%. On the other hand, the current account deficit is expected to be 2.1% of GDP, which is similar to the deficit the year before. As to the trend in inflation, the BDBR has taken steps to make it compatible with the targets. These range between 5% and 6% for 2003 and 3.5% and 5.5% for 2004.

In response to a request from certain members of Congress, this report contains an in-depth and thorough analysis of the strategy adopted by Banco de la República and its Board of Directors to manage the country's international reserves. Chapter IV addresses this topic and highlights how important reserves are to organized management of the economy and their function in absorbing external shocks to the Colombian economy. The criteria and rules adopted in recent years by the BDBR to manage reserves are explained in this context. The conclusion is that current reserves are adequate and sufficient to deal with future eventualities in the external sector.

The report ends with a section on the financial position of Banco de la República. Due to increased yield on the country's international reserves and a decline in operating expenses (concentrated in personnel and general expenses), Banco de la República reported Col$2,071.3 b in profits for 2002. This exceeds the projection in the July 2002 Report Congress (Col$667 b.) and allowed Col$1,481.4 b in profits to be transferred to the national government in February 2003, including Col$651 b (US$220 m) delivered directly in US dollars. It is the largest amount ever transferred to the national government.

II

Macroeconomic Policy

A. Monetary Policy

The focus of Colombia's monetary policy in recent years has been on promoting economy growth and meeting the inflation target. This policy is based on a inflation targeting strategy whereby the monetary authority changes its position in response to deviations between projected inflation and the established targets, provided these deviations do not originate with temporary shocks to the economy. Such shocks include those produced by weather and the increase in VAT, which can be accommo-dated by the monetary policy.

Relative exchange stability and the favorable trend in prices made it possible to reduce the Bank's intervention interest rates during the first half of 2002. However, in the second half of the year, the adverse change in terms for external financing and the speed of devaluation began to exert pressure on the price of tradable goods and those with a large imported component, evidencing transmission to internal prices. This was reflected by an upward trend in the various measurements of core inflation as of October[1]. During that period, while intervention rates remained unchanged, auctions of put options were held to control volatility of the exchange rate. US$414 m of these options were exercised.

Towards mid-August, further deterioration in the external environment and mounting uncertainty over prospects for public financing brought about a substantial increase in the country risk premium and rates on public borrowing. In view of these events, the Board of Directors moved up its standing purchases of TES on the secondary market and authorized stockbrokers and trust companies to conduct temporary expansion operations with Banco de la República. These provisions, coupled with quick definition of the fiscal strategy, restored calm to the government bond market.

Inflationary pressures intensified in early 2003, causing the BCBR to raise the Bank's intervention rates by one percentage point in January. However, despite this increase, the intervention interest rate and the interbank rate remained negative in real terms. For the same reasons, the Bank announced in February that it would auction up to US$1 b in put options. These measures are designed to stabilize the exchange market and to mitigate possible inflationary pressure on costs and expectations, which could jeopardize the inflation targets for 2003 and 2004.

1. Interest Rates

The stance of the country's monetary policy is reflected in the Bank's intervention interest rates. These are the rates it charges (pays) on expansion (contraction) operations for the short term (one-day repos). Banco de la República regulates liquidity in two ways: i) through auctions in which it sets liquidity quotas and respective minimum and maximum cut-

[1] See *The Inflation Report*, December 2002.

off rates for expansion and contraction operations, and ii) through access to windows to handle the liquidity surpluses or shortages of intermediaries at Lombard rates.

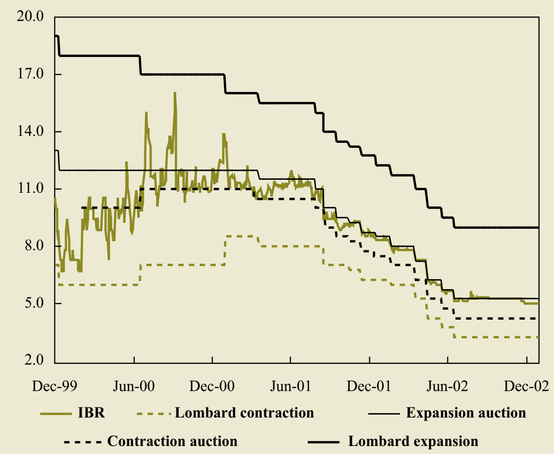
The general mechanism used by Banco de la República to supply liquidity allowed for a highly stable interbank interest rate (IBR), which fluctuated between the maximum contraction auction rate and the expansion auction minimum (Figure 1). Recent years have seen a decline in the level and volatility of the IBR, both in real and nominal terms. In fact, the real IIR at the end of the year stood at a negative value of 1.8% (Figure 2)[2]. This has affected the trend in nominal and real interest rates for longer maturities (on deposits and loans).

The Board of Directors lowered the intervention interest rate band on five occasions during 2002 (Table 1). In all, these reductions totaled 325 basis points (bp) for the minimum expansion and maximum contraction rates, while the Lombard expansion and contraction rates were reduced by 325 bp and 300 bp, respectively.

Expansion auctions throughout most of 2002 were held at the minimum cut-off rate, and one-day repo quotas were broad and underused during the year (Table 2). This period also saw sporadic use of window expansion operations in small amounts. On the other hand, contraction auctions were employed in amounts below those offered and at the maximum cut-off rates. Contraction window transactions were conducted throughout the period in minimum amounts, mostly with resources from excess liquidity in the National Treasury (NT).

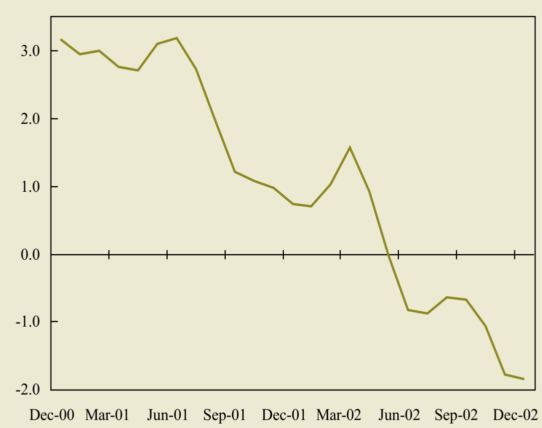
The nominal rate on time deposits (TD) dropped by 3.7 percentage points in 2002 to an average of 7.7% at December of that year, which is a historic low for this indicator[3]. In real terms, the interest rate on deposits declined from 3.5% at December 2001 to 0.7% during the same month in 2002. This last tendency is explained more by the decline in the nominal deposit rate than by higher inflation. Nominal and real interest on long-term deposits (360-day CDs) exhibited respective declines of 3.9 and 3.0 percentage points during 2002 (Figure 3).

Figure 1
Banco de la República Interbank and Intervention Rates
(Percentage)



Source: Banco de la República.

Figure 2
Trend in Real Interbank Interest Rates
(Average monthly percentages)



Source: Banco de la República and the Superintendent of Banks.

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2 Real rates are calculated as the coefficient between the nominal interest rate (1+r) and the actual rate of inflation ($1+\pi$).

3 Calculated as the weighted average interest on 90-day time deposits.

Table 1
Banco de la República Intervention Rates
(Percentages)

Valid from to: Since	Up to	Minimum contraction Rates (Lombard)	Contraction auction maximum	Expansion auction minimum	Maximum Expansion Rate (Lombard)	IBR (end of)
Dec-17-01	Jan-18-02	6.25	7.50	8.50	12.25	8.21
Jan-21-02	Mar-15-02	6.00	7.00	8.00	11.75	7.78
Mar-18-02	Apr-12-02	5.25	6.25	7.25	11.00	7.25
Apr-15-02	May-17-02	4.25	5.25	6.25	10.00	6.18
May-20-02	Jun-14-02	3.75	4.75	5.75	9.50	5.65
Jun-17-02	Jan-17-03	3.25	4.25	5.25	9.00	5.13

Source: Banco de la República.

Table 2
One-day Expansion and Contraction Operations - 2002 (*)
(Billions of pesos)

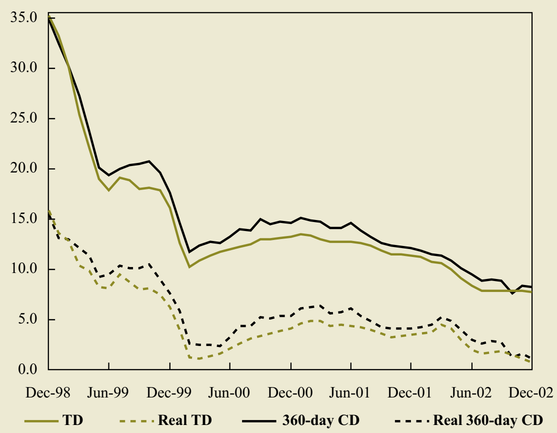
	Auction Transactions						Window Transactions		Overnight
	Expansion			Contraction			Expansion	Contraction	
	Quota	Use	% Used	Quota	Allocated	% Used			
January	550.0	280.4	51.0	1,292.9	261.7	20.2	10.8	63.6	15.6
February	890.0	428.6	48.2	1,082.5	261.1	24.1	16.9	31.1	14.2
March	1,045.6	648.3	62.0	544.4	138.6	25.5	30.1	16.7	14.9
April	725.0	356.6	49.2	1,154.5	764.7	66.2	14.3	75.1	15.7
May	776.2	370.2	47.7	823.8	545.4	66.2	9.1	39.1	14.1
June	800.0	575.8	72.0	725.0	307.2	42.4	15.4	25.9	12.3
July	990.9	817.9	82.5	852.3	199.6	23.4	64.1	22.5	8.6
August	1,325.0	1,087.3	82.1	680.0	217.9	32.0	49.0	12.8	17.1
September	1,040.5	676.3	65.0	902.4	569.0	63.1	11.5	32.4	11.5
October	1,529.5	1,082.5	70.8	620.5	420.0	67.7	17.1	36.0	10.4
November	1,105.3	490.3	44.4	663.2	480.9	72.5	11.4	104.2	14.6
December	1,940.5	637.4	32.8	577.5	220.2	38.1	21.6	28.6	17.1

(*) The figures pertain to the average for operations approved during the calendar month.
Source: Banco de la República.

Interest charged on loans in Colombia is classified into four types: consumer, regular, prime and treasury, depending on the risk to the financial intermediary at the time the loan is made[4]. Both nominal and real lending rates on credit of all types declined throughout 2002. Nominal interest on consumer loans was 27.0%,

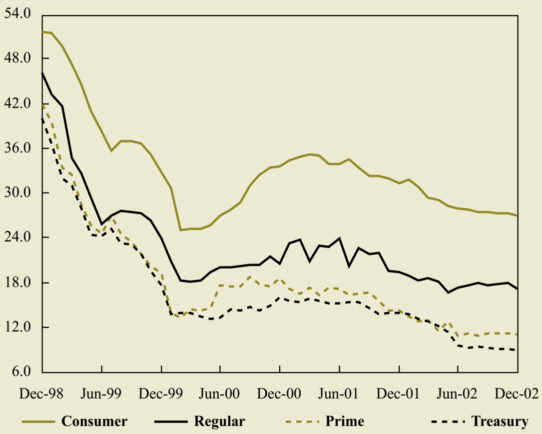
[4] There is another type of loan with interest indexed to inflation through the UVR (unit of real value). Pursuant to BDBR Resolution 14/2000, such loans are subject to a maximum remunerative rate of 13.9%, effective annually. A treasury loan is defined as prime credit for less than 30 days to meet short-term liquidity requirements. The market tends to charge higher interest on consumer credit than on other types of loans considered to be less risky, such as prime rate or treasury loans.

Figure 3
Nominal and Real Interest on Deposits (*)
(Percentage)



(*) CPI deflacted
Source: Banco de la República and the Banking Superintendent.

Figure 4
Nominal Lending Rates, According to Type of Credit
(Percentages)



Source: Banco de la República.

on average, at December 2002, as opposed to 17.1% for regular credit, 10.9% for prime rate loans and 9.0% for treasury loans. Compared with December 2001, this represents a decline of 4.3, 2.3, 3.2 and 4.9 percentage points, in that order (Figure 4). In real terms, lending rates declined by 2.8 percentage points on average.

After a systematic decline during the first six months of 2002, interest on government bonds rose significantly during the second half of the year. Changes in the international environment modified the public sector's prospects for financing, which had been favorable up to that point[5]. Between the end of March and mid-June, the rate on 10-year treasury bonds in pesos (the most liquid reference in the market) fell by approximately 290 bp to 12.59%[6]. At that point, it began to increase and was 17.5% by early October. Definite Treasury bond purchases (TES) by Banco de la República, coupled with announcement of an agreement to be signed with the IMF and congressional approval of the reform package restored confidence to the markets, substantially lowering the rates on government bonds once again. The 10-year bond rate ended the year at 15.0%.

In view of the liquidity requirements at year's end, the Board of Directors granted temporary liquidity for November and December through 30 and 90-day repo expansion operations. Average use of the established quota for one-day expansion repos in the last two months was only 38% (Table 2). In contrast, 90-day repos were in full demand (Col$600 b), while only 33.7% of the quota for 30-day Repos was used (Col$1.5 b).

2. Monetary Aggregates

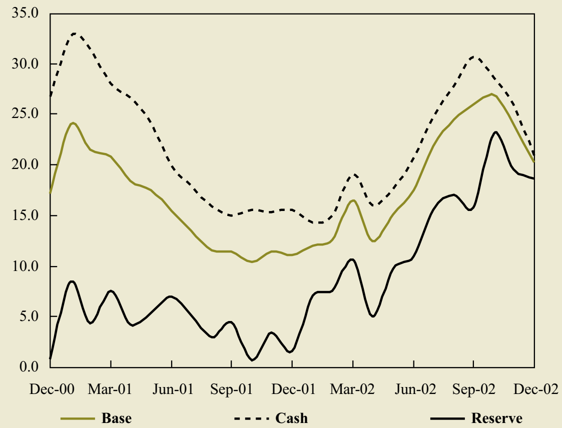
a. Monetary Base

The gradual reduction in short-term interest rates during the last few years is consistent with efforts to provide enough primary liquidity to satisfy any increase in demand on the monetary base. As of 1999, growth in the monetary base and cash has outpaced that of nominal GDP. Figure 5 shows the annual percentage change in the monthly average for this aggregate.

5 The political environment in Brazil and problems in the region were reflected in the close of international capital markets. The result was an increase in the country risk premium on the debt and generalized depreciation of Latin American currencies.

6 A bond that matures on January 25, 2010 and has a 15% coupon.

FIGURE 5
MONETARY BASE AND ITS USE
(ANNUAL PERCENTAGE CHANGE IN THE MONTHLY AVERAGE)



Source: Banco de la República.

Average annual nominal growth in monetary base was 19.2% in 2002 and 21.1% at year's end. These percentages are high compared with those of 2001. During this period, average annual growth in cash was 21.7% and reserves, 13.5% (Table 3). The demand for cash continued to rise, even though there was no change in the tax on financial transactions. This growth may have been associated with factors such as the reduced opportunity cost of maintaining monetary balances due to the drop in nominal interest rates and inflation as opposed to relatively high transaction costs[7].

The growth in demand for reserves this year, compared with previous years, was associated with redistribution of the portfolio of agents who exchanged their CD holdings for current and savings accounts with higher reserve requirements. The year also saw an accelerated increase in public-sector

[7] The TD rate fell by 3.5 percentage points between January 2001 and the same month in 2002, while the effective savings rate, which discounts the financial transaction tax, went from 4.0% in December 2000 to 2.5% in December 2001 and to 1.4% in 2002.

TABLE 3
MONETARY AGGREGATES

	Base	Cash	Reserve	M1	Quasi-money	M2	Quasi-money	M3
	Annual average (billions of pesos)							
1999	7,068.2	4,202.9	2,865.3	9,303.1	40,088.2	49,391.3	52,889.2	57,482.8
2000	8,227.7	5,391.1	2,836.6	12,405.3	40,096.5	52,501.8	53,616.5	59,419.6
2001	9,500.6	6,529.9	2,970.7	13,927.7	42,700.0	56,627.6	56,973.8	63,761.4
2002	11,323.1	7,950.0	3,373.0	16,897.6	44,334.2	61,231.8	60,766.1	68,941.6
	Annual nominal growth %							
1999-2000	16.4	28.3	(1.0)	33.3	0.0	6.3	1.4	3.4
2000-2001	15.5	21.1	4.7	12.3	6.5	7.9	6.3	7.3
2001-2002	19.2	21.7	13.5	21.3	3.8	8.1	6.7	8.1
	Annual real growth %							
1999-2000	7.0	17.9	(9.0)	22.6	(8.0)	(2.3)	(6.8)	(4.9)
2000-2001	7.3	12.5	(2.7)	4.3	(1.1)	0.2	(1.3)	(0.3)
2001-2002	11.4	13.8	6.1	13.4	(3.0)	1.1	(0.3)	1.1

Source: Banco de la República.

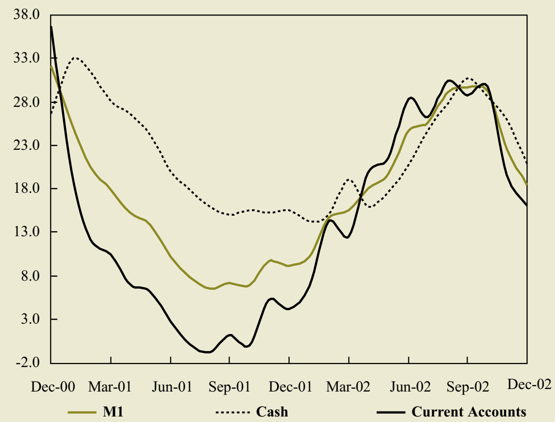
liabilities subject to reserve requirements (PSE) and somewhat less growth in private PSE, which expanded the required reserve. In effect, the average reserve requirement on public PSE is 6.8% compared with approximately 5.5% for private PSE as a whole. This is because current accounts occupy a larger share of the holdings of private agents.

In 2002, as in previous years, liquidity supplied by Banco de la República facilitated government financing by being based fundamentally on repos and liquidity quotas, net TES purchases on the secondary market, and the Bank's profit sharing with the government (Table 4).

b. Money Supply (M1)

The major acceleration in M2 growth during 2002 halted the downward trend observed as of late 2000 (Figure 6). Annual growth in money supply during this period was 21.3% on average. In the second half of the year, average annual M1 growth was 25.7%, as opposed to an annual rate of 16.8% in the first six months. This rise is explained by an average increase of 21.7% in the demand for cash during the year and a 20.9% average annual increase in current

FIGURE 6
M1 AND ITS COMPONENTS
(ANNUAL PERCENTAGE CHANGE IN THE MONTHLY AVERAGE)



Source: Banco de la República, SGEE.

TABLE 4
MONETARY BASE SOURCES: 1998- 2002
(ANNUAL FLOW IN BILLIONS OF PESOS)

	1998	1999	2000	2001	2002
Government	644	2.480	832	914	1,667
Transfer of profits	83	1,244	516	1,453	1,226
Net TES purchases	384	1,092	400	(623)	371
Treasury accounts with Banco de la República	177	143	(84)	84	70
Repos and liquidity quotas	899	1,730	(691)	(1,215)	1,128
Net purchase of foreign currency	(2,761)	(1,437)	692	1,445	(517)
Portfolio yield **1/**			(112)	(225)	(4)
Others	(148)	44	249 **2/**	18	182 **3/**
Total	(1,365)	2,817	971	938	2,457
Balance	6,922	9,739	10,710	11,648	14,105

1/ Primarily Granahorrar.
2/ Includes US$55 m. in foreign currency purchased from multilateral agencies, with an increased of Col$126 b.
3/ Includes US$48 m. in foreign currency purchased from multilateral agencies, with an increased of Col$123 b.
Source: Banco de la República.

accounts. The surge in current accounts, both public and private, was particularly strong, with average annual growth well above the rates observed in the same period the year before (30.2% and 16.2%, respectively).

The fast pace of M1 growth, particularly the increase in private current accounts, may have been due to less inflation and cuts in nominal interest rates, which lowered the opportunity cost of demand for liquid assets.

c. Broad Monetary Aggregate (M3)

Between 1999 and 2001, the broad monetary aggregate (M3) grew at rates below those for nominal GDP. This was associated with several factors; namely, i) less growth in income and ii) an increasing supply of government securities. As illustrated in Table 5, growth in the M3 + TES aggregate was similar to the increase in real GDP, although M3 declined in real terms.

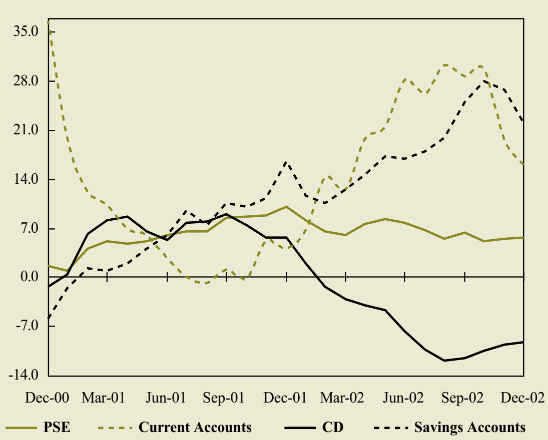
An analysis of M3 by components shows a steady drop in the demand for time certificates of deposit, which fell by 6.8% on average during the year (Figure 7). In contrast, there was an accelerated increase in current and savings accounts, with respective average annual growth rates of 20.9% and 18.8%. The drop in demand for time certificates of deposit was concentrated in the private sector (Table 6) and would be related to low nominal interest rates and the high transaction costs associated with their management. The year saw an increase of 2.5% in time certificates of deposit constituted by public agencies, but growth rates were negative in second half. The increase in current and savings accounts was similar in both the public and private sectors, although somewhat more pronounced in the latter.

B. The Exchange Market and Exchange Policy

1. Nominal Exchange Rate

Annual depreciation in the representative market exchange rate (TRM) was 25% in 2002, when it went from Col$2,291.2 per dollar on December 28, 2001 to Col$2,864.8 per dollar on December 30, 2002 (Figures 8 and 9). The nominal exchange rate devaluated by 9.1%, on average. This was the result a first period between January and May 2002, with -0.12%

Figure 7
PSE and Their Components
(Annual percentage change in the monthly average)



Source: Banco de la República, SGEE.

Figure 8
Trend in the Representative Market Exchange Rate - 2002
(Pesos per dollar)

Source: Banco de la República.

Table 5
Financial Holdings in the Productive Sector
(Billions of pesos)

End of:		Total			Public sector			Private sector (*)		
		M3	TES	M3 + TES	M3	TES	Total	M3	TES	Total
Balances										
1998		57,046	12,040	69,086	7,306	9,745	17,051	49,740	2,295	52,035
1999		60,358	15,491	75,849	5,424	11,126	16,550	54,934	4,365	59,299
2000		62,715	20,299	83,014	6,621	13,994	20,615	56,094	6,306	62,399
2001		68,575	24,744	93,319	9,186	16,463	25,649	59,389	8,281	67,670
2002	Jan.	66,667	24,412	91,079	9,460	15,789	25,249	57,206	8,623	65,830
	Feb.	67,198	25,642	92,840	10,718	15,936	26,653	56,480	9,706	66,186
	Mar.	67,883	25,921	93,803	10,574	16,094	26,667	57,309	9,827	67,136
	Apr.	68,484	26,316	94,800	11,521	15,801	27,322	56,963	10,514	67,478
	May.	68,198	27,820	96,018	11,213	15,329	26,542	56,985	12,492	69,477
	Jun.	68,200	28,207	96,407	10,043	15,298	25,341	58,157	12,909	71,066
	Jul.	68,194	29,077	97,271	10,578	15,734	26,312	57,616	13,343	70,959
	Aug.	68,830	28,493	97,323	10,556	15,955	26,512	58,274	12,538	70,812
	Sep.	69,334	28,432	97,766	10,195	16,142	26,337	59,139	12,290	71,429
	Oct.	69,360	28,111	97,471	10,391	15,794	26,185	58,968	12,317	71,285
	Nov.	71,101	28,132	99,233	11,483	15,997	27,480	59,618	12,136	71,754
	Dec.	73,104	28,859	101,962	10,488	16,215	26,703	62,616	12,643	75,259
Absolute annual change										
1999		3,312	3,451	6,763	(1,882)	1,381	(501)	5,194	2,071	7,264
2000		2,357	4,808	7,165	1,197	2,868	4,065	1,160	1,940	3,100
2001		5,860	4,445	10,305	2,565	2,469	5,035	3,295	1,975	5,270
2002		4,528	4,115	8,643	1,302	(248)	1,054	3,227	4,363	7,590
Annual % change at end of:										
1999		5.8	28.7	9.8	(25.8)	14.2	(2.9)	10.4	90.2	14.0
2000		3.9	31.0	9.4	22.1	25.8	24.6	2.1	44.4	5.2
2001		9.3	21.9	12.4	38.7	17.6	24.4	5.9	31.3	8.4
2002		6.6	16.6	9.3	14.2	(1.5)	4.1	5.4	52.7	11.2
Average annual % change each year										
2000		2.8	35.8	9.3	(11.7)	32.1	13.8	5.1	48.2	7.8
2001		7.5	17.8	10.1	25.3	11.5	15.6	5.4	36.0	8.0
2002		7.8	20.2	11.0	31.9	0.4	10.9	4.7	64.8	11.4

(*) Does not include TES held by the financial sector.
Source: Banco de la República. Calculations by SGEE, based on information from the Trust and Securities Department.

Table 6
Major Deposit Taking by Credit Agencies

End of:		Current Account			CD			Savings		
		Public	Private	Total	Public	Private	Total	Public	Private	Total
		(Billions of pesos)								
1999		1,732.9	5,071.2	6,804.0	1,103.3	22,698.9	23,802.2	1,047.7	16,109.3	17,157.0
2000		2,364.0	7.073.1	9,437.0	1,075.6	22,048.1	23,123.7	1,146.3	15,682.3	16,828.6
2001		3,287.4	7,115.6	10,403.0	1,615.7	22,763.6	24,379.3	1,672.7	17,452.0	19,124.7
2002	Jan.	2,158.5	5,865.2	8,023.7	1,537.3	23,161.0	24,698.3	2,054.8	17,014.5	19,069.4
	Feb.	2,374.2	5,894.0	8,268.2	1,694.9	22,886.1	24,581.1	2,103.1	16,830.5	18,933.5
	Mar.	2,371.2	5,801.7	8,172.9	1,467.0	22,829.6	24,296.6	2,453.3	16,923.5	19,376.7
	Apr.	2,791.9	5,905.2	8,697.1	1,609.4	22,512.9	24,122.3	2,734.5	17,306.4	20,040.9
	May.	2,768.1	5,967.2	8,735.3	1,583.0	22,111.5	23,694.6	2,971.8	17,448.4	20,420.2
	Jun.	2,899.7	6,470.6	9,370.3	1,513.1	21,366.4	22,879.5	2,725.3	18,186.3	20,911.6
	Jul.	2,687.5	6,257.6	8,945.1	1,479.1	21,053.4	22,532.5	2,940.0	18,190.9	21,130.9
	Aug.	2,624.5	6,475.3	9,099.8	1,447.7	21,002.2	22,449.9	3,078.7	18,772.4	21,851.1
	Sep.	2,555.1	6,389.6	8,944.7	1,576.0	20,850.5	22,426.5	3,231.0	19,046.8	22,277.8
	Oct.	2,548.3	6,369.0	8,917.3	1,702.1	20,958.7	22,660.8	3,316.8	19,478.6	22,795.4
	Nov.	2,739.9	6,654.6	9,394.5	1,600.0	20,866.2	22,466.2	3,766.8	19,605.4	23,372.1
	Dec.	3,393.4	8,217.6	11,611.0	1,466.2	20,638.8	22,105.0	2,814.4	20,064.5	22,878.9
		Annual percentage changes								
2000		36.4	39.5	38.7	(2.5)	(2.9)	(2.9)	9.4	(2.7)	(1.9)
2001		39.1	0.6	10.2	50.2	3.2	5.4	45.9	11.3	13.6
2002	Jan.	5.1	1.9	2.8	47.4	(1.4)	0.7	72.5	3.0	7.6
	Feb.	33.9	3.5	10.7	34.7	(3.9)	(1.9)	77.2	4.4	9.4
	Mar.	16.2	5.2	8.2	6.2	(4.4)	(3.8)	57.0	8.2	12.6
	Apr.	46.9	6.2	16.6	10.7	(5.0)	(4.1)	53.5	10.6	14.9
	May.	37.6	10.7	18.0	0.1	(5.3)	(5.0)	54.9	10.7	15.5
	Jun.	51.5	15.6	24.7	(11.2)	(9.0)	(9.2)	50.4	12.4	16.2
	Jul.	35.7	15.9	21.2	(9.4)	(11.5)	(11.4)	62.9	12.6	17.6
	Aug.	44.0	23.2	28.5	(15.1)	(12.1)	(12.3)	67.3	16.0	21.3
	Sep.	31.8	19.1	22.5	(9.4)	(11.7)	(11.6)	73.5	18.3	24.0
	Oct.	42.4	17.6	23.8	(4.0)	(10.4)	(10.0)	102.7	22.0	29.5
	Nov.	16.1	19.8	18.7	(10.7)	(9.3)	(9.4)	80.9	19.9	26.8
	Dec.	3.2	15.5	11.6	(9.2)	(9.3)	(9.3)	68.3	15.0	19.6
		Average annual percentage changes								
Jan-Jul de /02		32.41	8.44	14.60	11.22	(5.77)	(4.94)	61.21	8.83	13.42
Aug-Dec de /02		27.52	19.02	21.01	(9.67)	(10.58)	(10.52)	78.53	18.23	24.23
Jan-Dec de /02		30.37	12.85	17.27	2.51	(7.78)	(7.26)	68.43	12.74	17.93

Source: Banco de la República - SGEE, based on the monthly balance and the format presented by financial institutions containing operations with public agencies.

Figure 9
Annual Nominal Devaluation - 2002
(Percentage)

Source: Banco de la República.

revaluation in the nominal exchange rate, and a second period between June and December, when average devaluation increased at an annual rate of 15.5%.

As described in the July 2002 Report to Congress, the trend in the exchange rate since April was due to: i) the active participation of exchange agencies in the interbank market, which increased the supply of foreign currency traded on that market; ii) cover operations for obligatory pension funds, conducted pursuant to regulations established by the Banking Superintendent to reduce the exchange risk to their holdings in foreign currency[8]; iii) a reduction in the financial system's own position, given expectations that the National Treasury will convert foreign currency into cash; iv) considerable expansion in income originating with remittances from Colombian workers abroad; and v) the policy adopted by United States monetary authorities to reduce interest rates.

The exchange rate began to devaluate in mid-May due to the reduced supply of dollar futures from pension and severance funds that had taken part in the external-for-domestic debt swap conducted that month by the government. The productive sector's demand for resources for investments abroad was also a factor[9]. In July, external markets became even increasingly nervous in response to the political environment in Brazil and problems in the region. The result was limited access to international capital markets, plus an increase in debt margins and generalized depreciation of Latin American currencies[10].

In addition to these factors, the productive sector experienced an increase in demand for foreign currency for investments abroad. However, it could not be supplied by the financial system owning to the decline in its own position. This sparked a process of accelerated devaluation, causing the Bank to intervene in the exchange market on three occasions (in July, August and the first week of October) through auctions of put options on reserves to control exchange volatility. The exchange rate depreciated by 21.8% between late May and September. Through exercise of these options, the Bank sold US$414 m during that period

Between October and November, the representative market rate eased its upward climb, thanks to less uncertainty over the political situation in Brazil and because the government presented Congress with a structural reform bill. It also defined the major points of a new agreement with the IMF and managed to secure backing from multilateral banks for new external credit. These developments modified the market's expectations and halted the devaluationist trend, so much so that the condition for Banco de la República to exercise call options on US$50 m in reserves was reactivated on October 21, 2002.

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8 As to the investment portfolio of mandatory pension funds, the Banking Superintendent issued a circular on June 15, 2001 limiting the uncovered portion of the value of the fund to 20%.

9 The country exchanged US$428.3 m in Yankee bonds and $174.7 m euros in bonds maturing in 2003, 2004 and 2005 for class B Treasury bonds (TES B) denominated in pesos, at a fixed rate, with terms of five and seven years, and other bonds indexed to inflation at 10 years.

10 At the end of June, the national government floated a 10-year global bond issue valued at US$500 m. A portion of this issue was used to substitute US$300 m in external debt with maturities in 2003, 2004 and 2005.

In the first week of December, the government took advantage of the fact that the markets had reopened to float a 10-year bond issue in the amount of US$ 500 m to help finance the external debt. The demand for foreign currency increased again at the end of 2002, because of the economic and political crisis in Venezuela, and the representative market rate ended the year at Col$2,864.8 per dollar.

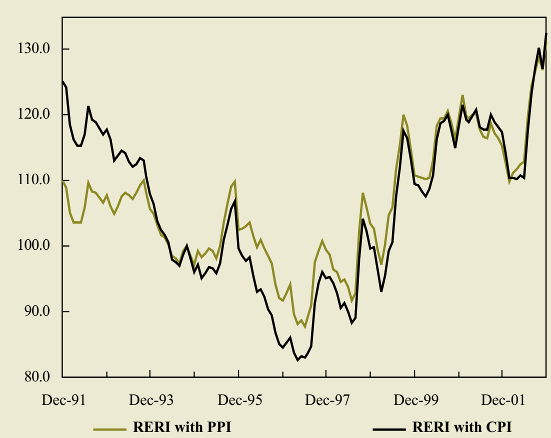
In spite of the reserves sold by the Bank in the second half of 2002, the balance at the end of that year was nearly US$650 m more than at the end of 2001. This was because US$200 m in reserves were purchased during the first semester and the yield on reserves came to US$804.9 m[11].

2. Real Exchange Rate

The real exchange rate index (RERI) is the indicator of relative prices used to measure changes in the country's competitiveness compared with its major trading partners. Traditionally, two indexes have been calculated for Colombia: the RERI-PPI and the IREI-CPI. These use the producer price index (PPI) and the consumer price index (CPI), in that order, as a measure of internal and external prices.

The RERI-PPI was 131.19 in December 2002, a historic high, with 13.8% real annual devaluation (Figure 10). This is explained by 22.0% devaluation in the Colombian peso against the dollar, while the country's 20 major trading partners reported 8.6% nominal depreciation[12]. Nominal external devaluation was less because sharp increases in the price of the dollar in countries such as Argentina (253.0%), Venezuela (76.0%), Brazil (53.0%) and Mexico (11.5%) were offset by the revaluation of currencies like the euro (-12.5%), the pound (-9.1%) and the yen (-4.3%)[13]. To a lesser extent, real devaluation in Colombia was also due to less of an increased in national producer prices (9.3%) compared with the external average (10.7%). The RERI-CPI behaved similarly, with 12.8% real annual depreciation, and was 132.58 at December of last year.

Figure 10
Real Exchange Rate Index in Colombia
Non-traditional Commerce
(CPI and PPI Deflated)



Source: Banco de la República and the Banking Superintendent.

Compared with competitor countries in the US market, the real exchange rate has also devaluated sharply (Figure 11), particularly when taking into account the basket of competitor countries in sales other than coffee[14].

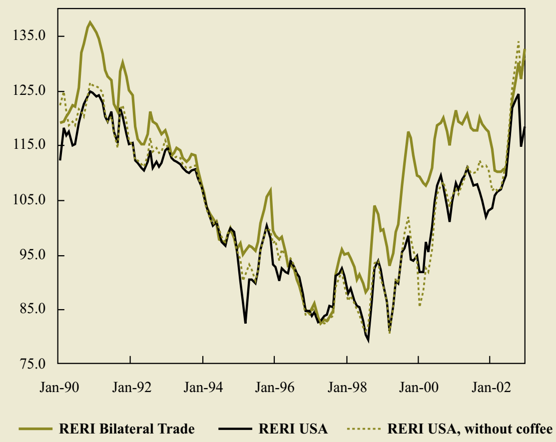
[11] Intervention by the Bank during the course of the year resulted in a net sale of US$163 m in international reserves. During the first six months of 2002, with the revaluation trend in the exchange rate, the Bank exercised options to accumulate US$202 m in international reserves. Later, the devaluationist trend in the market during the second half of 2002 led to auctions on three occasions (between July and October) to control exchange rate volatility. Banco de la República sold US$414 m in foreign currency as a result. At the end of October, the announcement of an agreement with the IMF changed the market's expectations and temporarily halted the devaluationist trend to the point where an auction to accumulate US$50 m in reserves was activated on October 21, 2002.

[12] This difference accounted for 12.3 percentage points of the total increase in the RERI-PPI.

[13] In calculating the indicator, the weight of countries such as Venezuela, Argentina, Brazil and Mexico is 21.0%. The weight of the euro, the yen and the British pound is 15.0%, 7.0% and 2.0% respectively.

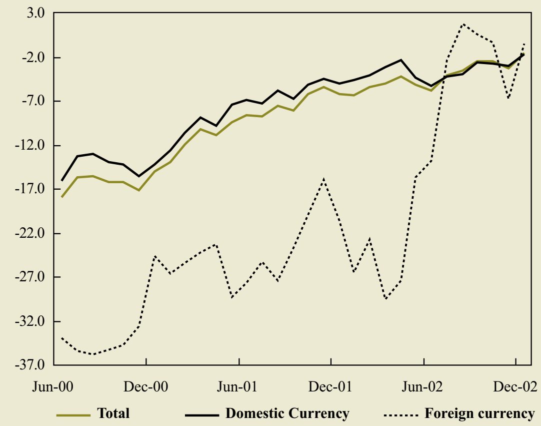
[14] This exchange rate is calculated according to a basket of countries that includes Colombia's major competitors on the US market in terms of exports of coffee, oil, flowers, textiles, bananas and coal.

Figure 11
Real Exchange Rate Index Compared With Competitor Countries in the United States



Source: Banco de la República and the Banking Superintendent.

Figure 12
Real Gross Portfolio, by Type of Currency
(Annual percentage change)



Source: Banco de la República and the Banking Superintendent.

C. Financial System

1. Credit in the Financial System

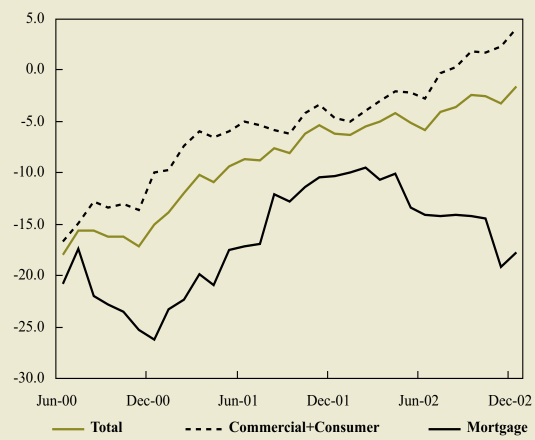
The nominal gross portfolio increased by 5.3% during 2002, with a 1.6% drop in real terms. This represents a change in the behavior of the portfolio compared with previous years. The total gross portfolio fell by 6.7% in nominal terms between December 1999 and December 2001 (-20.3% in real terms. Table 7).

The trend in the portfolio throughout the year continued to be explained by loans in domestic currency, which saw an increase of 5.3% in nominal terms and a real decline of 1.6%. The foreign currency portfolio measured in dollars fell by 14.9%. Between 1999 and 2001, the real portfolio in domestic currency declined by 18.5% and credit in foreign currency expressed in dollars fell by 42.8 % (Figure 12, Table 7).

In real terms, the consumer loan portfolio in domestic currency grew at an average annual rate of 1.4% during 2002. The commercial portfolio in domestic currency registered an average annual increase of 0.2% and the one in foreign currency fell at an average annual rate of 10.8% (Figure 13 and Table 8). In spite of this, the mortgage portfolio declined at an average annual rate of 13.5%. This was partially due to portfolio withdrawals originating with securitization and to a substantial increase in pre-payments. Mortgage loan disbursements rose significantly[15].

[15] Mortgage banking operations with Titularizadora Colombia came to Col$1,043 b.

Figure 13
Real Gross Portfolio in Domestic Currency, by Portfolio Type
(Annual percentage change)



Source: Banco de la República and the Banking Superintendent.

TABLE 7
ADJUSTED AND NON-ADJUSTED GROSS PORTFOLIO (*)
(ANNUAL % CHANGE)

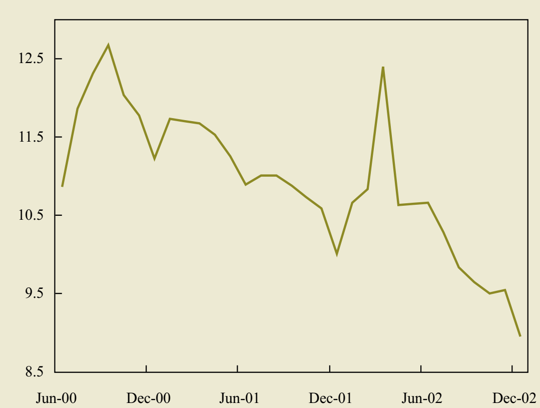
End of:		Real Growth				Nominal Growth			
		D/C	F/C	Total	Adjusted D/C (pr)	D/C	F/C	Total	Adjusted D/C (pr)
1999		(8.3)	(33.7)	(11.2)	(2.9)	0.1	(27.6)	(3.1)	6.1
2000		(14.2)	(24.6)	(15.1)	(2.5)	(6.7)	(18.1)	(7.7)	6.0
2001		(5.0)	(20.7)	(6.2)	(3.9)	2.3	(14.6)	1.0	3.5
2002	Jan.	(4.7)	(26.5)	(6.3)	(3.4)	2.4	(21.1)	0.6	3.7
	Feb.	(4.1)	(22.7)	(5.5)	(2.7)	2.4	(17.5)	0.9	3.8
	Mar.	(3.1)	(29.6)	(5.0)	(2.6)	2.6	(25.4)	0.5	3.2
	Apr.	(2.4)	(27.4)	(4.2)	(1.6)	3.1	(23.3)	1.2	4.0
	May.	(4.4)	(15.7)	(5.2)	(3.6)	1.2	(10.8)	0.3	2.1
	Jun.	(5.2)	(13.8)	(5.8)	(3.9)	0.7	(8.5)	0.0	2.1
	Jul.	(4.2)	(2.3)	(4.0)	(3.2)	1.7	3.7	1.9	2.8
	Aug.	(4.0)	1.9	(3.6)	(3.3)	1.8	8.0	2.2	2.4
	Sep.	(2.6)	0.6	(2.4)	(3.0)	3.2	6.6	3.4	2.8
	Oct.	(2.7)	(0.4)	(2.5)	(3.1)	3.5	6.0	3.7	3.0
	Nov.	(3.0)	(6.7)	(3.3)	(2.6)	3.8	(0.2)	3.6	4.3
	Dec.	(1.6)	(0.5)	(1.6)	(1.8)	5.3	6.4	5.3	5.1
Variations:									
Dec/99-Dec/01		(18.5)	(40.2)	(20.3)	(6.3)	(4.6)	(30.0)	(6.7)	9.7
Dec/01-Dec/02		(1.6)	(0.5)	(1.6)	(1.8)	5.3	6.4	5.3	5.1
Sep/02-Dec/02		1.2	(7.1)	0.6	1.5	2.8	(5.6)	2.2	3.2

(pr) Preliminary
(*) Includes entities in the process of liquidation. Does not include special financial institutions.
Note: The adjusted portfolio series attempts to reconstruct the effect of portfolio withdrawals on the balance sheet of financial intermediaries. This procedure is justified, since part of the decline in the nominal gross portfolio as of 1999 was due to withdrawals from the balance accounts of financial intermediaries caused by mortgage debt relief, property delivered as payment in kind, write-offs and mortgage securitization.
Fuente: Banco de la República, based on the monthly balance sheets of financial institutions.

2. Asset Quality

The traditional indicator of portfolio quality (past-due/gross portfolio), which was 10.0% in December 2001, fell during the first half of the year, reached a high of 12.4% in March and was 9.0% in December 2002 (Figure 14). This pattern was probably influenced by the change in portfolio classification criteria[16]. The past-due portfolio coverage index (provisions/past-due portfolio) rose from 78.8% in December 2001 to 88.7% in

FIGURE 14
PORTFOLIO QUALITY INDICATOR
(OVERDUE /GROSS PORTFOLIO)
(PERCENTAGES)



Source: Banco de la República , with information from the Banking Superintendent.

[16] The resolution issued by the Banking Superintendent to modify portfolio evaluation criterion on risk in relation to extent of default took effect in March 2002 and applies retroactively to January and February. It obliged institutions to adopt customer risk evaluation programs.

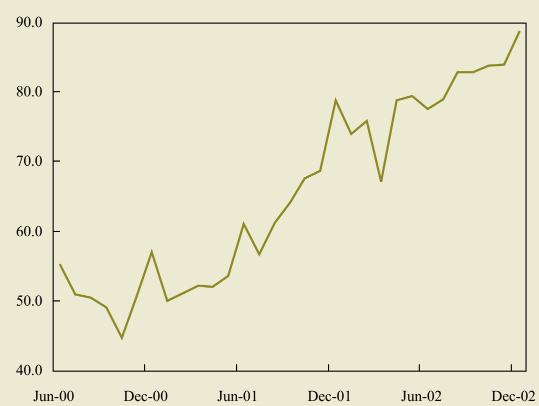
Table 8
Real Rate of Growth in the Gross Portfolio, by Type of Loan
(Annual % change)

End of:		Consumer			Commercial			Mortgage
		D/C	F/C	Total	D/C	F/C	Total	D/C
1999		(32.9)	(51.9)	(33.3)	(0.3)	(33.2)	(7.2)	(5.1)
2000		(10.5)	(33.9)	(10.8)	(7.1)	(24.4)	(9.8)	(26.2)
2001		3.7	27.8	3.9	(4.6)	(21.6)	(6.7)	(10.3)
2002	Jan.	3.3	8.7	3.4	(4.1)	(27.3)	(7.0)	(9.9)
	Feb.	4.7	3.5	4.7	(3.6)	(23.3)	(6.1)	(9.5)
	Mar.	(4.0)	(59.4)	(4.7)	1.1	(28.8)	(2.5)	(10.7)
	Apr.	(2.6)	(52.5)	(3.3)	1.8	(26.7)	(1.7)	(10.1)
	May.	(1.5)	(38.8)	(2.0)	(0.5)	(15.1)	(2.2)	(13.4)
	Jun.	(2.0)	(62.2)	(2.9)	(1.5)	(12.4)	(2.7)	(14.1)
	Jul.	(0.1)	(59.3)	(1.0)	(0.1)	(0.5)	(0.1)	(14.2)
	Aug.	3.5	(54.4)	2.7	(0.9)	3.8	(0.4)	(14.1)
	Sep.	4.1	(56.9)	3.2	1.3	2.6	1.5	(14.2)
	Oct.	3.9	(56.1)	3.0	1.4	1.6	1.4	(14.5)
	Nov.	3.3	(55.7)	2.5	3.2	(5.2)	2.3	(19.2)
	Dec.	4.7	(52.0)	4.0	4.5	1.1	4.1	(17.7)
Variations:								
Dec/99-Dec/01		(15.4)	(22.0)	(15.5)	(4.1)	(29.0)	(8.5)	(16.8)
Dec/01-Dec/02		1.4	(44.6)	0.8	0.2	(10.8)	(1.1)	(13.5)
Sep/02-Dec/02		4.0	(54.6)	3.2	3.0	(0.8)	2.6	(17.1)

Note: For the sake of consistency in the series, the microcredit portfolio is excluded from the consumer portfolio.
Source: Banco de la República, SGEE.

December 2002 (Figure 15). The increase in this indicator reflects a sounder situation in the financial system.

Figure 15
Coverage Indicator
(Portfolio Reserve/Past-due Portfolio)
(Percentages)



Source: Banco de la República, with information from the Banking Superintendent.

3. Solvency

Up until December 2002, the solvency indicator (technical equity/weighted assets) of the financial system as a whole was similar to what it had been at the end of 2001. In the case of public financial institutions, this indicator rose to 16.1% at December 2001 and 18.6% at December 2002, primarily due to an increase in the technical equity of Banco Agrario. The solvency indicator for private institutions remained at around 13.0%, which was similar to the year before. These levels are above the minimum required threshold of 9.0% (Figure 16)[17].

4. Profitability

The financial system reported Col$1,570 b in profits during 2002, which is a sign of recovery, compared with previous years. Although Col$344.2 b in profits were reported in 2001, the system accumulated Col$4,616 b in losses during the period from 1997 to 2001. In 2002, private financial institutions registered Col$765 b in profits and public institutions Col$368 b, while the profits of special official financial institutions came to Col$438 b[18] (Figure 17).

D. Fiscal Policy

1. Results of 2002

At the close of 2002, the consolidated public sector showed a deficit equivalent to 3.6% of GDP. This implies a reduction approaching 0.4% of GDP compared with the fiscal balance for 2001. The government's initial objective was a deficit equal to 2.6% of GDP, but a loss of momentum in tax revenue and new spending needs made this goal impossible to achieve.

In August, the new administration began to promote a series of legislative reforms that would have a fiscal impact as of 2003. To obtain additional resources for the armed forces and the police, the government established a one-time tax for democratic security (Table 9)

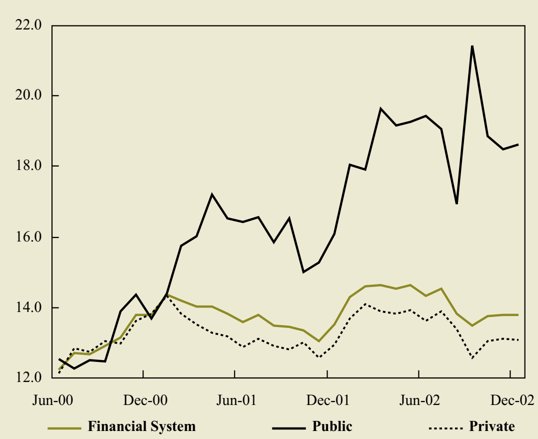
Central government finances showed a deficit equivalent to 6.3% of GDP. This exceeds the figure for 2001 by more than half a per cent point of GDP. The downturn in government finances originated with low income growth and the new spending items included in the budget. Total income rose by 10.0% and spending by 12.6%. A breakdown of income by components shows an increase of 9.2% in tax revenue, 21.9% in capital income and 31.6% in special funds (Table 10).

The most dynamic levies were income tax, internal VAT and external VAT, with respective increases of 6.0%, 6.2% and 6.0% in collections. Revenue from

17 Sharp fluctuations in this indicator during the third quarter were due to appraisal of investments during the TES crisis period.

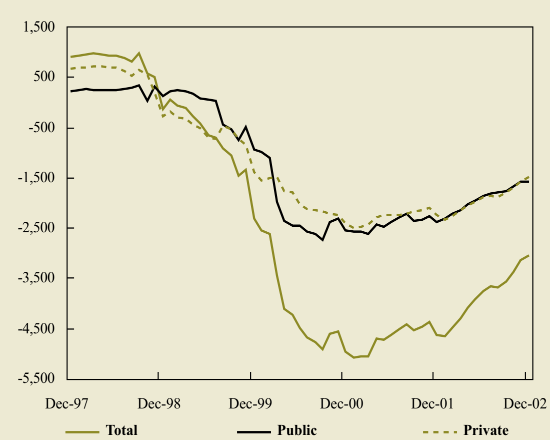
18 A portion of these profits (Col$411 b) pertain to Fogafin. Resources transferred to Fogafin from the National Treasury are entered on its books as income.

Figure 16
Solvency Ratio - Credit Establishments
(Percentage)



Source: Banco de la República, with information from the Banking Superintendent.

Figure 17
Profits Accumulated in the Financial System in a Five-year Period
(Billions of dollars)



Source: Banco de la República, with information from the Banking Superintendent.

TABLE 9
DEFICIT IN EFFECTIVE OPERATIONS
CONSOLIDATED PUBLIC SECTOR

Item	Billions of Pesos		Percentage of GDP	
	2001	2002 (pr)	2001	2002 (pr)
Electricity	255.0	192.0	0.1	0.1
Emcali	141.0	108.0	0.1	0.1
EPM	292.0	270.0	0.2	0.1
FAEP	451.0	(390.0)	0.2	(0.2)
Ecopetrol	779.0	408.0	0.4	0.2
Telecom	418.0	267.0	0.2	0.1
Other Entities	309.0	656.0	0.2	0.3
Social Security	1,100.0	2,362.0	0.6	1.2
Regional and Local Entities	24.0	889.0	0.0	0.4
National Coffee Fund	(77.0)	(168.0)	(0.0)	(0.1)
1. Sub-total: Decentralized Sector	3.692.0	4,594.0	1.9	2.2
2. National Government	(10,772.0)	(12,847.7)	(5.7)	(6.3)
A. Total non-financial public sector (SPNF) (1+2)	(7,080.0)	(8,253.7)	(3.7)	(4.0)
B. Cash losses and profits Banco de la República	1,393.0	1,635.0	0.7	0.8
C. Cash losses and profits - Fogafin	339.0	601.0	0.2	0.3
D. Cost of reorganizing the financial sector	(1,268.0)	(1,181.0)	(0.7)	(0.6)
E. Adjustments	520.0	(173.0)	0.3	(0.1)
F. Total Consolidated Public Sector (A + B + C + D + E)	(6,096.0)	(7,371.7)	(3.2)	(3.6)

(pr) Preliminary
Source: CONFIS.

the gasoline tax declined nominally by 11.7% due to illegal fuel sales and a reduction in the tax rate in August 2001. As to the tax for democratic security, payment of the first two installments produced Col$1.2 t in collected revenue.

Figures on spending show 5.4% growth in interest, 8.0% in operating expenses and 1.8% in investment. As part of payment for operating expenses, personal services increased by 8.3%, general expenses by 11.7% and transfers by 7.5%. The hike in general expenses was associated mostly with military spending on items other than personnel. These have increased significantly in recent years. The net loan was Col$1,258.7 b. This represents an annual reduction of 14.4%[19].

The deficit was financed with Col$6,258.9 b in Treasury portfolio resources and others, Col$ 1,226.0 b in profits transferred by Banco de la República, and Col$6,563.0 b in internal credit resources.

[19] This item includes Col$500 b in credit to the Social Security Institute (ISS), Col$213 b to Empresa Metro de Medellín and Col$312 b to Corelca.

Table 10
Effective Central Government Operations
(Billions of Pesos)

	2001	2002 (pr)	Annual Growth 2001/2002
I. Total Revenue (A + B + C + D + E)	27,594.3	30,344.0	10.0
A. Tax revenue	24,802.3	27,086.7	9.2
Income tax	10,022.5	10,626.4	6.0
Internal VAT	6,931.5	7,363.7	6.2
External VAT	3,079.4	3,264.8	6.0
Customs	2,150.1	2,083.5	(3.1)
Gasoline tax	1,106.4	976.6	(11.7)
Tax on financial transactions	1,421.3	1,443.2	1.5
Democratic security	0.0	1,240.7	n.a.
Others	91.1	87.8	(3.6)
B. Non-tax revenue	375.0	306.8	(18.2)
C. Special funds	240.0	315.9	31.6
D. Capital resources	2,071.0	2,523.6	21.9
Financial yields	571.0	553.7	(3.0)
Financial surpluses	1,320.0	1,501.8	13.8
Others	180.0	468.1	160.1
E. Accrued interest	106.0	111.0	4.7
II. Total Expenses (A + B + C + D + E + F)	38,366.3	43,191.7	12.6
A. Interest	7,497.0	7,902.4	5.4
External	3,114.4	3,621.5	16.3
Internal	4,382.6	4,280.9	(2.3)
B. Operating Costs	27,171.6	29,335.4	8.0
Personal services	5,279.6	5,719.6	8.3
General expenses	1,774.0	1,982.1	11.7
Transfers	20,118.0	21,633.7	7.5
C. Investment	2,903.9	2,955.0	1.8
D. Net loan	1,470.6	1,258.7	(14.4)
E. Floating debt	(942.9)	1,319.5	(239.9)
F. Indexing for TES B denominated in UVR	266.1	420.7	58.1
III. Deficit (-) or Surplus (+) (I - II) 1/	(10,772.0)	(12,847.7)	19.3
Cost of restructuring the financial system	1,267.7	1,181.2	(6.8)
IV. Financing (A + B + C + D)	(12,039.7)	(14,028.9)	16.5
A. Net external credit	8,747.0	(19.0)	(100.2)
Outlays	12,590.0	5,094.0	(59.5)
Amortization	3,843.0	5,113.0	33.0
B. Net internal credit	5,887.0	6,563.0	11.5
Outlays	13,812.0	13,704.0	(0.8)
Amortization	7,925.0	7,141.0	(9.9)
C. Banco de la República profits	1,453.0	1,226.0	(15.6)
D. Others	(4,047.3)	6,258.9	(254.6)
V. Deficit as a Percentage of GDP	(5.7)	(6.3)	

n/a: Not applicable
(pr) Preliminary
1/ Does not include the cost of restructuring the financial sector.
Source: Confis.

2. Tax and Fiscal Measures

A number of measures on taxes and public spending were adopted to address the country's deteriorating fiscal situation and the need for resources to pay for the security policy.

One-time payment of a tax to finance the national security strategy was decreed with declaration of a state of "internal unrest", as provided for in the Colombian constitution. This levy is equivalent to 1.2% of the net worth reported by companies and individuals, if in excess of Col$170 m at December 31, 2001. Declaration of a state of internal unrest and creation of the new tax were considered lawful by the Constitutional Court. The revenue from this tax was used to finance the military budget for 2002 and an increase in military and police spending for 2003. Effective income from this item will come to Col$2.4 trillion (t) when collection concludes in April 2003. This is more than 1% of GDP.

In September 2002, the government sent Congress a bill to increase tax revenue by altering the value-added tax (VAT) as of 2003 and 2005, establishing a surcharge on income tax for 2003, and implementing other changes in tax legislation. Congress passed the bill into law in December, allowing for a tax increase equal to approximately 1% of GDP in 2003, 1.7% of GDP in 2005 and around 2.0% of GDP as of 2006.

The law calling for a referendum, which also was passed by Congress, includes a number of provisions to reduce government spending. If the required majority of voters approve the referendum, special pension systems will be eliminated and a freeze placed on the wages and retirement pensions of public servants. The operating expenses of state agencies would also be frozen. The Finance Ministry predicts the fiscal savings on these items would amount to 0.7% of GDP in 2003 and 0.6% in 2004.

The pension reform bill was passed into law during the regular legislative session in 2002, providing for a gradual increase in pension contributions during the period between 2004 and 2008. The new system also introduces several changes in the number of workweeks, the contribution rates, retirement age and the size of pensions. Specifically, it calls for contributions to increase by 13.5% in 2003, 14.5% in 2004, 15.0% in 2005 and 15.5% in 2006. As of 2014, the retirement age will increase from 55 to 57 years for women and from 60 to 62 years for men. The pension law also redefines the requirements for access to old age, disability and survival pensions and for determining the size of the monthly stipend in each of these cases. The positive fiscal impact of the reform will be 0.32% of GDP in 2004 and 2.79% of GDP in 2010.

Congress also passed a labor reform bill to help create jobs and to make requirements for work contracts and employee dismissal more flexible. It granted the President of Colombia special faculties to modify the organizational structure of central government administration. Use of these faculties could generate fiscal savings on the order of 0.4% of GDP a year on a permanent basis.

The labor reform eliminated nearly 40,000 posts, including 30,000 occupied by employees who are scheduled to retire in the next three years and will not be replaced. Ten thousand employees will be dismissed directly. Other important reforms are scheduled for the coming months, such as a new budget law and the fiscal accountability act.

E. Agreement with the IMF

On January 15 of this year, the IMF Executive Board ratified a two-year Stand-by Agreement with the Colombian government for a total of 1,500 m in special drawing rights (SDR) (approximately US$2.1 m). Signature of the agreement entitles the country to an initial disbursement of 193.5 m in SDR (nearly US$264 m) and the remainder on a quarterly basis, subject to compliance with established targets and periodic IMF reviews of the ongoing program.

The agreement supports the consolidation of macroeconomic and structural policies aimed at ensuring an improvement in the dynamics of the public debt. The tax, pension and labor reforms approved recently by Congress are among the key components of the program. Table 11 shows all the targets met in 2002.

Cuadro 11
Program with the International Monetary Fund (IMF)

	Dec-02			IMF Target	
	IMF Target (a)	Actual (b)	Difference (b) - (a)	Mar-03	Jun-03 1/
RIN Floor (US$m.)	10,300	10,507	207	10,360	10,420
Target Inflation **2/**	6.00	6.99	0.99	6.10	5.90
Ceiling on the consolidated global deficit in the public sector as of January 1, 2002 (Col$ b,)	8,350	7,371	(979)	1,590	3,240
Ceiling on accrued net disbursement of the medium and long-term external debt in the public sector as of January 1, 2002 (US$m.) **3/**	1,100	266	(834)	650	1,050
Ceiling on accrued net disbursement of the short-term external debt in the public sector as of January 1, 2001 (US$m.)	375	195	(180)	300	300

1/ An indicative target and not a compliance criterion.
2/ According to a two-point inflation band, up and down, as provided for in the IMF agreement, the inflation target for December is regarded as having been met.
3/ Preliminary figures at December 2002.
Fuente: Banco de la República, DANE y Ministerio de Hacienda y Crédito Público.

III

Economic Activity in 2002 and Prospects for 2003

The drop in capital flows into the country was the most serious negative shock to hit the Colombian economy in 2002. Other Latin American countries were also affected by this situation, which caused their currencies to devaluate and increased country risk premiums throughout most of the year. The sharp drop in external demand further complicated matters. In this unfavorable external environment, product growth remained low, as in previous years, and was propelled by the increase in domestic spending, especially during the second half of the year.

The balance of payments for 2002 showed a current account deficit equal to 2.0% of GDP. This is similar to the deficit in 2001 and was due to the fact that exports declined more than imports. Net capital inflows amounted to 1.3% of GDP, which is 1.4% of GDP less than during the same period in 2001. Projections for 2003 indicate the current account deficit will come to 2.1% of GDP and will be financed with US$1,518 m in anticipated capital income (2.0% of GDP), which is slightly more than the year before.

GDP grew by 1.5% in 2002, which is close to the rate in 2001. After the first six months, when there were clear signs of a standstill, the remainder of the year saw a slight rebound in economic activity to the point where second-semester growth was 2.1%. This exceeds the rate observed in the first six months of the year (1.4%). The breakdown of the peace process undermined confidence in the economy during the first part of the year. In addition and despite the recovery in credit growth rates, economy activity remained slow due to recomposition of household and company finances, which has had a negative impact on economic growth. High unemployment and the violence perpetrated by criminal groups also adversely affected decisions on household consumption and company investments.

Growth in private internal demand during the second half of the year offset the declining external demand for traditional exports and products directed to Venezuela. Household consumption and investment contributed equally to the growth in demand, but particularly the latter. Even so, the rate of savings and investment in the Colombian economy is still very low. This partially explains why economic growth has been slow. The recovery was concentrated in industry, commerce and building construction.

According to the Development Plan, the forecast for GDP growth in 2003 is 2.0%. As in 2002, internal demand is expected to be the primary source of growth. Adverse conditions on the external front will continue, as there are no signs of recovery in the world economy and the Venezuelan crisis has worsened. Although international financial markets reopened temporarily for certain Latin American countries, including Colombia, the flow of financing for the region is likely to be less than in the past. Therefore, the Colombian economy will continue to depend on developments in consumption and private investment, which is expected to begin to grow at a somewhat faster pace.

Unemployment remained high in 2002 as a result of slow economic growth. However, the jobless rate in the 13 major cities declined and employment rose, as was the case in 2001. The outlook for employment is favorable, provided the structural reforms approved recently by Congress - particularly the labor bill - improve economic conditions and help to create jobs.

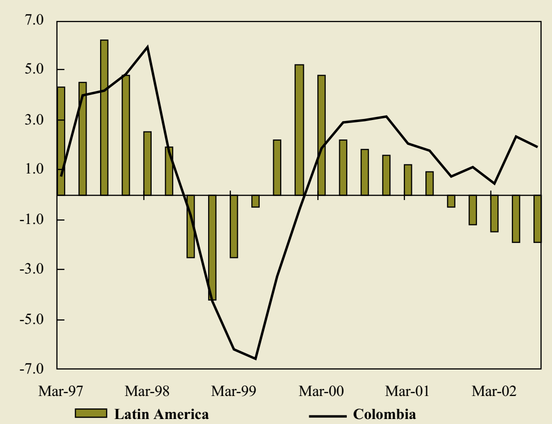
Consumer inflation was 6.99% at the end of 2002. This is 0.99 percentage points above the target set by the Board of Directors for that year, but is less than consumer inflation in 2001 (7.7%). The lag is due mainly to the trend in food prices brought on by supply problems (particularly in the case of potatoes). Core inflation was 5.6% at the end of the year. This is less than the target, but with a upward tendency as of October. The acceleration is attributed to rapid devaluation of the peso, since the Colombian economy has operated below its potential production capacity for several years. Therefore, it has nothing to do with factors related to aggregate demand. However, the rise in core inflation and the failure to meet the inflation target for 2002 could boost expectations of inflation. This situation, coupled with the temporary effect expansion of the value-added tax will have on prices, could jeopardize future inflation targets and necessitate corrective measures if the situation becomes more acute.

A. Economic Activity

The effect of external shocks that are common to the region, particularly those related to external financing, explains the similarity in economic growth cycles throughout the continent. The trend in GDP in Latin America and Colombia is shown in Figure 18.

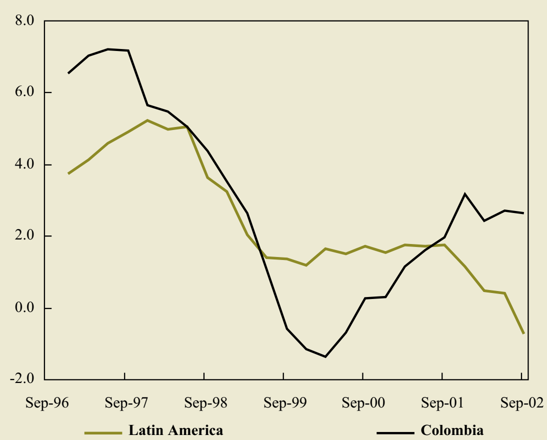
Limited access to external credit during the second half of the year was the most serious external shock to the Colombian economy in 2002. The same occurred in other countries of the region (Figure 19).

Figure 18
Rate of GDP Growth in Colombia and Latin America (1997:03-2002:09)
(Annualized quarterly growth rate)



Latin America: Argentina, Brazil, Chile, Colombia, Peru and Venezuela.
Course: IDB and DANE.

Figure 19
Capital Flows to Latin America and Colombia: 1996-2002
(Percentage of GDP)



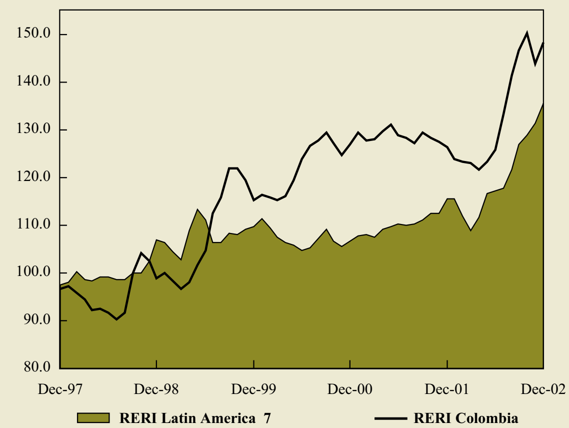
Source: Banco de la República calculations, based on IDB data.

Because of this unfavorable environment, growth did not live up to expectations and exchange rates devaluated simultaneously (Figure 20).

1. Analysis of Demand

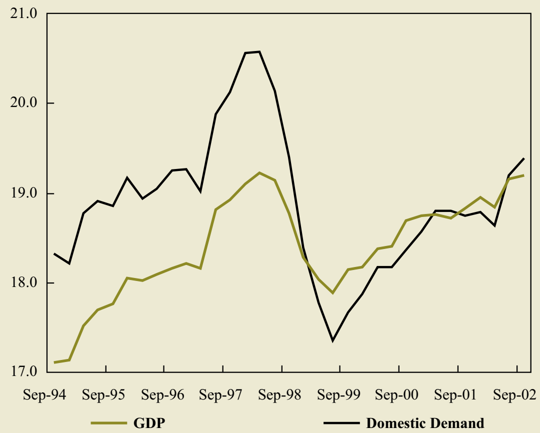
As noted earlier, product growth in Colombia was 1.5% during 2002, which is slightly above the rate for 2001 (1.4%). If illicit crops are excluded from

FIGURE 20
TREND IN REAL INTEREST RATES IN COLOMBIA AND LATIN AMERICA 1997-2002
(1998 INDEX = 100)



Source: Banco de la República calculations, DANE.

FIGURE 21
GDP VS. DOMESTIC DEMAND
DESEASONALIZED SERIES
(BILLIONS OF 1994 PESOS)



Source: Banco de la República calculations, DANE.

the statistic, growth was 1.9%, which is also higher than in 2001 (1.57%). Domestic demand was the principal source of economic growth (Figure 21).

Growth in private domestic consumption throughout 2002 was higher than in the two previous years, particularly for durables and semi-durables. The low interest rates supporting the recovery in household consumption contributed to the growth in semi-durables.

Investment rose by 5.13%, owing to more investment in building construction (22.89%) and transport equipment (8.55%). This improvement was particularly evident in the second quarter of 2002 and originates with the variety of measures adopted by the government to help the construction sector and industry. These include the low-income housing policies that have been applied since the previous administration and the reduction in tariffs on capital goods not produced in the Andean region. Approval of the Andean Trade Preference Act (ATPA), which had kept exporters anxious for months, probably enhanced the climate for investment, as did the security policies applied by the new administration.

There were major fluctuations in public consumption throughout the year. After almost no increase in the first quarter, real rates were positive in the second quarter, thanks to more need for public spending. The third quarter saw another decline in the growth of this variable, partially because of a major backlog of payments. As anticipated, growth in investment in civil works was negative throughout the year (Table 12).

The trend in exports was unfavorable in 2002. The end of the year saw a slight recovery in sales of non-traditional goods to the United States. However exports declined by 2.7% during the year as a whole, compared with 2001. Sales to Ecuador came to a standstill and those to Venezuela fell by more than 35.4% due to the crisis in that country and the trend in the bilateral exchange rate, which revaluated by nearly 20.0%. The only favorable performance was in sales to Colombia's other trading partners (Figure 22).

The latest projections by the Ministry of Finance and Public Credit and the National Department of Planning (DNP), as outlined in the Development Plan, anticipate 2.0% GDP growth in 2003 (Table 13). Much of this increase will originate with an improvement in household consumption, as was the trend in the final quarters of 2002. Nevertheless, consumption this year will face two contrary effects. The tax reform (particularly the expansion in VAT, the income tax surcharge and elimination of certain income tax

TABLE 12
ANNUAL GDP ACCORDING TO DEMAND
(PERCENTAGE CHANGE)

	2001 (p)					2002 (p)				
	I	II	III	IV	Annual	I	II	III	IV (*)	Annual (*)
Gross domestic product	2.05	1.76	0.72	1.09	1.40	0.47	2.31	1.91	2.03	1.50
Total Imports	12.24	15.45	12.01	3.64	10.70	3.65	6.60	8.80	7.44	0.11
Total End Supply	3.57	3.77	2.36	1.48	2.80	(0.96)	1.69	4.17	2.89	1.28
End Consumption	1.90	1.13	0.62	1.41	1.30	1.74	2.26	2.17	1.05	1.78
Household	2.44	1.30	0.04	1.16	1.20	2.19	2.02	2.51	1.81	2.20
Non-durables	1.46	(0.35)	(2.56)	(0.30)	(0.40)	0.19	0.55	1.18	0.84	0.91
Semi-durables	10.56	6.29	0.35	(1.10)	3.80	2.22	(2.39)	3.49	1.96	1.74
Utilities	2.32	2.20	2.46	2.93	2.50	2.28	1.86	2.09	2.12	1.95
Durables	3.74	3.31	3.56	7.97	4.70	8.87	15.34	8.66	6.01	10.65
Government	0.37	0.65	2.32	2.13	1.40	0.45	2.95	1.18	(1.14)	0.62
Gross Capital Formation	12.72	18.23	10.87	(0.40)	10.10	(15.17)	1.60	10.55	23.40	5.22
Gross fixed-capital formation	7.73	12.47	13.39	11.90	11.40	(1.76)	3.24	6.42	9.47	5.13
Machinery and equipment	17.73	32.41	21.45	9.62	20.00	(3.96)	(5.24)	3.59	6.09	1.17
Transport equipment	43.80	28.66	44.87	33.00	37.50	(18.14)	6.75	16.31	25.66	8.55
Buildings	7.04	10.51	8.41	18.00	11.00	23.69	21.74	19.89	25.62	22.89
Civil works	(12.19)	(8.86)	1.73	5.75	(3.60)	(17.10)	(3.77)	(6.83)	(5.63)	(7.86)
Subtotal: End Domestic Demand	3.43	3.46	2.03	1.14	2.50	(0.87)	2.16	3.42	4.34	2.30
Total Exports	4.30	5.43	4.10	3.23	4.30	(1.41)	(0.83)	(4.56)	(4.57)	(3.93)
Total End Demand	3.10	4.49	2.86	3.09	3.20	3.10	4.49	2.86	2.89	1.28

Note: This GDP estimate includes illegal crops. According to DANE, output from these crops declined by 30% during 2002.
(p) Provisional.
(*) Estimates by Banco de la República, SGEE.
Source: DANE.

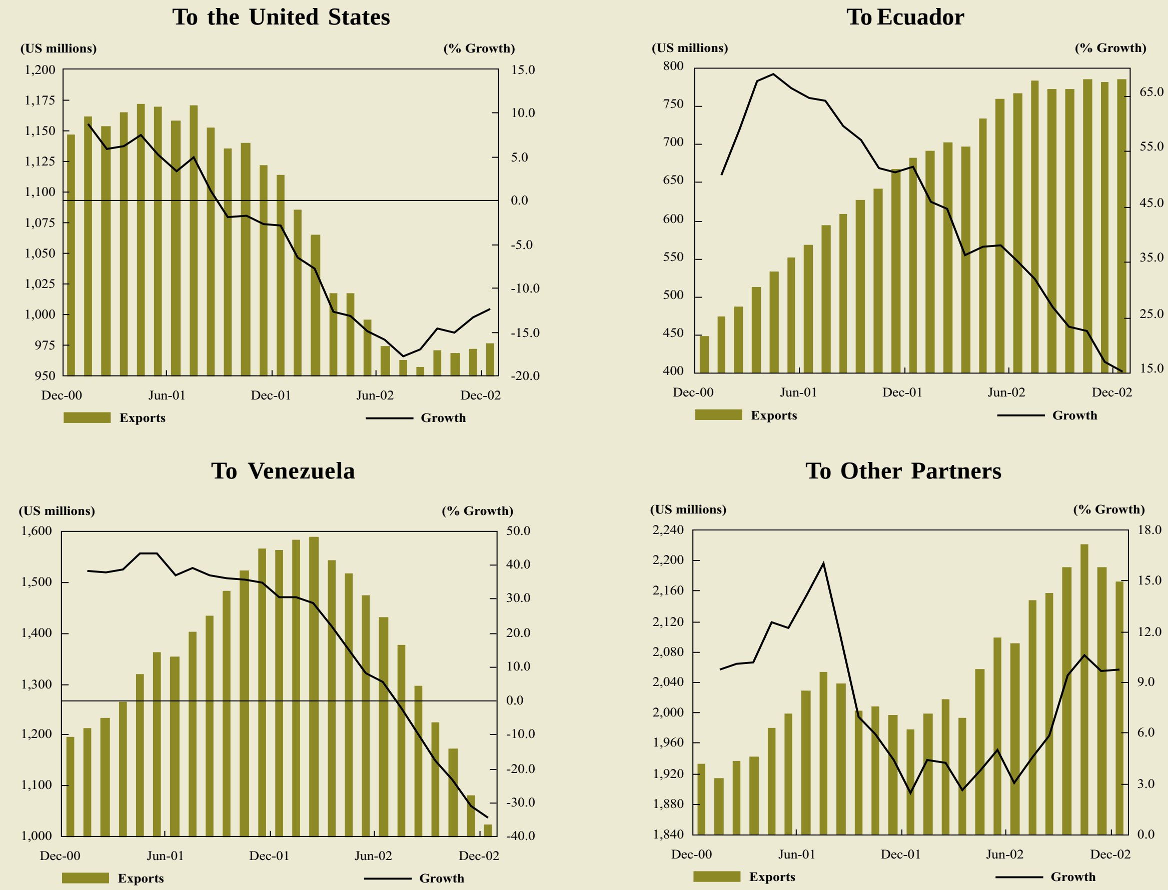
exemptions) will reduce the income available to households, causing a short-term negative effect on this variable. On the other hand, the feeling of confidence is expected to continue, thanks to the impact of reforms and the democratic security strategy. This climate of confidence will outweigh the effect of the tax reform.

Due to the backlog of payments accumulated during the final quarter of 2002, the current year is expected to see important annual growth in government consumption. Investment in civil works could recover due to projects undertaken by local administrations, such as the construction of new roadways and the mass transit systems in Bogota, Medellin and Cali.

Traditional exports are expected to decline in volume throughout 2003 because of the slowdown in oil production and coffee output. This will have a negative impact on real growth. However, the decline in the volume of crude oil exports could be offset by better prospects for international prices, which would increase the exported value.

The trend in non-traditional exports during 2003 will probably be mixed. Sales to the United States should

FIGURE 22
INDUSTRIAL NON-TRADITIONAL EXPORTS LAST 12 MONTHS



Source: DANE.

TABLE 13
PROJECTED GDP, BY TYPE OF EXPENSE
2003
(REAL GROWTH RATES)

Type of Expense	Percentage
Total consumption	1.3
Private consumption	2.3
Public consumption	(1.5)
Investment	1.3
Private investment	3.3
Public investment	0.4
Plan Colombia investment	(27.4)
Exports	3.3
Imports	(0.3)
Gross domestic product	2.0

Source: DNP.

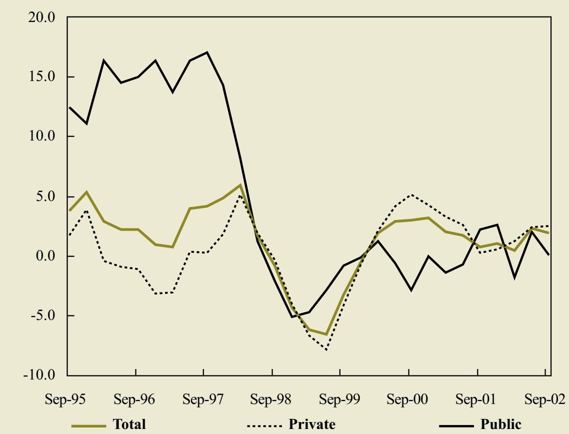
recover by the end of the year to the level observed at the close of 2001 or even higher, thanks to ATPA and devaluation of the exchange rate in 2002. Exports to Ecuador will suffer a major setback in growth, but still be positive. This will be due to less growth in that country's economy. The outlook for sales to Venezuela is not favorable. In light of recent events, a number of analysts expect a decline in product similar to or greater than the one in 2002. Closure of the exchange market and the implementation of exchange controls have complicated the situation and could continue to hamper payment for goods exported in recent months. This would further undermine the trade portfolio with Venezuela. On the whole, these effects are expected to cause a new decline in sales to the Venezuelan market, which could amount to nearly 40.0% in 2003.

The sector that exhibited the most growth in 2002 was construction (5.76%), followed by transportation (3.43%), electricity, gas and water (3.03%) and commerce (1.49%). Industry, services and agriculture registered low growth rates, while growth in mining and banking services was negative: -4.75% and -0.08% respectively.

Figure 23 shows public and private GDP. Total GDP in 2002 remained close to the trend in private GDP, as has been the case in recent years. Public GDP fluctuted in line with the tendency in public spending throughout the year, but did not affect performance of the economy in general.

Forecasts for 2003 point to better performance in most sectors (Table 14). Construction should

Figure 23
Growth in Public and Private GDP
1995-2002



Source: DANE and DNP.

Table 14
GDP by Branch of the Economy
(% annual change)
(Deseasonalized Series)

	2001 (pr)	2002 (pr)	2003 (proj.)
Agriculture, forestry, hunting and fishing	0.68	0.54	2.50
Mining and quarrying	(9.74)	(4.75)	(4.20)
Electrical power, gas and water	1.70	3.03	3.70
Manufacturing industry	(1.29)	1.10	2.10
Construction	13.77	5.76	9.10
Commerce, repairs, restaurants and hotels	2.27	1.49	1.40
Transport, storage and communications	4.33	3.43	4.10
Financial institutions, insurance companies, real estate agencies and other company services	(0.60)	2.35	2.20
Social, community and personal services	1.66	0.90	(0.50)
Financial brokerage services, indirectly measured	(5.51)	(0.08)	
Subtotal: Value added	1.15	1.50	2.00
Plus taxes minus subsidies	4.85	1.39	
GDP	1.39	1.5	2.00

Note: This estimate includes a 30% reduction in illegal crops.
(pr) Preliminary.
(proj.) Projected
Source: DANE and the Ministry of Finance and Public Credit.

continue to recover, backed by government policies, and growth rates for industry should be higher, thanks to the increase in construction and more exports of certain products to the United States market and to other countries. However, export growth will not be prominent, due to the outlook for other export markets such as Venezuela. Commerce is expected to recovery slightly and the transport sector should be more dynamic.

B. Balance Of Payments

1. Trend in the balance of payments in 2002

The country's balance of payments showed a current account deficit of US$1,612 m (2.0% of GDP) and US$1,084 m in net capital (1.3% of GDP). Accumulation of gross reserves during the year, excluding appreciation, came to US$142 m and the balance at December was US$10,844 m (Table 15).

a. Cuenta corriente

The current account deficit in 2002 increased by US$198 m compared with the previous year, due to a decline in the trade balance (non-factor goods and services). The trade deficit was US$886 m in 2001 and US$1,159 m in 2002. It originated with a decline of US$473 m in exports of goods, which exceeded the reduction in imports (US$190 m). The trend in exports of goods is explained by the lower dollar value reported for non-traditional exports (US$322 m) and coal (US$189 m).

The drop in the current account also added to the deficit in factor income (US$110 m), which was partially offset by the increase in net income from current transfers (US$185 m).

Table 16 summarizes the trend in exports, by product, during 2002. Foreign sales of hydrocarbons came to US$3,275 m, which is similar to the figure for 2002. Exports of coal declined by 16.0% because of a reduction in volume, while non-traditional exports fell by 5.0% as a result of the drop in sales to Venezuela and the United States (Table 17).

Annual growth in imports fell by 0.9% in 2002 due to fewer purchases of capital goods (7.5%). This slowdown was not offset by the increase in imports of consumer and intermediate goods (7.0% and 0.4% respectively) (Table 18). Nevertheless, the dollar value of imports did recover, since reductions of more than 10.0% in annual terms were observed during the early months of the year.

b. Capital account

The capital and financial account showed US$1,084 m in net resource flows. This is US$1,142 m less than during the same period the year before[20].

Net foreign direct investment stood at US$1,163 m. The flow of long-term financing for the public and private sectors was -US$1,316 m and -US$1,474 m respectively. Most short-term capital inflows originate with liquidation of the foreign portfolio, primarily in the public sector. The national government liquidated nearly US$1,780 m in pre-financing resources arranged abroad. These came to $1.9 m in 2001. Net short-term loans to Colombia totaled US$694 m.

c. Change in International Reserves

Movement in capital, goods and services during 2002 led to an accumulation of US$142 m in gross international reserves, not including appraisals[21]. This brought the balance to US$10,844 m, which is equivalent to 10.8 months imports of goods, 6.92 months imports of goods and services, and 1.09 ti mes the value of public and private debt amortization in one year.

[20] Nevertheless, errors and omissions came to US$670 m.. A portion of this amount may pertain to capital flows.

[21] The difference in the balance of international reserves for 2001 and 2002 does, however, include these appraisals.

Table 15
Colombia's Balance of Payments - Summary

	Millions of Dollars			As a % of GDP			Difference
	2001 (pr)	2002 (e)	2003 (proj.)	2001 (pr)	2002 (e)	2003 (proj.)	2002-2001 US$ millions
I. CURRENT ACCOUNT	(1,414)	(1,612)	(1,543)	(1.7)	(2.0)	(2.1)	(198)
Income	18,242	17,427	17,271	22.1	21.4	23.2	(814)
Outlays	19,656	19,039	18,814	23.8	23.3	25.3	(616)
A. Non-factor goods and services	(886)	(1,159)	(933)	(1.1)	(1.4)	(1.3)	(273)
1. Goods	510	227	472	0.6	0.3	0.6	(283)
Exports	12,777	12,304	12,245	15.5	15.1	16.5	(473)
Imports	12,267	12,077	11,772	14.9	14.8	15.8	(190)
2. Non-factor Services	(1,396)	(1,386)	(1,405)	(1.7)	(1.7)	(1.9)	10
Exports	2,198	1,879	1,879	2.7	2.3	2.5	(320)
Imports	3,594	3,265	3,284	4.4	4.0	4.4	(329)
B. Factor Income	(2,613)	(2,724)	(2,805)	(3.2)	(3.3)	(3.8)	(110)
Income	880	670	642	1.1	0.8	0.9	(210)
Outlays	3,493	3,394	3,448	4.2	4.2	4.6	(99)
C. Current Transfers	2,085	2,271	2,195	2.5	2.8	3.0	185
Income	2,387	2,574	2,505	2.9	3.2	3.4	188
Outlays	302	304	309	0.4	0.4	0.4	2
II. CAPITAL AND FINANCIAL ACCOUNT	2,226	1,084	1,518	2.7	1.3	2.0	(1,142)
A. Financial Account	2,226	1,084	1,518	2.7	1.3	2.0	(1,142)
1. Long-term Financial Flows	4,871	(1,658)	1,366	5.9	(2.0)	1.8	(6,529)
a. Assets	39	777	300	0.0	1.0	0.4	738
i. Colombian direct investment abroad	41	777	300	0.1	1.0	0.4	736
ii Loans **1/**	(2)	0	0	(0.0)	0.0	0.0	2
iii. Leasing	0	0	0	0.0	0.0	0.0	0
iv. Other assets	(1)	0	0	(0.0)	0.0	0.0	1
b. Liabilities	4,945	(851)	1,666	6.0	(1.0)	2.2	(5,796)
i. Foreign direct investment in Colombia	2,374	1,940	1,462	2.9	2.4	2.0	(434)
ii. Loans **1/**	2,791	(2,542)	340	3.4	(3.1)	0.5	(5,332)
Public sector	2,949	(1,309)	615	3.6	(1.6)	0.8	(4,257)
Private sector	(158)	(1,233)	(275)	(0.2)	(1.5)	(0.4)	(1,075)
iii. Leasing	(219)	(249)	(137)	(0.3)	(0.3)	(0.2)	(30)
Public sector	(0)	(8)	12	(0.0)	(0.0)	0.0	(7)
Private sector	(219)	(241)	(149)	(0.3)	(0.3)	(0.2)	(22)
iv. Other liabilities	0	0	0	0.0	0.0	0.0	0
Public sector	0	0	0	0.0	0.0	0.0	0
Private sector	0	0	0	0.0	0.0	0.0	0
c. Other long-term financial movement	(35)	(30)	0	(0.0)	(0.0)	0.0	5
2. Short-term Financial Flows	(2,646)	2,742	152	(3.2)	3.4	0.2	5,387
a. Assets	3,203	(2,140)	(319)	3.9	(2.6)	(0.4)	(5,343)
i. Portfolio investments	3,460	(2,032)	(308)	4.2	(2.5)	(0.4)	(5,492)
Public sector	1,594	(1,622)	(671)	1.9	(2.0)	(0.9)	(3,216)
Private sector	1,866	(410)	363	2.3	(0.5)	0.5	(2,276)
ii. Loans **1/**	(257)	(108)	(11)	(0.3)	(0.1)	(0.0)	149
Public sector	(4)	40	0	(0.0)	0.0	0.0	44
Private sector	(253)	(148)	(11)	(0.3)	(0.2)	(0.0)	105
b. Liabilities	557	602	(167)	0.7	0.7	(0.2)	44
i. Portfolio investments	(41)	16	0	(0.0)	0.0	0.0	57
Public sector	2	(1)	0	0.0	(0.0)	0.0	(3)
Private sector	(42)	17	0	(0.1)	0.0	0.0	59
ii. Loans **1/**	598	586	(167)	0.7	0.7	(0.2)	(12)
Public sector	121	109	(100)	0.1	0.1	(0.1)	(13)
Private sector	477	477	(67)	0.6	0.6	(0.1)	0
B. Special Capital Flows	0	0	0	0.0	0.0	0.0	0
III. NET ERRORS AND OMISSIONS	405	670	0	0.5	0.8	0.0	265
IV. CHANGES IN GROSS INTERNATIONAL RESERVES 2/	1,217	142	(25)	1.5	0.2	(0.0)	(1,075)
V. GROSS INTERNATIONAL RESERVES	10,245	10,844	10,819	12.4	13.3	14.6	599
VI. NET INTERNATIONAL RESERVES	10,192	10,841	10,816	12.3	13.3	14.5	649
Months import of goods	10.0	10.8	11.0				
Months import of goods and services	6.4	6.9	7.0				
Nominal GDP in millions of dollars	82,545	81,624	74,342				
VII. CHANGE IN NET INTERNATIONAL RESERVES	1,166	192	(25)	1.4	0.2	(0.0)	(974)

(pr) Preliminay.
(e) Estimated
(proj.) Projected
Assumptions for 2003: Export prices: Coffee US$0.74/pound (exdock), oil US$25.8/barril, growth in imports of goods -2.6% (-1.4% excluding Plan Colombia and Plan Fortaleza).
1/ Includes portfolio investments, direct loans and commercial credit.
2/ According to the balance-of-payments methodology.
Source: Banco de la República.

Table 16
Exports (FOB) According to Principal Products and Economic Sectors (pr)
(Millions of dollars)

	January-December		Variation	
	2001	**2002**	**Absolute**	**%**
Total Exports	12,309.1	11,911.0	(398.1)	(3.2)
Traditional Exports	5,555.7	5,496.0	(59.7)	(1.1)
Coffee	764.2	772.2	8.0	1.1
Coal	1,178.8	990.2	(188.6)	(16.0)
Ferronickel	235.2	272.5	37.2	15.8
Oil and petroleum by-products	3,285.1	3,275.0	(10.0)	(0.3)
Gold	3.3	94.4	91.2	n.a.
Emeralds	89.2	91.7	2.5	2.9
Non-traditional Exports (*)	6,753.4	6,415.0	(338.4)	(5.0)
Agricultural sector	1,365.7	1,382.8	17.1	1.3
Industrial sector	5,338.0	4,957.2	(380.7)	(7.1)
Mining sector	49.7	74.9	25.2	50.7

(pr) Preliminary.
(*) Does not include temporary exports, re-exports and others. Include balance-of-payment adjustments.
n.a. Not applicable
Source: DANE and Banco de la República.

2. Outlook for the Balance of Payments in 2003

The present forecast for the balance of payments (Table 15) points to a current account deficit of US$1,543 m in 2003 (2.1% of GDP). This deficit would be financed with US$1,518 m in anticipated capital income (2.0% of GDP) from net inflows of US$1,366 m and US$152 m in long and short-term capital.

As to the estimate for the current account, an annual reduction of 0.48% in exports of goods[22] is forecast. A decline in foreign sales in dollars of goods such as oil (0.28%) and non-traditional products (0.7%) is anticipated. However, exports of coffee, coal and ferronickel would rise by 1.48%, 1.34% and 8.61%, in that order. Imports of goods are expected to decline by 2.52%.

The projection for the capital and financial account includes US$1,366 m in long-term flows and US$152 m in short-term inflows. US$1,162 m. in net foreign direct investment and US$628 m. in net external borrowing by the public sector are anticipated as well. In contrast, the projection contemplates US$424 m. in net payments on the long-term debt in the private sector. The performance of short-term capital flows would be explained largely by the public sector, which would liquidate nearly US$671 m. in investments abroad, primarily government investments and those of the Oil Saving and Investment Fund (FAEP).

[22] Including special trade operations.

Table 17
Annual Percentage Growth in the Dollar Value of Colombian Exports
(January-December 2002)

	United States	Venezuela	Ecuador	Japan	Germany	Mexico	Others	Total
Totales	(0.3)	(35.4)	16.3	17.5	(20.4)	17.2	3.5	(3.2)
Non-traditional Exports	(2.7)	(35.5)	14.6	6.7	(9.6)	21.7	8.5	(5.0)
Agricultural Sector	9.8	(48.1)	(33.0)	(7.5)	(4.7)	183.1	8.0	1.3
Industrial Sector	(12.4)	(34.6)	15.2	16.7	(18.1)	21.1	8.6	(7.1)
Food. beverages and tobacco	20.8	(34.1)	21.7	5.1	(20.5)	(8.4)	16.7	0.6
Yarn and fabric	(13.4)	(36.8)	(22.2)	172.8	20.6	26.1	(1.5)	(14.8)
Clothing	2.1	(42.0)	16.7	578.2	(5.7)	54.5	(6.1)	(9.5)
Plastic and rubber products	(68.9)	(37.4)	(7.6)	n.a.	(96.3)	84.6	(26.0)	(26.8)
Leather and leather goods	(0.3)	(71.3)	(10.0)	17.7	(60.1)	47.0	(7.6)	(15.9)
Wood and wood products	(14.3)	(47.0)	24.3	n.a.	55.1	(50.0)	92.8	(4.3)
Graphic arts and publishing	(18.6)	(15.4)	19.6	49.2	(63.3)	(11.9)	(6.8)	(7.0)
Chemical industry	(49.7)	(19.5)	14.7	194.0	40.4	31.1	19.7	(2.7)
Non-metallic minerals	28.0	(11.6)	22.0	10.8	39.3	15.5	4.5	14.2
Common metals	(7.7)	(40.8)	17.7	71.4	(72.8)	6.5	13.2	(6.7)
Machinery and equipment	(22.5)	(41.2)	16.1	272.9	(65.7)	10.7	12.0	(11.7)
Transport material	(40.9)	(45.9)	27.1	(17.8)	327.4	106.2	(53.7)	(24.1)
Optical. cinema and other apparatus	25.4	(30.7)	(10.6)	439.3	(42.6)	3.4	3.8	(1.0)
Other industries	11.3	(26.7)	2.4	139.8	36.1	2.9	(7.1)	(6.4)
Mining sector **(*)**	35.4	36.9	135.6	(4.8)	(28.1)	56.9	(6.0)	20.0

n.a. Not applicable.
(*) Does not include emeralds.
Source: DANE and Banco de la República.

C. Employment

At the end of 2002, the unemployment rate for the country as a whole had increased with respect the figure observed at the end of 2001: 15.6% as opposed to 13.5%. However, unemployment for the 13 major cities declined from 16.4% to 15.7% during the same period.

Unemployment in January 2003 was 18.2% or 2.2 percentage points below the rate in January 2002 (Figure 24). In terms of the national total, unemployment declined and was 1.8 percentage points less than in January 2002. At the same time, the 13 major cities saw their employment rate increase (Figure 25).

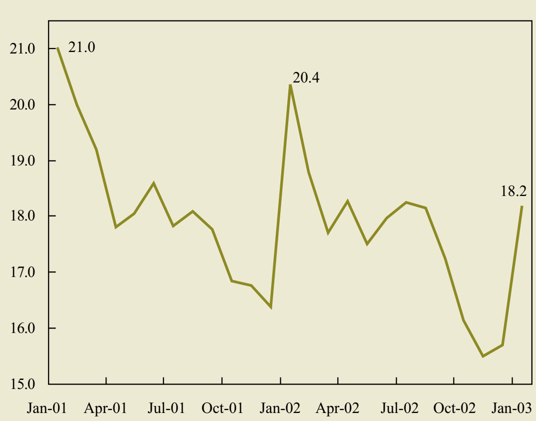
There are encouraging signs and the recovery in employment is expected to continue, particularly with the more flexible labor regulations approved by Congress. In fact, the expectation survey conducted by Banco de la República in January 2003 showed an increase in the percentage of entrepreneurs who plan to hire more employees or to make no staff changes, and a decline in those who intend to reduce their work force (Figure 26).

Table 18
Imports, According to Use or Economic Destination (pr)
(Millions of dollars, FOB)

	January-December		Variation	
	2001	2002	Absolute	%
Total Imports	12,009.8	11,899.2	(110.7)	(0.9)
Consumer Goods	2,356.8	2,521.0	164.2	7.0
Durables	1,457.3	1,409.1	(48.1)	(3.3)
Non-durables	899.5	1,111.8	212.3	23.6
Intermediate Goods	5,352.0	5,373.1	21.1	0.4
Fuel and lubricants (*)	173.2	174.1	0.9	0.5
For agriculture	444.0	438.1	(5.9)	(1.3)
For industry	4,734.9	4,761.0	26.1	0.6
Capital Goods	4,292.2	3,971.9	(320.4)	(7.5)
Construction materials	168.6	164.0	(4.6)	(2.7)
For agriculture	37.9	42.5	4.7	12.4
For industry	2,529.6	2,293.6	(236.0)	(9.3)
Transport equipment	1,556.2	1,471.7	(84.4)	(5.4)
Unclassified goods	8.8	33.2	24.4	276.6

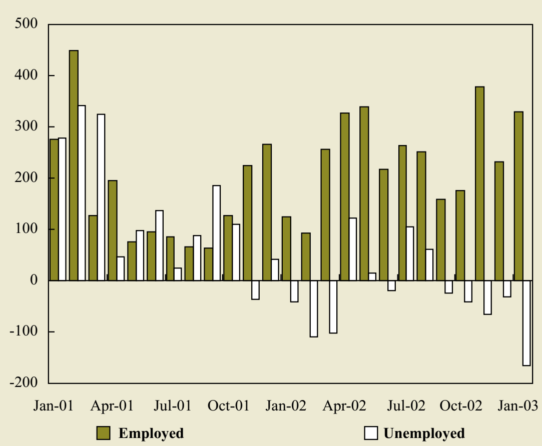
(pr) Preliminary.
(*) Includes petroleum and coal by-products.
Source: DANE and DIAN.

Figure 24
Unemployment Rate in 13 Cities
New Method
(Percentages)



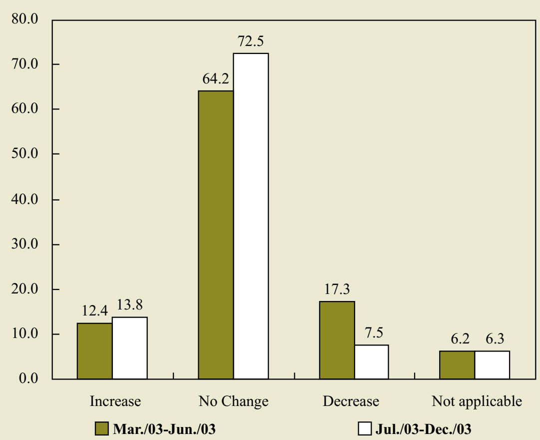
Source: DANE, Continuing Home Survey (ECH).

Figure 25
Annual Growth in the Number of Employed and Unemployed in the 13 Major Cities
(Thousands)



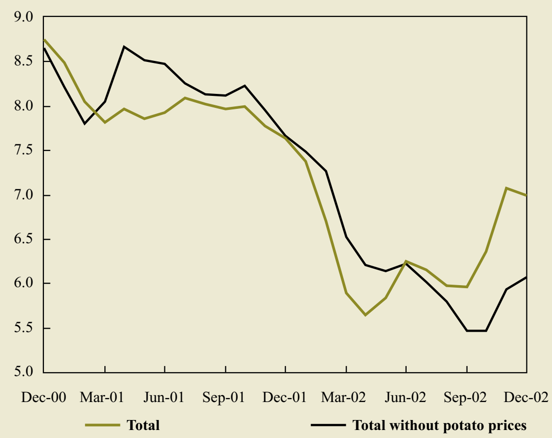
Source: DANE, Continuing Home Survey (ECH).

Figure 26
Short-term and Mid-term Trend in Company Personnel
(Percentage)



Source: Banco de la República Expectation Survey, January 2003.

Figure 27
Total Annual Inflation and Total without Potato Prices
(Percentage)



Source: DANE, Banco de la República calculations.

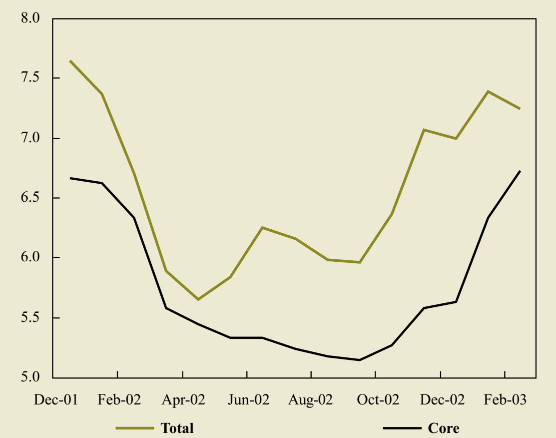
D. Inflation

Annual consumer inflation was 6.99% at the end of 2002. This is 0.99 percentage points above the inflation target set by the Board of Directors for that year, but less than consumer inflation in 2001 (7.7%). In December, the three measures of core inflation used by Banco de la República averaged 5.6%, which is less than the target. This difference is mainly due to the trend in food prices as a result of supply problems (particularly in the case of potatoes). If this product is excluded, total inflation was slightly above the target for the end of 2002 (Figure 27).

However, core inflation showed a tendency to increase as of October 2002 (Figure 28). Because the Colombian economy has operated for several years below its potential capacity for production, the recent acceleration in core inflation can be attributed to the inflationary pressure of costs associated largely with the effect of devaluation on prices for goods traded internationally.

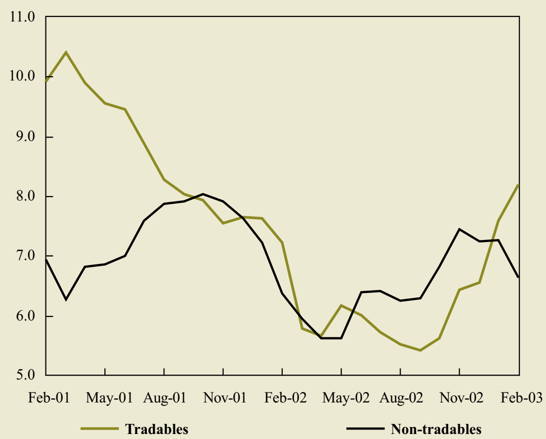
The importance of devaluation to the recent upswing in prices is evident in the trend in prices for tradable goods as opposed to non-tradables. During the early months of 2003, prices for non-tradables declined, while those for tradables continued to rise, as they had since late 2002 (Figure 29). Goods with a large measure of imported input, such as medicines, energy and fuel, jewelry and personal care products contributed the most to consumer inflation (Table 19). On the other hand, the PPI has been on the rise since mid-2002, boosted by imported goods, which

Figure 28
Trend in Annual Inflation, Total and Core
(Percentage)



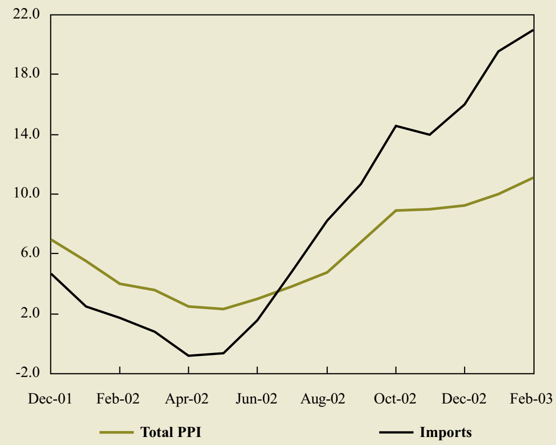
Source: DANE, Banco de la República calculations.

FIGURE 29
ANNUAL INFLATION IN TRADABLE AND NON-TRADABLE GOODS
(PERCENTAGE)



Source: Banco de la República, SGEE.

FIGURE 30
PRODUCER PRICE INDEX
(ANNUAL PERCENTAGE CHANGES)



Source: DANE, Banco de la República calculations.

showed an annual variation of 21.0% by February (Figure 30).

Expectations of inflation could increase due to the recent acceleration in core inflation and the failure to meet the inflation target for 2002. This fact, coupled with the temporary effect the change in the value-added tax will have on prices, could jeopardize future inflation targets. Accordingly, the Board of Directors adopted measures in the first quarter to keep prices on a path compatible with the inflation targets for this year and for 2004. These are in the 5% to 6% and 3.5% to 5.5% range, respectively. In January, the Board of Directors raised intervention interest rates by 100 bp to control this phenomenon and, in February, the Bank announced it would use up to US$1 b in reserves to control excessive adjustments in the exchange rate.

E. FISCAL OUTLOOK FOR 2003

The Fiscal Policy Council (CONFIS) set the target for the consolidated fiscal deficit in 2003 at 2.5% of GDP. This is 1.1% of GDP less than the deficit reported in 2002 (Table 20). Success of the adjustment program will reduce the central government deficit from 6.3% of GDP in 2002 to 4.7% of GDP at the end of 2003. According to the current schedule, income will increase by 16.0% and payments by 5.7%, assuming wages and pensions are frozen as a result of the Referendum Act. Tax revenue will increase by 18.2%. Income tax, external and internal VAT, and gasoline tax will be the most dynamic. Revenue from these levies is expected to increase by 12.4%, 12.6%, 12.3% and 11.3%, respectively. The additional income derived from the 2003 tax reform is estimated at 1.0% of GDP, and the two remaining installments on the tax for democratic security will generate revenue equivalent to 0.5% of GDP (Table 21).

As to spending, interest is expected to increase by 24.6% and operating expenses by 12.1%. A 2.6% decline is forecast for investment spending. As part of operating expenses, payments for personal services will increase by 1.7%, general expenses by 28.0% and transfers by 13.4%. The hike in general expenses is due to a build-up in the armed forces and the police. Revenue from the tax on net worth, which was established last year through declaration of a state of internal unrest, has been

TABLE 19
INFLATION INDICATORS
(ANNUAL PERCENTAGE CHANGES)

	Dec-01	Mar-02	Jun-02	Sep-02	Dec-02	Feb-03
I. CPI	7.6	5.9	6.2	6.0	7.0	7.2
Food	10.5	7.2	9.2	8.6	10.9	9.4
Housing	4.3	3.8	4.2	3.8	4.1	5.1
Clothing	2.6	2.2	1.1	0.9	0.7	1.0
Health	10.9	9.3	9.7	8.9	9.2	9.8
Education	10.2	9.3	6.7	6.4	6.5	5.2
Culture and recreation	7.1	7.0	5.9	4.7	5.3	4.3
Transportation	8.9	5.8	5.0	5.1	5.9	8.7
Miscellaneous expenses	7.6	6.7	6.8	7.7	9.0	9.2
II. Core Inflation 1/	6.7	5.6	5.3	5.1	5.6	6.7
CPI without food	6.5	5.3	5.0	4.9	5.4	6.3
Nucleus **2/**	7.4	6.0	5.8	5.6	6.2	7.4
CPI without staple foods. fuel and public utilities	6.1	5.4	5.1	5.0	5.3	6.3
III. PPI	6.9	3.6	2.9	6.8	9.3	11.1
By economic use or destination						
Intermediate consumption	5.8	2.9	1.2	6.2	9.9	13.3
End consumption	8.5	4.3	4.6	6.3	7.3	6.5
Capital goods	5.7	2.4	2.8	10.8	15.6	19.4
Construction materials	7.4	5.0	5.0	6.4	7.8	10.8
By source						
Produced and consumed	7.7	4.4	3.4	5.5	7.1	7.9
Imported	4.6	0.8	1.6	10.7	16.0	21.0
Exported **3/**	(7.9)	(7.1)	(2.4)	15.5	28.5	41.2
By industrial origin (CHU)						
Agriculture. forestry and fishing	7.6	2.4	2.1	6.8	9.2	7.1
Mining	(1.3)	1.7	2.1	22.4	33.3	49.4
Industrial manufacturing	7.0	3.9	3.2	6.3	8.6	11.0

1/ Average of the three core inflation indicators calculated by Banco de la República.

2/ Twenty percent (20%) of the weight of items exhibiting the most price volatility between January 1990 and April 1999 is excluded from the CPI.

3/ The total PPI does not include exported goods. It is calculated with the weighted sum of goods produced and consumed, plus imported goods.

Source: Banco de la República, SGEE. PPI, CPI and DANE tabulations.

earmarked for this purpose. The net loan would be Col$1,259 b in 2003, including Col$287 b for the Medellin Metro, Col$324 b for Corelca and Col$174 b for the Territorial Contingency Fund.

The national government's deficit will be financed with credit resources, use of the National Treasury portfolio and profits transferred by Banco de la República. Net external borrowing will come to

Table 20
Deficit in Effective Operations
Consolidated Public Sector

Item	Billions of Pesos		Percentage of GDP	
	2002	2003 (fcst.)	2002	2003 (fcst.)
Electricity	192.0	588.0	0.1	0.3
Emcali	108.0	167.0	0.1	0.1
EPM	270.0	423.0	0.1	0.2
FAEP	(390.0)	(622.0)	(0.2)	(0.3)
Ecopetrol	408.0	1,294.0	0.2	0.6
Telecom	267.0	4.0	0.1	0.0
Other Entities	656.0	1,460.0	0.3	0.7
Social Security	2,362.0	367.0	1.2	0.2
Regional and Local Entities	889.0	1,129.0	0.4	0.5
National Coffee Fund	(168.0)	45.0	(0.1)	0.0
1. Sub-total: Decentralized sector	4.594.0	4,855.0	2.2	2.2
2. National Government	(12,847.7)	(10,450.0)	(6.3)	(4.7)
A. Total non-financial public sector (SPNF) (1+2)	(8,253.7)	(5,595.0)	(4.0)	(2.5)
B. Cash losses and profits - Banco de la República	1,635.0	836.0	0.8	0.4
C. Cash losses and profits - Fogafin	601.0	298.0	0.3	0.1
D. Cost of reorganizing the financial sector	(1,181.0)	(1,030.0)	(0.6)	(0.5)
E. Adjustments	(173.0)	0.0	(0.1)	0.0
F. Total Consolidated Public Sector (A + B + C + D + E)	(7,371.7)	(5,491.0)	(3.6)	(2.5)

(Fcst.) Forecast
Source: Confis.

Col$2,695 b, thanks to Col$9,673 b in outlays and Col$6,978 b in amortization. Net internal borrowing will amount to Col$4,453 b, with Col$12,673 b in outlays and Col$8,220 b in amortization. The forecast for TES sales is Col$12,400 b. Col$5,500 b of this amount will be obtained through auctions and Col$6,900 b through agreed and forced investments.

Table 21
Effective Central Government Operations
(Billions of pesos)

	2002	2003 (fsct.)	Growth 2003/2002
I. Total Revenue (A + B + C + D + E)	30,344.0	35,195.0	16.0
A. Tax revenue	27,086.7	32,024.0	18.2
Income tax	10,626.4	11,943.0	12.4
Internal VAT	7,363.7	8,266.0	12.3
External VAT	3,264.8	3,675.0	12.6
Customs	2,083.5	2,191.0	5.2
Gas tax	976.6	1,087.0	11.3
Tax on financial transactions	1,443.2	1,518.0	5.2
Democratic security tax	1,240.7	1,195.0	(3.7)
Others	87.8	56.0	(36.2)
Tax reform	0.0	2,093.0	n.a
B. Non-tax revenue	306.8	160.0	(47.8)
C. Special funds	315.9	334.0	5.7
D. Capital resources	2,523.6	2,567.0	1.7
Financial yields	553.7	662.0	19.6
Financial surpluses	1,501.8	1,659.0	10.5
Others	468.1	246.0	(47.4)
E. E. Accrued income	111.0	110.0	(0.9)
II. Total Expenses (A + B + C + D + E + F)	43,191.7	45,645.0	5.7
A. Interest	7,902.4	9,844.0	24.6
External	3,621.5	4,556.0	25.8
Internal	4,280.9	5,288.0	23.5
B. Operating Costs	29,335.4	32,892.0	12.1
Personal services	5,719.6	5,819.0	1.7
General expenses	1,982.1	2,537.0	28.0
Transfers	21,633.7	24,536.0	13.4
C. Investment	2,955.0	2,877.0	(2.6)
D. Net loan	1,258.7	1,259.0	0.0
E. E. Floating debt	1,319.5	(1,648.0)	(224.9)
F. F. Indexation of TES B denominated in UVR	420.7	421.0	0.1
III. Deficit (-) or surplus (+) (I - II) 1/	(12,847.7)	(10,450.0)	(18.7)
Cost of restructuring the financial sector	1,181.2	1,030.0	(12.8)
IV. Financing (A + B + C + D)	(14,028.9)	(11,480.0)	(18.2)
A. Net external credit	(19.0)	2,695.0	14,284.2)
Outlays	5,094.0	9,673.0	89.9
Amortization	5,113.0	6,978.0	36.5
B. Net internal credit	6,563.0	4,453.0	(32.1)
Outlays	13,704.0	12,673.0	(7.5)
Amortization	7,141.0	8,220.0	15.1
C. Banco de la República earnings	1,226.0	1,481.4	21.3
D. Others	6,258.9	2,850.6	(54.5)
V. Deficit as a Percentage of GDP	(6.3)	(4.7)	

(fcst) Forecast.
1/ Does not include the cost of restructuring the financial sector.
Source: Confis.

IV

Colombia's International Reserves and their Recent Management

A. Role of international reserves in macroeconomic management

International reserves make it possible to absorb external shocks by limiting their negative effects on economic activity and the income of the population. If the country has no reserves to deal with negative external shocks, sharper adjustments will be required to adapt the economy to a situation with less import capacity and to generate the resources needed to service the debt. With a system of fixed or semi-fixed exchange rates, the authorities would have to take steps to generate a balance-of-payments surplus. This would lead to a decline in aggregate spending and product; that is, less economic activity.

With a free floating exchange system, most of the required adjustment occurs through devaluation in the exchange rate. Although an exchange adjustment helps to increase exports, it usually has recessive effects on product. Devaluation raises financial costs and undermines the balance sheets of the public sector and private companies with debts in dollars. It also creates inflationary pressure, lowers real wages, raises nominal interest rates, and is generally accompanied by capital flight. International reserves enable the country to absorb the shock of these effects and to make the necessary adjustment in the exchange rate at a more gradual pace, with fewer economic and social costs.

In effect, by providing the international liquidity needed to face a drastic reduction in financing flows or a sharp decline in exports, international reserves help to avoid paralysis of the productive apparatus or an unbounded increase in production costs with ensuing negative effects on prices and real wages.

International reserves also enable the country to deal with events such as natural disasters or wars, which might affect its export possibilities, without ceasing to address its external commitments.

International reserves broaden access to external financing. In times of instability and uncertainty, they are loan security or collateral. International financial markets suffer from a tremendous lack of information and are highly susceptible to changes in the perception of market risk. Therefore, the capital foreign lenders are willing to invest in small economies, like the one in Colombia, is highly volatile. Occasionally, loans of this type are suspended abruptly and for long periods when investors believe countries will not honor their external commitments or when confidence has declined. This can happen when countries face negative external shocks, some of which have nothing to do with their own economies but are a product of the "contagion" that often affects these markets.

Under these conditions, international reserves are a guarantee that the nation will honor its short-term debt and commitment to pay. Consequently, the greater the reserves, the more access to markets.

On the contrary, if reserves fall below the level regarded as "adequate" by international lenders, markets close and the country risk premium increases[23]. This level fluctuates according to developments in the international environment, the relative size of the external debt, the amortization profile, the strength of economic growth and other variables.

In a small economy, the amount of reserves that accumulate is not dependent solely on the decision of economic authorities. The decisions of lenders in terms of how much to loan and on what terms also influence the extent to which a country can accumulate reserves during a given period[24].

When deciding on the required amount of reserves, economic authorities must consider the costs and benefits of maintaining international reserves. An adequate level of reserves is one that equals these costs and benefits. Therefore, the policy on managing reserves should compare not only the opportunity cost of the various alternatives for investing reserves (consumption, investment or debt payment) but also what it costs the economy to be without adequate reserves. Allowing reserves to fall to levels that offer no guarantee against external shocks has a high economic and social price, and can lead to difficult situations that question the viability of a country's economy and policy. This was illustrated by the recent experience in Argentina and Ecuador. The policy for managing Colombia's reserves is based on these fundamental principles.

[23] However, as illustrated by Arellano and Mendoza (2002), not all the restrictions international financial systems imposed on countries for access to external financing translate into guarantee requirements. In some cases, these restrictions imply requirements with respect to generating income from tradable goods. At any rate, guarantee requirements constitute one of the aspects that justifies accumulating reserves . See "Credit Frictions and ´Sudden Stops´in Small Open Economies: An Equilibrium Business-cycle Framework for Emerging Market Crises," in *NBER*, Working Paper No. W8880, April.

[24] See García, Pl. (1999), "Demand for Reserves under International Capital Mobility," in *Banco de Chile*, Working Document No. 58, December.

B. Recent management of international reserves

1. Strategy for Managing International Reserves

The way the Bank manages international reserves is part of a more general macroeconomic strategy developed in coordination with the Ministry of Finance and Public Credit. This strategy has three main elements: 1) application of a monetary policy with an inflation target, 2) permanence of a floating exchange rate, and 3) effective management of international reserves.

These three components of the macroeconomic strategy seek to guaranty stability of the economy as a fundamental requirement for economic growth and social development. The primary justification for selecting this strategy is its proven capacity to equip the economy with tools for dealing with external shocks and domestic fluctuations, compared with other policy instruments. This has been demonstrated by international experience.

The strategy for managing international reserves in Colombia has three objectives: a) to *protect* the economy against possible external shocks that might affect its current account or capital flows; b) to invest the country's reserves from the perspective of a central bank, *minimizing risk* of loss and ensuring that international liquidity is available when needed; and c) to guarantee *effective* provision of international liquidity when conditions warrant using a portion of the country's reserves for this purpose.

To implement this strategy, the Board of Directors has defined a set of instruments to accumulate or deaccumulate international reserves and to control volatility of the exchange rate. Criteria for managing the country's international reserves have also been defined, as explained in this chapter. The following are the initial instruments.

- *Accumulation of international reserves*. Banco de la República is authorized to hold monthly auctions of call options to accumulate international reserves in amounts determined by the Board of Directors. These options may be exercised up until the last working day of the month subsequent to the one in which auction is conducted. If call options are to be exercised, the representative market rate must be below its average for the last 20 working days. While in effect, call options may be exercised all or in part. The auction must be convened or announced at least one working day in advance.

- *Deaccumulation of international reserves*. Occasionally, in the case of put options in amounts determined by the Board of Directors, the Bank may convene an auction less than one day in advance. Options to deaccumulate reserves may be exercised during a period of one month, as of the next working day after the auction. If these options are to be exercised all or in part, the representative market rate must be above its moving average for the last 20 working days.

- *Controlling exchange rate volatility*. Auctions for this purpose may be convoked only if the representative market rate is 4% or more below (call options) or above (put options) the moving average for the last 20 working days. The quota is determined by the Board of Directors and is currently US$180 m. The term for exercise of these options is one month, as of the auction date. They may be exercised on any working day during that period, provided the aforementioned criteria are met. New auctions to control volatility may be held even if all previously auctioned options have not been exercised. The amount of the new volatility auctions is determined at the Bank's discretion and stated in the announcement.

2. Current level of international reserves and criteria for their management

Colombia reported US$10,840.5 m in net international reserves at December 2002. This is US$648.7 m more than at December 2001[25]. The investment portfolio accounts for the bulk of these reserves: 90.6% of the total, or US$9,825.7 m at the end of 2002. The remainder includes: i) US$690.9 m in the country's reserve position with the International Monetary Fund and contributions to the Latin American Reserve Fund, ii) US$154.8 m in special drawing rights (SDR), iii) US$133.8 m in gold, Andean pesos and positive balances from international agreements, and iv) US$38.8 m in demand deposits and cash. At December 2002, short-term external liabilities stood at US$3.6 m (Table 22).

The three criteria defined by Banco de la República for managing international reserves are, in order of importance, security, liquidity and profitability. Based on these standards and to ensure the country is able to honor its external liabilities, reserves are invested in financial assets on a broad secondary market, while a portion are kept as working capital to guarantee immediate availability.

Based on these guidelines, external financial institutions are appointed to manage part of the portfolio in which the country's international reserves are invested. These institutions are scrutinized with care and selected according to their business experience, the size of the funds they manage, and the extent of their capacity for management and risk control. As mentioned in previous reports, their efforts have improved the profitability of international reserves through specialized management[26].

With respect to the investment portfolio as a whole, Banco de la República directly managed US$4,806.2 m (48.9% of the total investment tranche), including US$787.8 m in working capital by the end of 2002.

[25] This amount is equal to total international reserves, or gross reserves minus the Bank's external short-term liabilities. The latter are comprised of sight liabilities in foreign currency with non-resident agents.

[26] A number of central banks, such as those in Brazil and Chile, 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.

TABLE 22
PRINCIPAL COMPONENTS OF INTERNATIONAL RESERVES
(MILLIONS OF DOLLARS)

Description	December 2000	Share %	December 2001	Share %	December 2002	Share %
Cash	30.0	0.3	30.3	0.3	38.8	0.4
Vault	28.5	0.3	29.9	0.3	36.4	0.3
Demand deposits	1.5	0.0	0.5	0.0	2.4	0.0
Investments	8,083.2	89.8	9,317.0	91.4	9,825.7	90.6
Managed directly	5,173.0	57.5	6,236.3	61.2	4,806.3	44.3
Delegated management	2,910.2	32.3	3,080.7	30.2	5,019.5	46.3
Gold	89.4	1.0	90.6	0.9	112.1	1.0
Vault	0.0	0.0	0.0	0.0	0.0	0.0
Custody	89.4	1.0	90.6	0.9	112.1	1.0
International Monetary Fund	508.1	5.6	495.9	4.9	542.0	5.0
Special drawing rights	135.7	1.5	137.1	1.3	154.8	1.4
Reserve position	372.4	4.1	358.9	3.5	387.1	3.6
Latin American Reserve Fund	285.8	3.2	309.1	3.0	323.8	3.0
Contributions	265.8	3.0	289.1	2.8	303.8	2.8
Andean pesos	20.0	0.2	20.0	0.2	20.0	0.2
International Agreements	9.7	0.1	2.2	0.0	1.7	0.0
Total Gross Reserves	9,006.1	100.0	10,245.1	100.5	10,844.1	100.0
Short-term Liabilities	2.0	0.0	53.3	0.5	3.6	0.0
International agreements	0.0	0.0	0.0	0.0	0.0	0.0
Foreign banks	0.0	0.0	50.0	0.5	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 purchases	0.0	0.0	0.0	0.0	0.0	0.0
Liability accrual and valuation	2.0	0.0	3.3	0.0	3.6	0.0
Total Net Reserves	9,004.1	100.0	10,191.8	100.0	10,840.5	100.0

Source: Banco de la República.

Barclays Global Investors, JP Morgan Investment Management Inc., Goldman Sachs Asset Management and Morgan Stanley Investments LP managed the remaining 51.1% (US$5,019.5 m)[27].

During 2002, the reference index used to evaluate management of the portion of Colombia's international reserves administered by Barclays Global Investors and JP Morgan Investment Management Inc. showed a yield of 9.82%. However, both achieved annual yields above 10%: Barclays Global Investors obtained 10.58% annual yield and JP Morgan Investment Management, 10.07%. The reference index for the portfolio managed by Goldman Sachs Asset Management was 8.05% and the effective yield was 8.76%. In November and December, Morgan Stanley Investment LP reported 0.65% yield compared with the reference index of 0.67% for the same period. The portion managed by Banco de la República (not including working capital) yielded 7.54% during 2002

[27] On October 31, 2002, US$1,225 m were delegated to the new administrator, *Morgan Stanley Investments LP*. At the same time, the portfolio managed by Goldman Sachs Asset Management was increased by US$625 m, the portion managed by JP Morgan Investment Management was reduced by US$118 m, and the percentage managed by Barclays Global Investors was reduced by US$110 m.

as opposed to 7.58% for the reference index used to evaluate management of this portion[28]. The yield on working capital was 0.86%.

The credit risk for the investment portfolio as a whole is situated primarily in the sovereign sector, including short and long-term holdings, with 73.3% of the portfolio. The remainder is distributed among the other sectors: 12.9% in the banking sector, 5.6% in the corporate sector and 8.2% in the supranational sector. At December 2002, distribution of this risk according to ratings by specialized agencies was as follows: 33.0% P-1, 57.7% AAA, 5.4% AA, 0.3% A and 3.6% BIS[29]. The credit risk distribution reflects the security with which international reserves are managed.

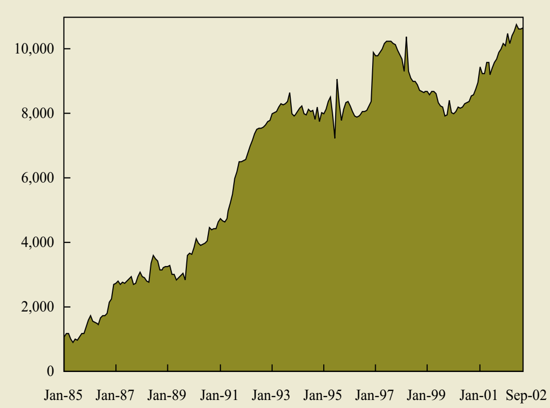
Banco de la República and the external managers secured US$804.8 m in total net yield on the international reserve investment portfolio, including US$359.0 m in income from accruals and US$445.8 m in earnings derived from appraisal of international reserves at market prices. Most of the appraisal earnings were due to developments in the euro, the yen and SDRs against the dollar (US$260 m), the appraisal of investments in bonds resulting from the reduction in interest rates, and the increase in the price of gold on international markets (US$185.8 m)[30].

3. Recent Developments in International Reserves

Figure 31 shows the trend in Colombia's international reserves between 1985 and 2002. As illustrated, the country has experienced several periods of reserve accumulation and deaccumulation in the last 17 years, particularly during the nineties. The period between 1998 and late 1999 was a time of accelerated deaccumulation coinciding with the Russian and Asian crises and with defense of the exchange band. Since then, the level of reserves has increased gradually from a minimum of US$7,899.6 m in September 1999 to US$10,840.5 m in December 2002.

The process to accumulate international reserves was part of an overall strategy adopted by the Bank to manage the country's reserves in a way that would reduce external vulnerability, which had increased substantially. Several of the country's debt indicators deteriorated sharply during those years (Figure 32). The rise in external vulnerability was also evident in an increase in the country risk premium during this period, when it matched the levels of other Latin American countries, having once been less (Figure 33).

FIGURE 31
COLOMBIA'S GROSS INTERNATIONAL RESERVES
1985-2002
(MILLIONS OF DOLLARS)



Source: Banco de la República.

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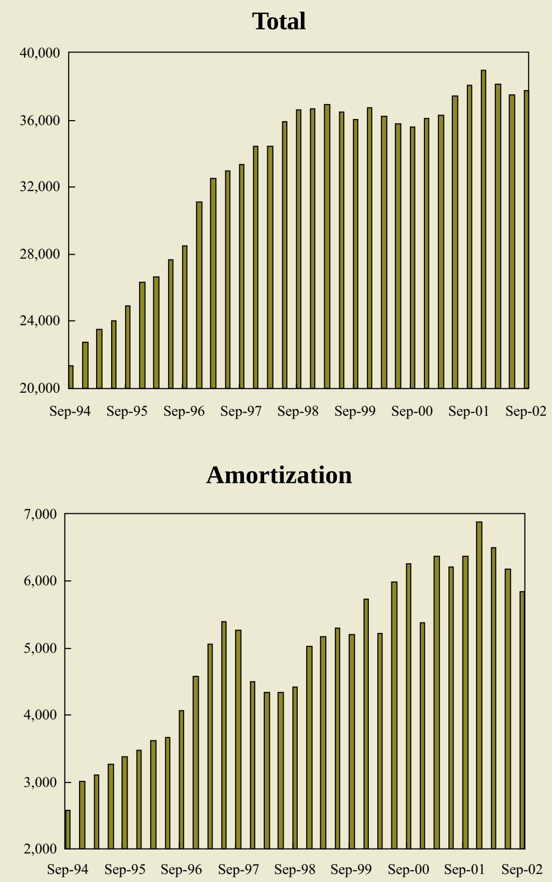
28 The reference portfolios , which are used to measure the performance of the externally-managed portion, are comprised of assets denominated in US dollars, euros and yen. These assets are invested in a combination of money market instruments and in one-to-five-year government bonds. At December 31, the average duration of the total investment tranche was 1.7 years and the exchange composition was 86% in US dollars, 11% in euros and 3% in yen.

29 Standard & Poors, Moody's and Fitch Ratings. P-1 is Moody's rating for a first-order system. It is used to rate the ability of issuers to honor their short-term liabilities (original maturities under one year). The P-1 rating is given to issuers with the highest likelihood of repayment.

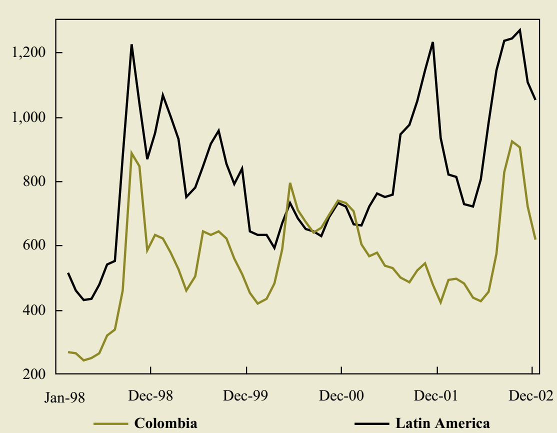
30 The price of good delivery gold (99.5% pure) on the international market (FIX A.M. of London) rose from US$276.5/ounce at December 31, 2001 to US$342.75/ounce at December 31, 2002.

Figure 32
Colombian External Debt: 1994-2002
(Millions of Dollars)



Source: Banco de la República calculations, based on IMF information.

Figure 33
Country Risk Premium for Colombia and Other Latin American Countries 1998-2002
(Basis Points)



Source: Ministry of Finance and Public Credit and Bloomberg.

Total accumulation of net international reserves in 2002, including appreciation, came to US$648.7 m. Essentially, this includes US$804.9 m in net yield on invested international reserves and US$252 m in foreign currency purchased through the exercise of options to accumulate reserves. At the same time US$414 m were sold to control exchange rate volatility.

Given the developments in the nominal exchange rate (see Chapter II of this report), several auctions of put options were held between January and May 2002 to accumulate US$349.9 m in international reserves; US$201.5 m of these options were exercised (Table 23). It was not until October, when the markets stabilized, that US$50 m. in put options were exercised for the sale of foreign currency to Banco de la República.

Due to the tendency in the exchange rate, three auctions of call options on Banco de la República to control exchange volatility were held in the months of July, August and October for US$180 m each. Exchange intermediaries exercised US$414.0 m of these options (Table 24).

The peso continued to devaluate quickly during the first months of 2003, even though the financial markets had reopened in December and the government had completed it external financing for the year. The political and economic crisis in Venezuela continued to aggravate the trend in the exchange rate and exerted new pressure on prices, placing inflation in January at the highest level in the last four years. Although the exchange rate has responded to the effect of these shocks, it tends to exhibit an excessive volatility that only magnifies them. The repercussions of exchange instability are many and extremely negative. They tend to be reflected in prices within the economy, interest rates and inflation, and can prompt agents to adopt poor decisions on consumption, investment and savings. In this sense they also have an undesired effect on economic performance in the longer term.

To soften the effect of external shocks on the different economic variables, including inflation, the

Table 23
Auctions of Put Options on Dollars to Banco de la República to Accumulate+ International Reserves (*)

Auction date	Amount Presented	Amount Aproved	Quota	Cut premium	Amount exercised
	(Millions of Dollars)			(Pesos/US Thousands)	(Millions of Dollars)
1999	924.5	200.0	200.0	4,000.0	200.0
2000	4,818.8	1,014.9	1,060.0	32,230.0	318.6
2001	3,242.0	834.9	835.0	67,660.0	629.2
2002 Jan.	188.5	50.0	50.0	8,000.0	50.0
Feb.	211.5	49.9	50.0	10,000.0	1.5
Mar.	107.5	50.0	50.0	8,560.0	50.0
Apr.	277.8	100.0	100.0	8,300.0	100.0
May.	275.0	100.0	100.0	3,566.0	0.0
Jun.	388.0	100.0	100.0	6,010.0	0.0
Jul.	243.0	100.0	100.0	3,510.0	0.0
Aug.	102.5	50.0	50.0	650.0	0.0
Sep.	165.0	50.0	50.0	4,010.0	0.0
Oct.	133.5	50.0	50.0	2,586.0	50.0
Nov.	0.0	0.0	0.0	0.0	0.0
Dec.	142.0	50.0	50.0	4,000.0	0.0
Accum. at Dec. 2002	2,234.3	749.9	750.0	59,192.0	251.5

(*) Options are auctioned on the last working day of the previous month.
Source: Banco de la República.

Bank recently adopted one of the measures contemplated in the rules designed by its Board of Directors to deaccumulate international reserves. It was decided that up to US$1 b of the country's international reserves would be used to intervene in the exchange market to absorb the negative impact of excessive exchange instability on the economy.

The Bank played a role by supplying liquidity to the exchange market so as to avoid over-adjustments in the exchange rate, which can jeopardize inflation targets. Because the country's reserve position is good for almost all indicators of liquidity, as will be analyzed later, there is a margin for deaccumulation without exerting a negative effect on the country's liquidity position or sending adverse signals to investors.

C. Reserve indicators and comparisons with other countries

Another way to assess reserve levels is to compare certain liquidity indicators with generally accepted international criteria, as a basis for determining "adequate" levels for Colombia.

Table 24
Auctions of Call Options on Foreign Currency by Banco de la República to Control Exchange Volatility

Auction date	Amount Presentado	Amount Aprobado	Quota	Cut premium	Amount Exercised
	(Millions of Dollars)			(Pesos/US Thousands)	(*)
2002 Jul.	354	180	180	3,800	180
Aug.	453	180	180	4,220	110
Sep.					
Oct.	599	180	180	5,157	125
Nov.	0	0	0	0	0
Dec.	0	0	0	0	0
Acum. Dec 2002	1,406	540	540	13,177	414

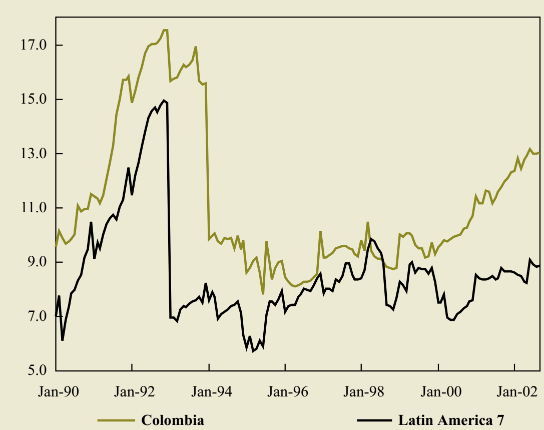
(*) Options to control volatility may be exercised within one month of the auction date. Banco de la República may convoke new auctions even if all previously auctioned options have not been exercised.
Source: Banco de la República.

1. International Reserves and GDP

The ratio of international reserves to GDP allows for comparisons with other emerging countries. As illustrated in Table 24, Colombia had a higher reserve/GDP ratio in 2001 than most of the other countries in the region, with the exception of Chile and Peru. The same was true in the 1990-2002 period. Figure 34 shows the ratio for Colombia and the average for the seven major economies in the region.

However, a comparison with the other emerging countries shows a different situation. While the ratio of reserves to GDP exceeded the average for the emerging countries at the onset of the nineties, this was not the case at the start of 2000. Other countries accumulated more reserves than Colombia during this period (Table 25).

Figure 34
International Reserves of Colombia and Latin America 7
(As a percentage of GDP)



Source: Calculations by Banco de la República, based on IMF information.
Latin America 7: Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela

2. Reserves as Months of Imports

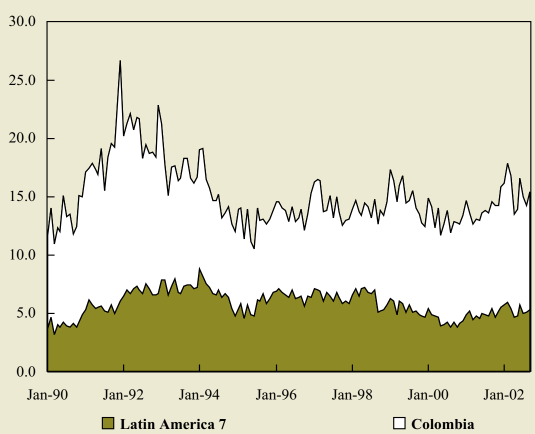
At the end of 2002, Colombia's ratio of reserves to imports exceeded the accepted international standard, which is three months of imports (Figure 35). The same occurred with the average of other Latin American countries. Their indicator was five months of imports. During the period from 1990 to 2002, Colombia was characterized as being above the average of the seven major economies on the continent.

TABLE 25
INTERNATIONAL RESERVES OF EMERGING COUNTRIES 1990-2001
(BILLIONS OF DOLLARS)

	Average 1990-1994		Average 1995-1999		2000		2001	
	Level	GDP %	Level	GDP %	Level	GDP%	Level	GDP %
Emerging Countries	490.2	9.3	943.3	13.9	1,206.4	16.6	1,321.7	18.2
Asia	298.8	15.3	553.3	19.2	728.3	22.8	807.6	25.3
China	34.5	7.4	127.0	14.4	168.9	15.6	216.3	18.7
Taiwán	83.3	41.3	92.3	33.3	107.4	34.7	122.8	43.5
Korea	18.3	5.6	42.6	10.4	96.2	20.8	102.8	24.3
Philippines	4.0	7.4	9.5	12.5	13.4	17.9	13.8	19.3
Thailand	21.1	18.7	32.7	22.7	32.1	26.3	32.5	28.3
Malaysia	18.2	29.9	25.6	29.8	29.6	32.8	30.5	34.7
Indonesia	10.3	7.2	19.7	13.1	28.6	18.8	27.4	18.8
Latin America	84.0	6.3	154.7	8.3	155.6	8.0	158.2	8.3
Argentina	10.0	4.6	21.2	7.4	25.1	8.8	14.6	5.4
Brazil	21.3	4.7	47.4	6.6	31.5	5.3	35.8	7.1
Mexico	15.6	4.5	25.7	6.6	35.5	6.1	44.8	7.2
Venezuela	9.7	17.5	11.9	13.7	13.6	11.2	9.7	7.7
Chile	9.1	20.1	15.3	20.0	14.7	19.7	14.2	21.4
Colombia	7.0	13.4	8.9	9.4	8.9	11.5	10.2	12.3
Peru	3.4	9.1	9.7	17.5	8.4	15.9	8.7	16.5
Emerging European Countries	31.2	3.8	101.2	10.0	132.8	13.8	145.4	14.5
Poland	4.5	5.6	21.4	14.5	26.7	16.9	25.8	14.6
Czech Republic	5.1	13.2	12.3	22.4	13.0	25.4	14.4	25.3
Hungary	4.6	12.0	10.1	21.9	11.2	24.0	10.7	20.7
Turkey	6.4	4.1	18.3	9.6	22.7	11.2	19.0	12.8
Emerging African Countries	20.4	5.2	36.8	8.6	53.1	12.3	64.7	15.4
South Africa	1.4	1.1	4.1	2.9	6.4	5.0	6.3	5.6

Source: Taken from *The World Economic Outlook*, IMF.

FIGURE 35
INTERNATIONAL RESERVES OF COLOMBIA AND LATIN AMERICA 1990-2002



Source: Banco de la República, based on IMF data.

3. International Reserves and External Debt

The ratio of international reserves to external debt is more an indicator of solvency than liquidity. Its use in assessing the level of reserves became generalized after the Russian and Asian crises and it is now part of early warning systems to predict crisis[31]. Although there is no reference criterion, as is the case with other indicators, its development in time is extremely important for drawing attention to the possible vulnerability problems exhibited by a country.

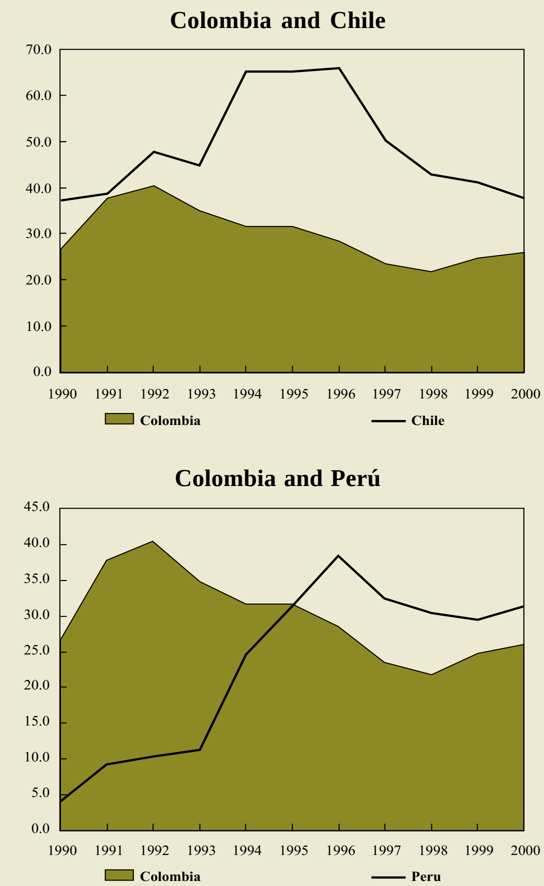
[31] IMF (2000), "Debt and Reserve-related Indicators of External Vulnerability" in *Policy Development and Review Department and Consultations with other Departments*, International Monetary Fund, May.

In the early nineties, Colombia's ratio of international reserves to its total external debt was above the average for the largest Latin American countries. The rapid increase in the country's external debt and the decline in international reserves changed this situation, but the indicator for Colombia has improved gradually since 2001 (Figure 36). In addition, a comparison with the indicator for countries such as Chile shows Colombia was in a less favorable position. During the last few years, Peru has achieved a better position in this respect than Colombia (Figure 37).

Figure 38 offers a comparison of the reserve/amortization indicator of the following year for the largest Latin American countries. This is the indicator most often used internationally to assess a country's liquidity. According to the reference standard, it should be equal to or above one. Brazil and Argentina failed to meet this requiremen t in 2002. Other countries such as Venezuela, Chile and Peru were above what is considered to be the adequate level, while Colombia and Mexico had a ratio very near the reference standard.

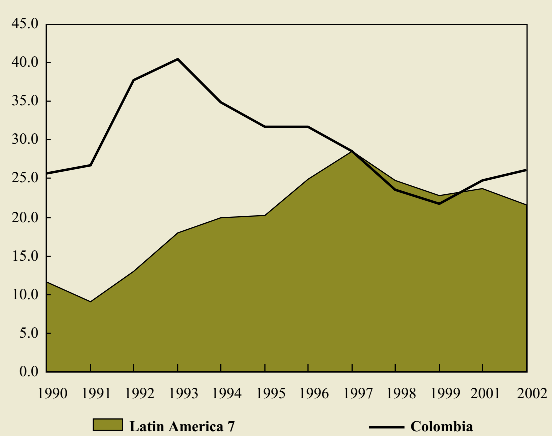
Figure 39 illustrates the reserve/amortization indicator for Colombia during the period from 1994 to 2002. A comparison between reserves and amortization for the following year shows the indicator was below

FIGURE 37
RESERVES AS A PROPORTION OF THE EXTERNAL DEBT 1990-2002



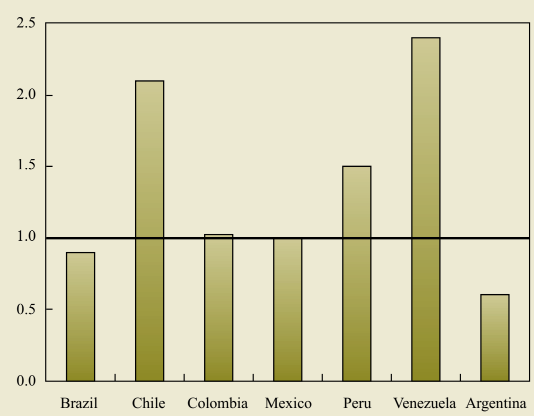
Source: Banco de la República calculations, based on IMF data.

FIGURE 36
COLOMBIAN AND LATIN AMERICAN RESERVES AS A PORTION OF THE EXTERNAL DEBT 1990-2002



Source: Banco de la República calculations, based on ECLAC and IMF data.

FIGURE 38
INTERNATIONAL RESERVES OF COLOMBIA AND LATIN AMERICA AS A PROPORTION OF DEBT AMORTIZATION IN THE FOLLOWING YEAR 2002



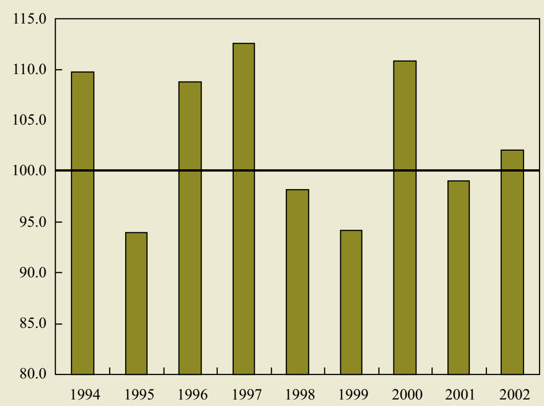
Source: Banco de la República calculations, based on IMF data.

the required level in 1995, 1998, 1999 and 2001. In 2002, it was slightly above what is considered adequate.

By December 2002, Colombia had US$10,840.5 m in international reserves. This is sufficient to cover US$10,166 m in debt amortization payable in 2003 and is 25.7% above the amount of amortization scheduled for 2004 (US$8,622 m).

In this respect, an anticipated deaccumulation of up to US$1 b in international reserves, the transfer of US$220 m in profits to the government, and accumulation from yield on reserves, according to the most recent projections, would place reserves at a level sufficient to prevent the reserve/amortization indicator from falling. It would still be above the unit.

FIGURE 39
COLOMBIA: INDICATOR OF RESERVES / DEBT AMORTIZATION 1994-2002
(PERCENTAGE)



Source: Banco de la República.

V

Financial Position of Banco de la República

A. Performance in 2002

Banco de la República reported Col$40,685.4 b in assets, with 27.6% annual growth (Col$8,810.9 b) (Table 26). This variation is explained by several factors; namely, (a) an increase of Col$6,890.6 b in international reserves due to an accumulation of US$575.7 million in reserves and devaluation of the peso against the dollar; (b) more of a demand for repos and temporary liquidity support on the part of the financial system (Col$1,100.6 b); c) growth in investments originating with the purchase of Col$315.9 b in TES; d) a positive change in other assets (Col$301.5 b), primarily due to appreciation of art works and cultural elements (Col$135.4 b) and the portfolio representative of pension funds (Col$108.6 b.); e) an increase in the value of contributions to international agencies (Col$198.2 b) because of the upsurge in the peso-dollar exchange rate; f) an increase in accounts receivable (Col$15.6 b); and g) a decline in the credit portfolio balance (Col$11.5 b).

The bank reported Col$17,701.5 b in total liabilities and Col$22,984.0 b in equity. Annual growth of these items came to Col$2,412.9 b and Col$6,398.1 b, respectively. The expansion in liabilities was due mainly to an increase of Col$2,456.7 b (21.09%) in the monetary base. The variation in equity originated with the peso-dollar exchange adjustment in international reserves (Col$5,413.8 b) and with the balancing entry for property appreciation (Col$138.9 b).

Banco de la República earned Col$2,071.3 b in profits during 2002 (Table 27), thanks to Col$2,827.2 b in income and Col$755.8 b in outlays. Income rose by 52.2%, primarily as a result of: a) Col$2,044.2 b in yield on international reserves, which is the peso equivalent of the yield in dollars (US$804.8 m); b) Col$274.8 b in appreciation on TES from monetary expansion operations; c) Col$259.9 b from the exchange difference[32]; d) Col$117.7 b in commissions on banking and trust services; and e) Col$48.1 b in interest on temporary purchases of securities (repos) and liquidity quotas. As to outlays, the major items were a) Col$161.2 b in personnel expenses, b) Col$139.3 b in exchange difference[33], c) Col$123.9 b for payments on deposit accounts, d) Col$91.7 b for retirement pensions and e) Col$43.9 b for general expenses[34]. The increase in outlays is explained essentially by the increase in exchange differences, in the costs and distribution of currency, and in payments for retirement pensions, oswing to a change in the formula used by the Banking Superintendent to calculate actuarial liability. Personnel expenses rose by only 5.5%, while general expenses declined by 2.6%.

32 Pertains to appraisal of assets denominated in foreign currency that are not part of international reserves.

33 Refers to appraisal of liabilities denominated in foreign currency that do not affect international reserves.

34 Includes public utilities, cleaning, surveillance, maintenance and repairs, currency transport, stationary, advertising, publicity and the like.

Table 26
General Balance Sheet - Banco de la República Financial Performance
(Billions of Pesos)

	2001		2002	
	Balance	**Share %**	**Balance**	**Share %**
Assets	31.874,5	100.0	40,685.4	100.0
Gross international reserves	23,634.5	74.1	30,525.0	75.0
Contributions with international organizations	2,482.3	7.8	2,680.5	6.6
Investments	2,056.0	6.5	2,371.9	5.8
Consolidated public debt	240.3	0.8	162.6	0.4
Public sector - monetary regulation	1,730.2	5.4	2,154.6	5.3
Public bank capitalization bonds and others	85.4	0.3	54.7	0.1
Loan portfolio	141.7	0.4	130.2	0.3
National government-public sector	3.4	0.0	3.1	0.0
Banks	3.5	0.0	1.8	0.0
Financial corporations	132.9	0.4	127.6	0.3
Savings and loan associations	0.0	0.0	0.0	0.0
Other loans	14.5	0.0	0.9	0.0
Provisions	(12.6)		(3.2)	(0.0)
Repurchase Agreements - Temporary liquidity support	1,111.4	3.5	2,212.0	5.4
Accounts receivable	94.3	0.3	110.0	0.3
Other net assets	2,354.3	7.4	2,655.8	6.5
Liabilities and Net Worth	31,874.5	100.0	40,685.4	100.0
Liabilities	15,288.6	48.0	17,701.5	43.5
Foreign currency liabilities affecting international reserves	123.0	0.4	10.2	0.0
Money supply	11,647.9	36.5	14,104.6	34.7
Notes in circulation	9,990.8	31.3	12,013.0	29.5
Treasury coins	357.7	1.1	349.7	0.9
Bank reserve requirement deposits	1,118.5	3.5	1,622.3	4.0
Current account deposits from rest of financial sector	180.9	0.6	119.6	0.3
Other deposits	244.5	0.8	179.6	0.4
National government - National Treasury	97.9	0.3	39.8	0.1
International agency liabilities	1,980.2	6.2	2,060.9	5.1
External credit liabilities	183.9	0.6	203.1	0.5
Securities for monetary and exchange control	162.7	0.5	134.6	0.3
Reverse Repos	161.8	0.5	134.0	0.3
Exchange certificates	0.0	0.0	0.0	0.0
Foreign currency funding certificates & Dep. Res. 5/97 J.D.	0.8	0.0	0.5	0.0
Others	0.1	0.0	0.1	0.0
Accounts payable	40.9	0.1	37.1	0.1
Other liabilities	807.6	2.5	931.5	2.3
Total Net Worth	16,585.9	52.0	22,984.0	56.5
Capital	12.7	0.0	12.7	0.0
Reserves	321.2	1.0	311.6	0.8
Capital surplus	14,172.1	44.5	19,593.3	48.2
Special exchange account liquidation	453.5	1.4	453.5	1.1
Exchange adjustment: 1993 and thereafter & surplus	13,689.3	42.9	19,103.2	47.0
Others	29.3	0.1	36.7	0.1
Appreciation of property (art. cultural works and real estate)	856.1	2.7	995.0	2.4
Profits (Losses)	1,223.8	3.8	2,071.3	5.1
Previous year profits/losses	0.0	0.0	0.0	0.0
Current year profits/losses	1,223.8	3.8	2,071.3	5.1

Source: Banco de la República.

Table 27
Income Statement - Banco de la República: 2000-2003
(Billions of pesos)

	Performance 2001 (a)	Performance 2002 (b)	Current annual change % (c)	Projection 2003 (d)	Estimated annual Change % (e)
I. Ingresos totales	1,857.5	2,827.2	52.2	1,044.1	(63.1)
1. Total Income	1,839.7	2,809.5	52.7	1,036.4	(63.1)
Interest and yield	1,604.0	2,412.0	50.4	826.7	(65.7)
Net international reserves	1,105.7	2,044.2	84.9	497.9	(75.6)
External credit lines	12.3	7.5	(39.2)	6.7	(10.8)
TES "A" appraisal at market prices	37.0	20.3	(45.1)	6.9	(65.8)
TES appraisal through monetary expansion transactions	297.8	274.8	(7.7)	252.1	(8.3)
TES Law 546	7.3	6.6	(9.6)	5.2	(21.2)
Temporary purchase of securities and quotas	66.0	48.1	(27.1)	49.9	3.7
Others	77.9	10.5	(86.5)	7.9	(24.5)
Commissions	96.2	117.7	22.3	125.4	6.6
Banking services and trusts	81.4	97.7	20.1	105.4	7.8
Foreign currency management	10.3	13.5	31.2	20.1	48.8
Others	4.5	6.4	42.9	0.0	(99.8)
Exchange difference	56.8	259.9	357.9	49.6	(80.9)
Coin Issue and precious metals	0.8	1.5	91.8	21.9	1,326.6
Others	81.9	18.4	(77.6)	12.8	(30.4)
2. Non-operational Income	17.8	17.7	(0.7)	7.7	(56.7)
II. Total Outlays	633.6	755.8	19.3	694.8	(8.1)
Interest and yield	227.9	179.1	(21.4)	164.4	(8.2)
Deposit accounts	180.4	123.9	(31.3)	124.9	0.8
Temporary sale of securities	18.3	19.3	5.4	4.9	(74.6)
External credit lines. exchangeable securities and others	9.9	9.6	(3.0)	9.4	(2.0)
Expenses for international reserve management	19.3	26.2	36.3	25.2	(4.0)
Commissions and fees	8.1	2.7	(67.2)	2.7	0.0
Exchange difference	31.3	139.3	344.8	23.5	(83.1)
International organizations	5.0	26.6	431.7	5.3	(79.9)
External credit lines	12.8	52.8	311.7	7.7	(85.4)
Others	13.5	60.0	344.1	10.5	(82.6)
Cost of currency issue	34.5	58.7	69.9	122.7	109.0
Personnel expenses	152.8	161.2	5.5	170.2	5.6
Retirement pensions	62.9	91.7	45.8	93.2	1.6
General expenses	45.0	43.9	(2.6)	46.3	5.5
Taxes	2.9	3.2	11.3	3.8	16.0
Insurance	5.3	7.9	48.3	11.6	47.5
Contributions to the Banking Superintendent. Cemla and others	2.4	3.3	40.0	3.8	15.4
Cultural expenses	5.7	6.3	11.3	7.0	11.8
Provisions. depreciation and amortization	34.0	38.6	13.7	36.6	(5.1)
Other operational and non-operational expenses	20.8	20.0	(3.7)	9.0	(55.2)
III. Fiscal Year profit/loss	1,223.9	2,071.3	69.2	349.3	(83.1)

(c) = (b) / (a); (e) = (d) / (b).
Note: The item known as expenses for international reserve management was created during the period between 2001 and 2003, and transport and packing was added to the cost of currency.

B. Establishment of reserves and distribution of profits

In accordance with the Bank's charter, the Board of Directors agreed to distribute Col$2,077.8 b in resources during the current year. This amount includes Col$2,071.3 b in profits from 2002 and Col$6.5 b in reserves accumulated to protect assets. The allocation contemplates a provision of Col$588.1 b for currency fluctuation[35] and a provision of Col$8.3 b for net investment in cultural goods. The remainder is earmarked for the national government (Col$1,481.4 b) (Table 28).

As to the provision for monetary and exchange stabilization, which currently registers no balance, the Board of Directors made no provision because no losses are anticipated for the next two years. The exchange reserve was not modified, since daily foreign currency transactions (purchase and sale) produced no losses in 2002.

35 Corresponds to the portion of profits generated by the exchange difference between the dollar and other reserve currencies.

Table 28
Distribution of Banco de la República Profits and Use of Reserves 2002
(Billions of pesos)

Resources for distribution	2,077.8
2002 profits	2,071.3
Use of the reserve for asset protection	6.5
Allocation	2,077.8
National government	1,481.4
Reserve for currency fluctuation	588.1
Net investment in cultural goods	8.3

Source: Banco de la República.

C. Projected income and spending for 2003

The estimate for the current year includes Col$1,044.1 b. in total income and Col$694.8 b. in outlays. Accordingly, the projection for profits stands at Col$349.3 b. The primary source of income would be interest and yield on international reserves and on the TES portfolio acquired by Banco de la República. These items would increase to Col$497.9 b and Col$252.1 b, respectively. Less yield from international reserves, compared with other years, is explained by two factors: i) lower interest rates on the international market, which will reduce the current yield on reserves, and ii) expectations of an increase in these rates during 2003, which would depreciate the reserve portfolio, negatively affecting its yield.

The calculated yield on international reserves does not include the possible effects of changes in the exchange rate for currencies in the reserve portfolio[36]. Therefore, the yield on this portfolio is subject to uncertainty over the trend in the exchange rate for the dollar compared with the euro and the yen.

As to outlays, total payments are expected to amount to Col$694.8 b, with a reduction of 8.1%. The projected decline in payment of interest and yield is 8.2%. Exchange differences are expected to fall by 83.1%[37], while general and personnel expenses would increase at respective rates of 5.5% and 5.6%. Banco de la República will make the necessary adjustments to comply fully with the rules on spending restraint included in the referendum.

36 The yield on international reserves was calculated with information available up to February 28, 2003. Therefore, it includes the change in exchange rates during the first two months of the year.

37 The cost of currency issue and distribution would increase by 109.0% due to new contracts to distribute currency for the branches in Cali, Barranquilla and Medellin.

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