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Introduction

The following report, presented to the Colombian Congress, offers a detailed analysis of recent economic performance and the macroeconomic policy implemented in 2001. Annual inflation that year, measured by the consumer price index (CPI), was 7.65%, which is slightly below the target set by the Board of Directors of Banco de la República (BDBR), in conjunction with the government. As to the balance of payments, the current account for 2001 showed a deficit, following equilibrium the year before. This was the result of import growth, a decline in the volume of oil exports, and lower prices for coffee on the international market. In spite of important increases in employment throughout the year, unemployment continued to be the most serious problem in the Colombian economy.

Chapter II of the report contains an analysis of the principal macroeconomic variables in 2001. The past year was a time of slow growth and less momentum compared with 2000. This was associated with the limited growth in demand brought on by external factors such as performance of the world economy and the drop in terms of trade. These factors affected other Latin American countries as well. Lower coffee prices had an important impact on the decline in aggregate demand. Less demand, in turn, was also influenced by domestic factors such as persistent unemployment. In terms of supply, the economy faced several major shocks, including the slowdown in oil and farm production due to violence in the countryside and the onset of retention in the cattle cycle. Guerrilla and paramilitary violence had a negative effect on investment and destroyed infrastructure, forcing public and private funds to be deviated for defense and security, besides prompting a flight of capital and skilled manpower from the country.

As is traditional, the report provides a detailed description of the country's macroeconomic policy with respect to monetary, exchange, financial and fiscal matters. Chapter III explains that macroeconomic policy in 2001 was applied to support maximum economic growth, without jeopardizing the inflation target. The exchange situation saw major changes in 2001. Depreciation of the peso in the first half of the year was followed by revaluation in the second. Even so, the exchange rate was 10.2% higher, on average, than in the year 2000. This upward trend was influenced by important external borrowing in the public sector, not only to finance the fiscal deficit but to guarantee the significant level of borrowing required for 2002.

The main indicators for the financial system continued to improve. Nevertheless, there are still problems, especially in mortgage banking where the portfolio declined throughout 2001. However, capitalization was possible at the end of the year, with the support of Fogafin.

The fiscal deficit is one of the primary concerns with respect to the macroeconomic situation. This has been the case for several years and steps were taken in 2001 to continue to reduce the deficit. Legislative Act 01 and Law 715 are two examples. Law 617/2000 began to be applied as well. Although these measures will imply fiscal savings, more needs to be done. Due to the persistent deficit in the country's public finances, primarily those of the central government, public borrowing continues to rise, although at a slower pace. And, unless efforts to reduce the deficit continue, it is likely to become a stumbling block to sound, short-term macroeconomic management and to long-term economic growth. The fiscal deficit and sustainability of the public debt are analyzed from this perspective in Chapter IV of the report

The macroeconomic prospects for 2002 with respect to inflation, the balance of payments, economic growth and the fiscal deficit are outlined in Chapter V. Inflation will continue to decline gradually, thanks to carefully implemented monetary policy. Accordingly, the BDBR is confident the target of 6% inflation for 2002 will be met. As to the country's balance of payments, the current account deficit in 2002 is expected to equal 3.1% of gross domestic product (GDP), due to a 1.8% decline in merchandise exports and a 3.9% increase in merchandise imports. On the other hand, weak product growth in 2001, coupled with the difficult international environment, prompted the Ministry of Finance and Public Credit to revise its projections for 2002. New government projections anticipate economic growth between 2.5% and 3.0%. The consolidated deficit in the public sector will be around 2.6% of GDP at year's end, with a variation near 0.7% of GDP compared with the size of the deficit in 2001.

The report ends with a look at the trend in international reserves and the financial position of Banco de la República. Due to low interest rates, Colombia expects less yield on its international reserves this year and a substantial reduction in profits for Banco de la República.