The Present Conditions, Monetary Policy and Outlook for the Economy and Investment in Colombia

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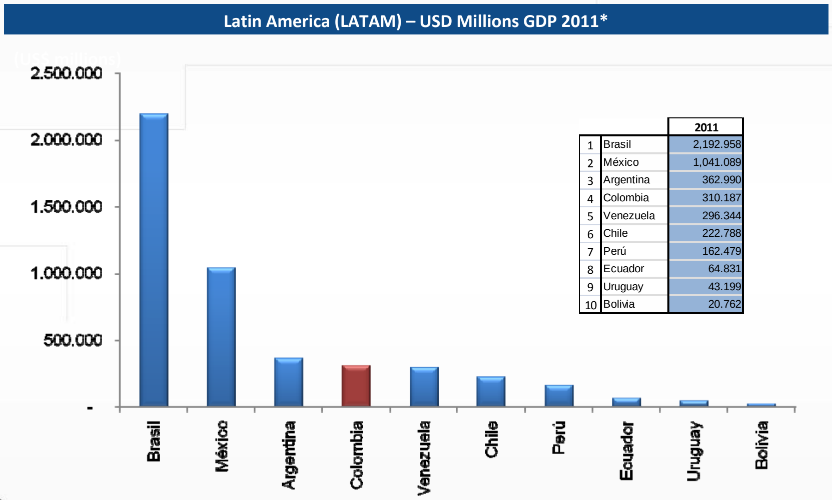
Colombia

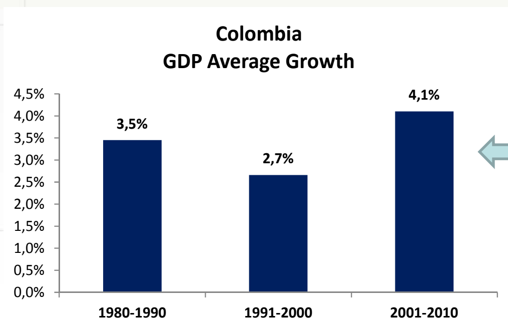
I. REAL INDICATORS

Among Latin-American countries, Colombia is the fourth largest economy



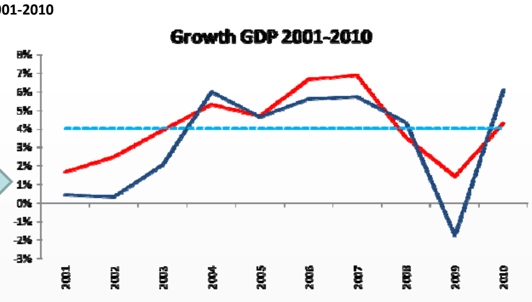
		2011
1	Brasil	2,192.958
2	México	1,041.089
3	Argentina	362.990
4	Colombia	310.187
5	Venezuela	296.344
6	Chile	222.788
7	Perú	162.479
8	Ecuador	64.831
9	Uruguay	43.199
10	Bolivia	20.762

Source: IMF.*Projected.



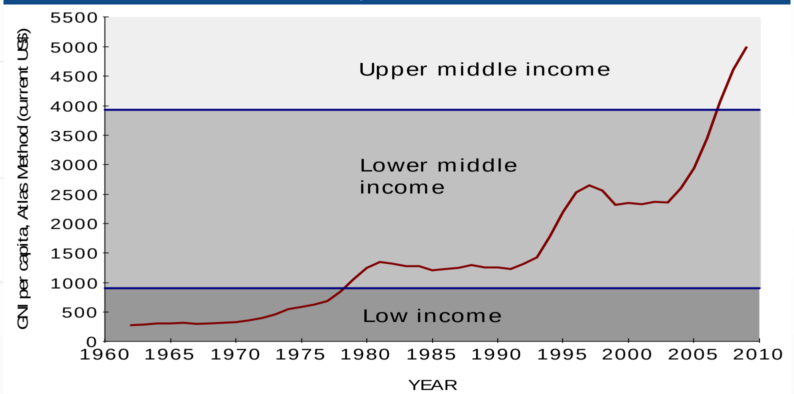
During the **1st decade of the 21st century,** Colombia achieved a long term growth that outperformed previous decades

GDP growth during most of the 1st decade exceeded the average for Latin America and the Caribbean



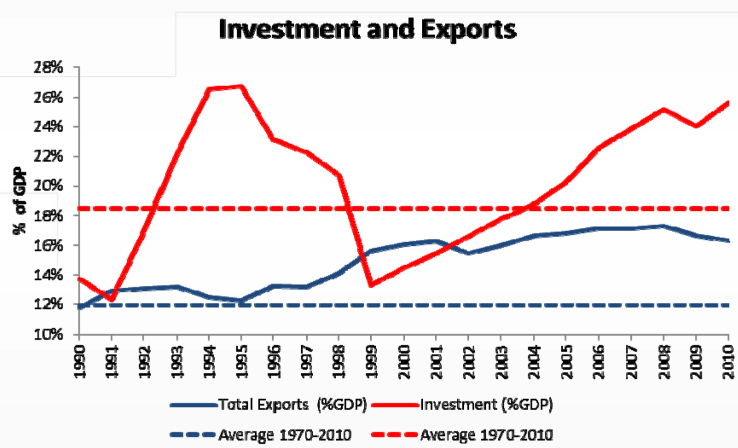
Source: Banco de la República estimates based on DANE statistcs

Good economic performance during the 1st decade placed Colombia in the upper middle income group of countries.



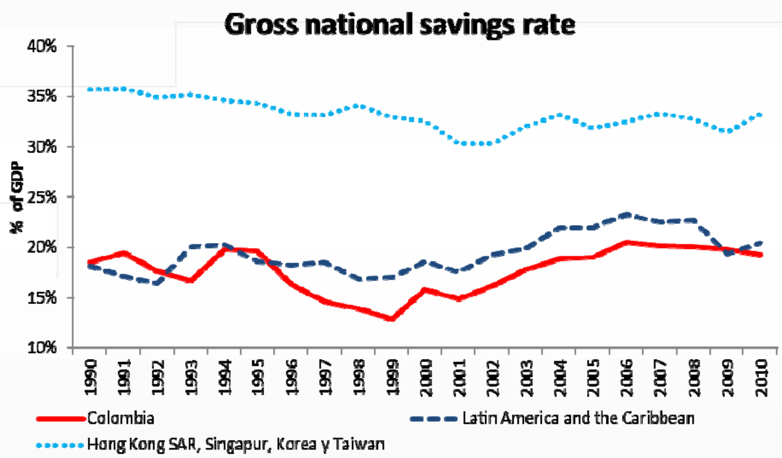
Source: Banco de la República estimates based on DANE statistcs

Key engines for economic growth have been investment and exports which have been well above historical averages. This suggests that Colombia is on a path of sustained growth.



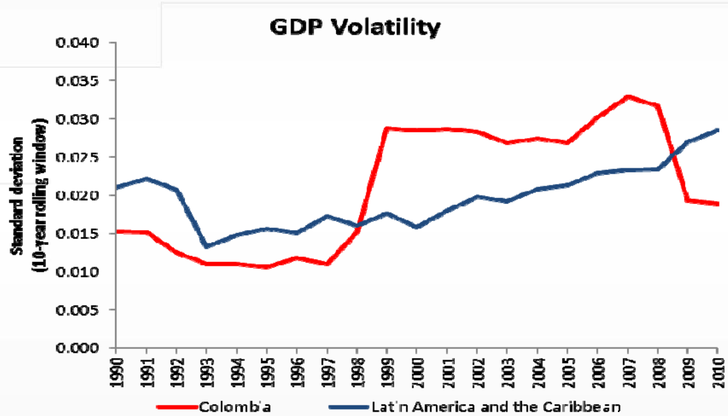
Source: DANE.*Estimated. Consistent with the National Development Plan.

The saving rate has also increased but it is still below Asian levels



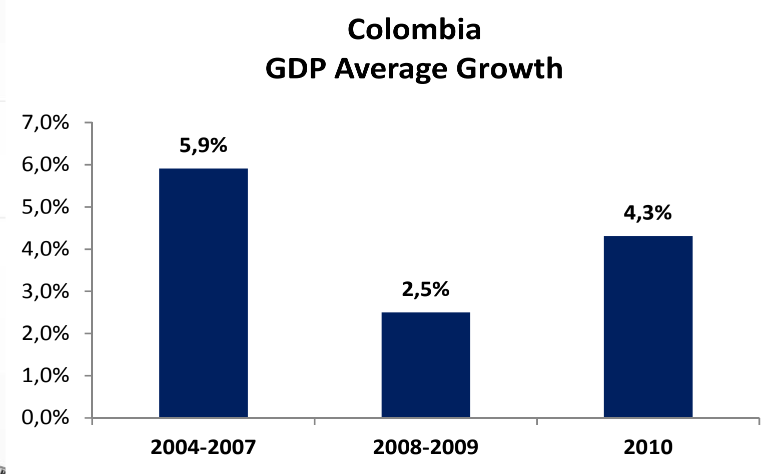
Source: FMI

In addition, the volatility of output growth has fallen drastically in recent years following a period of high volatility starting at the end of the nineties.



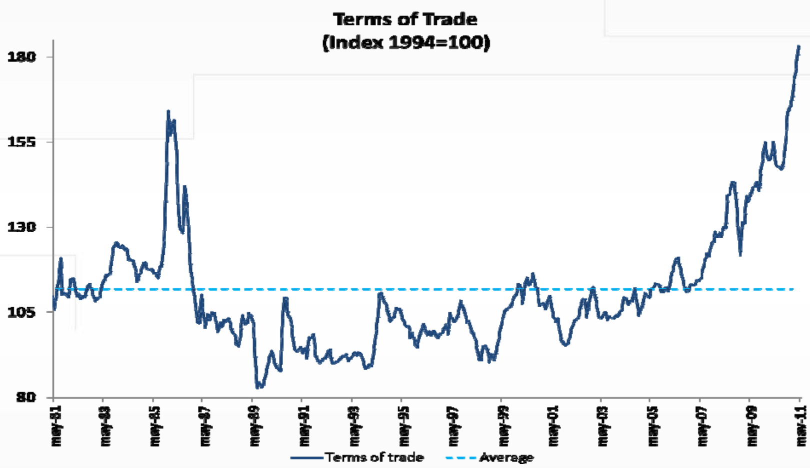
Sources: FMI, Banco de la República

Colombia showed strong resilience and a quick recovery during the recent financial crisis.



Source: DANE

Helped by high terms of trade…



…and a sound economic policy framework (to be explained)

Two main ideas

- The evidence suggests that Colombia has achieved a path of sustained growth, supported by high investment rates and the dynamism of its exports.
- Colombia has been able to reduce the volatility in its economy that characterizes small open economies thanks to the sound macroeconomic policy framework developed during the decade ending in 2010.

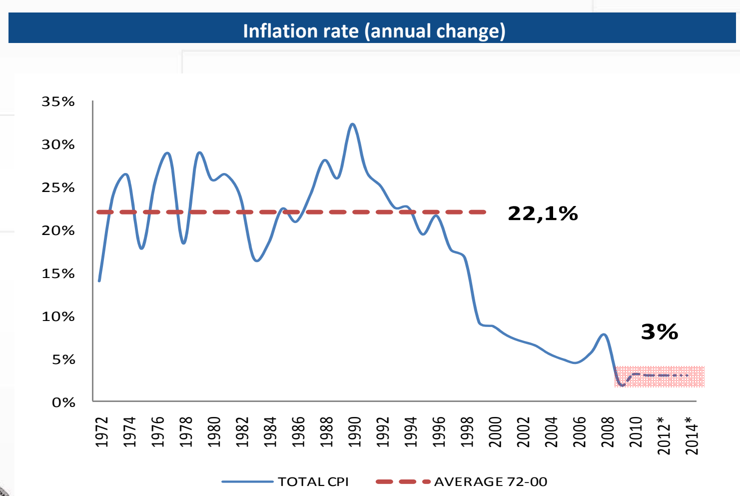
BANCO DE LA REPUBLICA COLOMBIA

II.MONETARY POLICY

Basic Framework

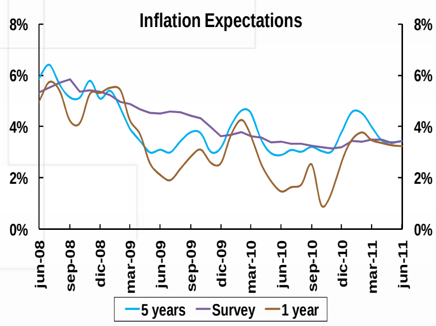
- An independent central bank since 1991.
- Flexible inflation targeting since 1999
- Monetary Policy Objectives:
  - Low, stable inflation (3% +/- 1pp)
  - Contribute to smoothing the business cycle
- Main instrument: Interest rate
- Flexible exchange rate

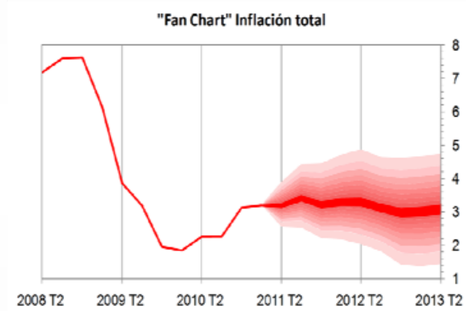
Long-term inflation target has been achieved.



Source: DANE.*Projected.

The inflation target has provided a sound anchor for inflation expectations.

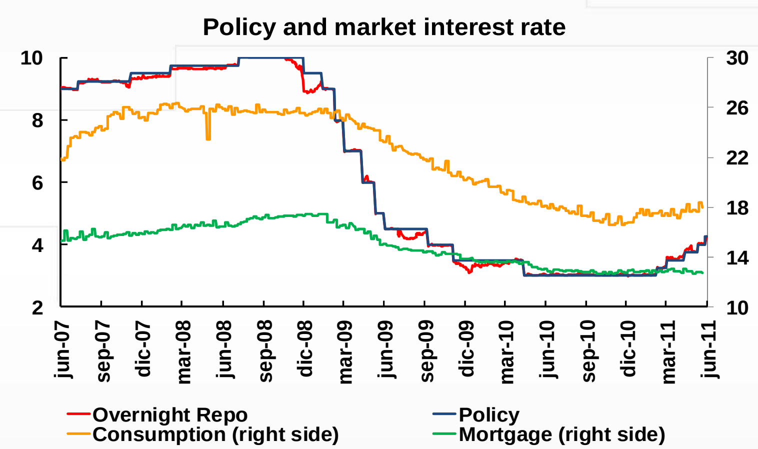




(*)Methodology: Nelson y Siegel

Fuente: MEC y SEC, Cálculos Banco de la República

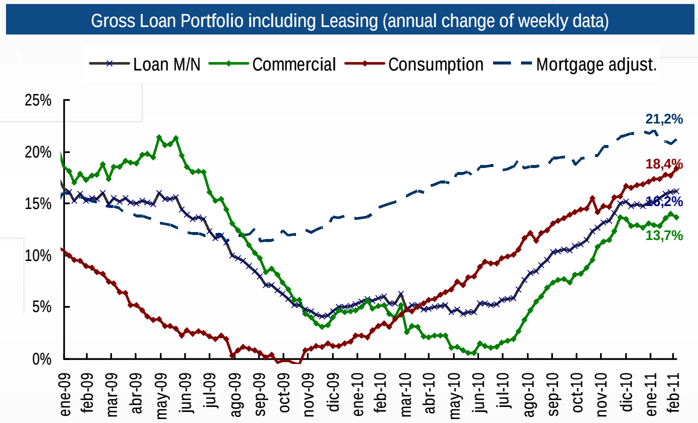
Policy interest rate has had a strong and fast impact on market interest rates.



During the financial crisis, the policy interest rate was reduced sharply.

Source: Superfinanciera, Banco de la República.

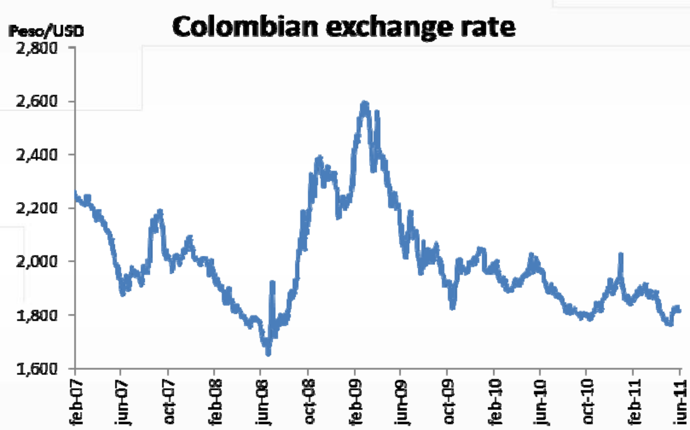
With a solid financial sector, the low interest rates led to a sound recovery of credit growth



Credit has helped to support economic growth

Source: Superfinanciera

The floating exchange rate regime has also contributed because of its stabilizing effect. During the crisis, the peso depreciated and acted as a buffer.



The exchange rate normally appreciates in good times and depreciates in bad ones.

Two main ideas

- Monetary policy has been effective. Inflation was controlled and, during the last 2-3 years, has been fairly stable at close to 3%.
- Exchange rate flexibility and a counter-cyclical monetary policy made a substantial contribution to Colombia's resilience to the world crisis.

III. ECONOMIC AND INVESTMENT OUTLOOK

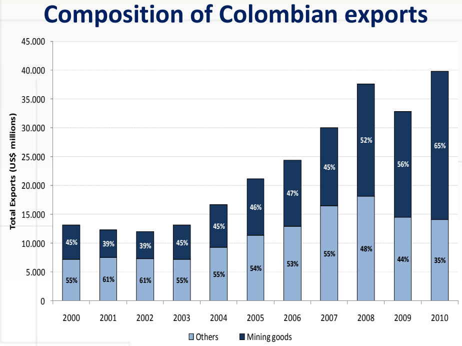
MEDIUM TERM OUTLOOK

Variable	2011	2012	Promedio 2013-2022
Real GDP Growth (Variation %)	5.0	5.0	4.8
Inflation (Variation %)	3.0	3.0	3.0
Oil Price - WTI (US$ per barrel)	92	92	90

Fuente: DGPM-Ministerio de Hacienda y Crédito Público.

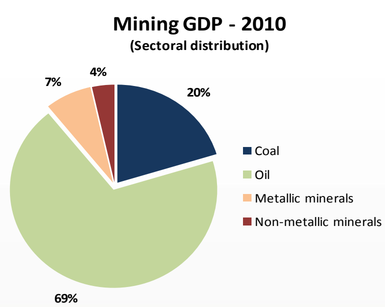
- **Long-term growth in Colombia is expected to be around 5% in a stable inflation environment.**
- **As a commodity producer, Colombia is benefitting from the changing structure of the global economy**

Composition of Colombian exports



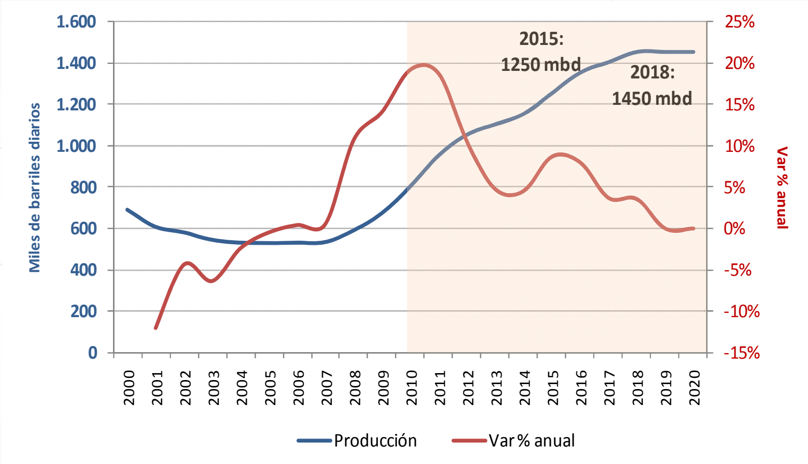
Oil and mining sector exports achieved a historically high share of the total exports in 2010.

Oil and coal contributed 89% of the mining GDP in 2010.



Source: DANE – DIAN

Colombia will significantly increase its oil production.

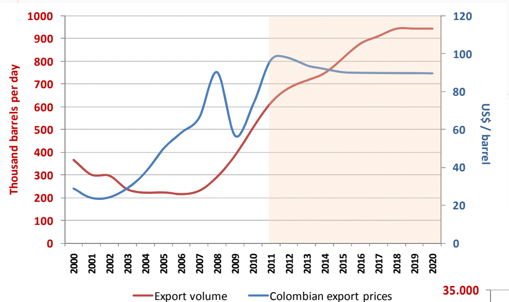


2011 to 2015: 9.5% annual growth

2016 to 2020: 3% annual growth

Fuente: Ministerio de Minas, DGPM – Ministerio de Hacienda y Crédito Público.

If oil prices remain high, oil windfall income will be high

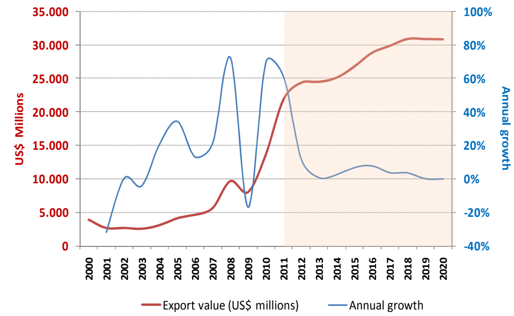


The expected increase in the value of oil exports will be mainly due to a rise in the export volume

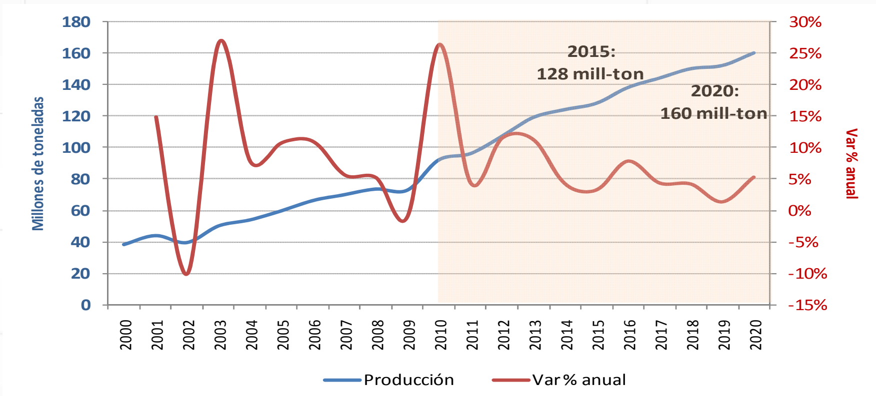
2010: Relationship of exports to production: 65%

2011-2020: same relationship is maintained

- *Export value:*
- *2011 - 2015: 16% annual growth*
- *2016 - 2020: 3% annual growth*



A significant increase in coal production is also expected

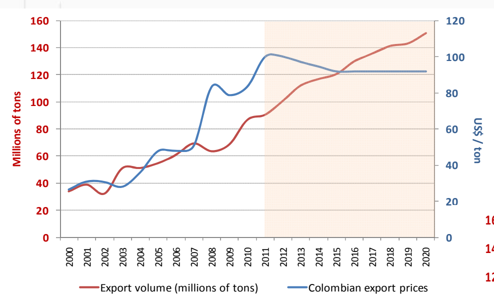


2011 to 2015: 6.9% annual growth

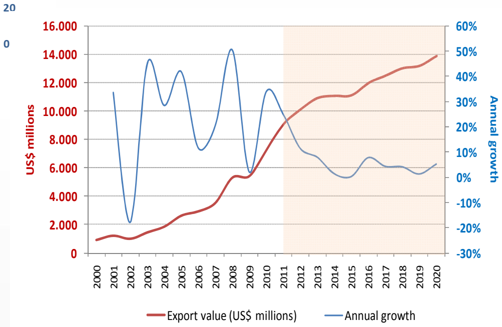
2016 to 2020: 4.6% annual growth

Fuente: Ministerio de Minas, DGPM – Ministerio de Hacienda y Crédito Público.

As in the case of oil, coal prices are also expected to remain high



The value of coal exports will increase mainly as a result of a rise in coal production

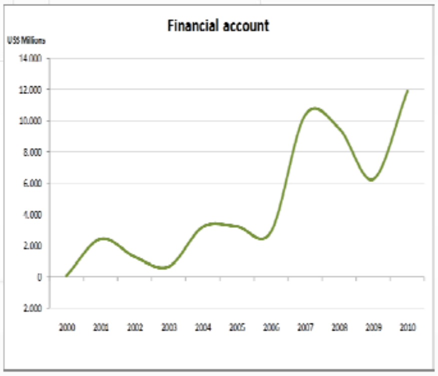


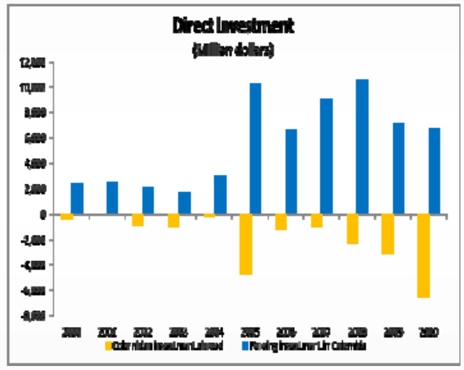
**2010: Relationship of exports to production : 94%*

2011-2020: same relationship is maintained

- ***Export value:***
- ***2011-2015: 9,2% annual growth***
- ***2016-2020: 4.6% annual growth***

High commodity prices and the investment grade recently approved for Colombia will likely led to strong capital inflows in the years to come.





•Source: Banco de la República

Two policy challenges

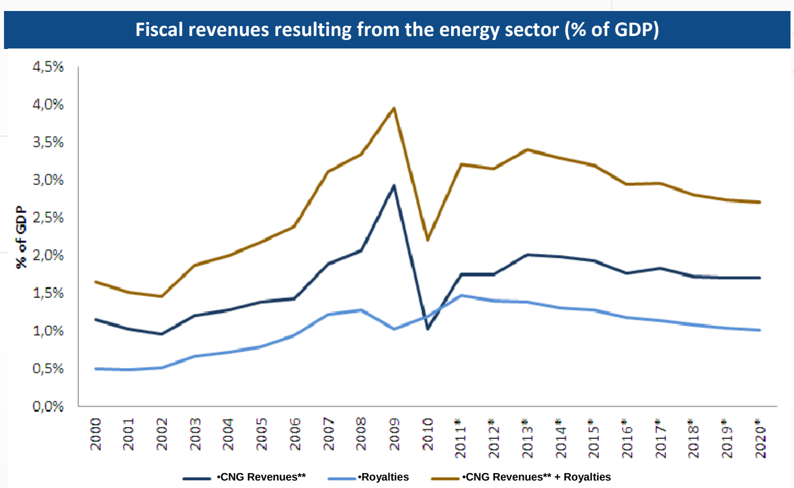
I. **Maintaining macroeconomic stability in the face of a significant expansion of the oil and mining sector and positive terms-of-trade shock.**

II. **Maximizing the return on large, volatile capital flows.**

Macroeconomic policy response based on three pillars

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

The fiscal revenues resulting from the expansion of the energy sector are expected to be quite significant

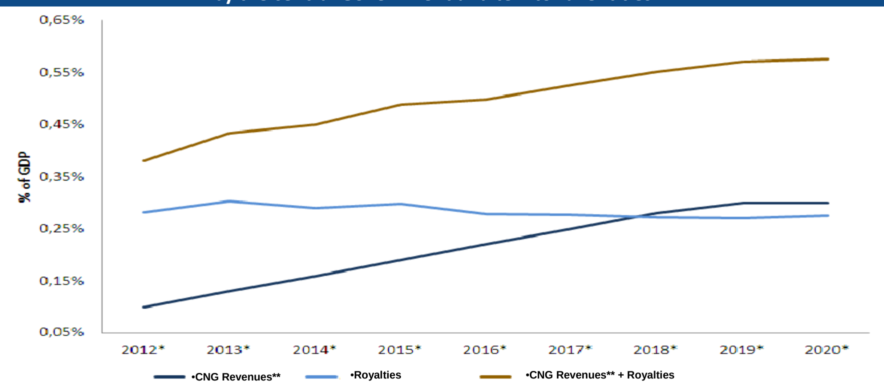


Fuente: Ecopetrol, Ministerio de Minas y DNP. Cálculos: DGPM-Ministerio de Hacienda y Crédito Público

Following the recent approval of a fiscal rule and a new system for royalties distribution, it is expected that the public sector will save a significant portion of the revenue windfall

Expected savings from energy-related revenues

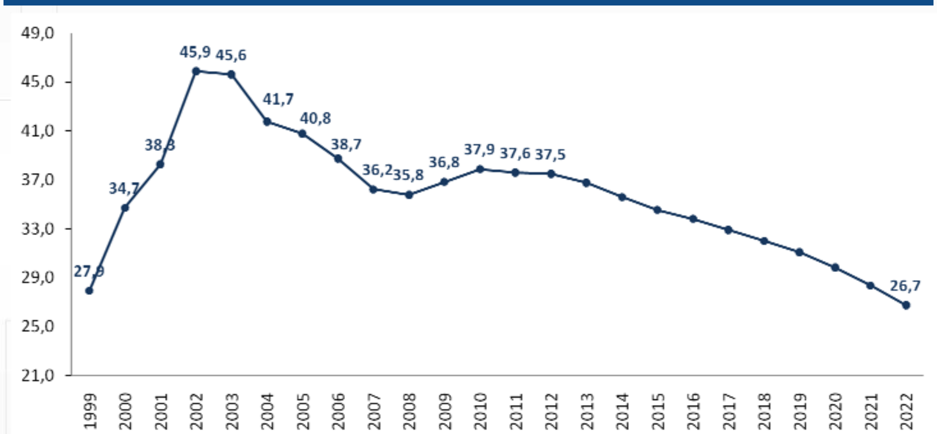
by the central Government and territorial entities



•Fuente: Ecopetrol, Ministerio de Minas y DNP. Cálculos: DGPM-Ministerio de Hacienda y Crédito Público.*Cifras proyectadas.

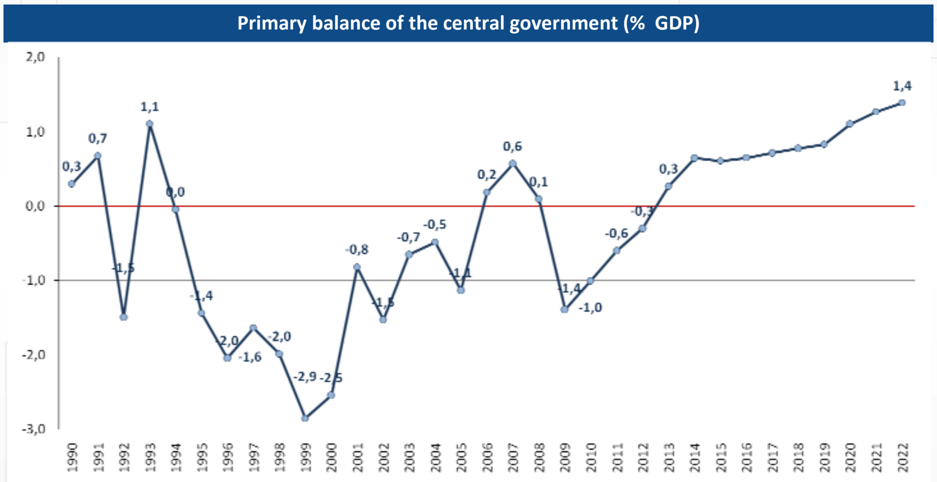
The fiscal rule and the revenue windfall will allow the Goverment to achieve a significant reduction in its debt

Central Government Debt (% of GDP)



Fuente: Cálculos: DGPM-Ministerio de Hacienda y Crédito Público.

… As well as a considerable improvement in its fiscal balance



•Fuente: Cálculos: DGPM-Ministerio de Hacienda y Crédito Público.*No incluye los Costos de la Restructuración Financiera ni Emergencia Invernal

Two main ideas

- The outlook for the Colombian economy looks promising. This is partly explained by the structural changes in the world economy, as well as by the expansion of the mining and energy sector in Colombia that is underway.
- The policy challenges are also huge. To face them properly, Colombia has been devising an adequate macroeconomic policy framework

Specifically

I. The monetary policy anchors inflation expectations which helps to smooth the economic cycle

II. The exchange rate floating regime also has a stabilizing effect. The Colombian peso normally depreciates in bad times and appreciates in good ones

III. The fiscal rule defines a countercyclical economic policy and the new royalties distribution law requires saving a portion of oil revenues, makes distribution fairer and increases its efficiency. This reduces the impact of the increasing oil revenues on domestic demand as well as on inflation and the exchange rates.

IV. The fiscal rule and the inflation targeting framework anchor inflation expectations and (partially) the exchange rate.