Economic policy during 2000 faces one of the most difficult challenges of its history: attaining a firm and sustained recovery of Colombian economy, while consolidating the advances obtained in inflation. This requires an adequate combination of monetary, fiscal and financial policies to facilitate reactivation of the economy. It relates to a process that will take some time, since the macroeconomic unbalances that gave origin to the crisis began to generate slowly, hence, obtaining their correction cannot be expected to occur in just a few months.

The macroeconomic program being under way is confronting the challenge through every tool available. It is a responsible program inspired on a view of sustainable development taking advantage of the enormous potentiality of our economy. Monetary policy, as an essential component of the program plays a crucial role in guaranteeing such sustainability. The policy currently being implemented has contributed to reactivating, without intending to induce an unsustainable incentive on the economy through an unexpected monetary expansion. An incentive of such nature would be ephemeral and would lead to accelerated inflation. This would bear perverse consequences on income distribution and on growth itself beyond the very short term. Without structural amendments to correct macroeconomic unbalances a long-term sustainable growth cannot be attained.

The characteristics and objectives of the macroeconomic program mentioned were explained widely in the Report to Congress last March of this year. The quarterly performance goals laid down in the program have been met rigorously. In the first place, the monetary policy has been consolidating its own strategy of inflation reduction for which purpose the Board of Directors of the Banco de la Republica has developed a constant monitoring on inflation evolution and perspectives of ten per cent (10%) during the current year, and not higher than 8% in 2001. Similarly, the Board has made a permanent follow-up on the behavior of monetary aggregates, to ensure that their evolution is compatible with the target inflation and it meets the liquidity requirements of economy, in accordance with the growth rate projected within the macroeconomic program.

In so far as the exchange policy is concerned, the rules provided for preventing the exchange rate to become extremely volatile and monthly auction sales are performed for accumulating options for international reserves. In the matter of regulation the regime was rendered more flexible, by allowing participation of stock exchange broker entities acting as foreign exchange market intermediaries, and furthermore, was attained in the promotion of foreign exchange hedging mechanisms, by allowing the participation of a greater number of agents, both national as well as foreign and, additionally, new transactions were authorized.
The fiscal policy on its part, continues to advance in the difficult process of clearance of public finances. The goals of the adjustment program establishing a maximum limit for the quarterly accumulated deficit of the consolidated public sector have been met for the last quarters ended in December and March. In fact, the effort in the fiscal adjustment added to the good results of the hydrocarbons sector, due to the high international petroleum prices, have permitted that the fiscal goals be met and have made feasible a consolidated deficit not in excess of 3.6% of the GDP by the end of 2000, under 5.4% of the GDP observed during 1999. However, all this means an effort in the adjustment that will exhaust the maneuvering margin of the public sector under the applicability of current legal provisions. Consequently, the continuance of this procedure during the next few years shall depend upon Congress approving the required legal amendments leading to a structural correction and straightening of public expenditure.

In so far as it concerns the financial policy, during the first half of the year the restructuring program of the financial sector has continued, through capitalization of public and private financial entities for the purpose of improving their equity situation and reactivating their credit activity. This capitalization has been financed through the issue of Fogafin funds, from provisions through taxes on financial transactions and funds arising from the private sector. On its part, the relief to mortgage debtors, financed through the emission of TES, has contributed to detain the overdue mortgage portfolio deterioration, at the time as it as incremented the consumption capacity within the families.

During the month of June the yearly inflation rate reached 9.7%, a level which coincides with the inflation target set out for the present year. However, its evolution through the first semester has not been uniform. During the first few months of the year an improvement appeared in the inflation rate as a consequence of transitory phenomena relating to the foodstuff price cycle. Such behavior had been foreseen given the remarkable seasonality characterizing relevant basic goods for family household consumption, such as potatoes, vegetables, legume, dairy et al. During the months of May and June such tendency began to revert, having favored reduction in prices of food, which will facilitate maintaining inflation within the limits established for the year 2000.

The coordinated effort of economic policy has begun to render results. During the first quarter of 2000 the economy grew 2.2%, which constitutes the first positive annual growth that has been observed since the second quarter of 1998. As described below, the mentioned growth was led by the significant recovery of the industrial sector, stimulated by an increase in exports and improvement in other industries related to sectors with less transactions. Although the economic recovery still requires consolidation, the result obtained during the first quarter tends to generate positive dynamics, which being accompanied by a healthy and coherent macroeconomic policy shall lead to definite recovery.

It should be added that the consolidation of the economic recovery during the second half of the current year and during the year 2001 requires preventing that the financing of the fiscal deficit may put pressure to bear on interest rates at times when the aggregate demand has begun to recover. The fiscal sustainability will only be possible if the new legislation were to
provide assistance in reducing pressures upon territorial and pension liability expenses, which will strengthen credibility in this process and facilitate governmental financing.

Regarding as international reserves and the Banco de la República situation are concerned, it the increase of the former through this point of the current year and a positive operational result a close to $500 thousand million (mm) during the first half of year 2000, are worth mentioning.

The report being hereby submitted to the Honorable Congress of the Republic is divided into five chapters. Chapter II describes the monetary, credit and foreign exchange policies; the balance of payments, the fiscal policy and the financial policy. In chapter III the inflation results and basic tendencies are discussed. Chapter IV describes the results of the economic activity and employment for the first quarter. Finally, chapter V presents the financial situation as well as the international reserves of the Banco de la República.