
REPORT OF THE **BOARD OF DIRECTORS** TO **CONGRESS**

ISSN-Pending



07/
2024



July 2024

REPORT OF THE
BOARD OF DIRECTORS
TO **CONGRESS**

Banco de la República
Bogotá, D. C., Colombia

ISSN - 1657 - 799X



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Bogotá, 02 August 2024

To
PRESIDENTS AND OTHER MEMBERS
Honorable Chairmen and Members
Standing Constitutional Committees
The Senate of the Republic
The House of Representatives

Dear Sirs:

In compliance with Article 5, Act of Congress 31/1992, the Board of Directors of *Banco de la República* hereby submits to the Congress of the Republic of Colombia their Report to Congress on the macro-economic results for the first half of 2023 and the outlook for what remains of the year for its consideration. The recent developments in inflation and the decisions made by the Bank's Board of Directors in this context are presented. Furthermore, the changes in the local financial and the credit markets, the country's foreign balance, the breakdown of the foreign reserves and their performance, the financial position of the Bank and its forecasts, and the trend of payments in the Colombian economy are described.

Cordially,



Leonardo Villar Gómez
Gerente General

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Introduction

During the first quarter of 2024, economic activity in Colombia maintained the recovery trend that it showed in the last quarter of 2023. After the gross domestic product (GDP) contraction of 0.7% in the third quarter of 2023, that variable registered a growth of 0.4% in the fourth quarter of last year and 0.9% between January and March of this year. While this growth rate remains moderate, the forecasts of the technical staff and various analysts suggest that it will consolidate in the coming months to get close to its potential capacity in 2025. On the other hand, the annual inflation rate advanced in its process of convergence towards the target during the first half of the year, decreasing from 9.3% in December to 7.4% in March and stabilizing around 7.2% in the second quarter. Likewise, the country's external imbalance continued to decrease, with a checking account deficit of 1.9% of GDP in the first three months of the year, which was lower than that of 2023 (2.5% of GDP) and that observed in the same period of the previous year (3.7% of GDP). Regarding public finances, the crucial correction of the fiscal imbalance achieved the previous year stands out, which resulted in a reduction in the General Government deficit from 6.3% to 2.7% of GDP between 2022 and 2023.

As of December 2023, these improvements on the macroeconomic front have been accompanied by the start of a new monetary policy cycle with progressive interest rate reductions. The decision to undertake this policy change arises from the consensus reached among the Board Members of the Board of Directors of *Banco de la República* (the Central Bank of Colombia, *Banrep*) (BDBR) that the conditions have been created to adopt a less contractionary policy stance, as confirmed by the downward trend that both annual inflation and its expectations have shown since April 2023, as well as the correction of the external deficit towards a more sustainable balance.

While identifying these favorable conditions, some critical risks are noted for the convergence of inflation towards its 3.0% target. Among those are the downward rigidity of inflation in some services, including leases and energy tariffs, as well as the risks of a depreciation of the peso against the dollar in the face of changing conditions in the external context and the uncertainty that remains on monetary policy in the United States and local public policy issues. Likewise, there is the risk related to food prices, whose inflation upturned in May and June due to El Niño phenomenon on the crops of some perishable foods. Additionally, although inflation expectations show a downward trend over time, they remain above the target for the relevant terms that the BDBR expects to achieve. Furthermore, the expected increase of the Central National Government (CNG) deficit in 2024 could hinder the convergence of inflation towards its target within the term the BDBR expects to achieve.

The existence of the mentioned risks on inflation performance requires that the monetary authority be especially cautious with the amounts of policy interest rate cuts. This is because there is a risk that very rapid decreases could have to be reversed, with high credibility costs, if events materialize that make it challenging to achieve the inflation target within the terms provided by the BDBR. Hence, each decision must use the latest available information as a basis for a detailed assessment of inflation performance and expectations, observed and expected economic

growth, and other key variables that determine the country's macroeconomic stability and inflation convergence toward its target. This task is regularly conducted by *Banco de la República's* technical staff for each BDBR session.

1. Executive Summary

International Macroeconomic Environment

Similarly to 2023, the global economy would continue to grow in 2024 at a rate slightly higher than 3.0%, according to International Monetary Fund (IMF) and Organization for Economic Cooperation and Development (OECD) forecasts. This dynamism is lower than the historical average of pre-pandemic due to the long-term consequences of COVID-19, Russia's invasion of Ukraine, and the growing geoeconomic fragmentation, among other reasons. Despite this, global growth has been remarkably resilient to interest rate increases by central banks seeking to restore price stability. Several advanced and some emerging economies, particularly the United States and some Asian countries, have managed to sustain favorable growth amid disinflationary processes, thanks to high aggregate demands supported by dynamic private consumption and high public spending. However, in several developing countries, inflationary pressures have been significant due to the transfer of high international costs of food, energy, and fertilizers and depreciations of their currencies above expectations. Those factors have affected the growth of these economies amid restrictive monetary policies. This has been the case for some Latin American economies, including Colombia.

Macroeconomic policies in 2024 would remain restrictive in most economies, with real interest rates remaining in contractionary territory and the gradual withdrawal of fiscal support. One exception would be China, where low interest rates and successful fiscal support are expected, which would support the Chinese government's announced 5.0% growth target. Generally, international uncertainty remains high, but the balance of risks has been balanced. It considers the high geopolitical tensions remaining in Europe and the Middle East, which could generate additional disruptions in the energy market, adverse weather events, and the lagging impacts of contractionary monetary policies on global economic activity. It would be offset by significant increases in productivity in some advanced economies and domestic demand in those countries that could be stronger than expected as inflationary pressures ease and interest rates continue to fall.

In some advanced economies, inflation moderated again in May, following the upward surprises seen in the first quarter of the year. In particular, the reduction in total annual inflation in the United States (3.3%) and the United Kingdom (2.0%) stands out, while some acceleration was observed in economies such as the Euro Zone (2.6%), Canada (2.9%) and Japan (2.8%), while core inflation continued to show persistence. In most emerging economies, inflation accelerated somewhat in May, with records above core inflation in most cases. For the major economies of Latin America, annual inflation in May stood at 3.9% in Brazil, 4.7% in Mexico, 4.1% in Chile, and 7.2% in Colombia. For the rest of the year, total inflation is expected to continue to decline but remain above its target by the end of 2024 in some of the major advanced economies, such as the United States and the Euro Zone, and in economies in the region, such as Colombia and Mexico.

In the first months of 2024, the Colombian peso operated in a narrow range below COP4,000 per dollar, and its movements responded, to a greater extent, to the evolution of external factors and to the perception of risk at the international level. The depreciation that occurred in June reflected, among other factors, the widespread strengthening of the dollar in the face of expectations that the United States

Federal Reserve (Fed) would delay cutting its interest rate; the processing of the Colombian Government's foreign debt quota bill, and the greater fiscal challenges. In recent days, the foreign exchange market has stabilized at an exchange rate slightly above COP4,000 per dollar after knowing the best performance of inflation in the United States; the announcement of a significant cut in the Colombian Government spending for the remainder of 2024, and the expansion of the external debt quota for this year.

Economic Activity in Colombia

In the context of the macroeconomic adjustment required to achieve sustainable growth with price stability, the economy recorded a growth of 0.6% in 2023, considerably below its historical average. In the first quarter of 2024, the figures from the National Administrative Department of Statistics (DANE in Spanish) showed that the economy achieved growth of 0.9%. Although moderate, this result confirmed the recovery path of the economy after the 0.7% contraction in the third quarter of 2023, followed by a 0.4% growth in the last quarter of the previous year.

From a spending point of view, the annual growth observed in the first quarter of 2024 was driven by the net external demand, given a decrease in imports and an increase in exports. Domestic demand continued to contract in this period (-2.9%) as a result of a significant drop in investment (-14.6%) and household consumption that did not grow (-0.1%). It indicates that the restrictive monetary policy and higher tax rates that characterized the 2023 adjustment continued to affect aggregate spending in the economy, which was also affected by low levels of business and consumer confidence in an environment of perceived uncertainty by the private sector regarding various aspects of public policy. On the supply side, the agricultural sector, public administration, health, education services, and arts and entertainment activities expanded the most. In contrast, the manufacturing industry had the most significant impairment. The construction sector stopped contracting thanks to the better performance of civil works, offsetting the contraction of the subsector of residential and non-residential buildings.

During the second quarter, economic activity continued to show signs of improvement, as suggested by the Economic Tracking Indicator (ISE in Spanish) for April and May prepared by DANE, which shows a good performance of the agricultural sector and services related to public administration, health, education, and entertainment. Other indicators, such as consumer credit disbursements, freight transportation, number of flyers, and Regional Economic Pulse (PER)¹, also point to increases in activity. However, these indicators also reveal important disparities in performance between productive sectors. In the case of the ISE of the secondary activities, which comprise manufacturing and construction, those continue to be on negative territory in May. Similarly, DANE's monthly industry and commerce survey continued to show significant declines in May for the manufacturing industry and real retail sales. According to this information, there is still a level of considerable uncertainty about the extent and persistence of recovery symptoms that some of the most widely used leading indicators have offered. In this context, the technical staff of *Banco de la República* foresees that in the second half of the year,

¹ The PER is an economic indicator prepared by experts from the Chief Office for Economic Studies of *Banco de la República*, which allows to identify the short-term dynamics and trends of seven regions and their national aggregate. The sources of information used are perceptions of business owners and managers, who know in real time the productive performance of the company they represent, and quantitative indicators disaggregated geographically and from monitoring activities.

the economy will continue to gradually improve its dynamism, to reach growth of around 1.8% in all of 2024 and continue to approach its potential growth in 2025.

Employment

At the beginning of 2024, the unemployment rate increased due to impairment of employment, after which this indicator remained relatively stable. Thus, between December 2023 and May 2024, the unemployment rate of the national aggregate rose 0.2 percentage points (pp) to reach 10.5% in May. For the same period, the unemployment rate of the 23 cities remained stable, while in the other capitals and the rural area grew 0.3 pp.

The number of employed remained relatively stable for the national aggregate, with levels close to 22.7 million (m) jobs. By geographical domains, the fall in the employed population that had been observed in the other capitals and the rural areas during the second half of 2023 was halted. So far in 2024, it remained at levels close to 10.7 m, thanks to the better performance of the agricultural sector. These positive variations have been offset by significant reductions in employment in sectors such as professional activities, transport and communications, public administration, and health and education. Given the stability of employment in the national aggregate, the employment rate in May stood at 57.3%, a level similar to that observed in December 2023 (57.2%).

By occupational position, in 2024, an unequal dynamic is observed between the labor market segments. On the one hand, the salaried and formal population in the national aggregate has decreased slightly after being the most dynamic segment in recent years. On the other hand, the contraction that occurred since September 2023 in the non-salaried segment slowed down and, in recent months, showed slight growth. The dynamics of non-salaried employment reflect the better performance of employment in the agricultural sector, where this type of employment is predominant. The reduction in salaried employment, together with the recent growth of the non-salaried segment, explains the increase in the informality rate, which stood at 56.2% in May 2024, one percentage point higher than that recorded in December 2023.

The Global Participation Rate (GPR), which measures the proportion of the working age population participating in the labor market, has remained stable at around 66% in urban areas so far in 2024. In the other capitals and the rural area, it stabilized at levels close to 62%. Additionally, by gender, in recent months, the exit of women from the workforce was stopped, which implied increases (0.6 pp) in their OPR compared to what was recorded at the end of last year. Thus, the OPR of women stood at 52.8% in May, while that of men reached 76.2%.

Inflation and Monetary Policy

Total inflation in June stood at 7.2%, lower than that observed in the previous December (9.3%) and well below the peak it reached in March 2023 (13.3%). The downward trend in inflation has been primarily the result of restrictive monetary policy applied by the BDBR through progressive increases of the benchmark interest rate initiated as of September 2021. These increases sought to promote the adjustment necessary for the Colombian economy to return to sustainable growth with price stability. In addition to containing inflationary pressures, this monetary policy stance also helped to correct the external imbalance, reduce, and stabilize the exchange rate, and moderate inflation expectations. This adjustment was given

in a context in which external pressures and different supply shocks associated with the pandemic, the effects of the second quarter of 2021 strike, and the war in Ukraine, subsided. All of this has allowed inflation to have a downward trend, continuing until the first half of 2024. Despite this, inflation continues to be above the 3.0% target, largely due to the inertia that characterizes price adjustments in Colombia. It is attributed, among other factors, to high levels of indexation and to the significant increases in real wages in recent years driven, in part, by increases in the minimum wage. In addition to this, there have been the effects of recent climate shocks and the necessary increases in gasoline prices to bring them to their international level.

So far in 2024, the decline in inflation has been led by adjustments in the prices of goods other than food, whose annual variation in June was 1.4%, well below the figure for December 2023 (7.1%). Substantial moderation of consumption, decrease of imported goods prices, and greater exchange rate stability have contributed to this result. Services have also contributed to lower inflation, albeit to a lesser extent, since it was 7.9% in June, contrary to the 9.0% recorded in December 2023. The relative rigidity of the services sub-basket is associated with the increase in the minimum wage and other wages, as well as with the importance of indexation formulas in the formation of several of these prices, as is the case with leases. The reduction in inflation of goods other than food, and to some extent that of services, has been reflected in the decrease in core inflation (inflation excluding food and regulated products), which stood at 6.0% in June, falling significantly compared to the result at the end of last year (8.4%) and the peak observed in June 2023 (10.5%).

In contrast, the annual change in food prices, which exerted significant downward pressures at the beginning of the year, reversed this trend in the second quarter mainly due to unfavorable weather conditions. Hence, food inflation stood at 5.3% in June, slightly higher than the 5.0% in December 2023. The reversal of food prices occurred mainly because of perishable foods, whose production was affected by the droughts from El Niño phenomenon.

Finally, the annual variation in regulated product prices fell significantly during the first half of 2024, from 17.2% in December 2023 to 13.3% in June 2024. After the adjustments made last year, the greater stability exhibited in the price of gasoline explained much of the decrease in inflation in this sub-basket. However, the relevance of indexation in utility prices and other factors that have affected electricity rates have prevented a more marked decline in this component of the consumer price index.

As mentioned before, monetary policy has played a key role in containing inflationary pressures caused by the overlap of persistent supply shocks with spending excesses that exceed the economy's productive capacity. Given the evidence of price increases and its forecasts, which showed an increasing trend in inflation, in September 2021 the BDBR began a progressive increase in the benchmark interest rate, which would lead monetary policy to a restrictive stance as required in those circumstances. The increases in this rate were implemented uninterruptedly and in different magnitudes, according to the information available to the BDBR in each of its sessions. Thus, the monetary policy interest rate went from 1.75% in September 2021 to 13.25% in May 2023, a level that remained unchanged until mid-December of that year, after which the BDBR began a progressive cut in the interest rate.

The decision of the Board of Directors to undertake a cycle of monetary policy loosening as of last December was based on the downward trend that annual inflation was exhibiting since April 2023 and the evidence that the restrictive monetary policy was meeting its objective of reducing excess spending in the economy. By June 2024, a cumulative cut of 2 percentage points (pp) in the policy interest rate had been conducted, which placed it at 11.25%.

Although the annual inflation rate has been reduced significantly, its level remains far from the target. The BDBR has stated its purpose of driving inflation around its 3.0% (+/-1.0%) goal by mid-2025. However, it is a process that is not free of risks that could slow this convergence. The risks include the downward rigidity that some services, including leases and energy tariffs, continue to show, the recent upturn in food prices, mainly perishables, and the possibility of a nominal exchange rate depreciation that could be passed on to domestic prices. In addition, despite the fact that inflation expectations have been showing a downward trend, they remain above the target at different terms, which promotes price indexation processes. In these circumstances, the BDBR requires special caution in the process of policy interest rate cuts, as discussed in detail in a special section of this *Report* (see shading 2).

Balance of Payments

Between January and March 2024, the checking account of the balance of payments registered a deficit of USD 1,924 million, USD 1,072 million lower than the reported in the same period of the previous year. As a share of quarterly GDP, the deficit fell from 3.7% of GDP in the first quarter of 2023 to 1.9% in the same period of 2024. The decrease in the checking account's deficit balance was explained by the better balance of the factor income item (USD 542 million), the favorable variation in the trade balance of services (USD 467 million), as well as by the increase in net income from current transfers (USD 235 million). These results were partially offset by the expansion in the trade deficit in goods (USD 171 million).

The improvement in the income balance sheet of the factors was mainly due to the reduction of the firms' profits with foreign direct investment (FDI) in Colombia, which was reflected in lower expenditures due to the remittance of profits. The lowest profits took place mostly in mining and quarrying, oil exploitation, financial institutions, and business, transport, and communications services. Furthermore, income from Colombia's investments abroad increased as a result of higher yields on foreign reserve assets and the increase in income associated with Colombia's direct investments abroad. This was partially offset by higher payments of external credit interest due to increases in international interest rates and, to a lesser extent, higher external debt balances.

Consequently, the trade balance showed a surplus of USD 125 million during the first trimester of 2024, contrary to a deficit of USD 343 m during the same period of 2023. This good result was made possible by higher sales of traditional services, especially travel services, due to the higher number of international travelers who arrived in the country. Sales of modern services also increased, among which the higher sales of computer services and technical services stand out.

Net current transfers showed a surplus of USD 3,332 million between January and March 2024, which exceeded the result of the first quarter of 2023 when they registered a surplus of USD 3,097. This significant progress was mainly explained by the higher income from worker remittances, which amounted to USD 2,721 m in the first quarter of 2024, with an annual increase of 9.9% (USD 245 m). These revenues are equivalent to 2.7% of quarterly GDP and 12.3% of current revenues of the balance of payments. Its growth was mainly explained by remittances sent from the United States and Spain.

The contribution of the aforementioned items to the improvement of the country's external balance in the first quarter of the year was limited by the increase in the trade deficit of goods. This deficit increased from USD 1,885 m in the first quarter of 2023 to USD 2,057 m in the first quarter of 2024. The widening of this imbalance was due to a stronger fall in exports of goods compared to the occurred with imports. The

contraction in export value was mainly due to lower sales of coal, ferronickel, and non-monetary gold, which were partly offset by higher sales of bananas and crude oil. In the case of coal, whose exported value showed the greatest decline, its fall was explained by the strong reduction in its implicit export price (41.5%), which could not be compensated by the higher quantities sold (7.5%). Implicit prices for other major exports, such as ferronickel, also strongly fell (46.2%). This caused the country's terms of trade to decrease 4.6% during the first quarter of 2024 regarding the same period in 2023. As for imports, the fall is mainly explained by lower external purchases of inputs and capital goods for the industry, transport equipment, and fuels and lubricants.

The country's financial account, including reserve assets, recorded net capital inflows of USD 1,397 m (1.4% of quarterly GDP) in the first quarter of 2024, down by USD 1,158 m from a year ago. The resources received by FDI (USD 3,620 m) and the income from foreign loan portfolio investments (USD 583 m) stand out. However, the amount by way of FDI was less than USD 489 m from what was received a year ago. This is mainly explained by the reduction in investments received in the activities of the manufacturing industry, oil, community and personal services, and electricity, gas, and water, while there was an increase in FDI in mining, commerce, and hotels.

By 2024, the technical staff projects a deficit in the checking account close to 2.8% of GDP, moderately higher than the deficit of 2.5% observed in 2023 and significantly lower than the deficit of 6.1% of GDP recorded in 2022. The country would maintain access to external financing, in a context of international interest rates and Colombian risk premium higher than its historical average. FDI would remain the main source of financing for the checking account deficit. However, it would be reduced compared to 2023, in line with lower international coal and oil prices and moderate economic growth.

Public Finance

The Medium-Term Fiscal Framework of 2024 (MTFF-24) presented by the Ministry of Finance in mid-June shows that the General Government (GG) showed a deficit of 2.7% of GDP in 2023, which means a reduction of 3.6 pp compared to 2022. This adjustment is explained by the improvement in the balance sheets of the social security subsector from the rest of the central level, to which the Fuel Price Stabilization Fund (FEPC in Spanish) belongs, and from CNG. The surplus of the FEPC, which closed at 0.4% of GDP in 2023, stands out, in contrast to the deficit of 1.3% registered a year ago. The correction of this imbalance was achieved thanks to the resources transferred by the nation to settle the outstanding obligations with Ecopetrol and other companies in the sector and the gradual and progressive adjustments in the price of gasoline that the CNG decreed since the end of 2022, to bring it closer to its international level. However, fiscal pressures still persist due to the differential in the price of diesel with its international equivalent, highlighting the need to reduce the subsidy granted to this fuel.

The adjustment of the CNG public finances in 2023 was supported by the impulse in tax collection derived from the reforms approved in 2021 and 2022, as well as by the good dynamism of economic and oil activity in those years. According to *MTFF-24*, in 2023, the fiscal deficit and net CNG debt reached 4.3% and 53.8% of GDP, respectively. This means a decrease in both indicators compared to 2022. In particular, the fiscal deficit reduction by 1.0 pp of GDP due to a higher increase in revenues, compared to expenses, stands out. This result was consistent with an overfulfilling

of 0.1 pp of GDP concerning the target established in the fiscal rule for the balance sheet of the Colombian Government.

The CNG deficit for 2024 would amount to the equivalent of 5.6% of GDP, according to the estimates presented in *MTFF-24*. This would mean a widening of the CNG imbalance by slightly more than one point of GDP compared to the deficit observed in 2023 (4.3% of GDP). This situation arises due to the lower tax revenues projected in *MTFF-24* and the increase in interest expense, which would not be offset by the cut in expenses of COP31 trillion (t) that the Government will apply to items other than interests.

The greater fiscal deficit of the National Government, together with the expected depreciation, would bring the net CNG debt to 55.3% of GDP at the end of 2024. Even though this represents an increase of 1.5 pp in the debt balance compared to what was observed in 2023, its projected level for 2024 would be consistent with the anchor value or prudent value of 55% of GDP associated with the fiscal rule.

According to *MTFF-24*, the fiscal deficit forecasts are consistent with compliance with the fiscal rule. However, as proposed by the Independent Fiscal Rule Committee (CARF in Spanish), there are risks regarding collection and spending expectations related to uncertainty about the additional resources expected by DIAN management, and the outlays that may be generated from the recent approval of pension reform. This could compromise compliance with the fiscal rule in the coming years.

Foreign Reserves

Net foreign reserves summed at USD 60,901 m as of 30 June 2024, which means an increase of USD 1,293.1 m this year. This increase is primarily due to the reserve accumulation program announced by the BDBR in December 2023. So far this year (as of 15 July), reserves have accumulated for USD 1,024.9 m, corresponding to 73% of the auctioned amount (USD 1,400 m) and 68% of the total amount of the reserve accumulation program (USD 1,500 m). Furthermore, this year's foreign reserves yields excluding the foreign exchange component amount to 1.43% (USD 864 m). This result is mainly explained by the higher interest rate levels, which have positively impacted the profitability of foreign reserves. This was partially offset by the devaluation of other reserve currencies vis-a-vis the US dollar.

An indicator widely used internationally to measure the appropriate level of foreign reserves is the methodology called *assessing reserve adequacy* (ARA), proposed by the IMF². This metric states that reserves must cover the main risks of the balance of payments in periods of pressure in the foreign exchange market, like those associated with loss of access to external financing, loss of confidence in local currency, reversal of capital flows, and possible collapse of external demand. An economy is considered to maintain adequate levels of reserves if the ARA ratio is between 1.0 and 1.5. Based on the information available as of June 2024, the IMF's ARA calculated for Colombia stands at 1.24.

Other indicators used to assess foreign reserves can give warning signs about the external vulnerability of economies. Among these are the ratios of foreign reserves to monetary aggregates, short-term external debt, and the checking account deficit. In the Colombian case, these indicators have remained relatively stable so far

2 FMI (2015). "Assessing Reserve Adequacy: Specific Proposals."

this year, and estimates show that the increase in foreign reserves has been sufficient to offset the decrease in the IMF³ flexible credit line (FCL). Thus, in June, these metrics pointed to the level of reserves remaining at adequate levels.

Banco de la República Profits

Banco de la República's profit at the end of the first half of 2024 amounted to COP4,088 billion (b) due to revenues of COP5,903 b and expenses of COP1,815 b. This profit was higher by COP39 b than that recorded in the same period of 2023.

Incomes during this period responded mainly to the foreign reserves yield, which amounted to COP3,770 b, with an increase of COP237 b compared to that received in the first half of the previous year. The expenses originated mainly from the remuneration to the deposits of the National Government in *Banrep*, which amounted to COP683 b, with a reduction of COP812 b compared to the first half of 2023, due, in particular, to the lower average balances held in *Banrep*. Corporate expenditures summed COP456 b with an annual increase of 7.6% compared to the same period in 2023. Personnel expenditures are included in this item, representing 64% of total corporate expenses.

By 2024, a profit of COP8,795 b is projected, lower by COP431 b than in 2023. This estimate has a high degree of uncertainty, considering the risks associated with the evolution of the foreign reserves yield and the growth and sources of expansion of the monetary base.

3 On 26 April 2024, the IMF approved a new two-year agreement in favor of Colombia under the FCL for an amount in special drawing rights (SDR) of 6,133.5 m (300% of Colombia's quota in the agency), which is equivalent to about USD8,100 m. This agreement will replace the previous one, approved in 2022, for an amount in SDRs of 7,155.7 m (corresponding to 350% of Colombia's quota), and will be considered by the Colombian authorities as a precautionary instrument to face external risks.

Box 1

Designation of *Banco de la República* as Administrator of the Reserve Fund of the Contributory Pillar of the Comprehensive Social Protection System for the Elderly¹

Law 2381 of 2024, “Whereby the Comprehensive Social Protection System for the Elderly, Disability, and Common Death is established, and other provisions are issued,” creates the Reserve Fund of the Contributory Pillar (hereinafter the Fund) and assigns its administration to *Banco de la República* (*Banrep*). This box presents some considerations regarding the main elements contained in Law 2381 of 2024 related to the function assigned to *Banrep*.

It should be noted that, during the processing of the bill, *Banrep* submitted comments related to the designation of *Banrep* as administrator of the Fund to the Congress of Colombia, the Government, and the public through communication GG-CA-07323-2024 dated 21 May 2024 (Annex B1.1) and its press release². These comments were intended to strengthen the public policy objectives pursued by the reform, proposing the construction of a solid legal framework that allows for a robust governance structure and adequate risk management, promoting efficient and transparent management of social security’s public resources.

The following are the major issues involved in the designation of *Banrep* as the administrator of the Fund within the framework of its constitutional function as the Government’s fiscal agent.

1. Purpose of the Reserve Fund of the Contributory Pillar

The Fund, as a savings mechanism, supports the National Government’s obligation to finance pensions under the pay-as-you-go component of the contributory pillar. In this regard, the responsibilities for financing pensions and covering any contingent risk are exclusively those of Colpensiones and the National Government, not of the Fund’s administrator.

The investment policy for the Fund’s resources is aligned with the investment policy set by the National Government and the Investment Committee. The investment policy will contribute to financing the pensions owed by Colpensiones.

The Fund’s resources must be allocated for purposes aligned with its objectives. It would be inconsistent to use them for financing operating expenses or investments, government plans, debt service, loans, or underwriting public and private debt issuances in the primary market.

2. The Role of *Banco de la República* as a Fiscal Agent

As the administrator of the Fund, *Banrep* operates within its constitutional function as the Government’s fiscal agent. Accordingly, the Fund’s resources must be recorded in *Banrep*’s off-balance-sheet accounts. A budgetary and accounting separation of the resources of *Banco de la República* would be maintained.

¹ See the letter at the following link: <https://www.banrep.gov.co/es/noticias/banrep-pronunci-posibilidad-administrar-fondo-ahorro-vejez> (available only in Spanish).

² <https://www.banrep.gov.co/es/noticias/banrep-pronunci-posibilidad-administrar-fondo-ahorro-vejez>

Banrep assumes sole responsibility of means and not of results in its role as administrator of the Fund, adhering to principles of prudence and diligence. Responsibilities of means are typical of management mandates in the capital market.

The administration of the Fund should not interfere with Banrep's core functions. Thus, this role will be exercised within a framework of operational independence from Banrep's other core functions.

The Steering Committee will establish the criteria for selecting the types of management contracts through which the resources will be managed, and investment decisions will be implemented, as well as for determining who will participate in the portfolio's management, and other technical and operational matters required for its management. Thus, following the mandates of the Steering Committee, Banrep will manage the fund's resources within the framework of its technical and operational autonomy.

3. Evaluation Criteria

The evaluation of the Fund should be subject to technical criteria, ensuring that investment and management decisions are evaluated collectively, considering the context of the investment portfolio rather than the performance of an individual investment. Thus, investments should be evaluated as part of an overall investment strategy in accordance with the risks and returns determined by the investment policy established by the Steering Committee. This would recognize that investment decisions are made based on changing market conditions and are subject to the effects of inflation or deflation, applicable taxes, and liquidity needs, among other factors. During specific periods, due to adverse market conditions, negative returns could be observed on specific investments or across the entire portfolio.

4. Composition of the Fund's Steering Committee: Expert Members

The Law assigns to the Board of Directors of Banco de la República (BDBR) the responsibility of appointing the expert members of the Steering Committee. The Fund will have a Steering Committee made up of seven members: the Minister of Finance and Public Credit or their delegate; the Minister of Labor or their delegate; the Director of the National Planning Department; and four experts in one or more of the disciplines indicated by law, who will be selected by the BDBR for a fixed term of five years and may be re-elected for another term.

The Fund's Steering Committee, as a governing body, must act in the best interest of the Fund and have a clear mandate, authority, and competence to perform its functions.

Annex B1.1



GG-CA-07323-2024

Bogotá D.C, 20 de mayo de 2024

Honorable Representante
MARTHA ALFONSO JURADO
Coordinadora Ponente
Comisión Séptima Constitucional Permanente - Congreso de la República
Bogotá D.C., Colombia

Asunto: Comentarios del Banco de la República al Proyecto de Ley No.293 de 2023 Senado
“Por medio de la cual se establece el sistema de protección social integral para la vejez, invalidez y muerte de origen común, y se dictan otras disposiciones”

Honorable Representante:

A continuación, se presentan los comentarios del Banco de la República (en adelante BR) al texto aprobado por la Plenaria del Senado en el trámite del Proyecto de Ley No. 293 de 2023 Senado (en adelante PL) en el cual se le designa como administrador del Fondo de Ahorro del Pilar Contributivo del Sistema de Protección Social Integral para la Vejez (en adelante el Fondo).

Agradecemos la confianza que a través de este acto deposita el Congreso de la República en el BR. Nuestros comentarios buscan contribuir a fortalecer los objetivos del proyecto y las finalidades de política pública que persigue, mediante la construcción de un marco legal sólido, que permita una estructura de gobierno robusta y una adecuada administración del riesgo, con el fin de asegurar una gestión eficiente y transparente de los recursos públicos de la seguridad social.

En ese contexto, y como se resaltaré más adelante, la ley debe concebir la participación del BR como administrador del Fondo en el marco de su función constitucional de servir como agente fiscal del gobierno, por lo que ejercerá su función en un marco de independencia operativa y sin resultar, por esta vía, siendo administrador de las pensiones o pagador directo de las mesadas pensionales. Consideramos asimismo que, en cumplimiento de lo establecido en el artículo 154 de la Constitución y teniendo en cuenta el alcance y la necesidad de coordinación interinstitucional que implica, el PL debe contar con el aval del gobierno.

A. Marco legal claro y objetivos del Fondo

1. El **marco legal** al que se sujete el Fondo debe ser claro, asegurar su correcta operación y el cumplimiento de sus objetivos, con el fin de soportar una estructura institucional y de gobernanza robusta y una clara delimitación de responsabilidades entre el Fondo y otras entidades.

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Annex B1.1
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- 1.1 Observamos que los artículos del PL que se refieren al Fondo requieren mayor claridad sobre los roles y responsabilidades de los órganos de gobierno del Fondo y de su administrador, y los lineamientos de administración y de inversión. En particular, falta precisión respecto del alcance del rol del Banco de la República como administrador del fondo.
- 1.2 El rol del Banco de la República como administrador del Fondo debe concebirse en el marco de su función constitucional de servir como agente fiscal del Gobierno. En este orden de ideas, esta entidad puede proveer una infraestructura técnica y operativa que le permita al Gobierno gestionar estos recursos, como responsable de dirigir el servicio público de seguridad social al que se refiere la Constitución. Sin embargo, no cabe dentro del rol constitucional de esta entidad asegurar la financiación de las pensiones ni definir los miembros del Comité Directivo. Consideramos inadecuado, en ese contexto, que el nombramiento de algunos miembros del Consejo Directivo quede en cabeza de la Junta Directiva de Banco de la República (JDBR).
- 1.3 Así mismo, es fundamental que se indique que las obligaciones del BR como administrador del Fondo serán **de medio y no de resultado**.
2. El **propósito** del Fondo debe estar claramente definido y divulgado públicamente. Esto facilita la formulación de estrategias de inversión apropiadas basadas en objetivos económicos y financieros y garantiza transparencia en su aplicación.
 - 2.1 Observamos que falta en el PL claridad respecto de la finalidad del Fondo, pues se le atribuye la función de financiar las pensiones del Componente de Prima Media del Pilar Contributivo, contribuir al cubrimiento del riesgo contingente de Colpensiones y asegurar un adecuado cubrimiento de las obligaciones del Componente de Prima Media del Pilar Contributivo. Debe ser claro que en el Componente de Prima Media del Pilar Contributivo las responsabilidades de financiar las pensiones y cubrir cualquier riesgo contingente son de Colpensiones y del Gobierno Nacional y no del administrador del Fondo, máxime cuando es bien conocido que dicho Fondo tiene un valor menor al del pasivo pensional. El hecho de que en la finalidad del Fondo se involucren aspectos que corresponden a otras entidades dificulta el cumplimiento de sus objetivos y la delimitación de responsabilidades.
 - 2.2 Es necesario aclarar los mandatos a los que se sujetaría el BR como administrador. El PL indica que se sometería *únicamente* a lo indicado en esta ley (art. 24), para luego señalar que debería considerar además el interés del Fondo y la política de inversiones que reglamente el Gobierno Nacional (art. 93). Adicionalmente, aunque no se señale de

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manera explícita, es posible entender que el BR debería atender también la política de administración de los recursos que expedirá el Comité Directivo.

3. El proyecto establece que la administración del Fondo no debe interferir con las funciones misionales del BR. Puesto que decisiones que el BR adelanta como ejecutor de la políticas monetaria, cambiaria y crediticia pueden afectar positiva o negativamente al Fondo, la ley debe reconocer explícitamente la prevalencia del mandato constitucional del BR de preservar la capacidad adquisitiva de la moneda.
4. Deben existir políticas, reglas y procedimientos claros y divulgados públicamente sobre las operaciones de **financiamiento, desacumulación y gasto** del Fondo.
 - 4.1 El PL deja estos asuntos, en su mayoría, al reglamento. Observamos que es necesario que los principios generales a los que se sometan estas operaciones queden establecidos en la ley y que se aclare que los órganos de administración del Fondo deben buscar generar rendimientos basados solamente en consideraciones económicas y financieras.
 - 4.2 Es de particular importancia que se establezcan en la ley los criterios a los que se someterá la **desacumulación** del Fondo, con el fin de asegurar que se cumpla su propósito legal y evitar que los recursos se utilicen con otros fines. Si bien el artículo 11 del PL señala que los aportes y cotizaciones no pueden usarse para financiar planes del Gobierno, no existe una disposición que señale de manera clara que los recursos del Fondo (los cuales no son equivalentes a los recursos de las cotizaciones) no pueden usarse para financiar gastos de funcionamiento o inversión, para financiar planes de gobierno o para el servicio de la deuda. Así mismo, debe señalarse que con cargo a los recursos del Fondo no pueden hacerse préstamos directos o suscribir emisiones de mercado primario.
 - 4.3 Falta también precisar en la ley los mecanismos por medio de los cuales los recursos del Fondo financian el componente de Prima Media del Pilar Contributivo. Se lee en el PL que será responsabilidad de Colpensiones reconocer y pagar las mesadas que se causen con base en el nuevo régimen, pero no se aclaran los mecanismos por medio de los cuales se apropiarán los recursos del Fondo en el presupuesto de Colpensiones. Es necesario también aclarar que el Fondo no será pagador directo de ninguna mesada pensional.

B. Marco institucional y estructura de gobierno

1. El marco de gobernanza del Fondo debe ser sólido y establecer una división clara y efectiva de roles y responsabilidades, para facilitar la rendición de cuentas.
 - 1.1 La gestión operativa debe llevarse a cabo de manera independiente, para garantizar que sus decisiones de inversión y operaciones se basen en consideraciones económicas y

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financieras consistentes con su política de inversión y objetivos. Por lo mismo, el Banco de la República, o quien actúe como administrador, no puede elegir a los miembros del Comité Directivo, en especial si este órgano aprueba la política de administración y emite concepto vinculante sobre la política de desacumulación.

- 1.2 Para cumplir con su finalidad como administrador del Fondo, el BR debe tener independencia operativa. Esto implica, entre otros, independencia para seleccionar los vehículos a través de los cuales se administrarán los recursos y se materializarán las decisiones de inversión, libertad en la elección de quienes participarán en la gestión del portafolio y demás asuntos técnicos y operativos requeridos para su gestión.
2. El **Comité Directivo** del Fondo, como órgano de gobierno, debe actuar en el mejor interés del Fondo, y contar con un mandato claro y la autoridad y competencia adecuados para llevar a cabo sus funciones.
 - 2.1 Para el adecuado funcionamiento del Comité Directivo, es necesario definir con claridad los mecanismos de designación de sus miembros, sus periodos, las condiciones en caso de ausencia temporal o definitiva de alguno de ellos, la contabilización de sus periodos, el código de buen gobierno y los mecanismos para gestionar los conflictos de interés, entre otros.
 - 2.2 En la ley debe señalarse claramente que el Comité Directivo es el responsable de establecer la estrategia y las políticas destinadas a alcanzar los objetivos del Fondo y es en última instancia el responsable de su desempeño.
3. Es indispensable designar un auditor del Fondo y un marco de rendición de cuentas de las operaciones. Para el efecto, en línea con la experiencia del Fondo de Ahorro y Estabilización, sugerimos que el auditor del Banco de la República sea el responsable de auditar el Fondo. Así mismo, debe detallarse la responsabilidad del Comité Directivo sobre el seguimiento del desempeño del Fondo, y la presentación y aprobación de los informes financieros.
4. Las decisiones de inversión y de administración deben ser evaluadas en forma conjunta, en contexto con el portafolio de inversiones. El desempeño de una inversión individual no debe evaluarse sin haber considerado la estrategia global de inversión, de acuerdo con los riesgos y rentabilidad determinados por la política de inversiones. En algunos periodos determinados por condiciones adversas del mercado, la totalidad del portafolio podrá también observar rentabilidades negativas.
5. Es importante que el Comité Directivo cuente con consultores y/o asesores externos especializados para el ejercicio de sus funciones. En cada caso, el Comité Directivo establecerá

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los criterios de selección. Todos los costos y gastos asociados al proceso de selección y contratación de los asesores se pagarán con cargo al Fondo.

6. Debe garantizarse la divulgación pública del (i) marco de gobernanza y los objetivos del Fondo, (ii) los mecanismos para garantizar la independencia operativa del Fondo; (iii) la información financiera relevante sobre el Fondo.

C. Marco de inversión y gestión del riesgo

1. En la ley debe señalarse con claridad que la política de inversión del Fondo debe ser clara y coherente con los objetivos del Fondo y con su tolerancia al riesgo, y que debe ser divulgada públicamente.
 - 1.1 Es conveniente que la política de inversiones se defina a nivel general en el reglamento y sea desarrollada posteriormente por el Comité Directivo, tal como se hizo en el Fondo de Ahorro y Estabilización. En cualquier caso, esta política debe autorizar al administrador, por intermedio de los terceros que designe (fiduciarias, fondos de pensiones, entre otros) para hacer inversiones en el exterior y debe aclarar que estas inversiones no hacen parte de las reservas internacionales del BR.
 - 1.2 Las decisiones de inversión del Fondo deben buscar maximizar los rendimientos financieros ajustados al riesgo, de manera consistente con la política de inversión, y basarse en fundamentos económicos y financieros. Las finalidades del Fondo definidas en la ley deben ajustarse para reflejar este principio. Si las decisiones de inversión están sujetas a consideraciones que no sean económicas y financieras, éstas deben establecerse claramente en las normas y en la política de inversión y ser divulgadas públicamente.
 - 1.3 Por lo mismo, deben revisarse las finalidades del Fondo, como ya se señaló. No resulta viable que a la administración del Fondo se le asigne el objetivo de “*generar la mejor mesada pensional*” ya que las mesadas pensionales del componente de Prima Media del Régimen Contributivo están explícitamente definidas por la Ley y la responsabilidad de pagarlas corresponde a Colpensiones y al Gobierno Nacional.
2. Es necesario incluir mecanismos para asegurar la transparencia en la gestión y administración del Fondo, en especial en lo relativo a los conflictos de interés y el acceso a información privilegiada. Es conveniente que la ley establezca estos principios generales, para ser tenidos en cuenta para el ejercicio de la facultad reglamentaria y para la expedición de los reglamentos de administración y de inversión.

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(continuation)

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3. La política de gestión de riesgos debe ser expedida por el Consejo Directivo y debe considerar los riesgos financieros, operativos, regulatorios y reputacionales. La gestión del riesgo del Fondo no puede ser una competencia exclusiva de su administrador.

En conclusión, es fundamental el establecimiento de un marco legal robusto, que permita una estructura de gobierno sólida en el marco de la cual se garantice la independencia operativa, con reglas claras sobre inversión y gestión de riesgo. Una estructura normativa y organizacional de este tipo asegura que la Junta Directiva del Banco de la República conserve su autonomía constitucional y garantiza un manejo responsable y transparente de los recursos del Componente de Prima Media del Pilar Contributivo.

Cordialmente,

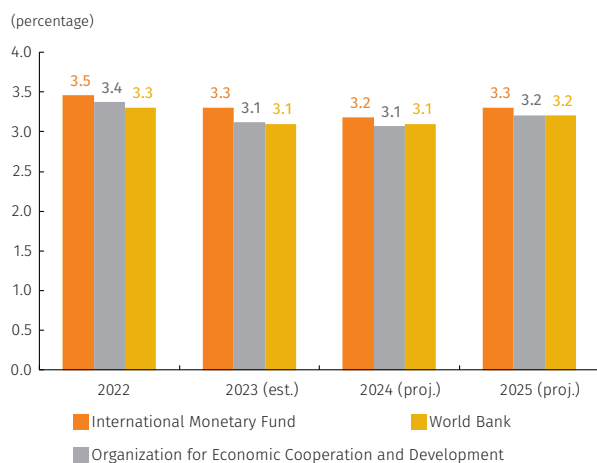

Leonardo Villar Gómez
Gerente
Gerencia General

2. Macroeconomic Environment

2.1 Evolution and Perspectives of the International Macroeconomic Environment

In the first quarter of 2024, the global economy continued to expand in an environment of inflation moderation and resilient labor markets. In this context, international organizations project a global growth in 2024 similar to that observed in 2023. During the second half of 2023 and so far in 2024, signs of more dynamic growth than expected by various international bodies and market analysts were observed in several global economies¹. The United States was the exception, as it experienced a downward surprise in first-quarter annual growth of 2.9%, albeit above its historical average². The global economy's resilience is projected to continue through the rest of 2024, albeit at moderate growth rates. In this sense, the IMF and the OECD project growth for 2024 of more than 3.0%³, similar to that observed the previous year (Graph 2.1). Macroeconomic policies in a context where macroeconomic policies would remain restrictive in most economies, with real interest rates remaining in contractionary territory and the gradual withdrawal of fiscal support. One exception would be China, where low interest rates and an increase of fiscal support of 7.5% of GDP are expected, which would support the Chinese government's announced 5.0% growth target. Although uncertainty remains high, the balance of risks has been leveling. It would consider the high geopolitical tensions remaining in Europe and the Middle East, which could generate additional disruptions in the energy market, adverse weather events, and the lagging impacts of contractionary monetary policies on global economic activity. This would be offset by increases in productivity in some advanced economies and domestic demand in such countries that could be stronger than expected insofar as a stronger reduction than that projected in inflation allows monetary policy to become less contractive for the remainder of 2024.

Graph 2.1
Global Economic Growth
(annual variation)



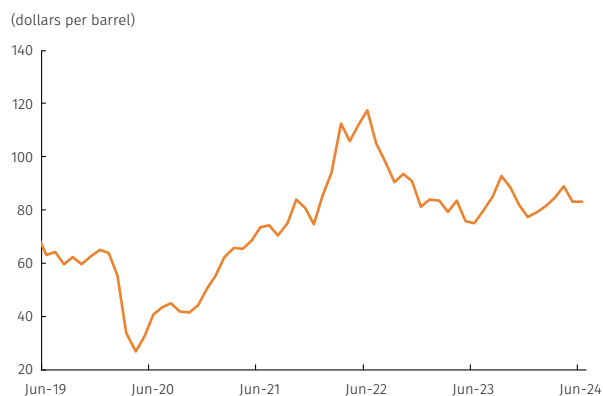
est.: estimated; proj.: projected

Source: International Monetary Fund (July 2024), World Bank (June 2024), Organization for Economic Cooperation and Development (May 2024).

The international oil price has increased in an environment of production cuts by the Organization of the Petroleum Exporting Countries and its allies (OPEC+) and increased geopolitical tensions in the Middle East and between Russia and Ukraine. In the first half of the year, the crude oil price for

- 1 For the first quarter of 2024, there were upward surprises in annual growth in countries such as India (7.8%), Indonesia (5.1%), China (5.3%), Brazil (2.5%), Chile (2.3%), Poland (2.0%), the Euro Zone (0.4%), and the United Kingdom (0.3%).
- 2 The historical average (2000-2023) of the annual growth of real GDP in the United States is 2.1%.
- 3 The IMF forecasts a 3.2% growth in the world economy and the OECD 3.1%.

Graph 2.2
International Oil Price^{a/}



a/ Brent Reference.
Source: Bloomberg.

the Brent benchmark was, on average, close to \$83 dollars per barrel (d/b), with an increase close to 4.0% compared to what was observed in the same period of 2023 (Graph 2.2). This dynamic occurred amid the execution of voluntary cuts to oil extraction by OPEC+ members, which would continue until September 2024⁴. Similarly, geopolitical tensions on account of conflicts in the Middle East and the continuation of the war between Russia and Ukraine have contributed to strengthening the prices throughout the year. Added to this is the reduction in production levels in Russia and the strong demand for crude oil, mainly driven by China and India's economic activity. However, the price increase has been limited by the increase in production levels in countries outside of OPEC+, of which the observed and expected production performance in the United States, Guiana, Canada, and Brazil stand out. Similarly, the increasing trend in production levels in some countries, such as Iran, has limited this increase. The July report of the United States Energy Information Administration (EIA) forecasts indicate that the price of Brent oil would average USD 86 per barrel (b) in 2024 and USD 88 per barrel in 2025.

The international price index of some of the main foodstuffs imported by Colombia has fallen in annual terms.

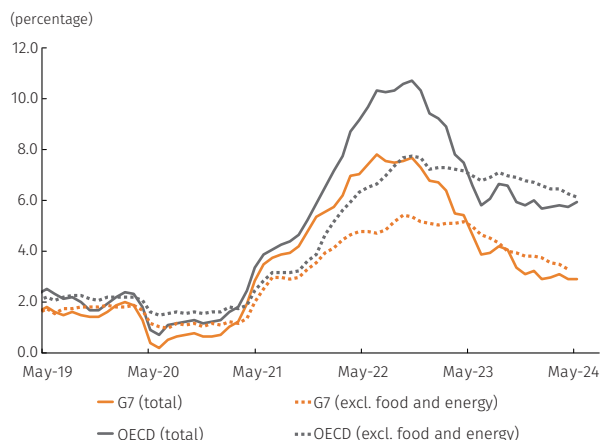
In June 2024, the World Bank cereal price index fell by 14% annually. The decline in corn (-28%), soy (-19%), and wheat (-17%) prices stands out, explained by the favorable outlook for their supply. Added to this is the annual drop (close to 15%) in fertilizer prices. According to the World Bank projections in its April report, the cereal price index is expected to decline by 11.3% in 2024 and 3.8% in 2025, while that of beverages and other foods would have a growth of 22% and 2.0%, respectively, in 2024, followed by a reduction of 12% and 2.8% in 2025.

So far in 2024, global inflation has continued to moderate but slower than expected. The decline has occurred amid contractionary monetary policy, tax consolidation in several countries, and a slowdown in some economies.

During 2023, the reduction in inflation worldwide resulted from lower energy and food prices, global economic slowdown, restrictive monetary policy, tax consolidation in several economies, and normalization in global supply chains. However, in the first quarter of 2024, this process was slightly reversed due to increases in international energy prices, rising sea transport costs, the persistence of service inflation, and labor markets that continued to tighten in several advanced countries with a workforce that remains below the number of jobs available and wage increases above total inflation. In line with this, in May 2024, the total annual inflation of OECD member countries was 5.9%, while for G7 countries, it

4 As of 2024, OPEC+ has kept voluntary cuts close to 2.2 million barrels per day. These would be in effect until September 2024, according to OPEC+ communication on 2 June.

Graph 2.3
Total CPI and CPI Excluding Food and Energy/
(annual variation)



a/ The countries in the G7 group are Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States.
Source: Organization for Economic Cooperation and Development (OECD).

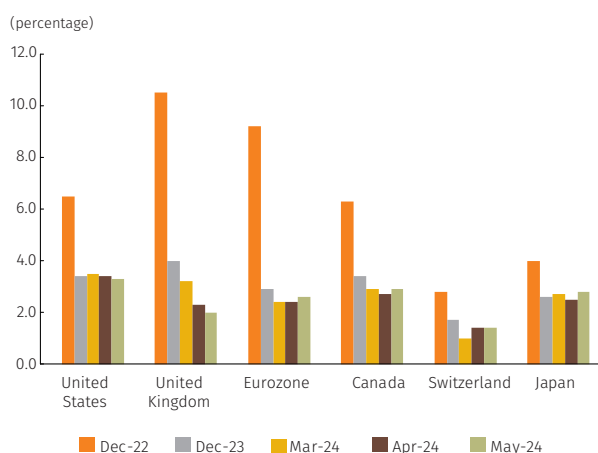
was 2.9%, values similar to those observed at the beginning of the year⁵ (Graph 2.3). In terms of core inflation (excluding food and energy), it continued to decrease so far in 2024 and, by April, was 6.2% for OECD member countries and 3.3% for G7. Inflation is expected to continue to decline for the rest of the year, driven by lower pressures on international prices of manufactured goods and energy. In this context, in its latest report, the IMF projects that global average total inflation would go from 6.7%, observed in 2023, to 5.9% in 2024 and 4.4% in 2025, representing a slower reduction than projected in its previous report.

Total inflation would continue to decline for the remainder of the year, but it would remain above target in some advanced economies and countries in the region.

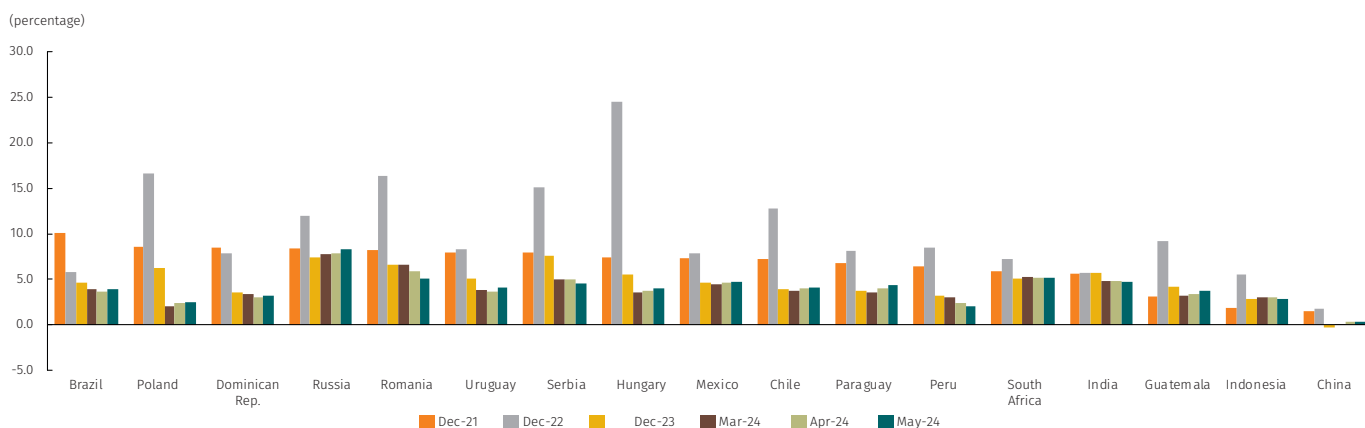
In some advanced economies, inflation moderated again in May 2024, following the upward surprises seen in the year's first quarter. In particular, the reduction in total annual inflation in the United States (3.3%) and the United Kingdom (2.0%) stands out, while some acceleration was observed in economies such as the Euro Zone (2.6%), Canada (2.9%), and Japan (2.8%) (Graph 2.4). In addition, core inflation continued to persist in advanced economies and in May was above total inflation in the United States (3.4%), the Euro Zone (2.9%), and the United Kingdom (3.5%). Similarly, in most emerging economies, there was an inflation acceleration in May, with records above core inflation in most cases. Thus, annual inflation in May for the major economies of Latin America stood at 3.9% in Brazil, 4.7% in Mexico, 4.1% in Chile, and 7.2% in Colombia (Graph 2.4, panel B). In accordance with the central banks' surveys, total inflation is expected to remain above its target at the end of 2024 in some of the main advanced economies, such as the United States and the Euro Zone, and in economies in the region, such as Colombia and Mexico.

Graph 2.4
Headline Consumer Inflation

A. Some advanced economies



B. Some major emerging economies and the region



Source: Bloomberg.

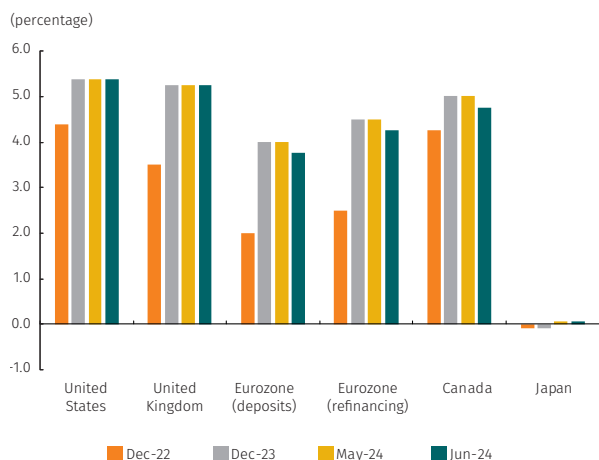
5 In January 2024, inflation for OECD member countries reached 5.7% and for G7 countries stood at 2.9%.

In Brazil, Peru, and Chile, 12-month inflation expectations and observed inflation are within their target range⁶.

The United States Federal Reserve (Fed) held its policy interest rate steady for the first half of the year. On the contrary, in other advanced economies, the first reductions have already occurred. In the United States, the Federal Open Market Committee (FOMC) kept its policy interest rate stable in the range of 5.25% to 5.50%, highlighting the good economic activity dynamics, the strength of the labor market, and the need to have greater confidence in the inflation trajectory before starting to cut interest rates. In line with the above, the median of the FOMC’s new projections released after its June meeting points to a 25 bps policy interest rate reduction, which would occur at the end of 2024 as inflation continues to moderate. On the contrary, at the end of the first half of 2024, the European Central Bank and the Bank of Canada began to reduce their policy interest rates despite the inflationary acceleration observed in May in these countries. In turn, in the first quarter of the year, Japan abandoned its policy of negative interest rates and yield curve control to control local inflationary pressures.

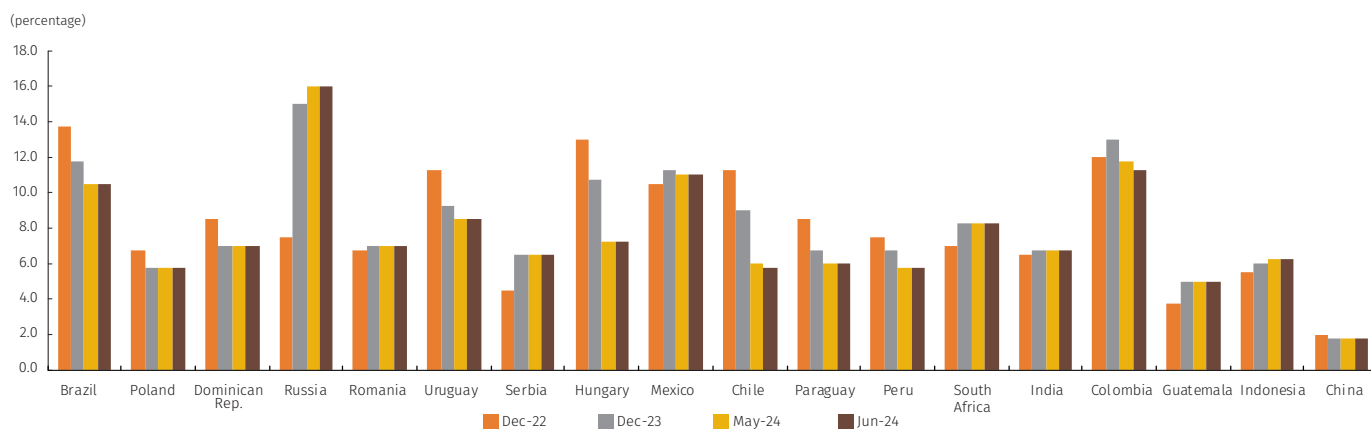
Graph 2.5
Monetary Policy Interest Rate in Some Economies

A. Some advanced economies



In some emerging economies, the cuts of monetary policy interest rates would continue insofar as inflation continues to moderate and their expectations are anchored at levels compatible with the target. As of June 2024, the monetary policy interest rate stood at 10.5% in Brazil, 8.5% in Uruguay, 6.0% in Paraguay, 11.0% in Mexico, 5.75% in Chile and Peru, and 11.25% in Colombia (Graph 2.5), after its peaks observed during 2023. Despite these reductions, in real terms, interest rates remain in contractionary territory (Graph 2.6). Other economies have kept their interest rates stable, such as India (6.75%), South Africa (8.25%), Indonesia (6.25%), Serbia (6.5%), Poland (5.75%), the Dominican Republic (7.0%),

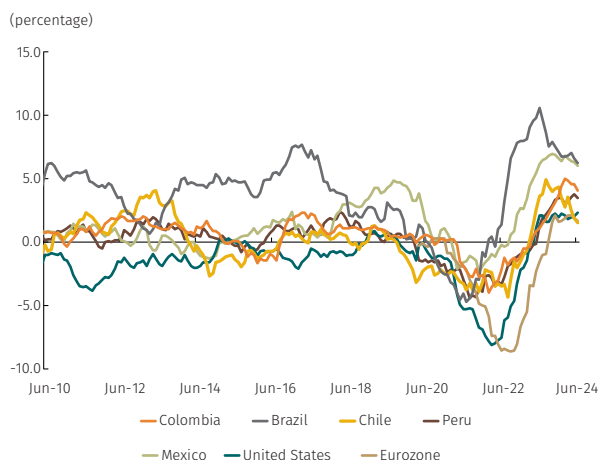
B. Some emerging and regional economies



Source: Bloomberg.

6 The inflation target in the United States and the Euro Zone is 2.0%. In Colombia, Mexico, Peru, and Chile it is 3.0%. In Brazil, it is 3.25% by 2024.

Graph 2.6
Ex Post^a Monetary Policy Interest Rate



a/ The real ex-post interest rate refers to the difference between the nominal monetary policy interest rate and the inflation observed for the same month. Sources: Bloomberg and central banks of each country; calculations by Banco de la República (the Central Bank of Colombia).

Guatemala (5.0%), and China (1.8%)⁷. Moving forward, interest rate reductions are expected in these countries, beginning in the second half of the year.

Developments around inflation and economic activity have led financial markets to significantly adjust their expectations about the cycle of interest rate cuts in major developed economies compared to what was expected at the beginning of the year. While the Fed and European Central Bank (ECB) were expected to make six cuts of 25 bps each in early 2024 during the year, only two are anticipated by the end of June. Despite the above, financial conditions in these economies remained relatively stable, given that expectations of higher interest rates, compared to what was discounted at the beginning of the year, were offset by the strength of the stock market and the compression of the credit spreads. In addition, towards the end of the period analyzed, the financial markets were also affected by electoral uncertainty in the face of the upcoming presidential elections in the United States and the parliamentary elections in France and the United Kingdom, which will be decisive for the fiscal future in these economies. Likewise, the persistence of geopolitical conflicts in the Middle East and Ukraine has led to episodes of volatility during the year. On the contrary, so far this July, monetary policy expectations have partially reversed the trend observed for much of the year, given the publication of some inflation and economic activity figures that have surprised the market downward. Thus, as of 23 July, the market is discounting three accumulated cuts during 2024 by both the Fed and the ECB.

In line with the above, interest rates on sovereign debt instruments increased globally. In major developed economies, these rates have increased by an average of 40 bps along the entire yield curve, affected by a less optimistic outlook on the monetary side and a greater uncertainty on the fiscal front. In Latin America, interest rates have risen by a greater magnitude⁸, influenced by the global environment and idiosyncratic factors, such as fiscal uncertainty in Brazil and Colombia. Similarly, the electoral result in Mexico (where the new Congress will have a pro-government majority) increased fears that legislators in the country could approve reforms that erode the checks on power and the institutional framework, and concerns that they promote reforms that could increase the government intervention in the economy.

The US dollar has strengthened against most developed and emerging countries' foreign currencies amid expectations that the Fed will delay its potential interest rate cut. Hence,

7 Corresponds to the seven-day repo rate set by the People's Bank of China.

8 Ten-year securities have devaluated by an average of 100 bps, while two-year securities have devaluated by 30 bps.

the DXY⁹ index has increased so far this year to 4.5% (as of 28 June), supported by the Fed’s release of some strong US economic data, higher-than-expected inflation figures, and a Fed stance perceived by the market as hawkish¹⁰. In this context, advanced economies’ currencies depreciated against the dollar (the yen, the euro, and the pound sterling) due to changes in monetary policy expectations in these economies. Similarly, Latin American currencies have depreciated, further affected by idiosyncratic factors. In contrast, so far this July (to 23 July), the dollar has weakened globally amid expectations of less contractive monetary policy in the United States.

The perception of risk internationally increased, particularly in the last months of the semester, after having registered low levels at the beginning of the year. The risk indicators globally, like Vix¹¹, Vstoxx¹², and Move¹³, upturned towards the end of the period as a result of adjustments in monetary policy expectations in developed economies, a higher political-economic uncertainty in Europe following the results of the European Parliament elections at the beginning of June, and the subsequent call for advance elections by the President of France, Emmanuel Macron (Graph 2.7).

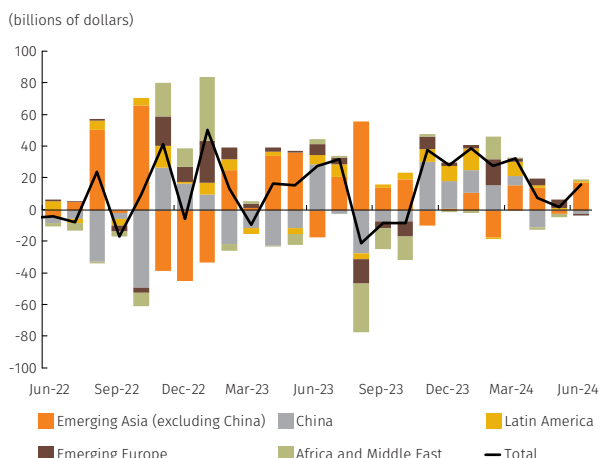
Net inflows of foreign portfolio investment to emerging economies have been observed in an amount higher than that observed in the same period of 2023. In accordance with available information from preliminary figures published by the Institute of International Finance (IIF), so far in 2024 (to June), net inflows of USD 126 billion (b) have been observed, of which USD 114 b and USD 12 b were directed to the debt and equity markets, respectively (Graph 2.8). This performance was mainly explained by inflows to China and emerging Europe. In the case of Latin America, portfolio capital flows had net inflows totaling USD 25 billion, of which USD 30 billion corresponded to fixed income market inflows and USD 5 billion to equity market outflows.

Graph 2.7
Risk Perception Indicators in International Financial Markets



Source: Bloomberg.

Graph 2.8
Total Portfolio Flows to Emerging Economies by Non-Residents (Equity and Debt)



Source: Institute of International Finance (IIF).

- 9 An index that compares the US foreign currency to six major currencies. The euro (EUR) weights 57.6%; the yen (JPY) 13.6%; the pound sterling (GBP) 11.9%; the Canadian dollar (CAD) 9.1%; the Swedish krona (SEK) 4.2% and the Swiss franc (CHF) 3.6%.
- 10 It is a term used to refer to the position of the members participating in the establishment of the benchmark rate and is usually associated with those who have a stronger position regarding the dynamics of inflation. In contrast, there is another term (*dovish*) to refer to those who give greater weight in their decisions to employment and economic activity considerations.
- 11 The Vix is the expected implied volatility in the one-month options on the S&P 500 index.
- 12 The Vstoxx is the expected implied volatility in the one-month options over the EuroStoxx 50 index.
- 13 The Move is the expected implied volatility in one-month options over treasuries.

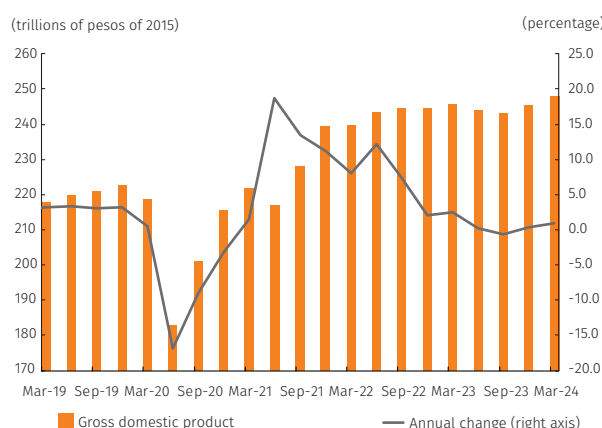
2.2 Evolution and Outlook of Economic Activity and the Labor Market

2.2.1 Economic Activity

During the first half of 2024, the Colombian economy grew at a slow rate, but it was higher than that observed in 2023 and with a tendency to recover. In accordance with the most recent publication of DANE, GDP registered an annual growth of 0.6% throughout 2023, which, despite being low compared to what was observed in previous years, reflects the reduction in excessive spending accumulated after the pandemic. The GDP figures for the first quarter of 2024, released by DANE in May, continue to show weak economic activity, with a growth rate of 0.9% per year - seasonally adjusted and corrected for calendar effects (DAEC in Spanish) series – (Graph 2.9). For the second quarter, the economy would have had a more favorable performance that, in accordance with the information available to date¹⁴, would be due to supply shocks in the agricultural sector and demand for some services. In this way, the economy would have continued to reflect the effects of a restrictive monetary policy, which seeks to reduce inflation, and a fiscal policy that last year led to an adjustment of the deficit of the Central National Government.

Low economic growth in the first half of this year would have continued to reflect a weak domestic demand with some signs of recovery (Table 2.1). Domestic demand registered an annual contraction in the first quarter of -2.6%, a magnitude similar to that observed in 2023. However, by the second quarter, *Banco de la República's* technical staff estimates indicate that it would have stopped falling. The reduction in overspending continued to be explained mainly by household consumption, which would have continued to grow at low rates. Although it remains at historically high levels and higher than those that would have been recorded if its pre-pandemic trend had continued. This would have allowed private savings to recover, which had decreased substantially since mid-2021. This dynamic of consumption continues to be due to interest rates that, in real terms, have remained high and credit that has grown little despite some signs of recovery at the end of the first half of the year. The consumption adjustment would have occurred mainly in durable and semi-durable goods, which had reached record levels until the beginning of 2023, partly stimulated by the VAT reduction measures. The correction would have been less marked for non-durable consumption, and for services, annual growths continue to be observed so far this year. Regarding public consumption, this would be sustained in the first half of the year at levels similar to those recorded during 2023, reporting, therefore, minimum annual growths. Hence, public consumption would have continued to contribute to

Graph 2.9
Gross Domestic Product^{a/}
(annual variation)



a/ Seasonally adjusted series and adjusted for calendar effects.
Source: National Administrative Department of Statistics (DANE in Spanish); calculations by *Banco de la República*.

¹⁴ This includes, but is not limited to, April's economic tracking indicator (ISE in Spanish), energy demand, road freight movement, regional economic pulse (PER in Spanish), and commercial bank transactions.

Table 2.1
Real Annual GDP Growth by Type of Expenditure^{a/}

	2023				2023	2024
	Q1	Q2	Q3	Q4	Full year	Q1
Final consumption expenditure	2.4	0.9	0.4	0.2	1.0	-0.3
Household final consumption expenditure	3.2	1.2	-0.2	-0.7	0.8	-0.1
Non-durable goods	3.5	1.6	0.4	-1.1	1.1	-0.1
Semi-durable goods	-2.1	-7.2	-6.9	-6.2	2.0	-6.5
Durable goods	-5.1	-14.3	-14.5	-7.7	-10.5	-8.2
Services	4.9	3.6	1.5	1.9	2.9	1.9
General government final consumption expenditure	-1.6	-0.1	3.2	5.4	1.6	0.9
Gross capital formation	-12.0	-24.5	-32.9	-32.5	-25.9	-14.6
Gross fixed capital formation	-3.9	-7.4	-11.3	-15.3	-9.5	-5.2
Housing	9.1	-1.0	-2.5	-9.6	-1.2	-7.0
Other buildings and structures	-7.0	-5.3	-9.5	3.0	-4.8	4.0
Machinery and equipment	-8.2	-16.0	-17.6	-27.6	-17.6	-5.6
Cultivated biological resources	0.6	6.2	7.2	4.7	4.6	2.4
Intellectual property products	-0.2	1.5	-0.7	2.1	0.7	2.7
Domestic demand	-0.4	-4.0	-6.9	-4.4	-4.0	-2.6
Exports	3.4	2.5	0.6	7.3	3.4	2.4
Imports	-8.0	-14.2	-23.2	-14.2	-15.0	-13.3
GDP	2.6	0.3	-0.7	0.4	0.6	0.9

a/ Corrected by seasonal adjustment and calendar effects, base year: 2015.
Source: DANE; calculations by Banco de la República.

the economic adjustment because, as a result of the pandemic, it recorded historical growths that, in part, have reversed.

So far this year, investment continued to show strong annual declines. Investment continued to perform poorly in an environment of high real interest rates, higher credit demands, and a reduction from the high levels recorded in previous years in components such as machinery and equipment. Within this aggregate, which fell 5.2% annually in the first quarter, the main cause was investment in machinery and equipment and, secondly, investment in housing. In addition, as observed during the second half of 2023, so far this year, there has been a significant de-accumulation of inventories, which has had a non-negligible effect on the fall in total investment. The performance of this spending component would be weaker than explained by the BDBR's increase in interest rates. Other factors outside of monetary policy and interest rates would have added to the fall of this item, such as those related to low levels of business confidence in an environment of perception of uncertainty regarding various aspects of public policy by the private sector; less foreign investment arrival, especially in the primary sector; changes in low-income housing policy, and very slow progress in investment programs at different levels of the public sector. However, at the beginning of the year, gross fixed capital formation increased quarterly, a performance that would have been extended to the second quarter. The recovery in the fixed investment margin would be driven by the impulse of civil works and improved machinery and equipment, particularly by capital goods for the industry.

In the first quarter, the reduction in the excesses of domestic spending continued to allow a decrease in imports, which, together with exports that continued to grow, led to a further decrease in the external imbalance measured in both dollars and pesos. The low growth of private consumption, but above all, the fall in investment continued to be reflected in a decrease in imports, which registered significant negative rates (-13.3% per year in the first quarter) and were similar to those observed in 2023. At the same time, exports increased annually (2.4% in the first quarter), particularly due to the dynamism of external sales of manufactures and services. Thanks to the above, in the first quarter, the trade deficit in constant pesos was reduced compared to what was observed a year ago and with respect to the end of 2023. It should be noted that the decrease in this external trade imbalance during 2023, which extended during the first quarter of 2024, translated into an adjustment of the deficit in the checking account (see Section 5.1 of this *Report*), which had its counterpart in a reduction in the savings-investment imbalance of the economy.

The lower dynamism of domestic spending also allowed for an additional decrease in the remaining excess demand in the economy, making it possible to reduce the inflationary pressures derived from spending. When the economy operates above its productive capacity (positive output gap), aggregate demand exceeds supply, impacting costs and prices, generating inflationary pressures, and diverting the economy from its sustainable growth path. Thus, the slowdown in domestic demand, which has resulted in annual decreases and, until the third quarter of 2023, decreases in its levels, has allowed further reductions in the large excesses of demand generated during 2021 and 2022. This, in turn, contributed to the continuation of the total and core inflation reduction process during the end of last year and the remainder of the current year.

The economic adjustment continued to have a heterogeneous impact on the different components of supply¹⁵ (Table 2.2). The annual growth of economic activity during the first quarter was mainly explained by the good performance of primary agricultural activities associated with crops other than coffee and livestock (pork and eggs), which registered an annual expansion of 3.1%. Tertiary activities also contributed, but to a lesser extent. Among these, the performance of entertainment services stands out, which continues to be driven by the boom in internet-operated games and online betting. Similarly, public administration, health, and education services, as a result of the public sector wage increase; and electricity, gas, and water services, caused by the high demand for regulated energy generated by the heat wave, stand out. In contrast, the secondary branches continued to contract in annual terms (-3.2%), especially due to the deterioration in the manufacturing industry and the subsector of residential and non-residential buildings, despite the better performance shown by civil works resulting from the progress of some regional projects. They include, the first line of the Bogotá Metro, the Valle road network, Magdalena I and II roads, and Accesos Norte II¹⁶.

The Colombian economy must gradually gain dynamism towards the second half of this year to recover growth rates close to those of its potential in 2025. The forecasts of *Banco de la República's* technical staff suggest a lower-than-potential annual growth rate for the remainder of the year, in an internal environment that

15 The primary branches are agriculture, livestock, fishing, exploitation of forest resources, and mining. The secondary branches are the industrial and construction sectors. The tertiary sector is made up of services in general, such as financial, transport, commercial, and professional activities.

16 For more detail, see Box 1.2: "Current Status of Fixed Investment in Colombia" in the *Medium-Term Fiscal Framework (MTFF)* of 2024.

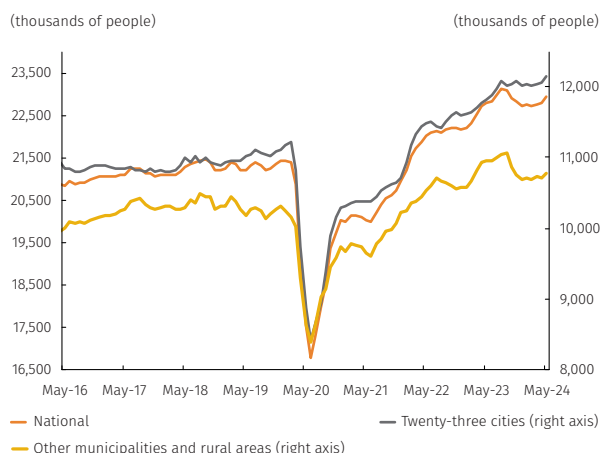
Table 2.2
Real Annual GDP Growth by Type of Economic Activity^{a/}

	2023				2023	2024
	Q1	Q2	Q3	Q4	Full year	Q1
Agriculture, Forestry, Hunting, and Fishing	0.8	-1.6	1.2	5.2	1.4	6.3
Mining and Quarrying	3.5	3.1	3.5	0.5	2.7	-1.6
Manufacturing Industry	1.4	-3.7	-6.6	-5.4	-3.6	-4.7
Electricity, Gas, and Water	1.6	1.4	2.6	2.8	2.1	4.6
Construction	-3.1	-3.1	-7.8	-2.2	-4.1	0.8
Buildings	2.4	4.1	-5.2	-1.2	-0.0	-2.4
Civil Works	-15.5	-16.4	-14.1	-2.0	-12.3	6.8
Specialized Construction Activities	-1.6	-1.9	-7.4	-2.2	-3.3	0.9
Commerce, Repair, Transportation, and Accommodation	-0.7	-3.5	-4.9	-2.0	-2.8	-1.2
Information and Communications	1.9	0.9	-0.8	4.0	1.5	-1.5
Financial and Insurance Activities	22.9	3.6	1.6	5.4	7.9	-3.0
Real Estate Activities	1.8	1.8	1.7	2.0	1.9	1.8
Professional, Scientific, and Technical Activities	1.7	0.9	-0.9	0.7	0.6	-0.3
Public Administration and Defense, Education and Health	-0.1	4.0	5.5	6.0	3.8	5.4
Arts, Entertainment, and Recreation Activities	14.5	11.2	5.2	-1.6	7.0	5.1
Subtotal value added	2.2	0.1	-0.4	0.6	0.6	1.0
Taxes less subsidies	6.1	1.4	-3.5	-1.7	0.5	0.4
GDP	2.6	0.3	-0.7	0.4	0.6	0.9

a/ Corrected by seasonal adjustment and calendar effects, base year: 2015.
Source: DANE; calculations by Banco de la República.

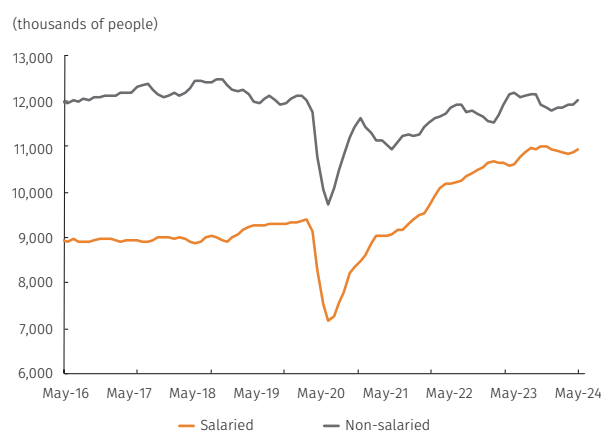
would gradually be more favorable, thanks to financial conditions that would gradually relax and inflation that would continue to give in. The above factors, as a whole, would enable better household consumption dynamics. However, no additional increases in public consumption are expected, given the spending adjustment announced by the Government for the second half of the year as a result of the reduction in the tax collection projection. As well as terms of trade that would continue to be lower than those recorded in 2023, which would contribute to lower national income. On the investment side, a significant reactivation is not expected for the rest of the year. Although greater dynamism is expected for 2025, by the hand of lower interest rates and greater progress in regional civil works projects, such as the Bogotá metro and others covered by the recently approved development plans of local administrations. The gradual growth of the economy would be consistent with more sustainable levels of productive capacity, which would allow annual reductions in inflation and its convergence with the target in 2025. It is also expected that these factors will also allow an additional closure of the external deficit. Nevertheless, *Banco de la República's* technical staff expects a growth close to 1.8% for all of 2024. Economic activity is expected to continue to accelerate next year as domestic demand and exports gain greater dynamism. It should be noted that these forecasts continue to face high levels of uncertainty related, in particular, to the high volatility that international financial conditions still reflect and the challenges in meeting the collection targets faced by the tax adjustment in Colombia.

Graph 2.10
Employed Population by Geographic Domain^{a/}



a/ Data on a quarterly moving average and seasonally adjusted data.
Source: DANE (GEIH); calculations by Banco de la República.

Graph 2.11
Employment by Occupation: National Aggregate^{a/}



a/ Data on a quarterly moving average and seasonally adjusted data.
Source: DANE (GEIH); calculations by Banco de la República.

2.2.2 Labor Market

So far in 2024, the employed population has remained relatively stable in all geographical domains in the national aggregate. In accordance with the data from the *Large Integrated Household Survey* (GEIH in Spanish)¹⁷, so far this year until May the employment series for the national aggregate remained relatively stable with levels close to 22.7 million employed. This employment performance has been observed in urban and rural areas (Graph 2.10). In particular, the fall that had been observed in other municipalities and the rural area during the second half of 2023 stopped and, so far this 2024, has remained at levels close to 10.7 million employed people. The stabilization of the domains of other municipalities and the rural area is explained by the better performance of the agricultural sector. In fact, during the first months of 2024, this sector, together with an upturn in employment in sectors such as commerce and manufacturing, has contributed positively to the variation in employment. However, these positive variations have been offset by significant reductions in employment in sectors such as professional activities, transport, and communications, as well as public administration, health, and education. The stability of employment was reflected in an employment to population rate (TO in Spanish) that remained at similar levels between May (57.3%) and December 2023 (57.2%).

The salaried segment, an important driver of the labor market during the post-pandemic period, has contracted so far this year. This situation has led to recent increases in the informality rate (TI in Spanish). The analysis by occupational position in the course of 2024 shows an unequal dynamic between the labor market segments. On the one hand, although its levels are still high, the salaried and formally employed population in the national aggregate has fallen slightly after being the most dynamic segment in recent years. This decrease in the salaried segment is confirmed by other sources of information, such as the records of the Integrated Record of Contributions to Social Security (PILA in Spanish) and family compensation fund affiliates. On the other hand, the contraction that occurred since September 2023 in the non-salaried segment slowed down in recent months; thus, the margin has a slight growth (Graph 2.11). This dynamic of non-salaried employment is aligned with employment in rural areas, whose fall also stopped, and with better employment performance in the agricultural sector. Thus, the reduction in salaried employment and the recent growth of the non-salaried segment explains why TI stood at 56.2% in May 2024, 1 pp higher than that recorded in December 2023.

Labor participation, measured through the Labor Force Participation rate (TGP in Spanish), has remained stable, particularly in urban areas. By geographical domains, in the 23

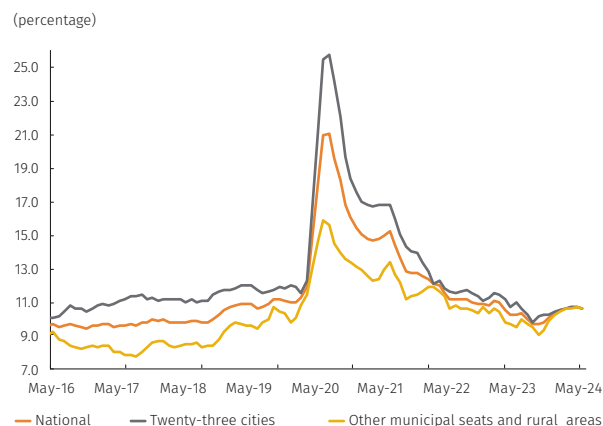
17 The labor market data for this Report are presented in a rolling quarter and seasonally adjusted.

Graph 2.12
Labor Force Participation Rate by Geographic Domain^{a/}



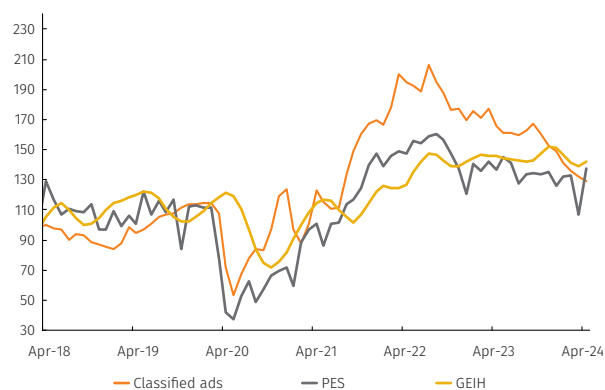
a/ Data on a quarterly moving average and seasonally adjusted data. Source: DANE (GEIH); calculations by Banco de la República.

Graph 2.13
Unemployment Rate by Geographic Domain^{a/}



a/ Data on a quarterly moving average and seasonally adjusted data. Source: DANE (GEIH); calculations by Banco de la República.

Graph 2.14
Job Vacancy Index from Different Sources^{a/}



a/ Seasonally adjusted data, base 2018. Source: Arango (2013), Morales, Hermida, and Dávalos (2019), Public Employment Service (SPE in Spanish); calculations by Banco de la República.

main cities, the TGP, which measures the proportion of the working age population that is employed or unemployed, has remained stable at around 66% so far in 2024. In turn, in other municipalities and the rural area, the TGP stabilized at levels close to 62% after having experienced significant contractions during the second half of the previous year (Graph 2.12). This is consistent with better employment performance in the non-salaried segment, which is overrepresented in such a domain. It is also characterized by a high degree of transition between employment and inactivity. By gender, in recent months, the exit of women from the workforce has stopped, implying increases in the TGP of women (0.6 pp) compared to what was recorded at the end of last year. Thus, the TGP of women stood at 52.8% in May, while men reached 76.2%.

The lower dynamism of the demand for labor, along with relatively stable labor participation, implied increases in the unemployment rate (TD in Spanish) in all geographical domains. During the first months of 2024, increases in TD were recorded. After this, the rate has remained relatively stable. Thus, between December 2023 and May 2024, the TD of the national aggregate increased by 0.2 pp and in the last month reached 10.5%. By geographical domains, for the same period, the TD of the 23 cities remained relatively constant, while in the other capitals and the rural area it grew by 0.3 pp, so in both domains, it stood at 10.5% (Graph 2.13). By gender, the TD of women remained practically unchanged compared to the end of the previous year, while in men, it increased by 0.3 pp. Thus, in May 2024, the TD of women was 12.9%, and that of men was 8.8%. This has allowed the gender gap in TD to continue to narrow, and for the last month, it stands at 4.1 pp.

Other labor demand indicators, such as vacancies and hiring expectations, show better performance on the margin. Some vacancy indicators, such as the one obtained from the GEIH, although showing a contraction of 6.3% compared to December 2023, show a slight growth in the last month. In addition, based on information from the Public Employment Service (*Servicio Público de Empleo* or SPE in Spanish), the vacancy index shows a positive variation of 9.1% in April relative to December 2023 (Graph 2.14). This improved performance of vacancies, seen in the data of the last few months, is in line with better-hiring expectations, according to the data of the Quarterly Survey of Economic Expectations (ETE in Spanish) of Banco de la República. This comes after this indicator contracted significantly during the second half of last year. Hence, the balance of hiring expectations, which measures the difference between the percentage of companies willing to expand their workforce and those that do not, was positive again (7.6 pp) after being in negative territory for two consecutive quarters.

2.3 Evolution and Outlooks of the Fiscal Situation

The General Government (GG) fiscal deficit¹⁸ experienced a significant correction in 2023 thanks to the adjustment of most of its components, in particular the Central National Government (CNG) and the fuel price stabilization fund¹⁹. According to figures from the recent Medium Term Fiscal Framework, 2024 (MTFF-24) presented by the Ministry of Finance, the GG deficit stood at 2.7% of GDP in 2023, representing a reduction of 3.6 pp compared to 2022²⁰. This adjustment responded to an improvement in the balance sheets of the social security sub-sector (1.5 pp), the rest of the central level (1.4 pp), to which the FEPC belongs, and the CNG (1.0 pp). The positive fiscal balance of the FEPC, which closed at 0.4% of GDP in 2023, stands out in contrast to the deficit of 1.3% registered a year ago. The reduction in the deficit position of the FEPC resulted from the adjustments implemented by the National Government to the price of gasoline since the end of 2022, which was reflected in closing the gap between the benchmark price and the price of gasoline in the local market at the end of 2023. However, fiscal pressures still persist due to the compensation differential in the case of ACPM (diesel fuel), which shows the importance of starting to reduce the subsidy granted to this fuel^{21,22}.

The adjustment of the CNG public finances in 2023 was supported by the impulse in tax collection derived from the reforms approved in 2021 and 2022, as well as by the good dynamism of economic and oil activity in those years. According to MTFF-24, in 2023, the fiscal deficit and net CNG debt reached 4.3% and 53.8% of GDP, respectively. It would mean a decrease in both indicators compared to 2022. In particular, the correction of the fiscal deficit by 1.0 pp of GDP due to a higher increase in income (2.6 pp of GDP) compared to expenses (1.6 pp of GDP) stands out. The increase in tax and oil revenues contributed to this favorable performance. A year ago, the good dynamism of economic activity also impacted higher income tax collection in 2023. In turn, the total spending of the CNG for 2023 amounted to 23.1% of GDP, evidencing the payment of interest for 3.9% of GDP and primary spending that reached 19.2% of GDP²³. Regarding the fiscal rule, the result of 2023 was con-

18 It should be remembered that the GG is made up of the CNG, regional and local governments, social security sector (pensions and health), and the other entities of the central level, among which the FEPC is included.

19 The net position of the FEPC is determined by the difference between the income to the producer (benchmark price) and the international prices of liquid fuels (LF) (parity price, which results from multiplying the international reference price of the LF by the exchange rate). The dynamics between the two prices multiplied by the amount of fuel sold in the period determines the fund's net position. Thus, when the benchmark price is higher than that of parity, a participation differential is generated (income of FEPC), while when this difference is negative, a compensation differential (expense) is generated (*Medium Term Fiscal Framework, 2022: 68*).

20 According to the DANE's methodology for the institutional sector economic accounts, the 2023 data reveal a GG deficit of 2.9% of GDP, which contrasts with the deficit of 5.3% of 2022.

21 The fiscal surplus recorded by the FEPC in 2023 results from the difference between the deficit caused (1.3% of GDP, equivalent to COP 20.5 t) and the resources transferred by the nation to the Fund to settle outstanding obligations with fuel importers and refiners accumulated until December 2022 (1.7% of GDP, COP 26.3 t).

22 In the process of reducing the ACPM price differential, with Decree 763 of June 2024, the Government established an adjustment in the price of diesel for large consumers, that is, those who have a special logistics operation and consume more than 20,000 gallons per month. It applies to oil, mining, cement companies, and other large consumers. It does not apply to gas stations or retail distributions.

23 Of this primary expenditure (i.e. operation plus investment), 1.7 pp correspond to payments by the nation to cover the net position of the FEPC.

sistent with an over-compliance of 0.2 pp of GDP concerning the target established for the net structural primary balance (NSPB)²⁴.

A deterioration of the total and primary balance of CNG compared to the previous year is projected for 2024, mainly due to the expected income deterioration. The projections presented in *MTFF-24* indicate that the total and primary deficit of CNG would reach 5.6% and 0.9% of GDP, respectively. This would imply an increase of 1.3 pp and 0.6 pp in these indicators, respectively, compared to what was recorded in 2023. The deterioration of 1.3 pp in the total balance sheet for 2024 would occur due to the fall in total income by 1.7 pp, exceeding the decrease in spending by 0.3 pp. The nation's income would go from COP 296.4 t in 2023 to COP 288.7 t in 2024, equivalent to a fall of 2.6%. This is mainly attributed to the lower collection of income and external tax payment quotas, as well as to the reduction of oil revenues on account of the drop in dividends issued by Ecopetrol and the collection of the oil industry's income tax. On the other hand, total spending is expected to increase from COP 363.3 t to COP 383.7 t between 2023 and 2024, with a growth of 5.6%. In annual terms, interest and primary expenditure would grow by 29.8% and 0.7%, respectively.

In line with what is projected for the CNG, an expansion of the GG fiscal deficit is expected between 2023 and 2024. According to *MTFF-24*, the GG's fiscal deficit would increase from 2.7% of the GDP observed in 2023 to 4.9% of the GDP in 2024. This is due to the CNG's deterioration in the fiscal balance by 1.3 pp of GDP and the lower surplus by 0.1 pp and 0.9 pp in regional and local governments and the social security sector, respectively. The fiscal balance of the FEPC, calculated as the difference between the net position caused and the payments received by the nation, would limit the deterioration of the GG deficit. Indeed, in 2024, the FEPC would reach a fiscal surplus of 0.4 pp higher than that recorded in 2023. The reduction of implicit subsidies on fuels mainly explains this.

The total CNG balance estimated for 2024 in *MTFF-24* implies a deterioration regarding the *Financial Plan (FP-24)* presented at the beginning of the year due to the increase in interest paid by the Government. The total deficit in 2024, equivalent to 5.6% of GDP, would increase by 0.3 pp of GDP compared to the *FP-24* due entirely to the upward revision of the interest payment. On the contrary, the primary deficit remained unchanged between both updates. The latter is attributable to the downward adjustment by about COP 31 t of both income and primary expenditure once the *MTFF-24* is compared with the *FP-24*, which meant that the primary deficit projections (0.9% of GDP) did not change.

The expected depreciation at the end of 2024, together with the larger fiscal deficit, would lead to an increase in net debt as a percentage of GDP between 2023 and 2024. The Ministry of Finance projects in its *MTFF-24* that the CNG's net debt would reach 55.3% of GDP at the end of 2024. Even though this represents an increase of 1.5 pp in the debt balance compared to what was observed in 2023, its projected level for 2024 would be equivalent to the anchor value or prudent value of 55% of GDP associated with the fiscal rule.

In accordance with the *MTFF-24*, the process of fiscal consolidation in the medium term would be largely supported by a gradual increase in tax revenues. The projections presented in *MTFF-24* indicate that the nation's tax revenues would gradually

²⁴ Law 2155 of 2021 stipulated that the operational targets of the fiscal rule must be defined on the BPNE. This variable corresponds to the fiscal balance after discounting interest expenses, income from financial yields, one-time transactions, and the cyclical components associated with the economic and oil cycle.

increase over the medium term, going from 15.4% of GDP in 2024 to 18.1% in 2035. This performance would be explained mainly by non-oil revenues associated with the accumulated collection from the DIAN's management. In addition, an increasing trend in oil tax revenues is expected in the production level increases between 2026 and 2032, accompanied by an average Brent price of \$89 dollars per barrel. Concerning the primary spending, it would remain relatively stable at around 18.1% of GDP between 2026 and 2030, a level similar to the 18.0% projected for 2024 and 2025 but higher by 2.2% of GDP than that observed in 2019. For the five-year period 2031-2035, the *MTFF-24* forecasts that primary spending will increase and will average around 18.8% of GDP.

Under the assumptions of *MTFF-24*, the fiscal deficit forecasts are consistent with the compliance of the fiscal rule, which is critical to ensuring the country's macroeconomic stability. However, as proposed by the Autonomous Committee for the Fiscal Rule (CARF in Spanish) in its assessment of *MTFF-24*²⁵, there are some risks around the collection and expense expectations that, if they materialize, could result in a failure to meet the fiscal rule's targets, especially in the period 2024-2027. The CARF highlights the uncertainty about the additional resources expected through the DIAN's management, which, if not materialized, would lead to lower levels of collection close to COP3.4 t and COP8 t in 2024 and 2025, respectively. In addition, the committee highlights that *MTFF-24* does not explicitly include expenses that can be generated from the recent approval of pension reform, especially those associated with the solidarity pillar that, in the short-term would amount to 0.3% of GDP²⁶. It also does not indicate the strategy to finance such expenses in line with compliance with the fiscal rule. In addition to the above, deviations from macroeconomic assumptions towards lower GDP growth rates or higher interest rates on debt would lead to a less favorable fiscal scenario and, therefore, to an additional effort of higher primary surpluses so that debt maintains a decreasing path.

The *MTFF-24* proposes to bring forward to 2025 the entry into force of the parametric mechanism of the 2026 fiscal rule based on the fact that the observed reduction in CNG's net debt has been somewhat faster than originally expected. Due to the unexpected fiscal shocks derived from the COVID-19 pandemic, Law 2155 of 2021 established a transitional regime of the fiscal rule between 2022 and 2025, with specific targets on the NSPB, regardless of the value of the debt that was always observed. Since 2026, the parametric formula that defines the new NSPB targets based on the difference between the observed debt and the level considered sustainable²⁷ would begin to be applied. Specifically, by 2025, the law mentioned above imposed a surplus of 0.5% of GDP for NSPB as a target. Bringing forward the entry into force of the parametric formula would imply having a target surplus of 0.2% of GDP in the NSPB²⁸.

25 Autonomous Committee for the Fiscal Rule (2023). "Statement No.11 on the Medium-term Fiscal Framework, 2024-2035" and its respective technical analysis document (carf.gov.co).

26 CARF also estimates that the semi-contributory and contributory pillar could generate additional fiscal spending that would reach a 0.4% of GDP on average between 2025 and 2028.

27 The parametric formula for the fiscal rule, established in Law 2155 of 2021, and which would begin to apply from 2026, is equal to: BPNE corresponds to the fiscal balance after discounting interest expenses, income from financial yields, one-time transactions, and the cyclical components associated with the economic and oil cycle.

28 Bringing forward to 2025 the entry into force of this formula would imply a BPNE equal to 0.2% of GDP.

Shaded Section 1 Regional Economy

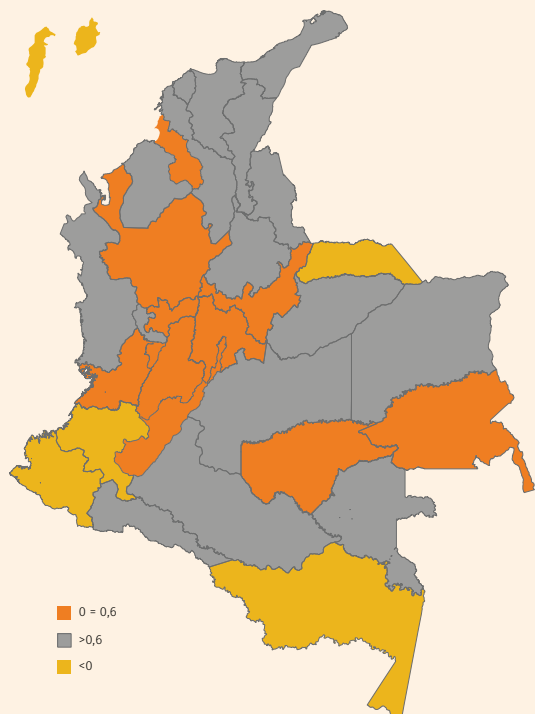
1. Overview of Departmental Economies in 2023

In 2023, the GDP of most departmental economies grew, except for Amazonas, Nariño, Cauca, Arauca, and San Andrés, Providencia, and Santa Catalina (Diagram S1.1). However, the pace of expansion was slow and lower than in 2022, a year characterized by excess aggregate demand in the economy. The dynamics in some regions were driven by the performance of primary activities, such as mining and the agricultural sector, as well as artistic and entertainment activities, which grew in all departments. In turn, the slowdown in most regions was associated with a contraction in commerce, industry, and construction activities, in line with low household consumption and business confidence.

The departments with the highest GDP growth were Meta, Putumayo, Cesar, La Guajira, and Chocó (Graph S1.1). In all these regions, mining activity led to positive results, with oil exploitation driving the growth in the first two, coal extraction in the third and fourth, and gold mining in the fifth. In Meta, the increase in oil production would be related to logistical improvements at the Caño Sur Este field and in water management at the Rubiales field, the main wells in the region. In contrast, San Andrés, Providencia, and Santa Catalina, Arauca, and Cauca reported the largest declines, experiencing sharp drops in their main economic activities. In the first case, the island's economy declined due to low demand for tourism services; in Arauca, the decline was caused by lower crude oil production, and in Cauca, its industry recorded the sharpest decline in the sector among all departments.

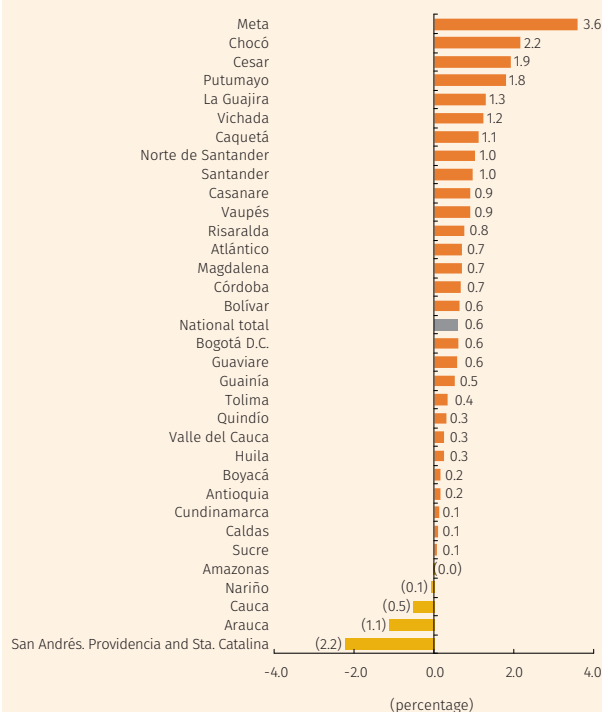
In addition to mining, the agricultural sector contributed to growth in more than half of the regional economies, highlighting the dynamics of several territories in the central part of the country, such as Huila, Tolima, Boyacá, and Cundinamarca, as well as in the Southwest, such as Cauca. Agricultural production increased, driven by improved weather conditions for crops, greater availability of inputs, higher domestic demand, and growth in agricultural credit disbursements. Notably, coffee production in Huila and Cauca, rice in Tolima, sugarcane in the Southwest, and *panela* cane and potatoes in Boyacá and Cundinamarca increased due to adequate rainfall levels during most of the year. In the livestock, leading regions in pork and poultry production, such as Antioquia and the Northeast region (Santanderes), respectively, were driven by an increase in consumption of these proteins amid reduced demand for beef due to high prices.

Diagram S1.1
Real Departmental GDP, 2023
(annual variation)



Source: DANE; calculations by Banco de la República.

Graph S1.1
Departmental GDP, 2023
(annual variation)



Source: DANE.

Meanwhile, artistic and entertainment activities positively contributed to growth in all the country's departments, although at a lower rate than reported in 2022. In Bogotá, Antioquia, and Atlántico, territories that accounted for more than half of the national GDP of this sector, the good performance of entertainment services was linked to concerts, the 2026 FIFA World Cup qualifiers, and the high demand for online gaming services. The latter, combined with gambling activities, stimulated growth in the economies of Norte de Santander, Risaralda, and Caldas to a greater extent than in other parts of the country.

Manufacturing production in industrial departments showed weak performance, consistent with an adjustment towards sustainable production levels after the excess supply during the post-pandemic period. Antioquia, Bogotá, Valle del Cauca, and Atlántico, which together accounted for 54.5% of national industry, exhibited a significant contraction. In all four regions, the food and beverage sector deteriorated as a result of lower product turnover due to high prices and the effect on consumption of the new health tax, which came into effect at the end of the year. In Antioquia and Bogotá, the manufacture of transport vehicles and chemicals also declined due to high inventory levels and lower domestic and foreign demand. The textiles and clothing sector, with significant shares in Antioquia and Valle del Cauca, also showed strong reductions after reaching a remarkable recovery in 2022. Other industrialized economies in the country with marked decreases in production were Cundinamarca and Cauca, registering declines in predominant activities such as non-metallic minerals and the production of sugar, panela, paper, and cardboard products, respectively. The only industrial departments that exhibited growth in this activity were Santander and Bolívar, driven by increased oil refining in Barrancabermeja and Cartagena.

The large sectors of commerce, transportation, and accommodation declined in all territories. The reduction in commerce was consistent with a moderation in private consumption and a contractionary monetary policy stance to control rising inflation. Additionally, households prioritized spending on essential goods, which was reflected in lower sales of computer equipment and household appliances. Consistent with this prioritization, the new motor vehicle sales highly contributed to the decline in retail sales, despite the normalization of unit availability in the market and the realization of the *Salón del Automóvil* (Auto Show) in Bogotá. In line with industrial performance, food and beverage sales declined, except for Santander, which recorded an annual increase. San Andrés experienced the largest decline in this large sector (5.7%), a territory mostly impacted by the decline in demand for tourism services. Departments in the Caribbean and *Eje Cafetero* regions were also affected by the cessation of operations of two

low-cost airlines and by the increase in air ticket prices and accommodation rates following the removal of the VAT exemption during the pandemic. In the *Eje Cafetero*, the orange alert on the Nevado del Ruiz volcano accentuated the loss of dynamism in tourism services.

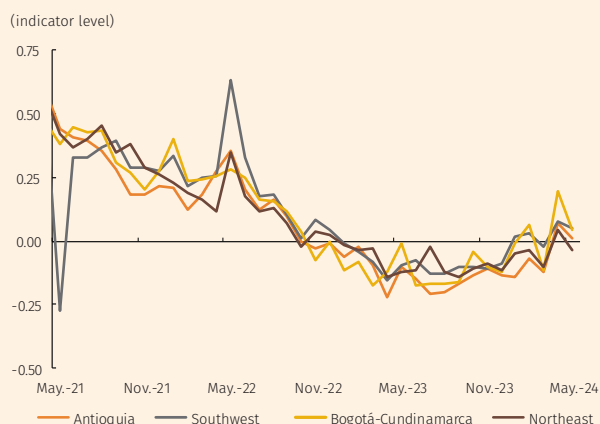
The construction sector also contracted in most territories, primarily explained by the deterioration in the building sector of residential and non-residential areas, which was offset, in some cases, by progress in civil works. Factors such as economic and political uncertainty, together with high interest rates, made it difficult for builders to close financial deals and delayed households' home-buying decisions. Despite the decline, Bogotá exhibited a greater execution of new works and roads due to the metro construction. Cundinamarca was one of the few regions with annual growth in construction GDP, highlighted by the development of industrial plants, aqueducts, and facilities for sports and recreation. Putumayo, San Andrés and Providencia, Risaralda, and Caldas also recorded increases attributed to the execution of civil works.

2. Evolution of the Regional Economy During 2024

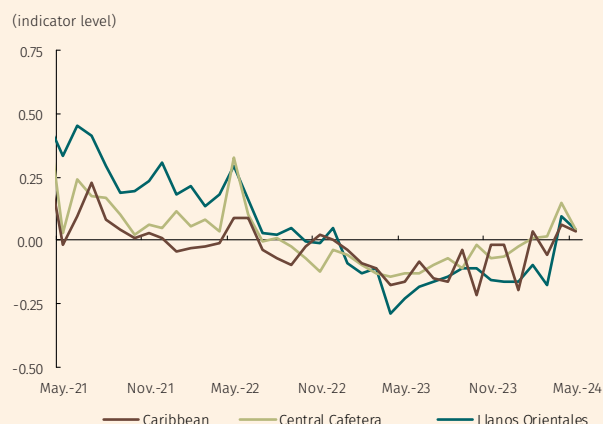
During the first five months of the year, regional economies exhibited signs of improvement recovery after remaining in negative territory throughout 2023, according to the Regional Economic Pulse (PER by its Spanish acronym) of *Banco de la República* (Graph S1.2, panels A and B). Indicators for the Southwest, Bogotá, and *Central Cafetera* regions recorded slightly positive values, while Antioquia, Northeast, the Caribbean, and *Llanos Orientales* experienced less

Graph S1.2
Regional Economic Pulse^{a/}

Panel A



Panel B



a/ The Regional Economic Pulse is constructed from monthly surveys of business owners and executives who share their perceptions about the annual performance of their companies and the factors driving such performance. The levels of the economic indicator fluctuate between -1 and 1, where values above zero represent annual growth and those below represent declines; it does not correspond to percentage variations. The indicator monitors six economic activities: agriculture, industry, commerce, transportation, finance, and housing. The monitoring regions are: Southwest (Valle del Cauca, Cauca, Nariño), Antioquia (Antioquia), Bogotá (Bogotá and Cundinamarca), Caribbean (Bolívar, Atlántico, Córdoba, Cesar, Magdalena, La Guajira, Sucre, and San Andrés and Providencia), Northeast (Santander, Norte de Santander, and Boyacá), Central Cafetera or Coffee Region (Caldas, Quindío, Risaralda, Tolima, Huila, and Caquetá), and Llanos Orientales (Meta and Casanare). For detailed information about the methodology and available series, visit: <https://www.banrep.gov.co/es/estadisticas-economicas/pulso-economico-regional>
Source: *Banco de la República*.

pronounced declines. Industrial production stabilized in regions such as the Southwest, Bogotá, and Antioquia, which would have contributed to their improved performance. However, according to PER sources, household consumption remained subdued and cautious due to economic uncertainty, despite the downward trend in the price level and a less restrictive monetary policy.

From January to May 2024, manufacturing production remained unchanged compared to the same period in the previous year. Industrial sources noted that the deceleration in domestic and foreign consumption persisted, along with high uncertainty and low investment levels, factors that reduced the activity's dynamism. Industrial production in the regions of Antioquia and Bogotá-Cundinamarca remained at similar levels to the previous year, adjusting their production to fulfill orders and reduce inventories. In turn, the Southwest industry grew slightly due to higher external orders and inventory replenishment in certain lines, as well as new contracts and operational improvements in some production plants in the Northeast. In contrast, the Caribbean industry declined, primarily due to reduced exports of chemicals in the face of lower international prices and a decline in the supply of non-metallic minerals, driven by high inventories and the closure of operations in some plants. Food production declined across all regions due to the impact of the new ultra-processed food tax on consumption.

Agricultural activity recorded positive results in most regions, with the exception of the Caribbean and Northeast, which were affected by the El Niño phenomenon. Agricultural production grew in Antioquia, driven by the export dynamics of the region's leading products, such as bananas and avocados. The Southwest increased its citrus and fruit production. Meanwhile, the agricultural sector in the *Central Cafetera* region was affected by high temperatures and reduced water availability, which reduced the quantity and quality of products such as coffee and rice. However, the subsequent moderation of the summer favored the productivity of different crops, benefiting the balance of this sector during the period. The opposite occurred in the Caribbean and *Llanos Orientales*, where adverse effects persisted, affecting rice production. A similar situation occurred in the Northeast, where production costs also increased. The livestock subsector improved in the Southwest, *Central Cafetera*, and *Llanos Orientales* regions due to increased demand for poultry, pork, and beef, and growth in the availability of livestock and poultry for processing. In the different regions, milk supply was adversely affected by a decrease in forage amid the intense summer and lower requirements of the industry. In the Caribbean, low dynamism in poultry and cattle further contracted the livestock sector.

Transportation reported positive performance across all regions except the Northeast. The air transportation segment stood out in the Caribbean, Bogotá, and *Llanos Orientales*, favored by the increase in domestic flight frequencies, the entry into operation of a new low-cost airline, and the implementation of commercial strategies in the face of high market competition. On the other hand, the air cargo segment was driven by external purchases via e-commerce platforms, where the flow of goods was concentrated at the Bogotá terminal. In land transportation, cargo mobilization advanced in most regions due to increased goods shipments. At the same time, inter-municipal passenger flow in the Southwest, Northeast, and Bogotá was a determining factor for the sector's positive performance. The transportation sector's dynamics in Northeast were hindered by operational difficulties in the urban passenger system.

On the contrary, domestic trade sales declined annually between January and May in all regions, with a more pronounced drop in Antioquia, *Central Cafetera*, Northeast, and the Caribbean. According to PER sources, this result was generally

attributed to cautious spending, lower customer flow, and a reduced willingness to borrow despite ongoing promotions and offers that mitigated the decline. Much of the sales drop in *Central Cafetera* and Antioquia was explained by lower average household spending, while Northeast and the Caribbean saw a low flow of customers, especially Venezuelans in the border area. In *Llanos Orientales*, the constant closures of the Llano highway negatively impacted the first half of the year. In turn, the Southwest and Bogotá regions exhibited the smallest declines, although economic and political conditions created caution and prioritization in purchases. The most affected sectors in most regions were construction and remodeling materials due to the low dynamics of the construction sector and processed food products due to new tax burdens. At the same time, new vehicle sales declined due to financing costs, high prices, and credit restrictions. Despite the slower demand for consumer credit, lower interest rates softened the decline in household and corporate debt. Moreover, commercial strategies and loan portfolio repurchases stimulated commercial loans in Bogotá and Antioquia.

Finally, hotel activity continued to decline during the first five months of the year. The Caribbean and Bogotá regions experienced the largest declines due to economic uncertainty and fewer corporate events. Additionally, occupancy was affected by ongoing mobility restrictions on the Bogotá-Villavicencio road in *Llanos Orientales*, while in Antioquia, foreign tourism predominated, with a preference for accommodations other than hotels.

3. Inflation and Monetary Policy Decisions

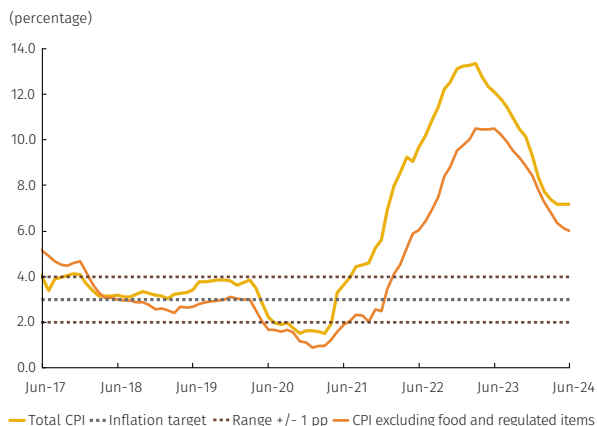
3.1 Evolution and Outlooks of Inflation

Upward pressures on inflation began to ease in the second half of last year and this trend was accentuated in the first quarter of 2024 thanks, in large part, to the cumulative effects of monetary policy. Since March last year, annual consumer inflation has fallen considerably, although it remains above the 3.0% target set by the BDBR. As widely expected, between March and June this trend was interrupted due to a lower comparison basis in the same period of 2023, when there were reductions in food prices. In particular, during the second quarter, total inflation remained stable and in June was 7.18%, a lower figure than that observed in December 2023 (9.28%) and March of this year (7.36%) (Graph 3.1). The significant decline in inflation can be attributed to several factors, among which the role of monetary policy stands out. Since mid-2022, the BDBR accelerated the adjustment of the policy interest rate in order to moderate the increasing demand pressures and, in this way, contribute to reducing the excess spending that was observed up to that point in the Colombian economy. This stance by the monetary authority also contributed to greater exchange rate stability and decreased the inflationary pressures from that front, as well as moderating inflation expectations. These effects, operating with lag, have continued to allow inflation to fall so far this year. It took place in a context in which external pressures and different supply shocks associated with the pandemic, the effects of the second quarter of 2021 strike, and the war in Ukraine were given in. However, inflation continues to be above the target, largely due to the inertia that characterizes price adjustments in Colombia. It is attributed, among other factors, to high levels of indexation in general and, particularly, to the significant increases in real wages in recent years driven partly by increases in the minimum wage.

So far this year, and unlike in 2023, much of the decrease in inflation has been focused on the consumer basket due, in particular, to the performance of inflation of goods other than food. Core inflation, measured as the consumer price index (CPI) excluding food and regulated products, stood at 6.0% in June, decreasing significantly compared to the result at the end of last year (8.42%) and the maximum observed in June of that year (10.51%). A considerable part of this decline was possible due to the slower pace of adjustment of the prices of non-food goods, whose annual variation in June was only 1.43%, well below the December 2023 record (7.11%). So far this year, as in much of 2023, the stabilization or decrease in international prices of imported goods, such as electronics, vehicles, and communication devices, among others, made it possible to decrease the inflation of this sub-basket. Now, it can be said that the upward shocks observed due to the pandemic have been fully overcome. Added to this is the greater stability of the exchange rate observed during much of the first half of 2024 and the substantial moderation in consumption.

To a lesser extent, services have also contributed to reducing both core and total inflation, although they still exhibit high rates. Annual services inflation gradually fell in the first months of the year to 7.89% in June, compared to a 8.96% registered in December 2023. A significant part of this decline was concentrated in food away from home (FAFH) that registered an annual variation of 9.75% in June of this year, contrary to the level close to 20% reached at the

Graph 3.1
CPI and CPI Excluding Food and Regulated Items
(annual variation)



Source: DANE; calculations by Banco de la República.

beginning of 2022 and 13.44% in December 2023. This has been made possible, in part, thanks to the slower pace of adjustment that food prices have shown. Other services that are particularly sensitive to demand performance, such as transport, package tour, nightclubs, and hotels, have also shown a significant decrease in the annual variation of their prices since the end of 2023 and so far in 2024. Despite the decline in services inflation, which can be attributed to the factors already mentioned, upward pressures persist in this basket that have prevented its faster decrease. They are associated with the significant increase in minimum wages and other salaries, as well as the influence of indexation formulas on the formation of several of these prices. The most relevant example in relation to the latter factor is that of leases, whose annual variation has continued to increase so far this year, going from 7.56% in December 2023 to 8.0% in June. It should be noted that this item is the one with the highest weight within the consumer basket with 25.2%.

Food, which exerted significant downward pressures at the beginning of the year, reversed this trend in the second quarter for reasons largely attributable to unfavorable weather conditions and factors associated with the performance of the agricultural cycle. The strong downward trend seen in the annual variation in food prices in 2023 and early 2024 was interrupted as of April this year with increases in the second quarter. It led food inflation to 5.3% in June, slightly higher than the 5.0% in December 2023. The reversal was mainly on account of perishable foods that, as had been anticipated, were affected by El Niño phenomenon and its impact on the agricultural cycle. On the contrary, the prices of processed foods, produced largely with imported raw materials and of a more tradable nature, continued to show a downward annual variation during much of the first half of the year. In this case, such a trend would be explained by the external shocks associated with the pandemic and war in Ukraine, the increased exchange rate stability, and moderate demand.

Although the regulated products basket maintains high annual growth rates in its prices, it has also contributed to the decrease in annual inflation, particularly since the domestic price of gasoline stabilized. After the sharp increases of 2023, the annual variation of regulated products decreased significantly during the first half of 2024, from 17.24% in December 2023 to 13.29% in June 2024. The greater stability exhibited in the price of gasoline after the necessary adjustments made last year explained much of the decrease in this sub-basket's annual variation. The importance of indexing utility prices, along with other factors that have affected electricity rates, has led to a less marked decline in these items. However, the annual adjustments are still very high. In the case of energy, in particular, the annual variation in June was 19.1%, similar to that recorded in December 2023 (20.7%).

For the remainder of the year, it is expected that the accumulated monetary policy actions and the dissolution of

some shocks, which have affected some prices, will continue contributing to the reduction of inflation. As well as it is expected that inflation will be in line with the target in 2025. These actions must contain inflationary pressures from demand and the exchange rate, and they should be reflected in a further reduction in core inflation in the remainder of the year. However, the presence of a significant indexing to previous inflation makes this convergence gradual and only happen by 2025. Although the annual adjustment of food prices must be sustained for a few more months at levels close to those observed in June 2024, towards the end of the year and for the next one, the adjustment must cede insofar as the effects of El Niño phenomenon disappear, in an environment of climatic conditions that are expected to be favorable¹. In addition, significant increases in the external prices of raw materials and agricultural inputs are not expected. In the case of regulated products, the increases made to date in utility rates determine high annual variation rates for this sub-basket, although decreasing. These forecasts assume there would be no significant readjustments of domestic gasoline prices. Diesel would have some additional upwards, which would not directly impact CPI. These forecasts face upside risks from potential pressures on the exchange rate caused by external and internal events, increased fiscal pressure that could have an expanding effect on aggregate demand and a more permanent rise in sea freight costs. If inflationary pressures were to materialize due to the risks as mentioned above, the indexing mechanisms would be activated at higher inflation rates, generating more persistent increases than those estimated in consumer prices.

So far in 2024, several of the inflation expectations measures lowered, and all have decreased as their terms increase. However, most of them still remain significantly above the target for the different horizons contemplated. For two-, three-, and five-year terms, the measures estimated based on public debt bonds (break-even inflation, BEI), adjusted for the inflationary risk and liquidity premium, decreased so far in 2024 to July by 139 bps, 110 bps, and 68 bps, and stood at 3.6%, 3.6%, and 3.5%, respectively. Likewise, the expectations of economic analysts, obtained from the monthly survey by *Banco de la República* applied in July, reduced their median for December 2024 in 28 bps compared to the January measurement and stand at 5.68%. On the contrary, for December 2025, they remained stable at around 3.8%. It should be noted that the analysts' two-year inflation expectations have remained within the 3.0% +/- 1 pp range over the past year. Despite this reduction, inflation expectations remain above those of the other countries in the region.

3.2 Monetary Policy Decisions

The actions taken by *Banco de la República* respond to the constitutional mandate to “preserve the purchasing power of the currency in coordination with the general economic policy.” In order to comply with the above, since 1999, the Board of Directors of *Banco de la República* (BDBR) has implemented an inflation targeting scheme with a flexible exchange rate regime, in which monetary policy actions are aimed at bringing inflation closer to the target (3.0% since 2001)² and

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- 1 In accordance with different meteorological agencies, the probability of La Niña phenomenon occurring in the second half of 2024 has increased, which usually increases the level of rainfall in Colombia. Nevertheless, this phenomenon would be moderate, in which case no adverse effects are expected on the country's agricultural production.
 - 2 Between 1991 and 2001, the BDBR set specific annual inflation targets. In November 2001, the BDBR reported that the long-term inflation target was 3.0% and explained that maintaining this objective was equivalent to promoting price stability in the country. From 2002 onwards, it began

reaching the maximum sustainable level of output and employment. This policy framework has, among other things, the advantage of facilitating monetary policy to be countercyclical so that, for example, an adverse external shock is reflected in a depreciation of the peso without it supposing, as in the past, necessarily lead to monetary restriction. In this framework, monetary policy decisions are made based on the analysis of the current state and the outlook for the economy, as well as the assessment of inflation and its expectations against the target. For example, if this analysis indicates that inflation could persistently deviate from 3.0% due to spending excesses or shortfalls against the economy's productive capacity, the monetary policy interest rate (MPR) is modified to return inflation to 3.0%. If the deviations are due to transitory factors (*e.g.*, a climatic phenomenon that affects food prices for a few months or temporary supply shocks) and inflation expectations remain anchored to the target, the MPR is not modified. On the contrary, if deviations initially considered transitory are accentuated due to more persistent inflation or by indexation processes, the MPR is modified to anchor expectations and contribute to inflation returning to target. This process of transmitting monetary policy is more efficient and less expensive if monetary policy is credible.

The decline in inflation, expectations more compatible with the target, the moderation of domestic demand, and a more sustainable external balance allowed the reduction in the monetary policy interest rate to continue. In the first half of 2024, total inflation and the core inflation measures continued to decline, but to levels that are still above target. On the contrary, medium- and long-term inflation expectations also declined and approached the 3.0% target. On the other hand, the latest indicators of economic activity suggest a recovery in economic growth (but at low rates) within a context in which the moderation of domestic demand has allowed economic activity to be brought to a trend level more compatible with productive capacity. It has contributed to inflation on a decreasing path and a more sustainable external position. In this macroeconomic environment, the BDBR decided to continue reducing the policy interest rate from 13.25% in December 2023 to 10.75% in July 2024. With these decisions taken, monetary policy maintains a stance in line to bring inflation to its target by mid-2025 while providing an impulse to the recovery of economic growth.

Insofar as the convergence of inflation and its expectations towards the target continues to consolidate and macroeconomic stability is reaffirmed, monetary policy can be less restrictive. Contractionary monetary policy has met its objective of reducing the economy's excess spending, which, added to the multiple and persistent supply shocks that have occurred since the pandemic, unleashed the strongest inflationary spiral that the country has faced since adopting the inflation targeting scheme. Going forward, the optimal pace of monetary policy normalization towards an interest rate consistent with low and stable inflation and a level of sustainable economic activity (neutral interest rate, see Box 2) depends on current and projected levels of inflation and economic growth and on consideration of the different risks that may affect those forecasts. Although moderation in aggregate demand has contributed to the reduction in inflation, inflation remains high, and its expectations exceed 3.0%. Added to this are some risks regarding the convergence of inflation to the target by mid-2025. For example, a persistent nominal depreciation due to adverse external financial conditions or increases in the country's risk perception in an environment of still high public debt can be passed through to domestic prices and stop inflation from falling. In particular, external

to announce an acceptable range around the specific target for the following year, the latter being the midpoint of this range. In mid-2009, inflation was around 3.0%, and since 2010, the inflation target has been focused on the long-term target (3.0%). See <https://www.banrep.gov.co/es/node/6354>

financing conditions could become less favorable as inflation in the United States becomes more persistent than expected by the Fed and delays interest rate cuts in that country. If the latter materializes, an accelerated decline in the MPR in Colombia could lead to a depreciation of peso that could translate into upward pressures on domestic prices. This is in the context of external and internal factors that could press the neutral interest rate of the Colombian economy upwards. On the domestic aspect, the downward rigidity of some services, such as leases, given the indexation mechanisms in this basket and the upturn in food prices and some public service tariffs (particularly electricity), may also slow down the convergence of inflation to the target. All these elements suggest that the reduction of MPR must be gradual to avoid very sharp declines in the interest rate, which will have to be reversed later in the face of the possible materialization of some of the aforementioned risks. Such reversals of the MPR would generate unwanted volatility that affects agent expectations, makes it difficult to converge inflation toward its target, and generates losses in overall well-being. Although it is desirable for monetary policy to support a more vigorous recovery in the country's economic activity, the process must be sustainable over time and compatible with the inflation target, which ensures lower interest rates in the medium-term and favorable conditions for investment and growth. The assessment of the state of the economy, its outlooks, and the risks mentioned will determine the rate of reduction of the policy interest rate (see Box 2).

Box 2

Determinants of the Adjustment Speed of the MPR

The levels of the monetary policy interest rate (MPR) are periodically set after deliberation processes within the Board of Directors of *Banco de la República* (BDBR). These discussions are informed by a detailed assessment of the performance of inflation, inflation expectations, economic growth, and other key variables affecting macroeconomic stability. This analysis is regularly carried out by the technical staff of *Banco de la República* and is presented quarterly in the *Monetary Policy Report*.

The current phase of interest rate cuts, which began in December 2023, has been made possible by the observed decline in headline and core inflation (excluding food and regulated items). This annual inflation peaked during the first half of 2023 (13.3% for headline inflation in March and 10.5% for core inflation in June), which began declining to 7.2% and 6.0% in June 2024 for headline and core inflation, respectively. This decline in inflation is largely due to the adjustment in economic activity, particularly in domestic demand. This adjustment, partially driven by a contractionary monetary policy that aimed at correcting significant internal and external imbalances of the post-pandemic economy, helped to reduce inflationary pressures stemming from domestic demand.

The question arises: at what speed and to what extent should the MPR be reduced? To answer this question, it is useful to introduce the concept of the neutral interest rate. First proposed by Wicksell (1898), the neutral interest rate is consistent with output growing at its potential level and inflation around its target (Laubach and Williams, 2003). Thus, if the MPR is set at a level equal to the neutral interest rate, monetary policy neither stimulates nor restricts economic growth, i.e., it is neither contractionary nor expansionary. On the contrary, if the MPR is above the neutral rate, monetary policy is contractionary, while if it is below, it is expansionary. The neutral interest rate can be decomposed into the sum of its real component and relevant inflation expectations. Its real level depends on structural factors outside the scope of monetary policy, such as long-term economic growth (which depends on productivity and demographics), aggregate savings and investment balances, or agents' levels of risk aversion, among other factors. There are mixed considerations about the current evolution of the real neutral interest rate determinants. On the one hand, demographic factors related to declining population growth and increased life expectancy would suggest a decrease in the neutral interest rate (Ho, 2024), which adds to the slow productivity growth observed in recent years. On the other hand, higher levels of public debt following the pandemic, along with the potential increase in global capital demand due to the accelerated development of artificial intelligence and the need for renewable energy, could suggest imbalances between aggregate savings and investment, generating upward pressure on neutral interest rates not only in Colombia but across much of the Western Hemisphere (Williams, 2024). Since the real neutral interest rate is an unobservable variable, *Banco de la República* has different methodologies for its estimation (see Grajales and Pulido, 2018), which are continuously updated and monitored.

The monetary policy has sought to be contractionary after the post-pandemic inflationary outbreak and this is reflected in the fact that the MPR was above its neutral level. Therefore, the answer to the question regarding the speed and limit of the MPR reduction depends on two different questions: 1) at what pace should the MPR converge to the neutral rate to stop being contractionary? (a process known as monetary policy normalization), and 2) what has happened to the level of the neutral rate?

Firstly, the optimal pace of monetary policy normalization depends on current and expected inflation and growth levels, as well as the consideration of risks that may affect these forecasts. On the first front, although inflation has been significantly reduced,

it remains high (7.2% as of June), compared to the 3.0% target to which the BDBR is committed under its constitutional mandate. This inflation exceeds that of other countries in the region, such as Chile, Peru, Brazil, and Mexico, which have inflation levels below 5.0%. Some of these countries waited for lower inflation levels than Colombia's to begin their normalization phases (see *Banco de la República*, 2024a). There are also upside risks to the still high inflation levels, which, although they have eased in recent months, have not disappeared. Domestically, there is uncertainty regarding the extent of indexation mechanisms, particularly in services prices. The annual variation in service prices has proven to be more rigid than that of other baskets, as many of these prices tend to adjust based on observed inflation and past minimum wage increases, given the labor-intensive nature of services. Additionally, there is uncertainty about the effects of climate phenomena on food and energy prices. Specifically, the annual adjustment in food prices increased from 4.4% to 5.3% between May and June, more than the technical staff had anticipated, due to the price rebound for certain perishable foods affected by the El Niño phenomenon. Externally, the pace of normalization of the US Federal Reserve's interest rate is expected to be gradual. In a context of relatively high Colombian debt risk premiums, it is more likely that if the Colombian MPR declines faster than the US MPR, upward pressures may arise on the exchange rate of the Colombian peso against the dollar. Such depreciation could, in turn, trigger upward pressures on inflation, hindering the convergence towards its target.

Secondly, regarding the neutral interest rate, the technical staff's estimates regarding its real component suggest that the considerations mentioned above about imbalances between savings and investment in a high-debt environment could weight more heavily and exhibit a real neutral interest rate that adjusts slightly upward during the forecast horizon, reaching an average of 2.5% in 2025 (*Banco de la República*, 2024b). As for inflation expectations, according to the July survey of economic analysts, they stand at around 4.2% for short-term horizons (twelve months), a value above the 4.0% tolerance range above the target, while for longer horizons, their level is closer to the inflation target. These expectations are also influenced by the expected pace of MPR adjustments, meaning that the terminal level of the MPR cuts (the nominal neutral interest rate) may depend, in turn, on the speed at which monetary policy normalization occurs.

All these factors suggest that the downward adjustment of the MPR should be carried out gradually. First, considerations regarding the optimal pace of normalization imply that there is a risk that rapid declines in the MPR may have to be reversed if upside inflation risks materialize. Such reversals of the MPR are undesirable, as increased volatility affects agents' expectations, hindering the convergence of inflation towards its target and ultimately resulting in general welfare losses (see, for example, Woodford, 2003). Furthermore, upside inflation risks increase the probability of missing the target, which could erode the credibility of monetary policy and make it less effective. This effect intensifies exponentially if such misses persist over several periods (for a recent quantification of this channel in Colombia, see Grajales et al., 2024). Finally, in an environment of growing macroeconomic imbalances, which exert upward pressures on the real neutral interest rate, a potential de-anchoring of inflation expectations, resulting from faster-than-expected declines in the MPR, would further increase the terminal levels of the MPR, so it is advisable to be cautious in the normalization process.

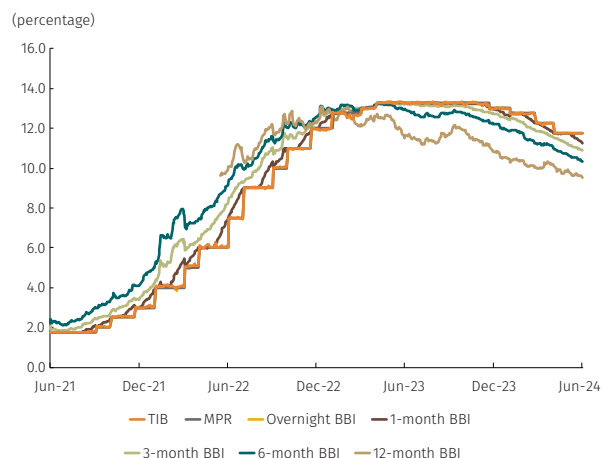
Thus, although a robust economic recovery is desirable, one that would undoubtedly benefit from a rapid easing of monetary policy, it is even more convenient that the process of monetary policy normalization occurs at a pace consistent with meeting the inflation target and ensuring growth converges toward a sustainable level. International experience exhibits that such normalization processes tend to be non-linear and more gradual as the MPR approaches its terminal point (Romer & Romer, 2024). Ultimately, it is essential that this normalization proceeds at a pace consistent with the considerations outlined here, particularly one that weights the potential materialization of risks to forecasts based on continuous monitoring of the new available information.

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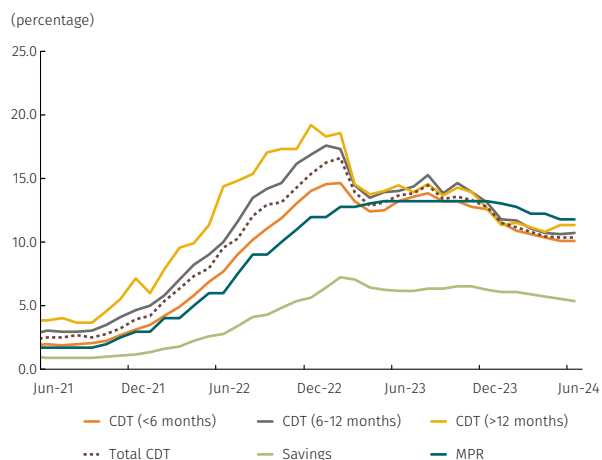
4. Financial and Credit Market Developments and Prospects

Graph 4.1
Monetary Policy Rate, Interbank Rate (TIB), and BBI^{a/}
(overnight, 1-month, 3-month, 6-month, and 12-month)



a/ Benchmark interbank rate (BBI)
 Sources: Banco de la República and Financial Superintendency of Colombia (Form 441).

Graph 4.2
Interest Rates on CDTs and Savings Deposits



Source: Banco de la República; calculations with information from the Financial Superintendency of Colombia (Form 441).

4.1 Financial Intermediation by Credit Institutions

Money market interest rates reflected reductions in the monetary policy interest rate (MPR). The overnight Benchmark Banking Indicator - BBI (IBR in Spanish) and the overnight Interbank Interest Rate (TIB in Spanish) are indicators of the funding cost of financial institutions in that term. During the first half of 2024, the overnight BBI and the TIB were in line with the MPR, decreasing by 122 bps and 120 bps¹, respectively. Compared to the end of December, the MPR was reduced by 125 bps, which included a 25-bps cut during the BDBR meeting on 19 December 2023. The three- and six-month BBI rates started to decline and have remained below the MPR since mid-2023, with reductions in 2024 surpassing the MPR amid declining inflation and decreasing inflation expectations. The fall in the 12-month BBI during the first half of this year has been less pronounced than for the three- and six-month² terms (Graph 4.1).

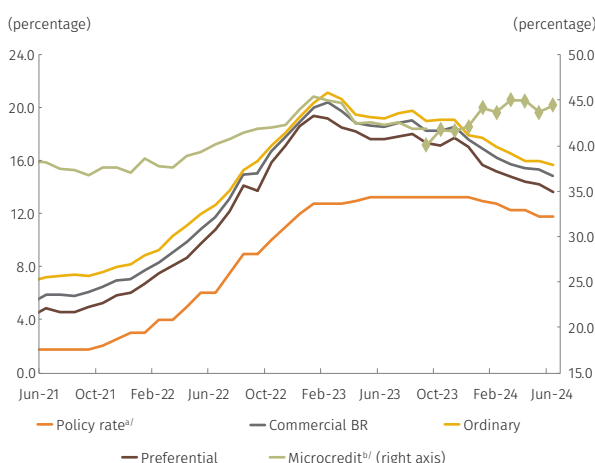
Falls in deposit and lending interest rates were also noted amid continued weak demand for credit. Deposit interest rates through Certificates of Deposit (CDT in Spanish) continued to decline. Market interest rates began to decline ahead of the monetary policy rate, starting in the first quarter of 2023 for passive rates and in the second quarter for credit interest rates, and since December 2023, deposit and lending rates have fallen more than the MPR. In particular, in the first half of 2024, the CDT³ rate fell by 239 bps, with more pronounced declines for maturities under one year⁴ (Graph 4.2). Savings deposit interest rates also saw reductions (86 bps), mainly in the legal people segment⁵. Loan interest rates continued to decline across all types of loans, especially in consumer and

- 1 On average, in the same period, the overnight BBI and the TIB were 1 bp below the MPR.
- 2 As of 28 June, compared to the end of December 2023, the one-month BBI decreased by 173 bps, the three- and six-month BBI by 187 bps, and the twelve-month BBI by 133 bps.
- 3 It corresponds to the average interest rate for CDT deposits at all terms, weighted by amount.
- 4 CDT rates for terms up to six months were reduced by 250 bps, for six to twelve months by 240 bps, and for over twelve months by 139 bps.
- 5 When comparing the average savings deposit interest rate (ordinary active) in June (as of the 28th) to that of December, rates for corporations fell by 154 bps, for official entities by 78 bps, while rates for individuals increased by 3 bps.

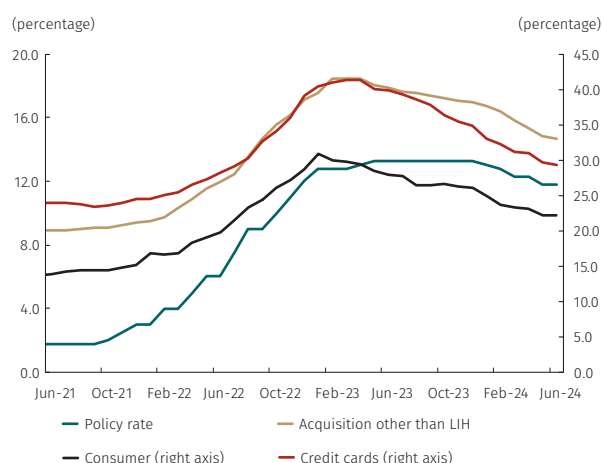
credit card loans, excluding microcredit (or productive credit)⁶ rates, which increased⁷ in the same period (Graph 4.3). In the consumer sector, the reduction in interest rates has been accompanied by an increase in disbursements through loans covered by automatic payroll deductions, which carry lower rates as they represent a lower-risk segment for financial intermediaries compared to other types of consumer credit⁸. The sharp declines in most deposit and lending interest rates suggest that, in addition to reflecting changes in monetary policy, they continue to anticipate future MPR cuts and possibly reflect the weaker credit market dynamics and the consequent reduction in funding needs by financial institutions.

Graph 4.3
Interest Rates on Loans

A. Loans to Business



B. Loans to Households



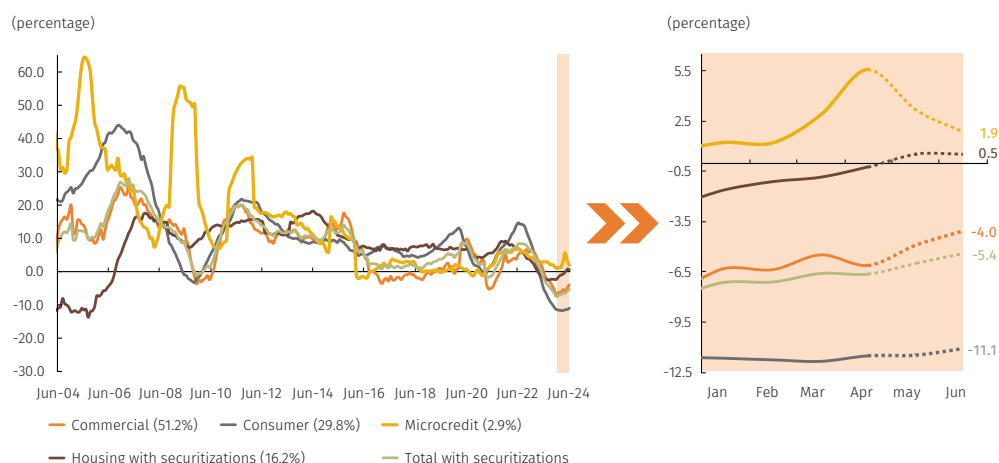
a/ The policy rate corresponds to the rate established by the BDBR at the monthly meeting; other rates correspond to the monthly average (weighted by amount). b/ Excludes loans granted through rediscounting.
Source: Banco de la República; calculations with information from the Financial Superintendency of Colombia (forms 088 and 414).

In line with the macroeconomic adjustment, the balance of the loan portfolio provided by credit institutions (CIs) continued to show negative real growth throughout 2024, although the contraction rate has slowed compared to the previous year. Nominally, the credit balance has stabilized. Since mid-2023, the nominal total gross loan portfolio of CIs has remained relatively steady at around COP 673.0 trillion (t) (42.5% of GDP). This trend is largely attributed to the commercial loan portfolio, which accounts for about half of the total loan portfolio. In contrast, the consumer loan portfolio (the second largest type of loan) continued to decline, while the housing loan portfolio increased. In terms of annual growth rate, as of June 2024, the total gross loan portfolio registered a real annual decrease of 6.0%

- 6 As of April 2023, productive credit types of loans were established (in accordance with Decree 455 of 29 March 2023 of the Ministry of Finance), replacing microcredit. The sub-types include rural and urban productive popular credits (less than 6 legal monthly minimum wages in force [SMMLV in Spanish]), rural and urban productive credits (between 6 and 25 SMMLV), and higher productive credits (between 25 and 120 SMMLV).
- 7 So far (to June) of the year, commercial loan rates decreased by 279 bps (ordinary loans by 227 bps and preferential loans by 341 bps), consumer (-396 bps), credit card (-549 bps), acquisition of non-LIH (low-income housing) (-231 bps), acquisition of LIH housing (-192 bps), while microcredit increased by 238 bps (the most significant increases occurred in the popular productive segment (less than 6 SMMLV), partly due to increases in the respective usury rates for rural and urban credits).
- 8 For loans granted through loans covered by automatic payroll deductions, payments are deducted directly from the debtor's payroll, which reduces the probability of default, provided the debtor remains employed.

and a nominal annual increase of 1.7% (Graph 4.4). The real slowdown observed since early 2023 can be attributed to lower demand for credit, according to CIs perceptions, a tighter supply of credit, and more stringent lending requirements compared to 2022⁹. The decline in the total loan portfolio is mainly due to lower real growth rates for consumer, commercial, and housing loans compared to the 2020 levels. However, since the beginning of 2024, the rate of contraction for these loan portfolios has slowed compared to late 2023, with a slight recovery in the housing portfolio. Meanwhile, microcredit has shown positive growth rates since March 2021.

Graph 4.4
Annual Real Growth of the Gross Loan Portfolio of Credit Institutions



Note 1: The dotted lines correspond to preliminary data for May 2024 from Form 281 of the Financial Superintendency of Colombia, which has weekly information on the main balance sheet accounts of credit institutions.

Note 2: The real growth rates presented in this graph were calculated using the consumer price index less food.

Note 3: The share of each type of loan in the total gross loan portfolio is shown in parentheses.

Source: Financial Superintendency of Colombia and Titularizadora de Colombia; calculations by Banco de la República.

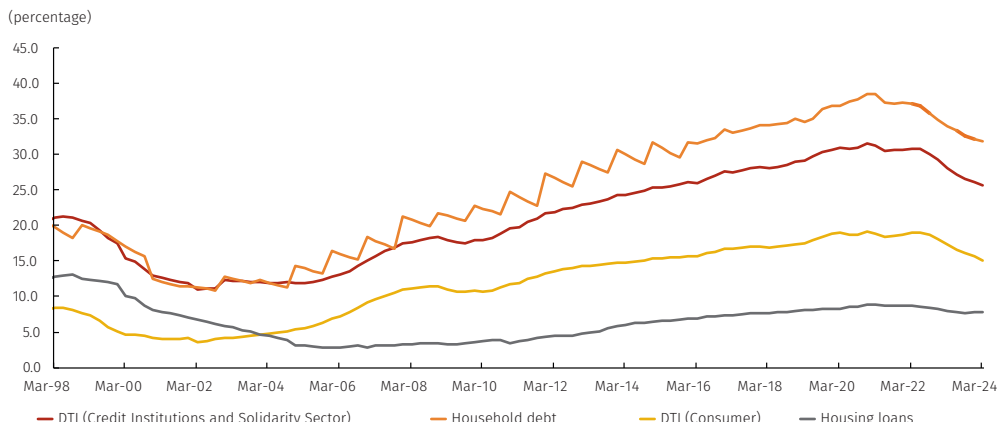
The household debt-to-income ratio continues to decline from the historically high values observed in 2022, in line with the slower growth of their debt portfolio.

As of March 2024, household leverage, as measured by the debt-to-disposable-income (DTI) ratio, completed seven consecutive quarters of reductions (Graph 4.5). This trend is explained by the fact that income continues to grow at rates higher than those of indebtedness. Household income, in turn, has benefited from high levels of remittances, which reached record highs by May 2024.

Likewise, as of the first quarter of the year, household savings continued to recover. In accordance with DANE's national accounts by institutional sector, annual household savings continued to exhibit increases in the last half of the year. This performance is mainly explained by lower growth in expenditure (Graph 4.6).

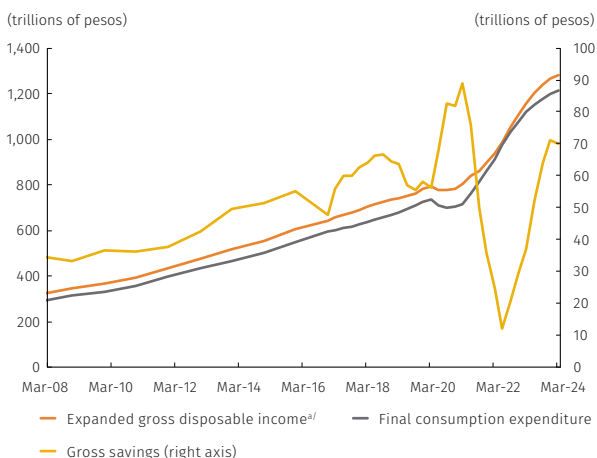
9 The perception of credit supply and demand referred to comes from the *Survey on the Credit Situation in Colombia* that applies to local credit institutions, available at: <https://www.banrep.gov.co/es/publicaciones-investigaciones/reporte-situacion-credito-colombia>

Graph 4.5
Household Debt to Disposable Income



Note: The graphs present the debt-to-income (DTI) ratio. To do this, the gross adjusted disposable income of households from the national accounts by institutional sector is used. The graph shows four measures of debt:
 Red Line: Household debt with credit institutions supervised by the Financial Superintendency of Colombia, savings and loan cooperatives, employee funds, and the Colombian Securitization Office.
 Orange Line: Household debt from the balances of the financial accounts published by *Banco de la República*. In addition to what is included in the red line, it includes microcredits and commercial loans owed by individuals, as well as obligations to other financial institutions.
 Yellow line: Consumer loans with credit institutions.
 Grey line: Housing loans with credit institutions.
 Sources: Financial Superintendency of Colombia, Superintendence of Solidary Economy, Colombian Securitization Office, *Banco de la República*, and DANE; calculations by *Banco de la República*.

Graph 4.6
Gross Savings of Households and its Components

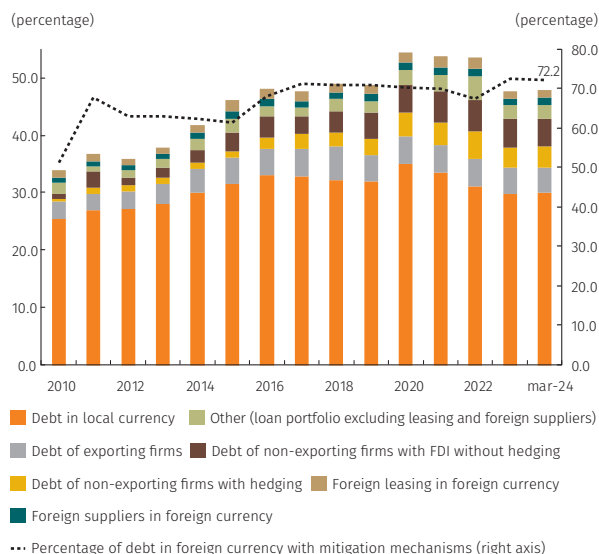


a/ Corresponds to gross disposable income including the adjustment for the variation in the net participation of households in pension funds.
 Source: DANE; calculations by *Banco de la República*.

Corporate sector borrowing as a share of GDP remained relatively stable in 2024, following declines in 2023, amid lower investment and a contraction in the real loan portfolio. As of March 2024, private corporate sector debt accounted to 47.9% of annual GDP, a level similar to that at the end of 2023 and lower than the figures observed between 2020 and 2022 (Graph 4.7). The reduction in debt as a share of GDP since 2023 is primarily attributed to the appreciation of the peso and its effect on dollar-denominated debt, (which, as of March 2024, represented 18.0% of GDP), as well as the lower growth of the commercial loan portfolio in a context of lower investment. In addition, the share of foreign currency debt, which has some mechanism to mitigate foreign exchange risk (export firms, firms with financial hedging operations, or companies with foreign direct investment [FDI]), has remained stable and continues to account for the majority of foreign currency debt (72.2%).

Several factors that may be related to low credit dynamics are associated with recent changes in the methodology for calculating interest rates caps for certain types of loans, which could potentially impact financial inclusion, credit deepening, and the performance of certain CIs. During 2023 and throughout 2024, the Financial Superintendency of Colombia (SFC in Spanish) introduced multiple modifications to the calculation of the current bank interest rate (IBC in Spanish), used as a benchmark to determine the interest rate cap. For instance, the calculation now includes rediscount credits, which are not issued at market rates and inherently offer more favorable financial conditions for borrowers.

Graph 4.7
Private Corporate Sector Debt, by Foreign Exchange Hedging, Foreign Direct Investment (FDI), and Foreign Trade of the Debtor (percentage of GDP)

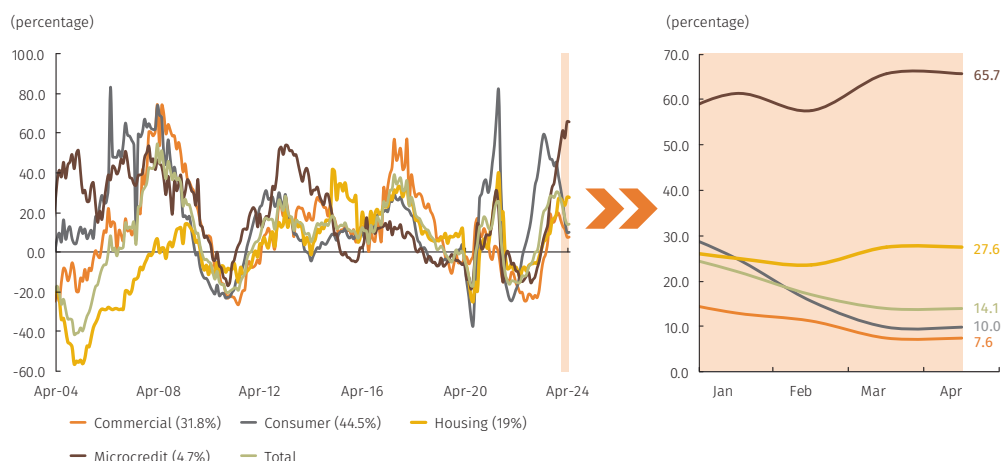


Note: Foreign currency debt from suppliers and leasing with foreign entities is not available by TIN and, therefore, it is not possible to identify whether this debt belongs to hedged companies.
Sources: Financial Superintendency of Colombia, DANE, and Banco de la República; calculations by Banco de la República.

Also, within the calculation, a greater weighting is given to larger institutions that concentrate their loan portfolios in categories with lower interest rates. This, in the context of declining MPR and weaker demand for credit, has resulted in significant reductions in the interest rate cap, mainly in rural productive, consumer, and ordinary loan categories. Extensive literature highlights the potential adverse effects of reductions in the interest rate caps on financial inclusion and deepening, as such reductions often exclude high-risk consumers profile whose interest rates are near or exceed the cap threshold. Other effects include the emergence and growth of informal credit markets and reduced use of the financial system by the most vulnerable populations. In addition, an abrupt reduction could adversely affect the ability of intermediaries to provide credit; for example, institutions would need to revalue existing loans with rates above the limit set by the SFC, potentially impacting profitability, which could concentrate in CIs engaged in riskier segments, such as credit¹⁰ cards.

The loan portfolio continued to deteriorate, with the non-performing loans indicator (NPL) remaining at high levels, although the non-performing loan portfolio exhibits a slower growth rate since late 2023. So far in 2024, the loan portfolio over thirty days past due in CIs continued to record annual real growth rates above the historical average. However, as of April 2024, this growth rate was lower than the peak observed in mid-2023 (Graph 4.8). This trend is attributed to a reduction in the growth of non-performing consumer and commercial loan portfolios, which fell by 37.1 and 11.4

Graph 4.8
Annual Real Growth of Non-Performing Loan Portfolio

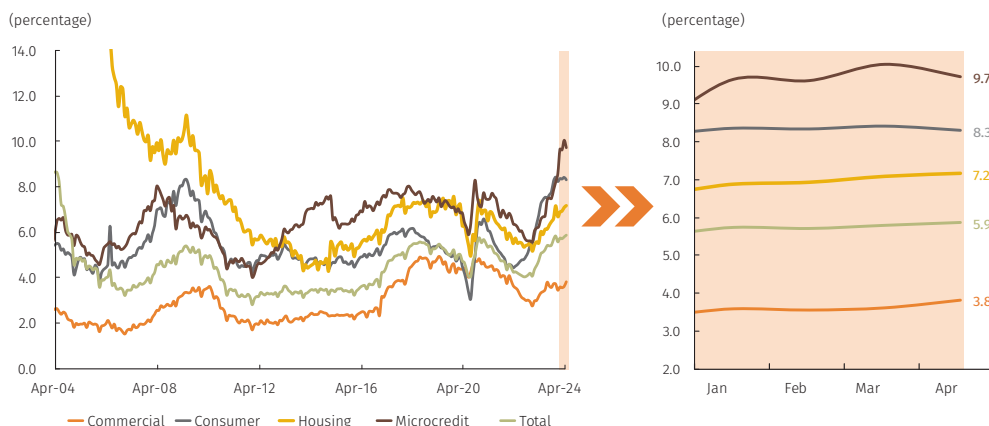


Note 1: The real growth rates were calculated using the CPI excluding food.
Note 2: The share of each type of loan in the total of the non-performing loan portfolio is shown in parentheses.
Source: Financial Superintendency of Colombia, calculations by Banco de la República.

10 For more information, see Box 3: “Potential Impact of Usury Rate Decreases on Financial Inclusion and Portfolio of Credit Institutions” of the *Financial Stability Report* for the first half of 2024, available at <https://repositorio.banrep.gov.co/server/api/core/bitstreams/eab56e1a-9753-4891-86a4-013b37208c26/content>

percentage points, respectively, between July 2023 and April 2024. These changes reflect the higher lending requirements imposed by CIs in 2023¹¹. In contrast, the growth of non-performing housing and microcredit loan portfolios continued to accelerate and remained above the historical average. The deterioration in the microcredit portfolio is particularly relevant, as its balance continued to rise despite the increasing default rate. Overall, high levels of NPLs persist across all loan portfolios, although the growth rate of non-performing loans has slowed (Graph 4.9).

Graph 4.9
Non-Performing Loans Indicator (NPL)



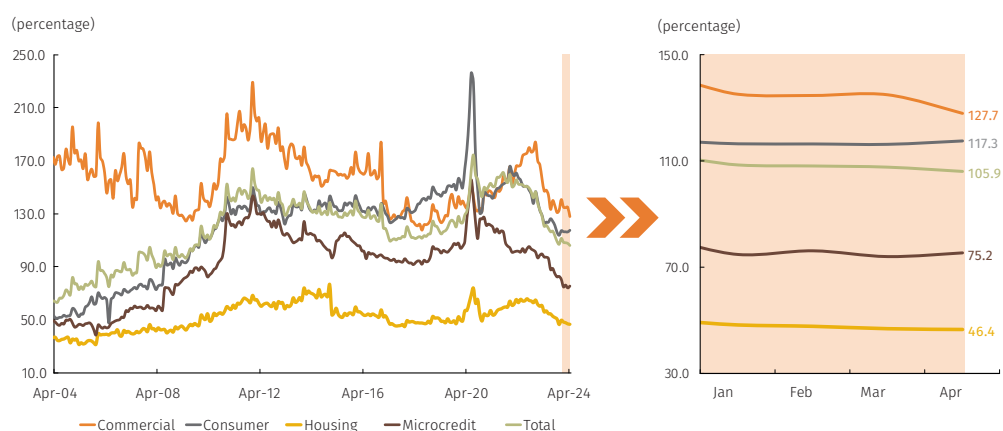
Nota: el indicador de calidad por mora de vivienda presentado en este gráfico difiere con el que usualmente reporta la SFC debido a que esta última entidad utiliza como cartera vencida de vivienda las cuotas vencidas para los plazos de mora de uno a cuatro meses, mientras que en este reporte se incluye, además, el total del capital del crédito.
Fuente: Superintendencia Financiera de Colombia; cálculos del Banco de la República.

The greater deterioration of the loan portfolio may be influenced by the issuance of regulations that have negatively affected banks’ ability to access debtors’ credit information, as well as to perform collection of financial obligations. The “Borrón y cuenta nueva” and “intimidación personal” laws would have had negative impacts on the quality of credit originations and on the collection ability of CIs, mainly in the consumer loan portfolio. Law 2157 of 2021, which eliminated negative reporting in credit bureaus for debtors who brought their debts up to date, would have had a negative impact on the ability of CIs to properly identify and evaluate new clients, which could be related to recent deteriorations observed, mainly in the consumer loan portfolio. In turn, Law 2300 of 2023, which regulated the channels, schedules, and periodicity of collection by entities, affected the recovery capacity of their non-performing loan portfolio, a situation that could negatively affect their expected income and their credit risk models. In this regard, it is essential that future legislative initiatives consider the impact of recent experience on CIs and the financial burden on credit users.

11 For more details, see the December 2023 Report on the Credit Situation in Colombia.

Despite increases in non-performing loan portfolio indicators, CIs maintain a level of provisions that appropriately covers loan portfolio deterioration. As of April 2024, the total provision¹² balance stood at COP 41.9 trillion, with a coverage ratio¹³ of 105.9%, suggesting that provisions more than proportionally cover the non-performing loan portfolio (Graph 4.10). So far in 2024, this indicator has been slightly reduced for commercial and housing loan portfolios; however, it is above 100% for the commercial loan portfolio and at 46.4%¹⁴ for the housing portfolio. In contrast, for the consumer portfolio, the indicator registered a slight increase, reaching 117.3%. On the other hand, for the microcredit loan portfolio, this indicator has been declining since late 2022 and has remained below 100% since January 2023, reaching 75.8% in April 2024. As regards the components of the provisions, the countercyclical provisions have exhibited a declining trend since mid-2022, with a growth rate of -44.5% as of April 2024 (Graph 4.11). This decline is attributed to some CIs decumulating these types of provisions between January 2023 and April 2024 to address the loan portfolio deterioration observed in the last year¹⁵. In particular, the use of countercyclical provisions allows institutions to reduce losses for the year since the recovery account increases. In turn, the pro-cyclical component registered growth of 1.4%.

Graph 4.10
Coverage Ratio

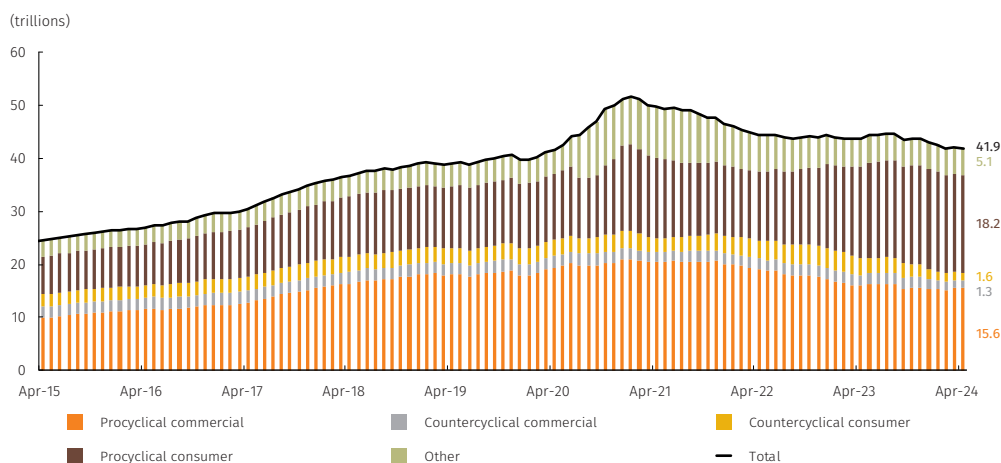


Note: The housing coverage ratio presented in this graph differs from the one usually reported by the SFC because the SFC uses as a non-performing housing loan portfolio the overdue payments for delinquency terms of one to four months, while this report also includes the total principal of the loan.

Source: Financial Superintendency of Colombia; calculations by Banco de la República.

- 12 Provisions correspond to funds held by the CIs to cover possible future credit losses. These are divided into procyclical, countercyclical, and other provisions. The procyclical component corresponds to the provisions set up for each debtor based on its risk rating. The countercyclical component corresponds to the provisions that are accumulated per debtor to be used later in times of high loan portfolio deterioration, and the “other provisions” component corresponds to housing, microcredit, and other loans.
- 13 The coverage ratio is defined as the ratio between the balance of provisions and the non-performing loan portfolio.
- 14 Provisions are calculated on the portion of the loan not covered by the collateral. Since in the housing loan portfolio the collateral corresponds to the real estate, the provisions are lower than in the other types of loans. As a result, the housing coverage ratio has historically been lower than that of the other types of loans.
- 15 According to Annex 1 of Chapter 31 of the Financial and Accounting Basic Circular (FABC), to trigger the use of countercyclical provisions, institutions must meet three of the following four conditions during a consecutive six-month period: (1) the real quarterly change in loan portfolio provisions must be greater than 9.0%; (2) the quarterly accumulated net provisions for recoveries as a percentage of accumulated income must be greater than 17%; (3) the quarterly accumulated net provisions for recoveries as a percentage of the adjusted financial margin must be between 0.0% and 42%; and (4) the real annual growth rate of the gross loan portfolio must be less than 23%.

Graph 4.11
Balance of Provisions



Note: The "Other" category corresponds to housing, microcredit, and others.
Source: Financial Superintendency of Colombia; calculations by Banco de la República.

While the aggregate profitability of the CI remains positive for the year 2024, it declined due to higher loan-loss provisions and lower interest income. As of April 2024, 54.7% of intermediaries, representing 24.9% of the total assets, reported losses. The return on assets (ROA)¹⁶ has shown a downward trend since April 2022, reaching 0.6% by April 2024 (Graph 4.12, panel A). This decline is due to higher loan-loss provisions and lower interest income that cannot be offset by the good performance of income from money market operations and administration fees (which are included in the "other income" category), as well as income from investment valuations and write-off recovery (Graph 4.12, panel B). As of April 2024, the ROA remained below the average for the last five years, with 29 entities¹⁷, representing 24.9% of the total assets of the CIs, recording accumulated losses during the fiscal year.

CIs have adequate capital and liquidity levels to address potential credit and liquidity risks at both the individual and consolidated levels, remaining above regulatory minimums. Between October 2023 and February 2024, total capital adequacy¹⁸ increased by 63 bps to 18.1%. Subsequently, due to a decline in capital levels, it decreased by 42.8 bps, standing at 17.7% as of April 2024 (Graph 4.13). Tier 1 capital¹⁹ and leverage²⁰ ratios exhibited a similar trend. In any case, the three capital adequacy ratios are above their regulatory minimums at the aggregate level. Likewise,

16 ROA is calculated as the ratio of the accumulated profit of the last 12 months of the CIs to the value of their total assets. The accumulated profit corresponds to the sum of 1) the annual difference of the month of analysis, and 2) the figure observed at the end of the previous year.

17 The number of institutions with accumulated losses for the year increased by seven between November 2023 and April 2024, and the share of the CIs' assets increased by 12 pp.

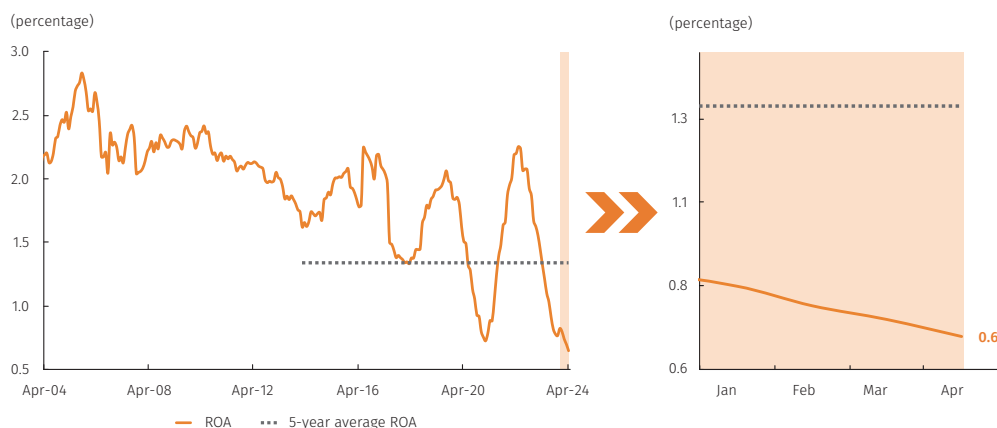
18 Total capital adequacy is defined as the ratio of total regulatory capital to the value of assets weighted by credit, market, and operational risks. The regulatory limit corresponds to 9.0%.

19 Tier 1 capital is defined as the ratio of Common Equity Tier 1 net of deductions to the value of assets weighted by the level of credit, market, and operational risks. The regulatory limit corresponds to 4.5%. This indicator captures the ability of institutions to face unexpected losses in terms of their best quality capital.

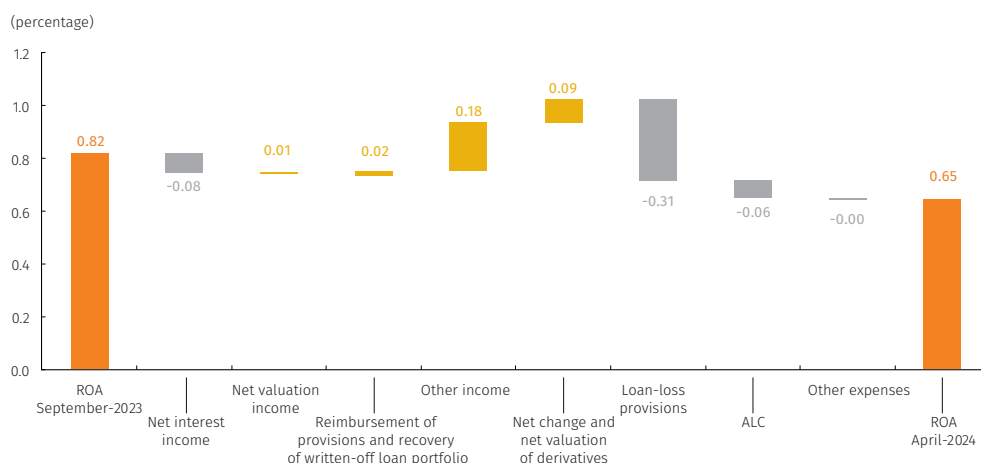
20 The leverage ratio is defined as the ratio between the sum of the value of Common Equity Tier 1 net of deductions and Additional Tier 1, and the value of leverage. The regulatory limit corresponds to 3.0%. This indicator captures the level of leverage maintained by the institution, regardless of its level of risk.

Graph 4.12
Aggregate Return On Assets (ROA) of Cis

A. Historical evolution



B. Decomposition of ROA variation



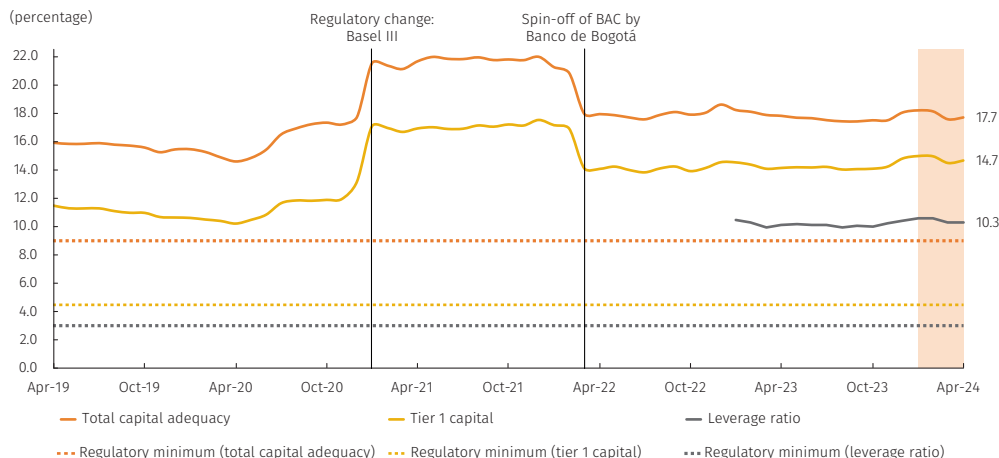
Note 1: The “Other income” category includes commissions, fees, income from money market operations, and equity investments.
 Note 2: The “Other expenses” category include taxes, expenses for money market operations, and equity investments.
 Source: Financial Superintendency of Colombia; calculations by Banco de la República.

systemically important²¹ financial institutions have adequate capital levels to mitigate various risk exposures.

In terms of funding, so far in 2024, new term deposit certificates have concentrated in shorter maturities than last year. Additionally, stocks in savings deposits and other demand liabilities exhibited higher growth than in 2023. As a result, during 2024, CDT stock with maturity of less than one year increased, while that with longer maturity decreased at the margin. The new deposits were concentrated in transactions conducted through bank branches, where clients are typically households and small to medium-sized enterprises seeking relatively short-term deposits. Clients who operate directly with banks’ treasuries, typically those investing in

21 Systemically important financial institutions correspond to larger, interconnected (too big to fail) institutions. To identify them, factors such as size, interconnectedness, substitutability, and complexity are considered.

Graph 4.13
Aggregate Capital Adequacy Indicators



Note: 1. The figures reported since January 2021 for capital adequacy and tier 1 capital are not comparable with the historical series due to regulatory changes that required entities to begin converging to the guidelines established by Basel III.
 Note 2: The regulatory limits for total capital adequacy and tier 1 capital are 9.0% and 4.5%, respectively. In 2023 (2024), the limits including the conservation buffer are 10.125% (10.5%), 6.75% (7.5%), and 5.625% (6.0%) for total capital adequacy, Additional Tier 1, and tier 1 capital, respectively. For systemically important financial institutions, an additional 50bps (75bps) is required. In practice, non-compliance with capital buffers does not imply non-compliance with regulatory limits, and thus does not constitute a situation of insolvency.
 Note 3: With the issuance of Decrees 1477 of 2018 and 1421 of 2019, entities had to start complying with the regulatory requirement of the leverage ratio as of January 2021. This ratio is defined as the sum of the value of Common Equity Tier 1 net of deductions and Additional Tier 1, divided by the leverage value defined as the sum of assets net of provisions, net exposures in repo operations or repurchase agreements, simultaneous operations and TTSs, credit exposures in derivatives, and contingency exposures. The regulatory limit for the leverage ratio is 3.0%.
 Source: Financial Superintendency of Colombia; calculations by Banco de la República.

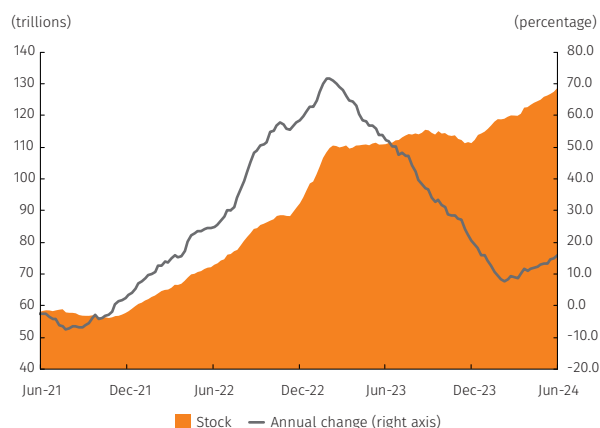
long-term CDT (greater than one year), reduced their demand for CDT as they faced lower interest rates²². At the same time, CIs have experienced improved liquidity levels, following measures implemented by Banco de la República²³ and the SFC²⁴, which have reduced their funding needs and, consequently, the incentives to rise long-term funding. In contrast, the stock of savings deposits (the main demand liabilities of CIs with their clients) have tended to increase, driven by the behavior of official entities and legal persons, while the stock belonging to natural persons have stabilized after a period of decline. These increases in the margin, together with a low comparative base in 2023, have resulted in higher annual growth rates than the previous year (Graph 4.14). This stands in contrast to trends observed in 2022 and the first half of 2023, when there was a strong substitution of CI funding coming from their clients from demand deposits to CDT.

The regulatory change in the Net Stable Funding Ratio (NSFR), which since September 2023 temporarily increased the available stable funding, has had a positive effect on the CIs ratio. Moving forward, they should continue adjusting their funding structure towards more stable sources to ensure future compliance with the NSFR. In September 2023, the SFC issued External Circular 013, which provided instructions to modify the NSFR calculation and reporting methodology. It established that, as of 30 September 2025, CIs should start differentiating between

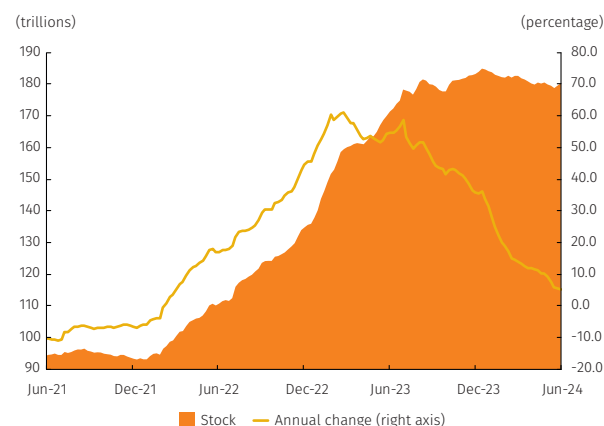
22 Instead, agents such as trust companies and pension funds have chosen to hold resources in interest-bearing deposits at Banco de la República.
 23 In line with its policy objectives, Banco de la República modified the amount offered in its repo auctions, extended the terms of these transactions, and made TES purchases. For more details, see Box 1: “Situación reciente de liquidez y el rol del Banco de la República” in the Financial Markets Report for the third quarter of 2023.
 24 In September 2023, the SFC issued External Circular 013, which provided instructions to modify the NSFR calculation and reporting methodology, resulting in growth in the ratio for CIs.

Graph 4.14
Demand Deposits and Term Deposit Certificates

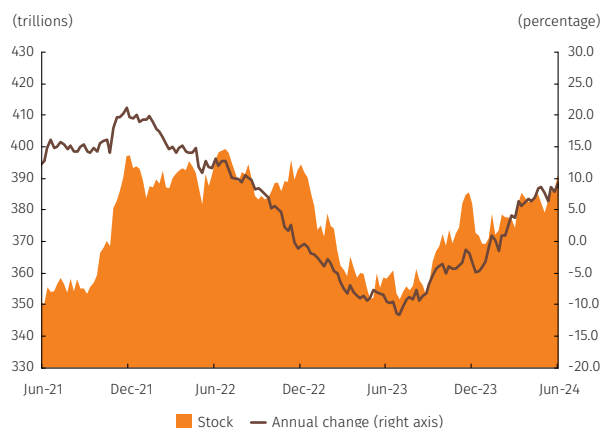
A. CDT with maturity of less than 12 months



B. CDT with maturity of 12 months or more



C. Demand deposits



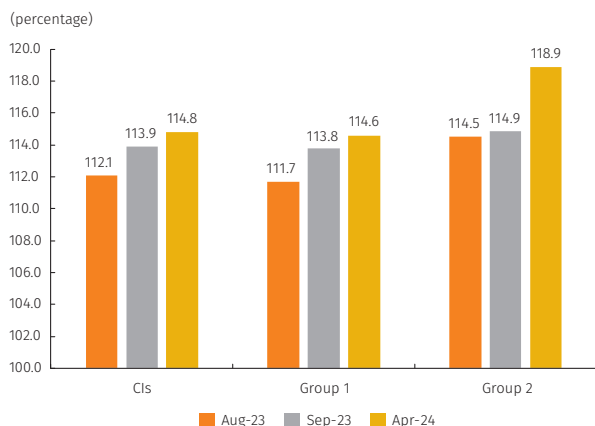
Source: Banco de la República, calculations with information from the Financial Superintendency of Colombia (Form 281).

operational²⁵ and non-operational²⁶ demand deposits for certain counterparties. Additionally, during the two-year transition period, the SFC temporarily increased the weightings in the available stable funding (ASF) for demand deposits of OECIFs and entities supervised by the SFC from 0% to 25%. This temporary change, which has been in effect since September 2023, explained most of the increase in the NSFR since then (Graph 4.15). Accordingly, the current temporary adjustment that has raised the level of ASF and therefore the NSFR will remain in place until August 2025. From September of the same year, depending on the classification of deposits as operational or non-operational, this change may result in an increase

25 A demand deposit is classified as operational if: 1) its remuneration component is not a driving factor in the client's decision to keep its resources in the CI, and 2) the client is dependent on the product to manage its cash flows in the development of its corporate operation. These deposits are considered more stable for NSFR purposes; therefore, they will have a higher weighting than non-operational deposits. For further details, see Annex 12 of Chapter XXXI of the FABC.

26 The amount exceeding the proportion of resources classified as operational, according to the methodology implemented by each CI, should be treated as non-operational. Additionally, deposits for which CIs do not establish a differentiation methodology will be classified as non-operational.

Graph 4.15
NSFR of the CIs, Before and After the Temporary Regulatory Change of September 2023



Note 1: The information for the CIs in both panels comprises information for groups 1 and 2 of institutions.
Note 2: Group 2 includes SOIs.
Source: Financial Superintendency of Colombia (Form 238 and website); calculations by Banco de la República.

or decrease in ASF and the NSFR²⁷, respectively. Thus, the CIs have an 18-month transition period during which they should gradually adjust their liabilities towards more stable sources to avoid potential negative shocks to ASF and the NSFR that could create liquidity pressures.

4.2 Local Financial Markets

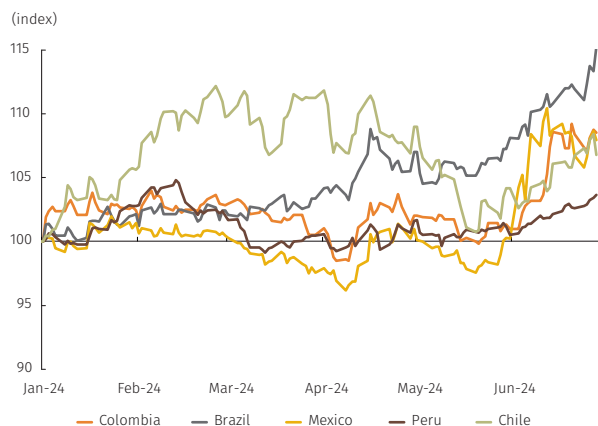
4.2.1 Foreign Exchange Market

To keep inflation low and stable while achieving the maximum sustainable level of output and employment, Banco de la República follows an inflation-targeting framework²⁸ with a flexible exchange rate regime. Exchange rate flexibility is considered a fundamental element in achieving these objectives because: 1) in the face of external shocks, much of the adjustment is made by the exchange rate²⁹; 2) authorities in a small, open economy with a flexible exchange rate have greater autonomy in their monetary policy, facilitating the achievement of their own inflation targets and enabling countercyclical responses to their own economic cycles³⁰; 3) it reduces incentives for excessive exchange rate risk³¹; and 4) the inherent volatility of a floating exchange rate stimulates the development of the hedging market, which is important for maintaining financial stability and promoting the market development³².

During 2024, the Colombian peso depreciated, in line with the performance of most of its regional and emerging market peers, affected by the strengthening of the dollar and some idiosyncratic factors, such as concerns regarding the

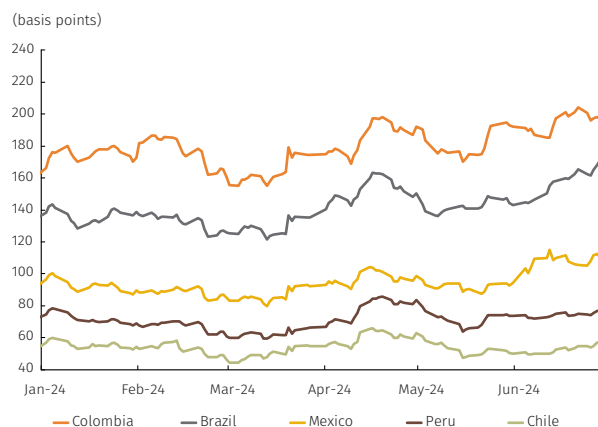
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- 27 For demand deposits from supervised entities and OECIFs, the classification between operational and non-operational deposits as of September 2025 will have an ambiguous effect on the ASF. This is because the value of the weighting will increase from 25% for total resources to 50% for operational deposits and will decrease to 0% for non-operational deposits. Thus, the effect on the ASF may be positive (negative) depending on whether the largest proportion of these resources is classified as operational (non-operational) according to the internal methodology.
- 28 Within this framework, monetary policy actions are aimed at bringing future inflation within the target set in the policy horizon.
- 29 The internal market interest rate is more stable under a flexible regime than under a fixed exchange rate regime.
- 30 Otherwise, when a fixed exchange rate is maintained against the currency of a developed country, monetary policy is subject to the decisions of the external monetary authority. In this way, if business cycles are not synchronized, the monetary actions of the developed country could have adverse effects on the output and employment of the emerging country.
- 31 Currency mismatches arise when an agent has income in local currency and part of their liabilities in another currency without any hedging. Under a flexible regime, agents are encouraged to internalize and limit their exposure to exchange rate risk. Although Colombia has strong regulations regarding currency mismatches for financial intermediaries, exchange rate volatility creates incentives for real-sector agents to take steps to mitigate their exposure to such risk.
- 32 The existence of these instruments allows agents to obtain exchange rate risk hedging at competitive prices.

Graph 4.16
Performance of the Foreign Exchange Market in the Region^{a/}



a/ Corresponds to the nominal exchange rate index, base 2021.
Source: Bloomberg.

Graph 4.17
Risk Premium^{a/} for Some Economies in the Region



a/ five-year CDS.
Source: Bloomberg.

country's fiscal situation (Graph 4.16). At the beginning of the year, the peso-dollar exchange rate traded within a narrow range, with its movements largely reflecting the evolution of external factors and international risk perceptions. However, according to market participants, the currency depreciation towards the end of the semester reflected the generalized strengthening of the dollar, political uncertainty in some countries in the region (reflected in the increase in most of their CDSs, Graph 4.17), the process of processing the National Government's external debt ceiling bill, and greater fiscal challenges³³. Additionally, the currency may have been affected by lower foreign currency revenues for tax payments compared to those anticipated by the market.

In this context, there has been an improvement in liquidity conditions³⁴ in the foreign exchange market and a decrease in the average volatility of the currency. The improvement in liquidity was reflected in a decrease in transaction costs (as measured by the bid-ask spread) and an increase in the depth of the spot market.

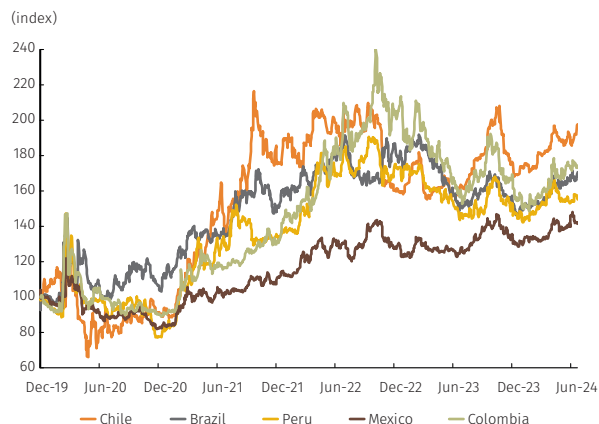
4.2.2 Debt and Stock Markets

During 2024, local sovereign debt securities have registered a higher depreciation than that of the region, along with a deterioration in their liquidity and volatility indicators. This comes amid heightened uncertainty regarding the country's fiscal soundness and discussions that could affect the Colombian institutional framework. During this period, ten-year local currency securities have depreciated by 130 bps, surpassing the average depreciation of 90 bps of their regional peers (Graph 4.18). In addition to the unfavorable international environment for fixed-income securities, this performance is also explained by the fiscal uncertainty arising from low tax collection so far this year, the increase in the fiscal deficit projected by the Government, and some statements by the high government regarding the potential

33 These fiscal challenges led to an increase in the limit for foreign currency borrowing and adjustments to the Medium-Term Fiscal Framework. Thus, on 20 June, the Congress of Colombia approved a bill to expand the external debt ceiling by USD 17.6 billion, placing it at USD 87.6 billion.

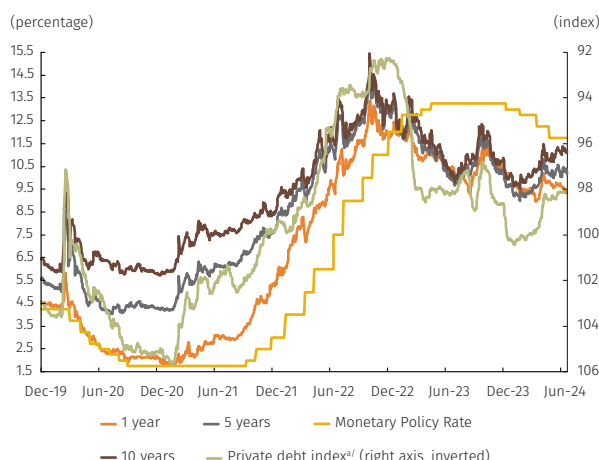
34 This is measured through the bid-ask spread (BAS) and market depth measures. The BAS is calculated as the average of the difference between the best bid price and the best ask price in the Set-FX Spot session for each second between 8:30 a.m. and 1:00 p.m. each day, divided by the average Set-FX exchange rate of the day. An increase in the indicator reflects lower liquidity. Market depth measures correspond to the average sum of the amounts of the purchase quotes and the sum of the amount of the sales quotes of the peso/dollar, which are extracted from Set-FX every five minutes between 8:30 a.m. and 1:00 p.m. for the best quotes within a range of +/- \$5 and +/- \$10, and the total market. A decrease in the indicator reflects lower liquidity. In the first half of 2024 (as of 28 June), the average BAS was 0.045% compared to 0.064% in 2023. Depth measures at COP 5, COP 10, and total averaged USD 10.1 million (m), USD 19.4 m, and USD 52.3 m, respectively in 2024 (as of June 28) compared to USD 6.1 m, USD 11.6 m, and USD 42.9 m, respectively in 2023.

Graph 4.18
Interest Rate Index^{a/} in Some Economies in the Region



a/ Base 31 December 2019.
Sources: Bloomberg, Electronic Trading System (SEN in Spanish), and MasterTrader; calculations by Banco de la República.

Graph 4.19
Zero-Coupon TES Rates in Pesos by Term, Private Debt Index, and Monetary Policy Rate



a/ Base December 2016.
Sources: Bloomberg, SEN, and MasterTrader; calculations by Banco de la República.

relaxation of the fiscal rule and the calling of a constituent assembly (Graph 4.19).

Additionally, the inclusion of India in one of the benchmark indexes most used by foreign investors to invest in the local currency public debt market, starting in June 2024, is expected to have a moderate effect on these agents' flows. India's inclusion in the GBI-EM Global Diversified Index³⁵ will occur gradually, with monthly increases of 1.0% until reaching a ceiling of 10% by March 2025. This modification in the index would gradually reduce the weighting of several countries, including Colombia, which could lead to TES sales by foreign agents using the GBI-EM as a reference to invest in Colombia. However, no significant effects on these agents' flows are anticipated, as the process will be gradual, over a large time window, and the magnitude of the decrease in weighting will be uniform across the existing issuers in the index³⁶.

Regarding participants in the local public debt market, foreign investors³⁷ have accumulated net inflows so far in 2024. This trend aligns with a strategy to maintain a stable participation of Colombian securities within their loan portfolios, in light of rising TES yields and the depreciation of the peso during the year. Foreign investors thus reversed their selling trend from 2023³⁸. During 2024, these agents have made net purchases of TES in pesos and UVR amounting to COP 3.4 t (Graph 4.20), mainly in long-term³⁹ securities, in line with the steepening of the yield curve. In this way, they have established themselves as the second-largest holders of public debt securities⁴⁰, followed by local pension funds. Additionally, there has been a restructuring of the foreign

35 Index constructed by JP Morgan from a basket of local currency public debt securities held by a group of emerging countries.

36 In accordance with estimates reported by JP Morgan, the decrease in the weights of current issuers is expected to be around 17% for most issuers. The phased scheme to include this new issuer would be identical to the one used for China's entry into the GBI-EM between February and November 2020. At that time, there was no significant impact on foreign investor flows, and net TES inflows from these agents totaled COP 8.9 t for the year.

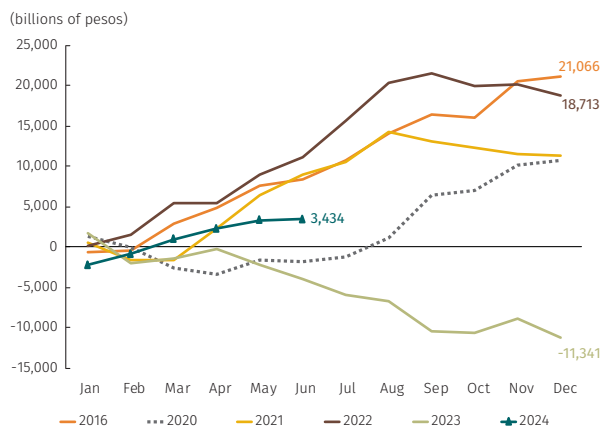
37 For more details on the performance of these agents in the Colombian public debt market, see <https://www.banrep.gov.co/es/publicaciones-investigaciones/reporte-mercados-financieros/recuadro-3-tercer-trimestre-2023>

38 During 2023, foreign investors made significant sales of TES totaling COP 11 t, driven by the good performance of Colombian securities and the appreciation of the peso throughout the year, which increased the dollar value of TES in their portfolios. These factors led these agents to sell Colombian securities to keep their exposure to these assets stable. Thus, in 2024, the peso has depreciated, and combined with rising TES yields, this has favored purchases by foreign agents that seek to keep the participation of these securities stable within their portfolios.

39 Foreign investors made purchases of COP 7.7 t in securities of the long end of the curve, while in the medium and short end they sold COP 2.4 t and COP 1.9 t, respectively.

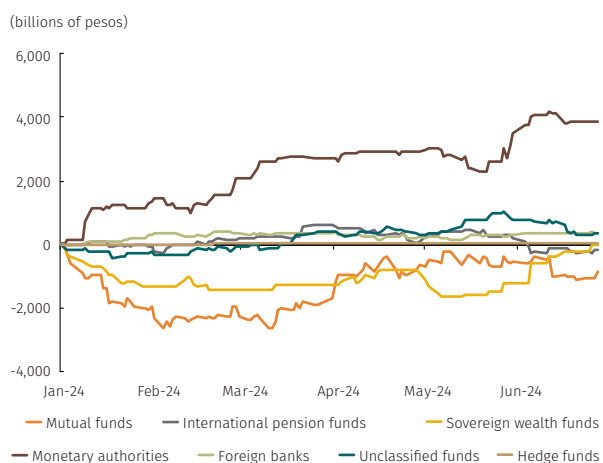
40 Foreign investors' share of the public-debt market stood at 21% as of June 2024.

Graph 4.20
Cumulative Net Purchases per Year by Foreign Investors in the TES Spot Market



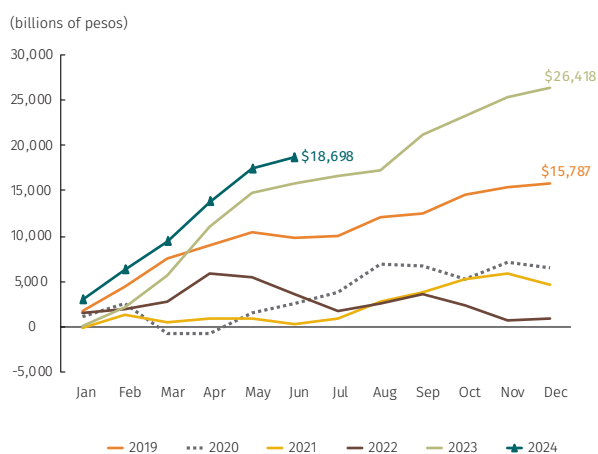
Source: Central Securities Depository (DCV); calculations by Banco de la República.

Graph 4.21
Cumulative Net Purchases by Type of Foreign Investor in the TES Spot Market



Source: Central Securities Depository (DCV); calculations by Banco de la República.

Graph 4.22
Cumulative Net Purchases per Year of Pension and Severance Funds in the TES Spot Market



Source: Central Securities Depository (DCV); calculations by Banco de la República.

investor base towards agents with more stable market performance, with significant inflows from monetary authorities (Graph 4.21)⁴¹. These agents have made purchases for COP 3.9 t, while mutual funds have adopted a net selling position of COP -853 b.

Local pension funds continued to show significant inflows into the Colombian public debt market, consolidating themselves as the main holders of local currency securities. Both foreign investors and pension funds have increased the duration of their portfolios through purchases of long-term securities. Local pension funds have made purchases amounting to COP 18.7 t in local currency public debt securities during 2024 (Graph 4.22), concentrated on the long end of the curve (COP 20.3 t). Thus, their share in total local currency public debt increased from 31% to 33% between December 2023 and June 2024.

So far in 2024, financing through the placement of corporate debt securities has decreased compared to the second half of 2023, mainly due to a lower participation from the non-financial sector. During this period, placements through the Colombian Stock Exchange totaled COP 2.2 t, lower than in the previous semester (COP 2.9 t), mainly explained by a 48% decline in issuances from the non-financial sector.

The MSCI COLCAP Index⁴² increased over the year above the average recorded in the region⁴³ and exhibited improved liquidity conditions. The index showed a favorable performance and increased liquidity during the semester, correcting the trend observed in 2023. The valuations were supported by the delivery of favorable corporate results and the evolution of some special transactions in the market⁴⁴. Additionally, the daily average traded volume in the market reached COP 82.7 b during the semester, the highest observed since the first half of 2022 (COP 137.7 b).

41 See <https://www.banrep.gov.co/es/publicaciones-investigaciones/reporte-mercados-financieros/recuadro-3-tercer-trimestre-2023>

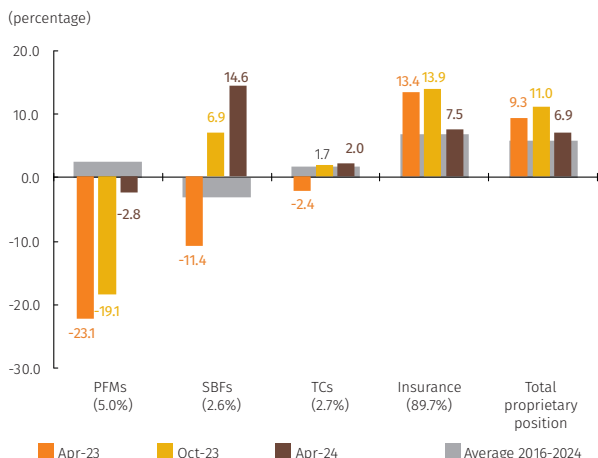
42 It is an index calculated by the index provider MSCI and corresponds to the main reference of the Colombian stock market and consists of the 20 issuers and 25 most liquid shares in the market, weighting the shares by adjusted market capitalization without participation limit.

43 In 2024 (as of June 28) the MSCI COLCAP Index increased a 15.5%, while the main stock indices of Mexico, Peru, Brazil and Chile increased 0.6% on average.

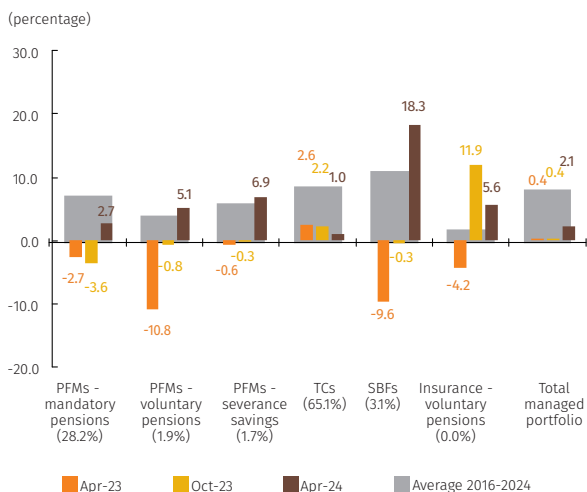
44 Particularly, it highlighted the completion of the operation between the Gilinski Group and the Grupo Empresarial Antioqueño (GEA), where it was sought that the Gilinski Group and its partner result as main shareholders of Nutresa and deliver their holdings in Grupo Sura and Grupo Argos to the companies of the GEA. In addition, the announcements of share buyback programs by Cementos Argos, Celsia and Grupo Bolívar stand out.

Graph 4.23
Real Annual Growth of the Assets of Non-Bank Financial Institutions

A. Proprietary portfolio



B. Managed Portfolio



Note 1: The graph includes information from pension fund managers (PFM); stock brokerage firms (SBF), trust companies (TC), and insurance companies (Insurers). The series are deflated using the CPI excluding food.
 Note 2: In parentheses, reference is made to the share of the loan portfolio of each type of entity in the total.
 Source: Financial Superintendency of Colombia (SFC); calculations by Banco de la República.

4.3 Market Risk Exposure of the Financial System and Evolution of Non-Bank Financial Institutions' Loan Portfolios

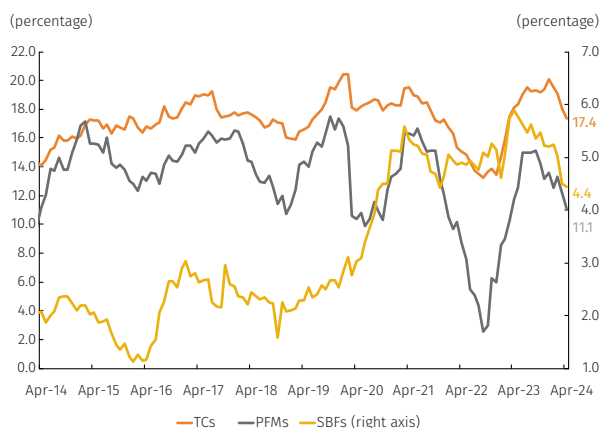
During 2024, non-bank financial institutions (NBFIs) reported growth in both their proprietary position loan portfolios and managed loan portfolios. The loan portfolio in proprietary position, which amounts to COP 164.9 t, registered real annual growth of 6.9% in April 2024⁴⁵, a figure above the average of recent years (Graph 4.23, panel A). This performance was mainly due to the good performance of investments, which positively impacted the assets of the insurance sector, trust companies, and stock brokerage firms, collectively representing 95% of the sector's proprietary account assets. Regarding the loan portfolio managed by NBFIs, while there was a real annual growth of 2.1%, reaching a value of COP 1,522.0 t, this increase is lower than its historical average (Graph 4.23, panel B). This was due to the low growth observed for resources managed by mandatory pension funds and those managed by trust companies, which account for 28.2% and 65.1% of the managed loan portfolio, respectively.

After recovering and returning to pre-pandemic levels in 2023, the profitability of NBFIs' proprietary position has shown a downward trend over the course of the year. During the early months of 2024, a downward trend in the ROA of all NBFIs was evident. However, for most, the observed values are around the average of the last ten years (Graph 4.24). For stock brokerage firms (SBFs), profitability remains at historically high levels, which have been maintained over the last four years (Graph 4.24, panel A). For insurance companies, a decrease in profitability was observed, although general insurance remains at a historically high level (Graph 4.24, panel B).

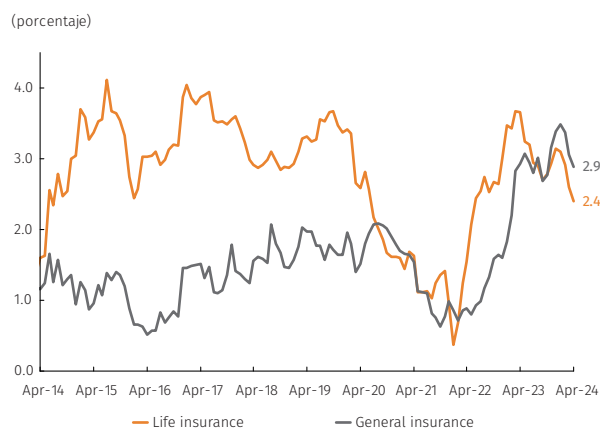
45 Real annual growth rates were calculated using the non-food CPI.

Graph 4.24
ROA of Non-Bank Financial Institutions

A. TCs, PFMs, and SBFs^{a/}

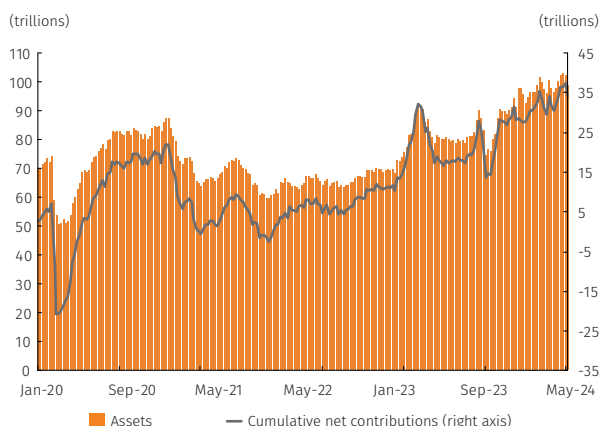


B. General and Life Insurance



a/ The graph includes information from pension fund managers (PFM); stock brokerage firms (SBF), trust companies (TC), and insurance companies (Insurers).
Source: Financial Superintendency of Colombia (SFC); calculations by Banco de la República.

Graph 4.25
Assets and Net Contributions of Open-End Collective Investment Funds (OECIFs)



Source: Financial Superintendency of Colombia (SFC); calculations by Banco de la República.

The assets managed by open-end collective investment funds (OECIFs) reached record highs amid the high volatility that characterize these instruments. By mid-May 2024, OECIFs⁴⁶ assets reached record highs, registering COP 102.8 t. However, given the volatility characteristic of the assets associated with the performance of net contributions⁴⁷ from investors, this amount slightly declined at the end of the same month, reaching COP 98.6 t (Graph 4.25). This trend coincided with the behavior of the prices of short- and medium-term⁴⁸ CDTs, which constitute about 58.9% of the investment portfolio of these funds⁴⁹.

46 Collective investment funds (CIFs) are financial savings and investment vehicles managed by specialized companies in which resources are invested from the contributions of several investors in an asset portfolio. In particular, the OECIFs provide liquidity to investors, profitability and stability to capital through investments in high-quality short-term securities. Given their nature, they are susceptible to withdrawals that, in normal times, they back up with resources in demand deposits and the maturity of their securities. However, in the face of massive withdrawals by their investors, the funds could resort to the early settlement of their securities, which would generate greater pressures on their price and market volatility.

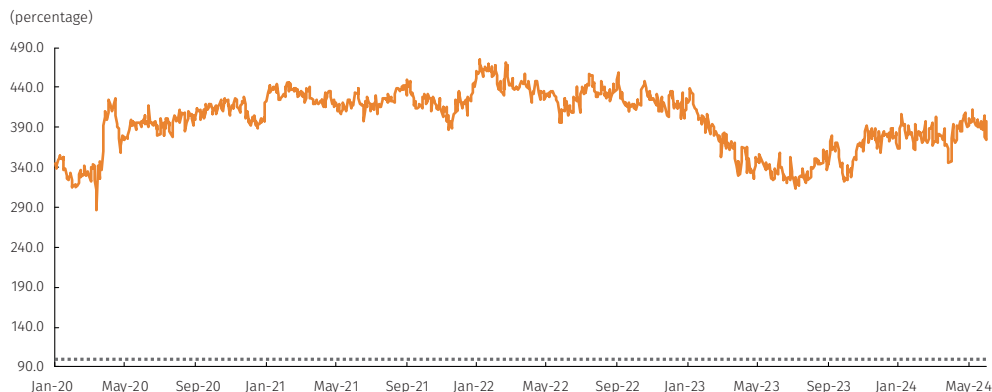
47 Accumulated net contributions are total contributions minus total accumulated withdrawals.

48 Short-term CDTs are those with a maturity of less than or equal to 365 days; medium-term CDTs are those with a maturity of more than 365 days and less than and equal to 1,095 days; long-term CDTs are those with a maturity of more than 1,095 days.

49 For more details, see Section 2.1.3.1 of the *Financial Stability Report* of the first quarter of 2024, available at: <https://www.banrep.gov.co/es/publicaciones-investigaciones/reporte-estabilidad-financiera/primer-semester-2024>

During 2024, the liquidity of OECIFs increased compared to the levels recorded during 2023, remaining above the regulatory minimums. On average, during the first six months of 2024, the OECIFs' liquidity risk indicator (LRI) remained at adequate levels and was above the average recorded in 2023. However, in mid-March 2024, this indicator experienced a slight decline, as resources available in demand deposits used to address the increase in withdrawals by investors decreased (Graph 4.26).

Graph 4.26
LRI of Open-End Collective Investment Funds



Note: The dotted line corresponds to the regulatory limit of the liquidity risk indicator for OECIFs.
Source: Financial Superintendency of Colombia (SFC); calculations by Banco de la República.

Shaded Section 2

Monetary Base and M3

Throughout the first half of 2024, monetary aggregates continued to show relatively low annual growth in historical terms. However, for cash, the monetary base, the most liquid payment instruments (such as checking and savings accounts), and short-term CDTs, the annual variations were higher than those recorded in 2023 due to the effect of a low base for comparison of the previous year, as well as increases in the margin. For the broader monetary aggregate (M3), the increase in demand for demand or short-term payment instruments was offset by lower dynamism in long-term CDTs and bonds. This occurred in an environment of more dynamic economic activity than the previous year and reductions in interest and inflation rates.

During the first half of the year, the monetary base registered an average annual growth of 3.0% (vs. -0.1% on average for the entire year of 2023). This is explained by the behavior of cash held by the public, which is the primary component of the monetary base¹, and by the bank reserves². As for cash, its nominal balance returned to levels similar to those of 2022 after a decline for most of 2023³. For the bank reserves, the recovery in demand for savings accounts and, to a lesser extent, for other demand liabilities from financial institutions, such as checking accounts, boosted the required reserve balance because demand liabilities have a higher reserve requirement than CDTs and other term liabilities⁴. Regarding GDP, the monetary base and cash levels were close to those observed before the pandemic⁵ (Graphs S2.1 and S2.2).

At the end of June 2024, the monetary base balance was COP 5,953 billion (b) lower than at the end of 2023 (cash decreased by COP 4,079 b and reserves by COP 1,874 b). This decrease in the balance is mainly due to the seasonal effect on cash demand during the first half of the year. From the perspectives of sources⁶, *Banco de la República (Banrep)* made sales of TES amounting to COP 16,499 b to offset the strong expansionary effect caused by low levels of government deposits at *Banrep*⁷. These deposits typically reach a minimum level at the end of each year

1 Between January and June 2024, the share of cash held by the public in the monetary base was 74%.

2 With weekly data (cut-off as of Friday), the average annual growth of cash and bank reserve was 3.0% during the first half of the year (vs. -0.8% for cash and 1.9% for bank reserve on average for 2023).

3 During 2023, there was a sharp correction in the effect of the COVID-19 pandemic shock on cash demand. See Box 2, "Primary Liquidity Supply by *Banco de la República*, 2023-2024," in this Report.

4 Currently, demand liabilities are subject to a reserve requirement of 8.0% of their balance, while CDTs and other liabilities with a maturity of less than eighteen months are subject to a 3.5% reserve requirement, and those with a longer maturity have a 0.0% reserve requirement. See External Resolution 5 of 2008, available at <https://www.banrep.gov.co/es/normatividad/credicia/encaje>

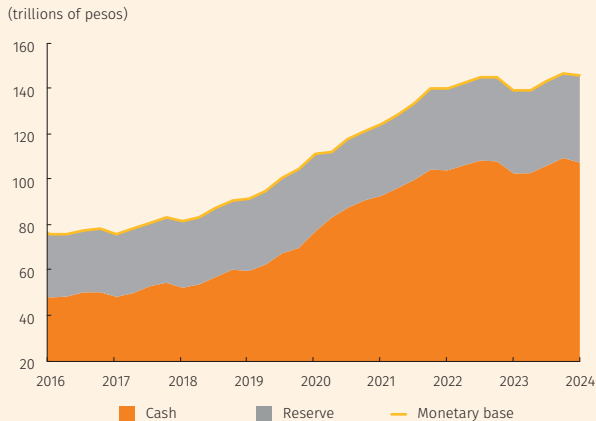
5 As of June 2024, the monetary base and cash are equivalent to 9.0% and 6.7%, respectively (compared to 9.5% and 6.4% at the end of 2019).

6 For a more detailed explanation of how *Banrep* selects operations to be carried out to ensure an adequate supply of primary liquidity, see Box 2: "Primary Liquidity Supply by *Banco de la República*, 2023-2024," in this Report.

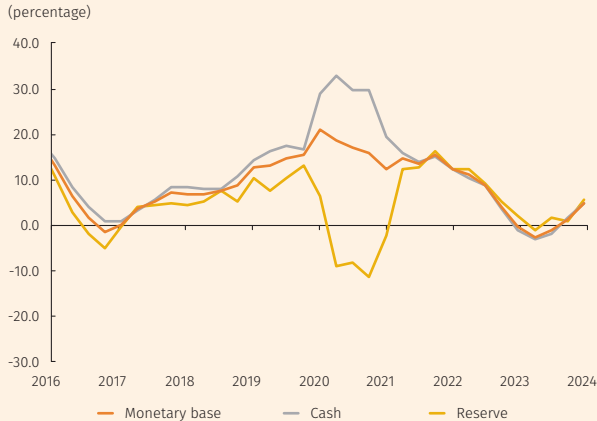
7 In addition to TES sales, during the first half of 2024, interest-bearing deposits not constituting reserves requirements (contraction deposits), whose balance was significant (COP 8,171 b on average), also contributed to drain excess liquidity. For most of the period, only contraction deposits were received only through the overnight term window (7- and 14-day term auctions were conducted, the first days of the year until 11 January 2024, between 7 and 16 February 2024, and between 5 and 11 March 2024; and terms of thirty days between 5 and 7 March 2024).

Graph S2.1
Monetary Base, Cash, and Bank Reserves

A. Balance

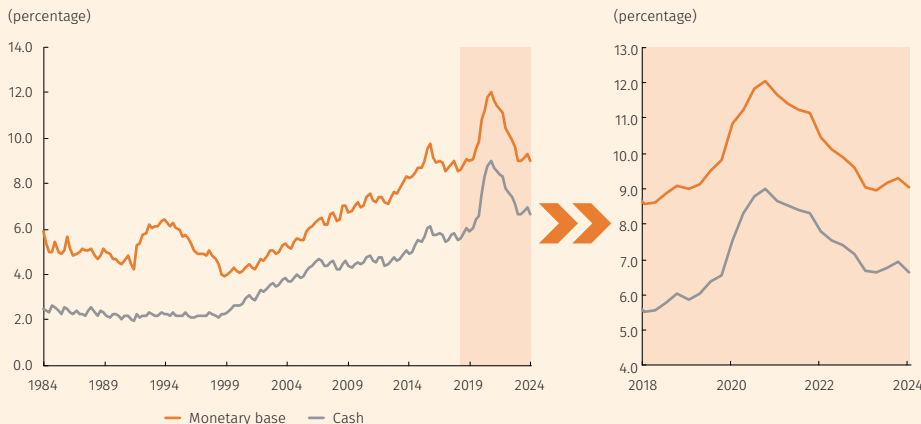


B. Annual variation



Source: Banco de la República.

Graph S2.2
Monetary Base and Cash
(percentage of GDP)



Note: Quarterly average balances of weekly data (as of Friday) are considered. Information updated as of 28 June 2024.
Source: Banco de la República.

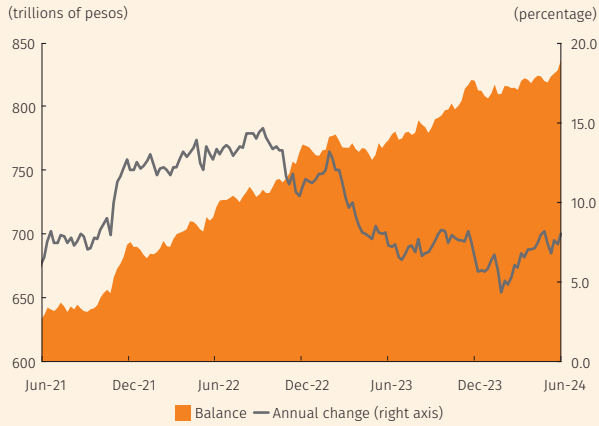
and subsequently increase again, generating a contractionary effect in the first half of the year. This time, the increase in the government’s account balance at *Banrep* in the first half was lower compared to previous years and the expansion seen at the end of 2023. On some days, its deposits were even lower than at the end of 2023⁸.

Regarding transactions with an expansionary effect on the monetary base, the purchase of USD 824.9 million of foreign reserves through put options as part

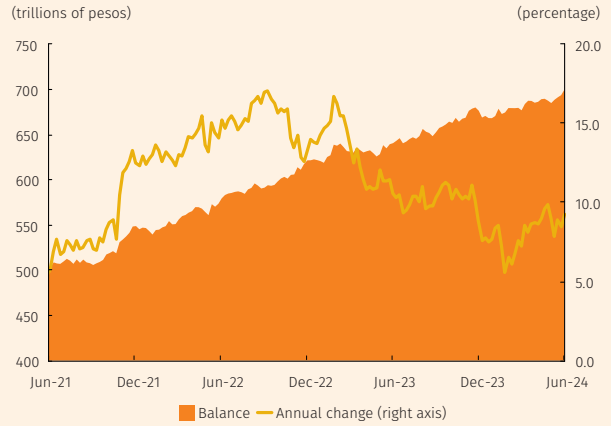
8 At the end of 2023, the balance of government deposits at *Banrep* was COP 6,824 b, and on average, in the first half of 2024, COP 12,083 b, with a minimum of COP 2,302 b.

Graph S2.3
M3 and Deposits

A. M3



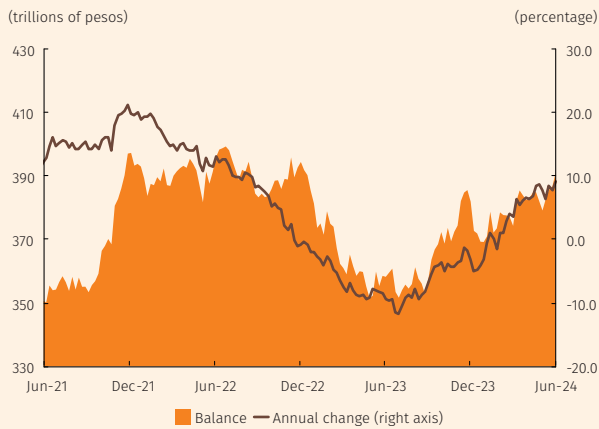
B. Total deposits



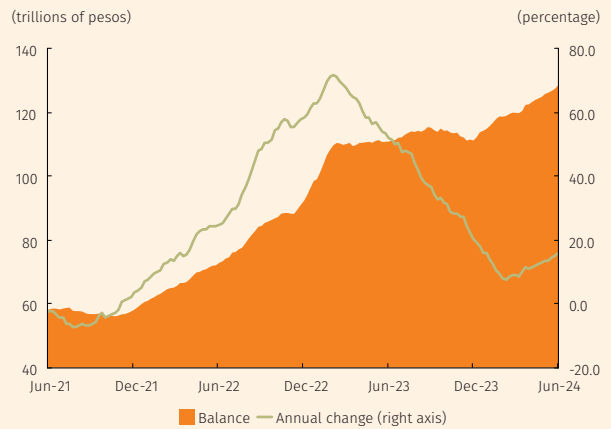
Source: Financial Superintendency of Colombia (Form 281); calculations by Banco de la República.

Graph S2.4
Demand and Term Deposits

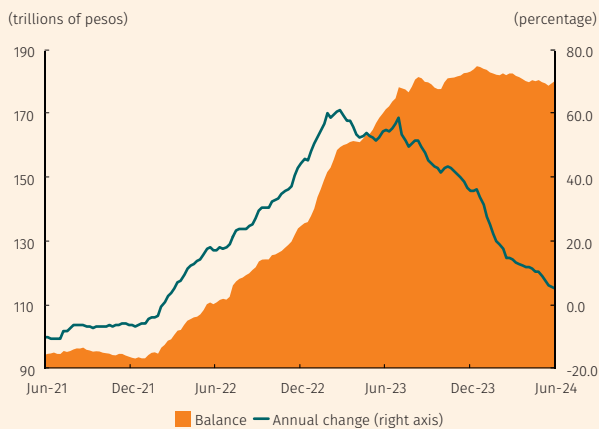
A. Demand deposits



B. CDT with a term of less than 12 months



C. CDT and bonds with a term of 12 months or more

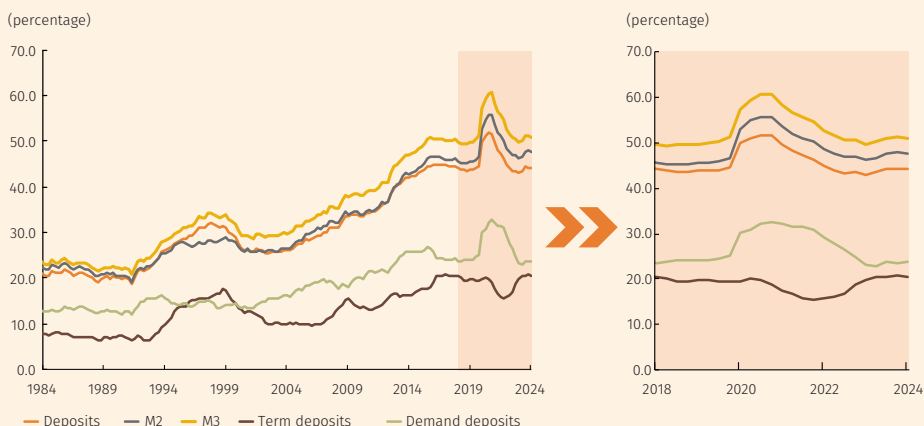


Source: Financial Superintendency of Colombia (Form 281); calculations by Banco de la República.

of the accumulation program announced in December 2023⁹ and the transfer of *Banrep*'s profits to the government for the fiscal year 2023 were notable. Specifically, on 27 March, COP 9,216.7 b were transferred to the government, of which COP 4,904.1 b were delivered in TES, as requested by the Ministry of Finance and Public Credit, while the remaining COP 4,312.6 b was credited to its account in pesos at *Banrep*.

So far to the end of June, M3 (Graph S2.3), the broader monetary aggregate, recorded an average annual variation of 6.5% (vs. 8.7% on average in 2023). This aggregate comprises cash held by the public and assets issued by credit institutions that fulfill the functions of money in terms that they can be used for making payments in legal tender (such as checking or savings accounts) or for saving (store of value) in instruments for which there is some level of certainty regarding their face value, and that can be converted into liquid payment instruments (e.g., CDTs)¹⁰. The recovery in demand for savings deposits and other demand deposits (Graph S2.4), as well as for CDTs with a maturity of less than one year, has driven the M3 balance at the margin, offsetting the slight decline in the balances of long-term CDTs and bonds. The balances of different monetary aggregates relative to GDP remained at levels similar to those observed at the end of 2023 (Graph S2.5).

Graph S2.5
Deposits and Monetary Aggregates
(percentage of GDP)



Note 1: M2 includes cash held by the public, checking and savings accounts, and CDTs; M3 includes M2 plus bonds, trust deposits (collection services), and other demand deposits.
 Note 2: Quarterly average balances of weekly data (as of Friday) are considered. Information updated as of 28 June 2024.
 Source: Financial Superintendency of Colombia (Form 281); calculations by Banco de la República.

9 See <https://www.banrep.gov.co/es/noticias/jdbr-decidio-iniciar-programa-acumulacion-reservas-international>

10 In particular, in Colombia, M1 includes cash held by the public and checking accounts; M2 includes M1, savings accounts and CDTs, and M3, M2 plus bonds, fiduciary deposits (collection services) and other demand deposits.

Box 3

Liquidity Supply by *Banco de la República*, 2023-2024

The monetary policy of *Banco de la República* (*Banrep*) aims to maintain a low and stable inflation rate in coordination with overall economic policy. To achieve this, *Banrep* follows an inflation targeting framework within a flexible exchange rate regime; in other words, monetary policy actions are aimed to ensure future inflation within the target set in the policy horizon. In Colombia, the inflation target set by the Board of Directors of *Banco de la República* (BDBR) is 3.0%¹.

Within this framework, the BDBR's main instrument for controlling inflation is the monetary policy interest rate (MPR). The MPR is the minimum interest rate charged by the bank to financial institutions for liquidity provided (generally overnight). It also serves as a benchmark to establish the maximum interest rate paid to receive any surplus money. By setting this rate, the BDBR aims to influence the cost of money (interest rate) in the short-term in the economy and, with it, the entry into operation of a series of mechanisms for the transmission of monetary policy, which have effects on the decisions of the agents and, ultimately, lead to a result in terms of economic growth and inflation².

The operationalization of monetary policy uses various instruments provided by the central bank to supply or contract liquidity within the economy³. In particular, there are instruments for providing or withdrawing liquidity from the economy on a permanent or temporary basis. The temporary instruments available to *Banrep* correspond, as explained below, to repo operations at different maturities and remunerated non-reserve deposits (DRNCE in Spanish), while permanent operations refer to the purchase or sale of securities (mainly debt securities issued by the Colombian Government, such as TES).

Operationally, the supply or withdrawal of liquidity seeks to minimize the gap between the short-term interest rate, approximated by the benchmark interbank rate (BBI in Spanish)⁴ and the MPR established by the BDBR. Within this framework, no specific targets are set on the amount of money in the economy. Pronounced and persistent deviations of the BBI from the MPR indicate that the cost of short-term money in the economy differs from the level considered compatible by the BDBR for achieving the inflation target. When short-term interest rates are stable and aligned with the MPR, financial institutions better manage their liquidity and their own lending and deposit interest rate scheme. This is because they are confident that changes in the MPR will be maintained in the rates at which they access short-term resources in the market. To achieve this objective, *Banrep* considers internal projections of demand and supply for the monetary base, which, despite being subject to significant uncertainty, allows it to evaluate the appropriateness of different ways of providing or withdrawing liquidity from the economy. A situation in which the BBI exceeds the MPR suggests high liquidity pressures, while the opposite indicates the presence of excess liquidity.

1 Please refer to <https://www.banrep.gov.co/es/noticias/junta-directiva-banco-republica-reitera-meta-inflacion-3>

2 For further details on monetary policy transmission channels, please refer to <https://www.banrep.gov.co/nuestro-banco-central/politica-monetaria>

3 See External Resolution 5/2022, available at <https://www.banrep.gov.co/es/reglamentacion-expansion-y-contraccion-monetaria>

4 For more information on BBI, please refer to <https://www.banrep.gov.co/es/estadisticas/indicador-bancario-referencia-BBI>

This box provides a brief description of the main instruments used by *Banrep* to implement monetary policy. It also compares the operational framework for monetary policy in other countries, which allows us to appreciate that the local framework aligns with best international practices. It also describes the supply and demand projections for the monetary base, which are essential inputs in assessing the economy's liquidity needs. Finally, the implementation of the policy framework is exemplified, referencing the evolution of the money market in 2023 and 2024.

1. Main Instruments for Contracting or Providing Liquidity to the Economy

Repo operations at different terms are used to provide temporary liquidity. In these transactions, financial institutions⁵ deliver securities to *Banrep* as collateral and receive cash in exchange. Upon maturity, the transaction is reversed, which implies that *Banrep* receives the cash plus accrued interest and returns the collateral to the financial institution. Under normal conditions, *Banrep* offers one- and seven-day term repos, allocated through auctions, with a total amount announced daily. As these transactions are set with specific terms, they are considered a source of temporary liquidity.

There may also be scenarios where the economy experiences temporary excess liquidity. In these cases, *Banrep* uses the DRNCE. Through these operations, allocated through auctions, financial institutions deposit resources with the Issuer for a specific term in exchange for a return. This generates a monetary contraction effect during the term in which the DRNCE is active.

When significant and persistent liquidity needs or excess liquidity are foreseen in the economy, purchases or sales of securities are conducted in the secondary market, primarily involving debt securities issued by the Colombian Government (TES). In this case, *Banrep* participates as another agent in the secondary securities market, seeking to be a price taker⁶ and not significantly affect the prices of these financial assets⁷. It provides liquidity to the system by purchasing securities or withdrawing excess liquidity by selling them.

In addition, *Banrep* has contraction and expansion windows through which it is willing to provide liquidity or receive excess liquidity from the system without a cap limit under these instruments' terms and interest rate conditions. *Banrep* has established a 100 basis points (bps) rate corridor around the MPR. On the one hand, the contraction window corresponds to overnight DRNCE, which is remunerated at the MPR minus 100 bps without consideration of the total amount of transactions. On the other hand, the expansion window corresponds to an overnight repo operation with a rate of MPR plus 100 bps. At this rate, and subject to the availability of eligible securities for access to repo operations by institutions, *Banrep* is willing to provide the required liquidity to the system without a pre-established limit.

2. International Experience on the Operational Framework for Monetary Policy

The BIS conducts a survey directed at central banks, allowing for a comparison of the objectives and instruments used to implement monetary policy cross different jurisdictions⁸. Although the implementation framework of monetary policy responds to the

5 The financial institutions with which *Banco de la República* conducts temporary liquidity transactions are called "OMO's placement agents" and are specified in External Resolution 5 of 2022 (<https://www.banrep.gov.co/es/reglamentacion-expansion-y-contraccion-monetaria>).

6 An agent is considered a price taker if they agree to buy or sell a security at the price being traded in the market. In other words, the supply or demand of a price taker cannot influence the market price.

7 The yield curve of the public debt market exhibits the relationship between the interest rates paid by Government bonds (TES) and their respective terms. To avoid affecting this curve, *Banrep* can offer or purchase bonds at different terms, thereby preventing an oversupply or overdemand of a specific security and thus preventing the price of the various securities from being affected.

8 For more details, please refer to <https://www.bis.org/mc/comparison.htm?m=150>

characteristics of each country, the comparison among jurisdictions allows the identification of some common elements.

The instruments used by some central banks in the region exhibit great similarity to the mechanisms for providing local liquidity (Table B3.1). It should be noted that the countries in the sample use an overnight interest rate as the operational target, and all employ an interest rate corridor in their framework⁹. Concerning the transactions used, it is found that repos are among the principal transactions carried out by the countries analyzed, as well as the purchase and sale of sovereign securities within the group of other liquidity management measures in Brazil and Mexico. Government flows, or deposits, are identified in all cases as the primary source of volatility in the economy's liquidity projections.

Table B3.1
Liquidity Management Mechanisms of Different Central Banks in Emerging Economies

Variable	Brasil	Chile	Colombia	Mexico	Peru	Indonesia	South Korea	Thailand
Target rate term	Overnight	Overnight	Overnight	Overnight	Overnight	Overnight	Overnight	1-day repo
Interest rate corridor	(-35 bps; 35bps)	(-25 bps; 25 bps)	(-100 bps; 100 bps)	Variable	250 bps	150 bps	200 bps	100 bps
Main transactions	Repo / reverse repo	Central Bank securities	Repos	Repos and deposits	Repos, central bank securities, and term deposits	Reverse repo	Reverse repo, central bank securities, and monetary stabilization account	Reverse repo, central bank securities, and FX Swap
Main transactions terms	1 to 360 days	1 to 360 days	Usually 7 and 1 day	Up to 30 days	Variable	7 to 360 days	Variable	1,7,14 days and 1 month / 3 months to 2 years / up to 1 year
Frequency	Variable	Daily	Daily	Daily	Variable	Daily (1 week)	Variable	Variable
Structural liquidity position	Surplus	Surplus	Surplus	Surplus	Surplus	Surplus	Surplus	Surplus
Most volatile factor in liquidity projections	Government flows	Government flows	Government deposits	Government flows	Government flows	Use of rupee reserves, government flows, and foreign currency flows	Government flows	Public sector flows
Other liquidity management measures	Purchases and sales of sovereign securities and voluntary deposits	Term deposits, issuance of securities, and conditional loan facilities	Purchases and sales of sovereign securities, interest-bearing deposits, and issuance of securities	Purchases and sales of sovereign securities and voluntary deposits	FX repo, FX certificates of deposit, and certificates and deposits	Purchases and sales of sovereign securities, interest-bearing deposits, and term repos	Monetary stabilization account, Purchases and sales of sovereign securities	Purchases and sales of sovereign securities

Source: Monetary policy frameworks and central bank market operations BIS compendium (2022).

9 In other jurisdictions, such as the United States or the Eurozone, an interest rate corridor is not employed. Instead, the policy rate operates as a floor for market interest rates. See, for example, <https://www.federalreserve.gov/econres/feds/the-feds-ample-reserves-approach-to-implementing-monetary-policy.htm> or <https://www.ecb.europa.eu/pub/pdf/scpops/ecb.op282-6017392312.en.pdf>

3. Projections of Supply and Demand for Monetary Base

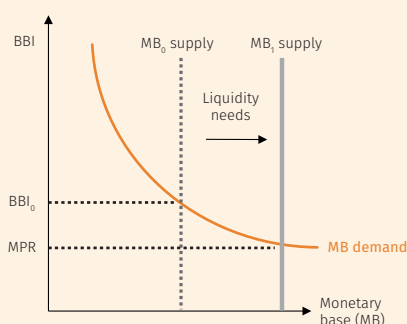
Money supplied by a central bank is called the monetary base, which is made up of cash and bank reserves¹⁰. Cash refers to the banknotes and coins held by the public¹¹, while bank reserves refer to the resources held by credit institutions (depository companies) in their vaults or deposit accounts at *Banrep* to meet their reserve requirements and operate in the payment system. The monetary base is also called high-powered money since it underpins the expansion of broader forms of money¹² and credit.

Under the inflation-targeting framework, given the demand for the monetary base driven by various macroeconomic conditions, *Banrep* adjusts the supply of the monetary base to aim for equilibrium in the money market at an overnight interest rate equal to the MPR. The demand for the monetary base is affected by several factors, primarily economic activity, the interest rate, levels of uncertainty, and the different technologies available for making payments, among others. This is related to the fact that the public demands cash to carry out transactions (means of exchange function), as a savings instrument, or as a precaution against uncertainties (store of value function). Financial intermediaries demand bank reserves for their transaction needs in the large-value payment system to meet their obligations to clients¹³ and comply with the reserve requirements (therefore, it is determined by the balances of liabilities subject to this requirement). The supply of the monetary base, in turn, results from all transactions that have affected the cash held by the public, cash balances, or deposits of credit institutions at the central bank.

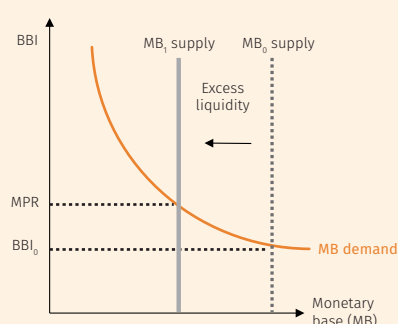
The negative relationship between the demand for the monetary base and the interest rate, as well as its relationship with *Banrep*'s transactions in scenarios of liquidity needs and excess liquidity, is schematically illustrated in Graph B3.1. As mentioned, the interest rate that *Banrep* follows as a reference for the overnight cost of term money in the market is the BBI for that horizon. The dotted vertical line indicates the supply for the monetary base if, at a given time, the central bank does not carry out any operation

Graph B3.1
Supply and Demand of Monetary Base

A. Situation with liquidity needs



B. Situation with excess liquidity



Note: the MB₀ supply corresponds to the offer without additional liquidity operations from *Banrep*; the MB₁ offer corresponds to the situation with additional liquidity operations from *Banrep*.
Source: *Banco de la República*.

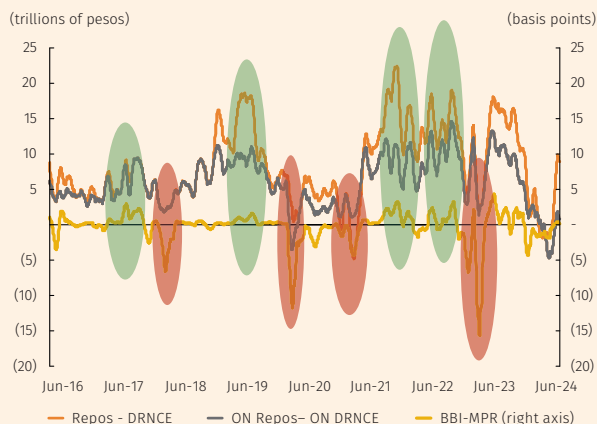
- 10 Another way to categorize the monetary base is by dividing it into circulating banknotes and coins and the balances in deposits at the central bank.
- 11 The monetary base also includes the balances of deposits from individuals at *Banco de la República*, which consist of balances in deposit accounts held by non-financial entities participating in the large-value payment system (CUD Deposit Accounts System), which have a low share. For simplicity, they are included as part of cash.
- 12 Broader definitions of money include instruments issued by the financial system, such as checking accounts or savings accounts, among others.
- 13 In this regard, customers of financial institutions need to be able to make transfers to other intermediaries, and also be able to withdraw cash resources.

Table B3.2
Diagram of the Balance Sheet of Banco de la República

Assets	Liabilities
<ul style="list-style-type: none"> Foreign reserves TES Repos Other net assets 	<ul style="list-style-type: none"> Monetary base <ul style="list-style-type: none"> - Cash - Reserves Government deposits in pesos Contraction deposits (DRNCE^{a/})
	Equity
	<ul style="list-style-type: none"> Capital Profits

a/ remunerated non-reserve deposits.
Source: Banco de la República.

Graph B3.2
Banrep Position and Difference of Overnight BBI Vs. MPR (20-Day Moving Average)



Note: *Banrep* position corresponds to the difference between the repo balance and the balance of remunerated non-reserve deposits (DRNCE in Spanish). The total position and the overnight (ON) position are presented.
Source: Banco de la República.

that affects it. In Panel A, in the absence of transactions with *Banrep*, the market would equilibrate at an interest rate (BBI_0) higher than the MPR. If this situation persists, that is, if the short-term interest rate in the economy is higher than the one considered compatible with the inflation target, *Banrep* would, *de facto*, have a more restrictive stance than announced. In the case where the supply of the monetary base is insufficient to equilibrate the market at a rate close to the MPR, the economy experiences liquidity needs, and *Banrep* is required to conduct operations to expand the monetary base. In the opposite case, as illustrated in Panel B, the economy has excess liquidity, which would lead to a market interest rate that is lower than the central bank's announced MPR (i.e., *de facto*, the stance would be more relaxed), thus requiring the collection of such excess. In this scenario, the economy is said to have contraction needs.

To determine the type of transactions required by the economy and to prevent situations in which significant liquidity needs or excess liquidity persist, which may divert the BBI, *Banrep* needs to make projections of the supply and demand of the monetary base. For the supply of the monetary base, projections are made for different items of *Banrep*'s balance sheet. Table B3.2 exhibits a simplified scheme of the Central Bank's balance sheet. The monetary base constitutes the primary liability of the monetary authority and serves as a counterpart to flows in other accounts. For example, when the Central Bank acquires foreign currency¹⁴, it pays pesos to the accounts at *Banrep* of financial intermediaries involved in the transactions and, therefore, increases the bank reserves and the monetary base. On the contrary, when the government increases its account balance at the central bank due to public debt issuance or tax collection, the monetary base declines. Within the inflation-targeting framework, many movements in *Banrep*'s balance sheet do not result from liquidity supply considerations. For example, in the case of deposits from the General Directorate of Public Credit and the National Treasury (DGCPTN in Spanish), these movements are driven by the Central Government's inflows and outflows, which are external decisions to *Banrep*. To project the government's peso-denominated cash flows at *Banrep*, there are coordination mechanisms with the Ministry of Finance that allow for detailed monitoring. In turn, the demand for the monetary base is estimated using time series techniques incorporating both its recent behavior and expectations for various macroeconomic factors.

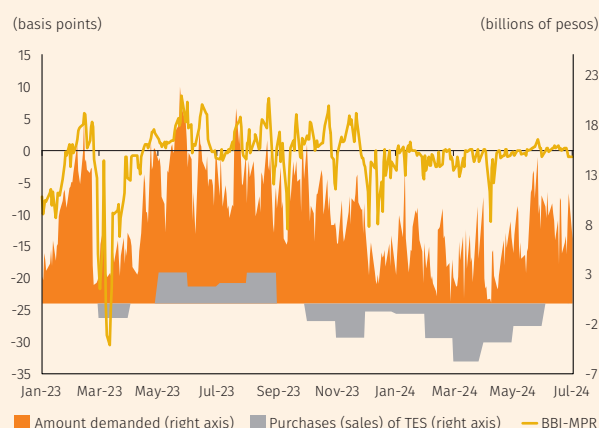
***Banrep* selects the different instruments to regulate the economy's liquidity, seeking a structural creditor position without reaching excessive levels.** The Central Bank chooses its instruments to maintain a situation in which there are certain levels of liquidity needs. As shown in Graph B3.2, during periods when there has been excess liquidity and even low liquidity needs, the overnight BBI has exhibited more significant and persistent deviations than when the economy experiences not-so-low liquidity needs. However, if these needs exceed a certain level, upward pressures on the overnight BBI are often evident.

14 This has been the case throughout 2024 following the start of the USD 1,500 million international reserve accumulation program announced in December 2023. See <https://www.banrep.gov.co/es/noticias/jdbr-decidio-iniciar-programa-acumulacion-reservas-internacionales>.

Thus, when broad and persistent differences between the supply and demand for the monetary base are expected, the use of permanent instruments, i.e., the purchase or sale of securities, is evaluated. When the differences between the supply and demand of the monetary base are not significant, liquidity requirements (excess) can be met (withdrawn) through temporary instruments. In this regard, projections of supply and demand of the monetary base, the expected temporality of liquidity needs or excess liquidity, and the objective of avoiding significant deviations from the overnight BBI to the MPR largely guide the use of temporary and permanent instruments to provide or withdraw liquidity from the system. It should be noted that the evaluation of the possibility of intervening through purchasing or selling securities considers the market environment at the time of the transactions and the fact that these projections are subject to uncertainty, both on the supply and demand sides.

The Monetary and Foreign Exchange Intervention Committee (CIMC in Spanish) is responsible for establishing the conditions to carry out transactions aimed at regulating the economy's liquidity, subject to the guidelines set by the BDBR. This committee is made up of the Governor, the other board members of *Banrep*, and a delegate from the Minister of Finance. It bases its decisions on projections and analyses carried out by the Central Bank's Office of the Deputy Technical Governor. The Committee meets periodically, while the Office of the Deputy Technical Governor updates short-term projections daily and monitors market conditions. This allows for an agile and efficient adjustment of the quotas and terms of the expansionary repo and contraction deposit auctions (when the latter are conducted). Daily monitoring also keeps the Committee members informed between ordinary meetings and enables them to convene extraordinary meetings if necessary.

Graph B3.3
Evolution of the Difference between the BBI-MPR, Purchase and Sale of TES from Banrep, and Amount Awarded in Repo Operations



Purchases – Sales of TES (trillions of pesos)					
Jan-23	Feb-23	Mar-23	Apr-23	May-23	Jun-23
-	-	-1.5	-	3.1	1.7
Jul-23	Aug-23	Sep-23	Oct-23	Nov-23	Dec-23
2.1	3.1	-	-1.8	-3.4	-0.8
Jan-24	Feb-24	Mar-24	Apr-24	May-24	Jun-24
-1.0	-3.5	-6.0	-4.0	-2.3	-

Source: Banco de la República.

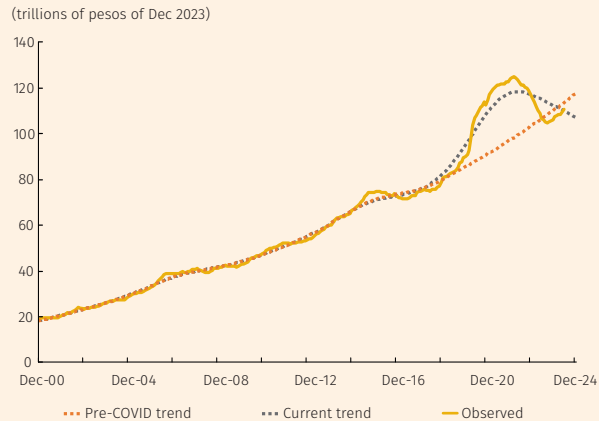
4. Liquidity Supply for 2023–2024

In compliance with its operational objective, *Banrep* has employed instruments to provide or withdraw liquidity from the economy, allowing the overnight BBI to be very close to the MPR throughout 2023 and so far in 2024 (Graph B3.3). In 2023, the BBI was, on average, 0.4 bps below the MPR (minimum -30.6 bps and maximum 8.5 bps), while in the first half of 2024, it was 0.8 bps below (minimum -11.7 bps and maximum 1.7 bps). In line with this, during 2023 and so far in 2024, negative deviations have been more pronounced.

During 2023, there was a marked slowdown in the demand for the monetary base, reversing the increase recorded during the pandemic. In nominal terms, between the end of 2022 and the end of 2023, the balance of the monetary base remained stable (increasing by COP 34 billion, 0.02%). The demand for cash, its main component, had significantly increased during the pandemic, reflecting a preference for liquid assets amid high uncertainty. However, in 2023, it consolidated its return to the trend level calculated using data from before the onset of the pandemic (which had begun in 2022), showing the lowest annual changes so far this century (in nominal and real terms)¹⁵. As illustrated in

15 In 2023, with weekly information (as of Friday), cash showed an average annual variation of -0.08%, corresponding to -11.3% in real terms (using the CPI as a deflator).

Graph B3.4
Cash Held by the Public
(seasonally adjusted real balance)



Note: The total CPI was used as the deflator. Seasonally adjusted series using X13-ARIMA-SEATS. The Hodrick-Prescott filter was used to calculate the pre-COVID trend using data up to February 2020, and the full sample for the current trend.
Source: Banco de la República.

Graph B3.4, the reversal of the shock was more pronounced than the shock itself. This occurred in an environment of lower dynamism of economic activity compared to previous periods, with interest and inflation rates remaining elevated. It is important to note that interest and inflation rates represent opportunity costs for cash holders (as well as for holders of other liquid assets, such as checking and savings accounts). As for the bank reserves, the lower growth of reserve requirements and the shift from demand deposits (such as checking and savings accounts) to term liabilities (such as CDTs), which have lower reserve requirement ratio¹⁶, also implied a significant deceleration in the required reserves¹⁷ (Graph B3.5).

In the first half of 2024, nominal growth in the demand for the monetary base continues to be low, although higher than in 2023.

At the end of June, the balance of the monetary base decreased by COP 6.0 trillion (3.8%) compared to the end of December 2023, mainly due to the seasonal decline in cash, which tends to peak at the end of each year. However, its balance has shown some increases in the margin. Similarly, the balances of checking and savings accounts have risen again, increasing their share within the total liabilities subject to reserve requirements, resulting in a higher balance of the required reserves and, therefore, bank reserves.

During the period under analysis, Banrep carried out the necessary operations to ensure an adequate supply of primary liquidity, aiming to prevent significant pressures in the money market from arising due to differences between supply and demand. This involved alternating periods of sales and purchases of TES, conducting contraction deposit auctions and those of expansionary repos at maturities longer than the usual seven days and overnight. In particular:

- **In the early months of 2023, Banrep combined DRNCE auctions (from late February to mid-April) together with TES sales in March¹⁸**, which sought to offset the strong expansion generated by the maturity of TES UVR on 23 February, as well as the payments and maturities of short-term TES, and coupons in early March.
- **In the second and third quarters of 2023, liquidity needs increased significantly, which was expected to persist for some months. Therefore, Banrep started purchasing TES¹⁹ in May. Additionally, the Central Bank supported the provision of liquidity through longer-term repo operations to its seven-day and overnight standard²⁰.** This, given the significant level

Graph B3.5
Reserve Requirement
(real balance)



Note: The total CPI was used as the deflator.
Source: Banco de la República.

16 The share of demand deposits (with a reserve ratio of 8.0%), such as checking and savings accounts, decreased from 63.9% on average in 2022 to 54.3% in 2023. In turn, liabilities subject to reserve requirements for terms of eighteen months or less, which mainly correspond to CDTs and have a reserve ratio of 3.5%, had an average participation of 26.2% (vs. 18.4% in 2022). Finally, those with a term of more than eighteen months, corresponding mainly to CDTs and bonds (with a reserve ratio of 0.0%), increased from 17.7% on average in 2022 to 19.5% in 2023.

17 The excess reserve is usually close to 3.0% of the total reserve requirement.

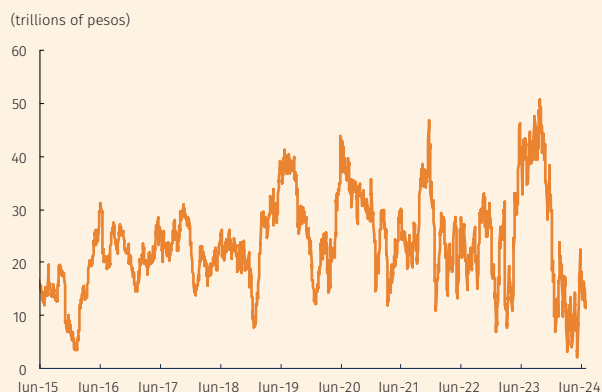
18 In that month, Banrep made sales of TES in the secondary market for COP 1.5 trillion.

19 Between May and August, Banrep made purchases of TES for about COP 10 trillion.

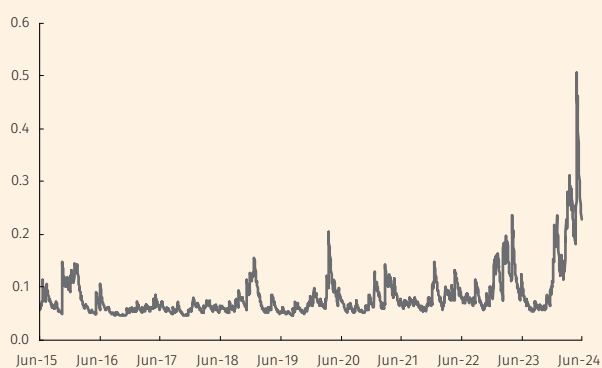
20 From May, thirty- and fourteen-day term repos were offered, in addition to the usual seven-day and overnight repos. In August and September, 90- and 180-day repos were also offered.

Graph B3.6
Balance and Volatility of Deposits of the General Directorate of Public Credit and the National Treasury (DGCPTN in Spanish)^{a/} in Banco de la República

A. Daily balances^{b/}



B. Volatility of DGCPTN balances^{c/}



a/ General Directorate of Public Credit and the National Treasury.

b/ Includes interest-bearing and non-interest-bearing balances. It does not include the balance of monetary control deposits.

c/ A GARCH model (1,1) was used, which includes the modeling of the mean with an ARMA model of order $ar = 5$ and $ma = 3$.

Source: Banco de la República.

of deposits from the National Treasury at *Banrep*, which reached highs between August and September (Graph B3.6), and the accumulation of CDT maturities, among other factors²¹.

- **From October 2023 to May 2024, *Banrep* made sales of TES²².** In the first months, sales were made in anticipation of the expansionary effect on the monetary base due to the seasonal reduction of the Government's deposits at *Banrep* at the end of each year, given that most of its payments are concentrated at this time. In 2024, sales sought to offset the low levels of government deposits at the Central Bank²³, which also exhibited greater-than-usual volatility (Graph B3.6). During this period, DRNCE auctions were only conducted at certain times, depending on observed demand in the contraction window²⁴.

***Banrep* remains committed to maintaining an adequate balance of liquidity in the economy.** *Banrep* has a robust monetary policy implementation framework that has proven effective and adaptable at various junctures. The combination of temporary and permanent liquidity instruments has allowed the Central Bank to achieve its operational objectives, contributing to the adequate transmission of monetary policy decisions, reinforcing credibility in monetary policy, and enabling effective liquidity management within the financial system.

21 For more details on the different factors that affected the system's liquidity needs in the second and third quarters of 2023, see the box "Recent Liquidity Situation and the Role of *Banrep*," published in the *Financial Markets Report of Banco de la República* in the third quarter of 2023 (banrep.gov.co).

22 Between October and December 2023, *Banrep* made sales of TES for COP 6 trillion, and between January and May 2024, for an additional COP 16.5 t.

23 Government deposits at *Banrep* usually recover after reaching a low at the end of each year. However, in 2024, they have remained at low levels.

24 At the counter, contraction deposits are constituted overnight term, and their remuneration is 100 bps below the MPR. Unlike repo and DRNCE transactions, which have an assigned quota, over the counter operations do not.

5. External Balance and Foreign Reserves

5.1 Developments and Outlook of Colombia's Balance of Payments

During the first quarter of 2024, the current account registered a deficit of USD 1,924 million (m), corresponding to 1.9% of GDP. This represented a reduction of 1.8 percentage points (pp) of GDP compared to the same period of the previous year (Table 5.1). This reduction in the external imbalance occurred in a context of lower domestic demand, mainly as a result of the contraction in investment in machinery and equipment. This performance was reflected in a significant decline in the value of imports, which, together with growth in services exports, significantly reduced the trade deficit. The country's current account deficit has shown significant annual adjustments since the third quarter of 2022, a trend that continued into the first quarter of 2024, consistent with a slowdown in economic activity and higher local savings.

Lower net factor income outflows and favorable changes in the services trade balance are the main factors behind the reduction in the current account deficit. The improvement in the services trade balance would be associated with the higher influx of international travelers (USD 389 m) and lower domestic demand, particularly for investment, which is reflected in the lower value recorded in freight transportation services (USD 186 m). This improvement in the deficit is also supported by a decrease in net factor income outflows amounting to USD 542 m, mainly explained by reduced profits of companies with foreign direct investment (FDI), leading to lower outflows from remittance of profits. In turn, net income from current transfers increased by USD 235 m, with revenue from workers' remittances reaching USD 2,721 m between January and March 2024, reflecting an annual increase of 9.9% (USD 245 m). These results were partially offset by a widening of the trade deficit in goods (USD 171 m), resulting from the larger decline in exports compared to imports.

The lower deficit in factor income is explained by the reduction in estimated profits for firms with FDI in the country and the increase in income from Colombian investments abroad, a result partially offset by higher interest payments on foreign loans. Compared to a year ago, factorial income expenses decreased by USD 395 m, mainly explained by the reduction in estimated profits for companies with FDI (USD 1,278 m), partly offset by the increase in interest payments on foreign loans (USD 564 m). The decline in FDI profits was widespread and particularly driven by lower estimated earnings for firms operating in mining and quarrying (USD 926.6 m), oil exploitation (USD 129.5 m), financial institutions and business services (USD 76.8 m), and transportation and communications (USD 55.6 m). Higher interest payments on foreign loans are supported by generalized increases in international interest rates and, to a lesser extent, higher external debt¹ balances. Factor income

¹ The increase in the income of the other investment between 2024 and 2023 is explained by 64.8% for the increase in interest rates, 29.4% for the increase in the balance and 5.8% for the cross-effect (increase in balance and rates).

Table 5.1
Colombia's Balance of Payments

Current account (millions of dollars)	2023 (p) Jan-Mar	2024 (p) Jan-Mar	Variation (millions of dollars)
Checking account (A + B + C)	-2,996	-1,924	1,072
Percentage of GDP	-3,7%	-1,9%	
A. Goods and services	-2,228	-1,932	296
1. Goods	-1,885	-2,057	-171
FOB exports	13,490	11,781	-1,709
FOB imports	15,376	13,838	-1,538
2. Services	-343	125	467
Exports	3,601	4,251	650
Imports	3,943	4,126	183
B. Factor income	-3,866	-3,324	542
Income	2,137	2,283	147
Expenses	6,002	5,607	-395
C. Current transfers	3,097	3,332	235
Income	3,404	3,737	333
Expenses	307	405	98
Financial account Annual flows (millions of dollars)	2023 (p) Jan-Mar	2024 (p) Jan-Mar	Variation (millions of dollars)
Financial account with variation in foreign reserves (A + B + C + D)	-2,556	-1,397	1,158
Percentage of GDP	-3,2%	-1,4%	
A. Direct investment (ii-i)	-3,564	-2,533	1,031
1. Foreign direct investment in Colombia (FDI)	4,109	3,620	-489
Percentage of GDP (FDI)	5,1%	3,6%	
2. Colombian investment abroad	545	1,087	542
B. Portfolio investment (1+2)	1,111	1,589	477
1. Public sector (ii-i)	-1,108	-263	845
i. Foreign portfolio investment (a + b)	1,463	749	
a. International markets (bonds)	1,729	641	
b. Local market (TES)	-267	108	
ii. Portfolio investment abroad	355	486	
2. Private sector (ii-i)	2,219	1,852	-367
i. Foreign portfolio investment (a + b)	-473	-166	
a. International markets (bonds)	-500	-170	
b. Local market	27	4	
ii. Portfolio investment abroad	1,746	1,686	
C. Other public sector + private sector capital flows	-468	-1,404	-936
D. Reserve assets	366	951	586
Errors and omissions (E and O)	441	527	86
Memo item			
Financial account with no variation in foreign reserves	-2,921	-2,349	573
Variation in foreign reserves	366	951	

(p) provisional.
(PR) preliminary.
Source: Banco de la República.

revenues were USD 147 m higher than a year ago, due to higher returns on foreign reserves and higher income associated with Colombia's direct investments abroad. **The surplus in the services balance was mainly due to the favorable performance of tourism revenues, which grew by 19%, while expenditures decreased, partly due to items related to the transportation of goods.** In the case of the services balance surplus (USD 125 m), the higher number of international travelers arriving in the country, together with the higher sales of IT and technical services, explained the growth of services exports amounting to USD 650 m. On the services imports side, payments for travel services and purchases of modern services increased, partially offset by lower purchases associated with freight transportation services, leading to an increase in services imports of USD 183 m. As for the trade deficit in goods, it widened by USD 171 m compared to a year ago. This was the result of a greater reduction in the value of exports (USD 1,709 m) compared to imports (USD 1,538 m). Lower coal and ferro-nickel prices explained the decline in goods exports. Additionally, a decline in gross fixed capital formation in the first quarter, particularly in machinery and equipment (-10.8% per year), contributed to the overall contraction in the value of external purchases of goods.

The main source of financing is foreign capital inflows from FDI and, to a lesser extent, from portfolio investments. Between January and March 2024, the financial account recorded net capital inflows of USD 1,397 m (1.4% of quarterly GDP), lower than a year ago (USD 2,553 m, 3.2% of quarterly GDP). Highlights include resources received from FDI (USD 3,620 m) and foreign portfolio investment income (USD 583 m) versus net repayments from foreign loans and other capital flows (USD 493 m). It should be noted that the amount of FDI was USD 489 m lower than a year earlier. This FDI trend is mainly explained by the reduction in investments received in manufacturing (USD 240 m), oil (USD 229 m), community and personal services (USD 148 m) and electricity, gas, and water (USD 76 m), while there is an increase in FDI in mining (USD 162 m) and trade and hotels (USD 92 m).

In turn, domestic capital continued to flow out to build up private-sector assets abroad in financial and direct investment. In the first three months of 2024, public and private foreign portfolio investments were estimated at USD 583 m, resulting from long-term debt security placements in international markets (USD 471 m) and net purchases of financial instruments in the local market by non-residents (USD 112 m). In turn, net amortizations in foreign loans and other capital flows amounted to USD 489 m, highlighting net payments made by the private sector (USD 498 m) against the net disbursements received by the public sector (USD 6 m).

For 2024, the technical staff projects a current account deficit close to 3.0% of GDP, maintaining the adjustment process from the 6.1% deficit recorded in 2022, while exhibiting a moderate widening from the 2.5% deficit observed in 2023. For 2024, a larger imbalance in the goods account is expected compared to the previous year; however, the current account deficit would remain close to its historical average² thanks to the persistent adjustment dynamics of the services accounts, factor income, and current transfers. Specifically, the widening of the trade deficit in goods would take place in a context of lower international prices of some traditional export products and amidst a recovery in domestic demand and economic activity, which would be reflected in a rebound in imports. However, the widening of the trade imbalance would be partially offset by continued favorable performance

² The average of the current account deficit of the Balance of Payments for the period 2000 to 2023 is -3.0% of GDP.

in tourism services exports, lower FDI profits sent abroad, high returns on foreign reserves, and higher income from workers' remittances. Regarding the savings and investment outlook, the moderate widening of the deficit in 2024 would be consistent with a larger public sector imbalance, as announced by the Medium-Term Fiscal Framework, 2024 (MTFF-2024), which would be partially offset by higher private sector savings compared to the previous year.

In 2024, the country would maintain access to external financing in a context of tight financial conditions, with international interest rates and Colombian risk premium above historical averages. By 2024, FDI would remain the main source of financing for the current deficit, although it would decline compared to 2023 in line with lower international coal prices and moderate economic growth. In turn, the public sector would continue to require external resources, while the private sector would establish assets abroad.

5.2 Foreign Reserves

In accordance with Law 31 of 1992, Banco de la República (Banrep) manages foreign reserves in accordance with the public interest, benefiting the national economy and facilitating the country's payments abroad. Consequently, the law defines that the investment of reserve assets shall adhere to the criteria of security, liquidity, and profitability. The security criterion for managing foreign reserves in Colombia involves adequately controlling the risks associated with these investments. To manage these risks within acceptable parameters and levels, *Banrep's*³ Foreign Reserves Committee defines strict limits for exposures to different risks faced by reserves. To meet the liquidity criterion, *Banrep* invests foreign reserves in financial assets that are easy to liquidate, if necessary, or in assets maturing within the upcoming months, and defines investment tranches based on liquidity and profitability objectives. Once the criteria for low-risk investment of the foreign reserves portfolio have been defined, the management policy seeks to ensure adequate profitability, as this criterion is part of the mandate given by law to *Banrep*. An explanation of the policies guiding reserve investment and some relevant definitions are provided in the Annex.

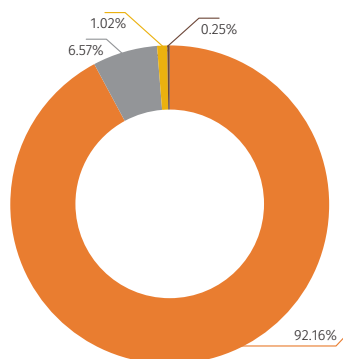
The main objective of foreign reserves is to protect the country from external shocks that may affect both trade and financial flows and, depending on their size, may jeopardize macroeconomic stability. Trade flows may be affected, for example, by a drastic reduction in exports or an unusual increase in imports that worsens the external liquidity situation; in turn, financial flows could be affected due to barriers to accessing external financing, such as reduced access to international credit or increased capital outflows from both foreign investors and residents. A country's foreign reserves are also a determining factor in the perceived repayment capacity of domestic borrowers, as credit rating agencies and external lenders consider that an adequate level of reserves would enable residents to service foreign currency obligations, such as payments for imports and the servicing of external debt during periods of restricted access to external financing. In this way, an adequate level of reserves contributes to improving the risk perception of the country and its residents, facilitating government and private sector access to international capital markets.

³ The Foreign reserves Committee is composed of the Minister of Finance and Public Credit or their delegate, the full-time members of the Board of Directors and the Governor.

Banco de la República maintains external liquidity buffers in amounts deemed sufficient to meet the objective mentioned above. In this regard, the importance of maintaining an adequate level of foreign currency liquidity to prevent and address external shocks is recognized, considering various international metrics. For example, it is desirable that the level of external liquidity managed by *Banrep* be greater than the sum of the current account deficit and projected external debt payments.

During 2024, there has been an increase in the level of foreign reserves. The main factor behind this increase is the gradual foreign reserves accumulation program implemented by Banco de la República since the beginning of the year. The positive profitability achieved over the year has also contributed to the increase in the level of reserves. As of 30 June 2024, net foreign reserves⁴ totaled USD 60,901 million (m), an increase of USD 1,293.1 m over the course of 2024. This increase is mainly due to the reserve accumulation program announced by the BDBR in December 2023, which recorded a reserve accumulation of USD 824.9 m by the end of June. Moreover, the year-to-date return on foreign reserves, excluding the foreign exchange component, is 1.43% (USD 864 m). This result is mainly explained by higher interest rates, which have had a positive impact on the profitability of foreign reserves through higher interest earned on investments. This has been partially offset by the depreciation of other reserve currencies against the US dollar, resulting in a negative exchange rate effect on the valuation of reserves (USD -344 m).

Graph 5.1
Composition of Foreign Reserves^{a/}
(as of 30 June 2024)



● Investment portfolio ● International Monetary Fund
● Latin American Reserve Fund ● Other

a/ Gold is included within the investment portfolio. The “Other” category includes international agreements, cash on hand, and demand deposits.
Source: Banco de la República.

The main component of foreign reserves is the investment portfolio. This corresponds to investments in financial instruments on the international market and certified physical gold (91.59% and 0.57% of the reserves, respectively). The composition of foreign reserves at the end of the first half of 2024 is shown in Graph 5.1.

5.2.1 Reserve Indicators

Indicators assessing the level of foreign reserves (FRs), including those from the IMF, suggest that their level is adequate. A widely used international indicator to measure the appropriate level of foreign reserves is the one proposed by the IMF denominated the Assessing Reserve Adequacy (ARA) methodology. This framework states that reserves should cover the main balance of payments risks during periods of foreign exchange market pressure. According to the IMF, this indicator aims to cover risks associated with loss of access to external

4 Net foreign reserves are equal to the total foreign reserves, or gross reserves, minus the short-term external liabilities of *Banco de la República*. The latter consist of foreign currency overnight obligations with non-resident agents. Gross foreign reserves amounted to USD 60,931.5 m and short-term external liabilities amounted to USD 30.1 m.

financing, loss of confidence in the local currency, reversal of capital flows, and a potential collapse of external demand⁵. An economy is considered to hold adequate reserve levels if the ARA ratio is between 1.0 and 1.5. Based on the latest available information in June 2024, the IMF’s ARA ratio for Colombia was 1.24.

So far this year (as of July 15), Banrep has accumulated reserves amounting to USD 1,024.9 m, representing 73% of the amount auctioned (USD 1,400 m) and 68% of the total amount of the reserve accumulation program announced by the BDBR in December 2023 (USD 1,500 m). In total, seven auctions have been held, which have experienced overdemand by participating agents. In June, given the ongoing depreciation of the peso, the exercise condition was not active on any trading day, resulting in no reserve accumulation, while in July, all the amount auctioned for the month were already exercised.

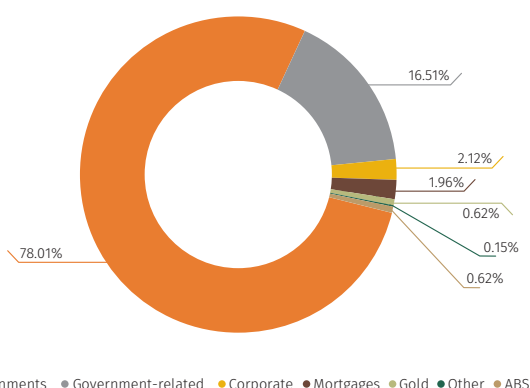
In line with the accumulation of FRs and the higher yields obtained, relative stability in the different reserve adequacy metrics has been observed during 2024, showing that Colombia maintains an adequate level of reserves. Other indicators used to assess foreign reserves may warn about the external vulnerability of economies. These include the ratios of foreign reserves to monetary aggregates, short-term external debt, and the current account deficit. In the case of Colombia, these other indicators have remained relatively stable throughout the year, and estimates show that the increase in FRs has been adequate to offset the decrease in the Flexible Credit Line (FCL) with the IMF⁶. Thus, in June, the metrics suggest that the level of reserves remains at adequate levels.

5.2.2 Composition of the Investment Portfolio

The investment portfolio consists mainly of securities issued by governments and government-related entities. Graph 5.2 shows the composition of the investment portfolio as of 30 June 2024, when around 94.53% was invested in issues of these entities.

The composition of the portfolio by rating shows the high credit quality of the assets in which the portfolio is invested. Graph 5.3 shows that 24.70% of the portfolio was invested in instruments rated AAA, while 71.25% was invested in AA-rated instruments. *Banrep* uses the lowest investment grade rating

Graph 5.2
Composition of the Investment Portfolio by Sector
(as of 30 June 2024)



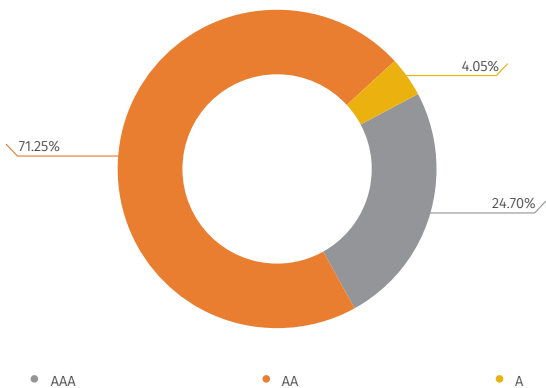
● Governments ● Government-related ● Corporate ● Mortgages ● Gold ● Other ● ABS

Source: Banco de la República.

5 IMF (2015). “Assessing Reserve Adequacy: Specific Proposals.”

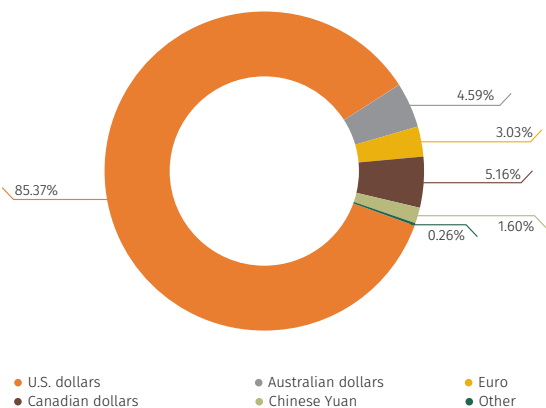
6 On 26 April 2024, the IMF approved a new two-year FCL arrangement for Colombia in the amount of Special Drawing Rights (SDRs) of 6,133.5 m (300% of Colombia’s quota in the agency), equivalent to about USD 8,100 m. This agreement will replace the previous one, approved in 2022 for an SDR amount of 7,155.7 m (corresponding to 350% of Colombia’s quota) and will be considered by the Colombian authorities as a precautionary instrument to face external risks.

Graph 5.3
Distribution of Investments by Credit Rating
(as of 30 June 2024)



Source: Banco de la República.

Graph 5.4
Currency Composition of the Investment Portfolio
(as of 30 June 2024)



Source: Banco de la República.

Graph 5.5
Duration of the Investment Portfolio
(as of 30 June 2024)



Source: Banco de la República.

granted by at least two of the three main credit rating agencies (S&P, Moody’s and Fitch Ratings) as a minimum reference. In addition to credit ratings, *Banrep* incorporates monitoring of environmental, social, and governance (ESG) risk factors into its international reserve risk management process.

The investment portfolio comprises currencies characterized by high daily trading volumes and belong to countries with high credit ratings, with the US dollar having the largest share. Graph 5.4 shows the currency composition of the investment portfolio as of 30 June 2024. Given that one of the objectives of foreign reserves is to meet the country’s external payments during periods of reduced external financing sources, the currency composition of Colombia’s foreign reserves aims to replicate the performance of the country’s balance of payments outflows. In this way, the reserves seek to cover the volatility of the country’s external payments derived from exchange rate movements. The US dollar has the largest share of Colombia’s foreign reserves, as most of the country’s trade and financial transactions with the rest of the world are conducted in this currency. Additionally, investments are allowed in the following currencies: Canadian dollar, Australian dollar, and New Zealand dollar; Swedish krona, pound sterling, Swiss franc, euro, yuan, yen, Norwegian krona, renminbi, Hong Kong dollar, Singapore dollar, and won.

During 2024, Banco de la República has gradually increased the duration⁷ of the investment portfolio, which allows it to have a portfolio with a higher level of expected return due to the risk assumed. Graph 5.5 shows the evolution of the duration of the investment portfolio. As of 30 June 2024, the investment portfolio had a duration of 3.11, meaning that the portfolio value could increase (decrease) by 3.11% versus a 1.0% decrease (increase) in yields of all bonds in the portfolio.

7 Duration is a measure of risk that is defined as the percentage decrease (increase) in the value of the portfolio versus a 1.0% increase (decrease) in all interest rates.

5.2.3 Return on Reserves

The return on reserves mainly depends on two factors: the interest and the capital appreciation. The first factor corresponds to the interest earned on the instruments in which it is invested, while the valuation factor relates to changes in the prices of these securities due to movements in interest rates. This second factor arises from the inverse relationship between bond prices and interest rates, that is, bond prices decrease as interest rates rise, and vice versa.

As of 30 June 2024, foreign reserves recorded a positive return mainly due to interest earned on investment portfolio (interest factor). Foreign reserves have recorded a return of 1.43%⁸ so far this year. Increases in central banks' benchmark interest rates in 2023 and inflation performance in developed economies kept interest rates at levels higher than those observed in recent years. As a result, so far in 2024, the interest income produced a positive return (interest factor), outweighing the negative valuation effects resulting from the increase in the yield curve of US bonds in the early months of the year.

The outlook for the return on foreign reserves is favorable for 2024. With interest rates in international markets remaining relatively high compared to recent years, reserve investments are expected to continue to generate high interest income (interest factor) throughout the year. Additionally, as headline inflation levels continue to decline, interest rates on sovereign debt securities would tend to decline, generating investment valuations. The outlook for the return on foreign reserves remains favorable given the higher level of interest earned on portfolio assets. Additionally, interest rate cuts may occur in the coming months, as monetary authorities have signaled an end to the **hiking** cycle of their monetary policy rates and are projecting interest rate reductions for 2024. In the medium term, interest rates on sovereign debt securities will decline, resulting in investment valuations and lower interest income.

5.2.4 Measures to Strengthen International Liquidity

On 26 April, the Executive Board of the International Monetary Fund (IMF) approved a new two-year Flexible Credit Line (FCL) arrangement for Colombia for an amount of 300% of the country's quota at the Fund (about USD 8,100 million)⁹. The current high level of uncertainty, driven by geopolitical factors, highlights the importance of maintaining adequate levels of external liquidity and, in this sense, this line constitutes a source of external liquidity that complements foreign reserves.

The FCL is a precautionary instrument created by the IMF to provide early and flexible financing to member countries with strong macroeconomic policy frameworks and a favorable record of economic performance. Access to the FCL represents a very important signal about the stability, good performance, and resilience of the beneficiary countries, and contributes to strengthening international confidence, facilitating access to international financial markets under favorable terms.

⁸ This return is obtained by dividing the observed return by the average value of net reserves on 31 December 2023 and 30 June 2024. Since 2015, the impact of the exchange rate effect of the return on reserves has been excluded.

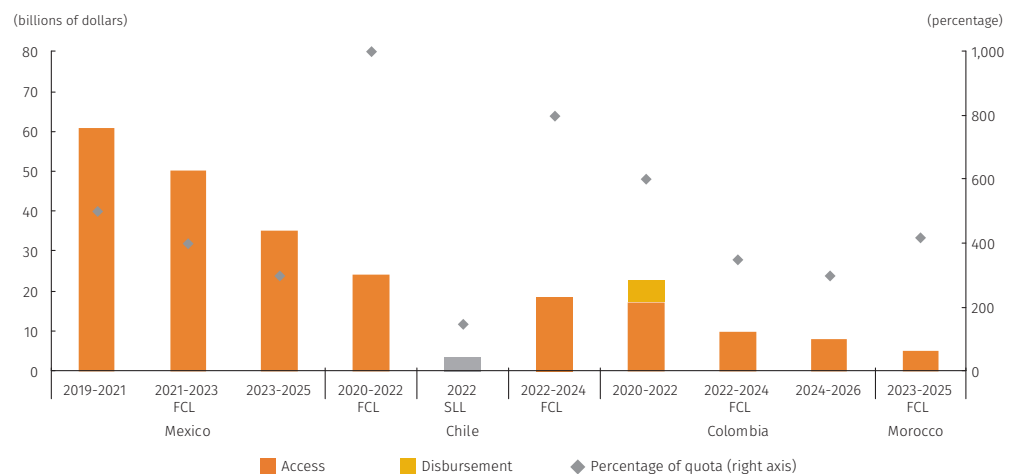
⁹ The new agreement replaced the previous one, approved in 2022, which had a level of access equivalent to 350% of the country's quota in the agency.

The IMF considers that the country continues to meet the eligibility criteria¹⁰ for this instrument and highlighted its strong institutional policy framework. This includes a highly credible inflation targeting regime, a flexible exchange rate, a solid fiscal framework, and effective financial regulation and supervision. In its assessment, the Fund highlighted that, in a globally uncertain macroeconomic and financial environment, the country has managed to reduce its imbalances and mitigate external vulnerabilities, allowing it to reach more sustainable levels of economic activity. However, while external risks have moderated, they remain elevated, making it prudent to maintain adequate levels of external liquidity.

The new agreement is for a lower access than that of the previous one and reflects the authorities' commitment to continue with a strategy of gradual reduction of access to the instrument as external risks recede. In this sense, the reserve accumulation program that *Banco de la República* has been carrying out since the beginning of 2024 seeks to compensate for the reduced access to the FCL.

Colombia has had access to the FCL since 2009, during which the requested amounts have varied in response to the shocks and risks faced by the economy. Access to this instrument has been maintained due to the country's strong macroeconomic policy framework and prudent management of the economy, enabling it to meet the required criteria. Currently, three other countries have access to the instrument¹¹: Mexico, Chile, and Morocco (Graph 5.6).

Graph 5.6
Recent Agreements of the Flexible Credit Line (FCL)



Sources: IMF, *Banco de la República*.

¹⁰ The criteria are: (1) a sustainable external position; (2) a capital account dominated by private flows; (3) a track record of access to international capital markets on favorable terms; (4) a relatively large level of reserves when applying for the FCL on a precautionary reasons; (5) sound public finances (including sustainable public debt conditions); (6) low and stable inflation in the context of a sound monetary and exchange rate policy framework; (7) a sound financial system and the absence of bank solvency problems that pose a systemic threat to the stability of the banking system; (8) effective supervision of the financial sector; and (9) integrity and transparency of information.

¹¹ Peru allowed its two-year agreement (from 2022 to 2024) to expire on 26 May 2024, and decided not to request a renewal of the agreement, meaning it no longer has access to the instrument.

Additionally, *Banco de la República* also has access to the Federal Reserve's FIMA Repo Facility, which serves as an instrument for immediate liquidity under extreme circumstances. In these transactions, FIMA account holders (central banks and other international monetary authorities with accounts at the Federal Reserve Bank of New York) exchange their US Treasury bonds held at the Federal Reserve (Fed) for US dollars, with a commitment to repurchase the securities the next day, together with interest. The main benefit for *Banrep* in accessing the FIMA facility is to be able to have liquidity in US dollars without having to permanently sell assets from the foreign reserves portfolios, which mitigates liquidity and market risk. *Banrep* would use this facility only if, having decided to sell dollars on the spot market, the Treasury securities market presents very low liquidity at that time.

Finally, *Banco de la República* has access to liquidity facilities from the Bank for International Settlements (BIS), which complement the availability of external liquidity for foreign reserves. Under these facilities, central banks' investments with the BIS serve as collateral for liquidity provision by the BIS. In this sense, *Banrep* could access contingent and immediate liquidity without having to sell assets from foreign reserves portfolios invested in BIS instruments, which could be particularly useful in extreme circumstances of low liquidity in global fixed-income markets or episodes of high-risk aversion. Particularly, in the first half of 2024, the BIS renewed these facilities for *Banrep* for a total amount of USD 1,600 m, which would only be used exceptionally in extreme market situations¹². In this sense, *Banrep* considers these facilities as precautionary lines that complement the availability of external liquidity for foreign reserves.

12 The BIS reserves the right to approve or reject requests to access the facility and to disburse the facility. The BIS examines each central bank's request for access to the line and the possibility of requesting its disbursement.

Shaded Section 3

Participation of *Banco de la República* in the Bank for International Settlements

In compliance with Law 1484 of 12 December 2011, which authorized the incorporation of *Banco de la República* as a shareholder of the Bank for International Settlements (BIS)¹, this section details the most relevant activities carried out with that entity in recent months. In accordance with the granted authorization, the bank subscribed to 3,000 shares of the BIS for an amount of 65,712,000 Special Drawing Rights (SDRs), equivalent to USD 100,978,710, which are recorded at their acquisition cost in SDRs according to the contribution item in international organizations and entities.

This year, during the BIS Annual General Meeting, a decision was made to pay a dividend of SDRs 370 per share, comprising an ordinary dividend of SDRs 295 per share and a final dividend of SDRs 75 per share, which, on this occasion, is given to members due to the organization's strong financial performance over the past two years. Thus, following the payment of dividends, the profits for the 2023-2024 period were allocated to the General Reserve Fund, the Special Reserve Fund for Dividends, and the Free Reserve Fund².

In recent months, as usual, *Banco de la República's* management has participated in the periodic meetings held by the organization, in which recent events and the outlook of the global economy and financial markets are reviewed. Recent discussions in the meetings of governors from BIS member countries have focused on global monetary policy divergence, the recent inflation trajectory, foreign exchange intervention in emerging economies, the performance of the neutral interest rate post-pandemic, environmental considerations regarding capital flows, new working formats in central banks, and the application of artificial intelligence in central banking.

Furthermore, within the framework of the BIS advisory groups that conduct research and analysis in areas such as financial stability and banking transactions, *Banco de la República's* regular participation in meetings of the Consultative Group of Directors of Financial Stability (CGDFS) stands out, where discussions have focused on the financial stability risks derived from high interest rates. Additionally, the Scientific Committee meeting approved the 2024 work plan, focusing on issues of economic growth, monetary policy, digital finance, and climate change.

The 23rd BIS Annual Conference³, held at the end of June this year in Basel (Switzerland), is also highlighted. On this occasion, discussions focused on the

1 This international institution was created in 1930 and currently includes 63 central banks. Its mission is to support central banks in their quest for monetary and financial stability by fostering international cooperation in these areas, as well as serve as to serve as bank for the member central banks. Its headquarters are located in Basel, Switzerland, and it has two representative offices, one in Hong Kong and the other in Mexico City.

2 In accordance with the bylaws, 5.0% of the net return for the 2023/2024 period, after deducting the dividend payment, was transferred to the General Reserve Fund, and the remaining amount was distributed between the Special Dividend Reserve Fund and the Free Reserve Fund.

3 The presentations of the 23rd annual conference of the organization are available at: <https://www.bis.org/events/conf240628/overview.htm>

opportunities and risks of artificial intelligence for central banks, geopolitical risks for economies, sustainable finance, and the performance of monetary policy post-pandemic. Additionally, during the BIS annual general meeting, the organization presented the chapters of the *2024 Annual Economic Report*⁴. The report is divided into three chapters, which focus on developments in the economic situation to establish a solid macro-financial foundation for the future, lessons learned from 21st-century monetary policy, and the advances and effects of artificial intelligence on the financial sector and the economy.

Finally, bank representatives had the opportunity to attend the fourth edition of the BIS Innovation Summit⁵, which focused on technological innovation, the future of central bank digital currencies (CBDC), the presentation of BIS Innovation Hub projects, and the implications of artificial intelligence for finance. The event was held in early May in Basel and brought together policymakers, academics, and senior officials from the financial and technology industries to discuss these issues.

4 The report is available at the following link: <https://www.bis.org/publ/arpdf/ar2024e.htm>

5 The agenda and recordings of the event are available at the following link: https://www.bis.org/events/bis_innovation_summit_2024/overview.htm

6. Financial Situation of *Banco de la República*

6.1 Statement of Financial Position of *Banco de la República* (Balance Sheet)¹

As of 30 June 2024, *Banco de la República* (*Banrep*) assets amounted to COP 305,083 billion (b), liabilities to COP 190,486 b, and equity to COP 114,597 b. *Banrep*'s assets increased compared to the end of 2023, mainly as a result of the depreciation of the Colombian peso against the currencies in which foreign reserves are invested, which increased its balance in pesos and had as a counterpart an increase in the exchange adjustment account in equity (Table 6.1). The balance of liabilities, on the other hand, declined largely due to the reduction in the monetary base and remunerated deposits not constituting reserve requirements .

Compared to the end of 2023, assets increased by COP 7,900 b, mainly as a result of the higher value of net foreign reserves in pesos. During the first half of the year, the peso balance of these reserves, which are the main component of assets, increased by COP 24,796 b (10.9%)², of which COP 18,364 b is explained by the depreciation of the Colombian peso against all reserve currencies, COP 3,424 b (USD 865 m) from their yield, and COP 3,217 b (USD 825 m) from foreign exchange purchases through the put option mechanism for reserve accumulation³. Additionally, the balance of expansionary repo operations increased by COP 6,320 b compared to the end of the previous year. The increase in these assets was partially offset by a decline in the market price balance of the TES portfolio held by *Banrep* per COP 21,938 b (-50%), mainly explained by TES sales (COP 16,499 b)⁴ and by the transfer of TES to the National Government for the distribution of a part of the 2023 results (COP 4,904 b)⁵.

Liabilities decreased by COP 3,301 b (-1.7%), mainly due to a lower monetary base. The balance of the monetary base at the end of June 2024 was COP 5,953 b lower than at the end of 2023 due to the seasonal dynamic of cash demand by the public. In turn, the decrease in remunerated deposits not constituting reserve requirements per COP 1,259 b contributed, to a lesser extent, to the decrease in liabilities

1 This section shows the items according to economic and non-accounting criteria. Compared to the financial statements presented to the Financial Superintendent of Colombia and the Accounts Office, the differences are: 1) the assets discount the value of the liabilities associated with portfolio purchase operations of foreign reserves on which payment has not yet been made (in the financial statements of *Banrep* this is recorded as a higher value of the asset and as an enforceability of foreign reserves on the liability); 2) the assets and liabilities of this section include the currency in circulation, which is not part of the accounting information of the financial statement of *Banrep*, and 3) other reclassifications of accounts of lower value. In this regard, the asset and liability values presented in this Report (COP 305.083 billion and COP 190.486 billion, respectively) differ from those recorded in the financial statements as at 30 June 2024 (COP 309.692 billion and COP 195.095 billion).

2 See Chapter 5 of this Report.

3 The BDBR at its meeting on 19 December 2023 decided to initiate a foreign reserve accumulation program. See <https://www.banrep.gov.co/es/noticias/jdbr-decidio-iniciar-programa-acumulacion-reservas-internacionales>

4 See Box 3: "Liquidity provision by *Banco de la República*, 2023–2024" and the shading of the monetary base and M3 in this Report.

5 The total transfer of profits to the National Government from the 2023 results was COP 9,217 b. The remaining value, per COP 4,313 b, was transferred by deposit into the Government accounts at *Banrep*. See <https://www.banrep.gov.co/es/noticias/banrep-utilidad-nueve-punto-dos-billones-2023>

Table 6.1
Statement of Financial Position of Banco de la República Classified by Economic Criteria
(billions of pesos)

Accounts	December 2023		June 2024		Variation	
	Balances	Percentage share	Balances	Percentage share	Absolute	Percentage
Assets	297,183	100.0	305,083	100.0	7,900	2.7
Net foreign reserves ^{a/}	227,826	76.7	252,622	82.8	24,796	10.9
Participation in international organizations and entities	10,052	3.4	8,270	2.7	-1,783	-17.7
Investments in TES held by the Bank	43,887	14.8	21,949	7.2	-21,938	-50.0
Repo operations	8,880	3.0	15,200	5.0	6,320	71.2
Other net assets	6,537	2.2	7,043	2.3	505	7.7
Liabilities and equity	297,183	100.0	305,083	100.0	7,900	2.7
Liabilities	193,787	65.2	190,486	62.4	-3,301	-1.7
Monetary base	154,778	52.1	148,826	48.8	-5,953	-3.8
Cash	114,870	38.7	110,791	36.3	-4,079	-3.6
Reserves	39,909	13.4	38,035	12.5	-1,874	-4.7
Remunerated deposits not constituting reserve requirements	8,393	2.8	7,135	2.3	-1,259	-15.0
National Government Deposits	6,824	2.3	11,676	3.8	4,852	71.1
Obligations to international organizations	23,657	8.0	22,734	7.5	-923	-3.9
Other deposits	135	0.0	116	0.0	-19	-13.9
Equity	103,396	34.8	114,597	37.6	11,201	10.8
Capital	13	0.0	13	0.0	-0	-0.0
Reserves	744	0.3	744	0.2	-0	-0.0
Surplus	95,737	32.2	113,219	37.1	17,482	18.3
Exchange rate adjustment account ^{b/}	96,787	32.6	114,259	37.5	17,472	18.1
Special Foreign-exchange Account (CEC in Spanish)	453	0.2	453	0.1	-0	-0.0
Investment in assets for cultural activities	373	0.1	382	0.1	10	2.6
Transfers to international organizations	-1,943	-0.7	-1,943	-0.6	-0	0.0
Cumulative effect of accounting change – Decree 2386 of December 2015	67	0.0	67	0.0	-0	-0.0
Other Comprehensive Income (OCI)	-2,325	-0.8	-3,467	-1.1	-1,142	49.1
Results	9,226	3.1	4,088	1.3	-5,138	-55.7

a/ Previous reports presented gross foreign reserves separately from liabilities affecting these reserves. This report presents their net balance.

b/ Includes the exchange rate adjustment of net foreign reserves, of the liabilities to the IMF (SDR allocations), and liabilities to FLAR (Andean pesos).

Note: This table presents the items according to economic criteria, but not an accounting criterion. Compared to the financial statements submitted to the Financial Superintendency of Colombia and the National General Accounting Office, the differences are: i) the assets deduct the value of the liabilities associated with purchases of foreign reserves portfolios for which payment has not yet been made (in the Central Bank's financial statements, this is recorded as a higher asset value and as an enforceability of foreign reserves in the liabilities); (ii) the assets and liabilities in this section include coins in circulation, which is not part of the accounting information in the Central Bank's Statement of Financial Position; and (iii) other reclassifications of lower-value accounts. In this regard, the values of assets and liabilities presented in this Report (COP 305,083 b and COP 190,486 b, respectively) differ from those recorded in the Financial Statements as of 30 June 2024 (COP 309,692 b and COP 195,095 b).

Source: Banco de la República.

This was partially offset by an increase in deposits from the National Government in *Banrep* by COP 4,852 b⁶.

Finally, equity increased by COP 11,201 b (10.8%) due to a positive change in the exchange rate adjustment of foreign reserves. The change in equity was driven by an increase in the exchange rate adjustment for COP 17,472 b⁷ and the profit for the first half of 2024 for COP 4,088 b. This was partially offset by the negative change in the other comprehensive income (OCI) account for COP 1,142 b, resulting mainly from the change in unrealized valuations of TES held by *Banrep*, and the distribution of profit of 2023 for COP 9,217 b.

6.2 Income Statement (P&L)

6.2.1 Closure as of June 2024

At the end of the first half of 2024, *Banrep* reported a profit of COP 4,088 b, resulting from revenues of COP 5,903 b and expenses of COP 1,815 b (Table 6.2). Profit was derived from net monetary income per COP 4,519 b, which was partially offset by net expenses from the issuance and putting into circulation of banknotes and coins amounting to COP 83 b and net corporate expenses of COP 348 b⁸. Profit was higher by COP 39 b compared to the same period in 2023.

During the first half of 2024, revenues were mostly driven by the return on foreign reserves. Specifically, the yield on foreign reserves reported in the P&L⁹ was COP 3,770 b¹⁰, with an annual increase of COP 237 b compared to the cumulative period January to June 2023. The accrual of interest accounted for a large proportion of these yields. In turn, the TES held by *Banrep* and the expansionary repos generated income per COP 1,310 b and COP 616 b, respectively, with annual decreases of COP 617 b and COP 113 b in each case, resulting from the reduction of average balances and remuneration rates. It is highlighted that the reduction in the average balance of the TES was the result of net sales in the market and the transfer of securities as part of the distribution of the 2023 results to the National Government, and that the lower remuneration rate of the repos¹¹ responded to the decreasing path of the monetary policy interest rate set by the Board of Directors of *Banco de la*

6 See Box 3: "Primary liquidity provision by *Banco de la República*, 2023–2024" and shading 2: Monetary base and M3 in this Report.

7 The exchange rate adjustment account is the counterpart of movements in the balance of net foreign reserves due to fluctuations in the Colombian peso vis-à-vis reserve currencies (COP 18,364 b). It includes the valuation by exchange rate differences of the obligations of the allocations with the International Monetary Fund (IMF) and of the Andean pesos with the FLAR (COP -892 b).

8 Including pensioner spending.

9 As of 2022, unrealized returns resulting from changes in the market prices of portfolio securities under the passive management mandate (passive portfolio) are recorded in the OCI account in *Banrep's* equity, with no impact on the P&L. When realized, these yields (profits or losses) are transferred from the OCI to the P&L. The above, in accordance with the provisions of Decree 2443 of 12 December 2022. In addition, the P&L does not record the exchange adjustment resulting from changes in the exchange rates of the peso against the currencies in which the foreign reserves are invested. This effect is recorded in the *Banrep* equity exchange adjustment surplus account.

10 The yield on foreign reserves that is accounted for in the P&L, COP 3,770 b, is obtained from discounting from the total yield of the reserves, COP 3,424 b, the net transfers from the P&L to the OCI by -COP 345 b. These transfers only consider the portfolio results under the mandate of passive management of the reserves and are explained by: 1) unrealized losses in the first half of 2024 by COP 915 b, excluded from the P&L and recognized in the OCI, and 2) realization of accumulated losses of previous periods by COP 570 b, transferred from the OCI to the P&L.

11 During the first half of 2024, the remuneration rate and daily volume of expansion repos averaged 12.41% and COP 10,507 b, compared with 13.03% and COP 12,010 B in the same period in 2023.

Table 6.2
Income Statement (P&L) of Banco de la República, January to June
(billions of pesos)

	Observed as of June		Annual changes	
	2023	2024	Absolute	Percentage
I. Total income (A + B + C)	6,423	5,903	-520	-8.1
A. Monetary	6,204	5,738	-466	-7.5
1. Interest and yields	6,191	5,696	-495	-8.0
Foreign reserves	3,533	3,770	237	6.7
Private debt bonds held by Banrep	2	0	-2	-100.0
TES held by Banrep	1,927	1,310	-617	-32.0
Expansionary repos	729	616	-113	-15.6
2. Foreign exchange differences	8	22	14	170.4
3. Other monetary income	5	21	16	335.0
B. Face value of coins put into circulation	78	57	-21	-27.3
C. Corporate	141	108	-33	-23.4
II. Total expenses (A + B + C + D)	2,374	1,815	-559	-23.5
A. Monetary	1,824	1,219	-605	-33.2
1. Interest and yields	1,694	1,135	-559	-33.0
National Government deposits	1,495	683	-812	-54.3
Monetary contraction deposits	199	452	253	127.4
2. Administration and fund management expenses abroad	22	29	6	28.5
3. Flexible credit line commitment fee (IMF)	50	50	-1	-1.1
4. Foreign exchange differences	56	5	-52	-91.9
5. Other monetary expenses	1	1	-0	-24.7
B. Issuance and putting into circulation of banknotes and coins	126	140	14	10.9
C. Corporate	424	456	32	7.6
1. Personnel expenses	272	290	18	6.7
2. Overhead	80	90	10	12.4
3. Other corporate expenses	72	76	4	5.7
D. Pensioners	0	0	0	558.6
Results for the year (I – II)	4,049	4,088	39	1.0

Source: Banco de la República.

República (BDBR) since December 2023. In turn, income from exchange rate differences, the face value of coins put into circulation, *Banrep's* corporate activities, and other monetary income¹² totaled COP 22 b, COP 57 b, COP 108 b, and COP 21 b, respectively, with annual variations of COP 14 b, COP -21 b, COP -33 b, and COP 16 b.

On the other hand, expenses are mainly explained by the remuneration of deposits from the National Government in *Banrep* and contractionary deposits. During 2024 to June, remuneration of government deposits amounted to COP 683 b, a reduction of COP 812 b compared to the first half of 2023. This decline was due to lower average balances and, to a lesser extent, a reduction in the interest rate¹³. In turn, remuneration for contractionary deposits increased by COP 253 b, totaling COP 452 b during the period due to higher average deposits in *Banrep*¹⁴. On the other hand, corporate expenses totaled COP 456 b, explained by personnel expenses per COP 290 b, general expenses per COP 90 b, and other corporate expenses per COP 76 b. In the first half of 2024, the annual variation of total corporate expenses was COP 32 b, with an annual increase of 7.6%, which considers the salary adjustment determined by the Collective Bargaining Agreement (10.28%) within personnel expenses, which represent 64% of the total corporate expenses.

6.2.2 Projection for 2024

For 2024, a profit of COP 8,795 b is projected, which is COP 431 b lower than in 2023 (Table 6.3). Net monetary income, reflecting the results of monetary, exchange rate, and credit policy, of the administration of foreign reserves, and of the role of banker and lender of last resort of credit institutions, would total COP 9,833 b in the year. This estimate highlights the share of foreign reserve yields. In turn, net expenses from corporate results and issuance are anticipated to be COP 849 b and COP 189 b, respectively. It is important to note that the corporate results are derived from the administrative management of *Banrep*, while results as issuing bank arise from the difference between income from the face value of coins put into circulation and the expenses of issuing and putting into circulation the monetary species. Under this breakdown, the reduction in profit in 2024 would be explained by lower net monetary income per COP 105 b, corporate income per COP 251 b, and as issuing bank per COP 75 b.

It should be noted that the estimated result is highly uncertain and that there are risks associated with this projection, mainly linked to developments in the yield on foreign reserves and the growth and sources of expansion of the monetary base. Particularly, changes in the paths and expectations of external interest rates could significantly affect the projected yield on foreign reserves, while an unanticipated change in the growth or sources of expansion of the monetary base would change the net income from monetary policy¹⁵, which is the second most representative component within monetary results. In fact, during the first half of 2024, interest rates in external debt markets, particularly in the United States, and the

12 Product, mainly, of the premiums paid to *Banrep* for the put options for reserve accumulation.

13 In the first half of 2024, the average daily volume of these deposits was COP 11,700 b, with a remuneration rate of 12.42%, lower than those observed in the first half of 2023, when these values amounted to COP 24,850 b and 12.90%, respectively.

14 In particular, the average daily volume of contractionary deposits amounted to COP 8,223 b in the period from 2024 to June, higher than that observed in 2023, when it amounted to COP 3,452 b. By contrast, remuneration interest rates fell from 12.32% in the first half of 2023 to 11.64% in the same period in 2024.

15 Net monetary policy income results from income from yields on investments in national currency held by *Banrep* and from expansion repos minus outflows from remuneration on government deposits held by *Banrep* and from monetary contraction deposits.

Table 6.3
Income Statement (P&L) of Banco de la República
(billions of pesos)

	Observed	Projection	Annual changes	
	2023	2024	Absolute	Percentage
I. Total income (A + B + C)	14,798	12,944	-1,854	-12.5
A. Monetary netarios	14,271	12,404	-1,866	-13.1
Interest and yields	14,252	12,361	-1,892	-13.3
Foreign reserves	8,708	8,407	-301	-3.5
TES held by <i>Banrep</i>	3,881	2,255	-1,627	-41.9
Private debt bonds held by <i>Banrep</i>	2	0	-2	-100.0
Expansionary repos	1,661	1,699	38	2.3
Foreign exchange differences	13	16	2	18.6
Other monetary income	5	28	23	474.4
B. Face value of coins put into circulation	230	338	108	46.7
C. Corporate	297	202	-95	-32.1
Fees and commissions: banking services and trust businesses	265	167	-99	-37.2
Other corporate income	32	35	3	10.9
II. Total expenses (A + B + C + D)	5,572	4,148	-1,423	-25.5
A. Monetary	4,333	2,571	-1,762	-40.7
Interest and yields	4,093	2,403	-1,690	-41.3
National Government deposits	3,739	1,728	-2,011	-53.8
Monetary contraction deposits	354	675	321	90.6
Administration and fund management expenses abroad	47	71	24	50.2
Flexible credit line commitment fee (IMF)	107	83	-24	-22.0
Foreign exchange differences	85	12	-73	-86.1
Other monetary expenses	1	2	1	150.8
B. Issuance and putting into circulation of banknotes and coins	344	527	182	52.9
C. Corporate	890	1,035	144	16.2
Personnel expenses	553	627	74	13.3
Overhead expenses	189	240	50	26.5
Other corporate expenses	148	163	15	10.2
Flexible budget availability	0	5	5	n. a.
D. Pensioners	4	16	12	285.5
III. Result of the year (I – II)	9,226	8,795	-431	-4.7

Source: Banco de la República.

performance of the exchange rate of the peso against reserve currencies showed high volatility, which increased the uncertainty in the projections of peso yields on foreign reserves and, consequently, in the expected profits throughout the year¹⁶.

In 2024, Banrep's revenues would amount to COP 12,944 b, which would imply a 12.5% reduction compared to 2023, mainly due to the decrease in the yield of the TES portfolio and foreign reserves. Among the revenues recognized in Banrep's P&L, the estimated yield on foreign reserves for 2024 would amount to COP 8,407 b. High levels of interest rates on external bonds would imply high accruals of interests, which would be the major component of these yields. Similarly, the estimated yield of TES held by Banrep, amounting to COP 2,255 b, would decrease by COP 1,627 b compared to 2023, as a result of its lower average balance. In turn, interest on expansionary repos would amount to COP 1,699 b, due to the expected increase in these operations¹⁷. Finally, revenue from the face value of coins put into circulation, estimated at COP 338 b, is expected to increase due to a recovery in the demand for coins at the end of the year, while corporate income, COP 202 b, is expected to reduce by the lower value of the fees for banking services and trust businesses.

On the other hand, expenses for 2024 are expected to amount to COP 4,148 b, lower than those recorded in 2023, mainly due to the expected remuneration of deposits from the National Government in Banrep. Specifically, remuneration for these deposits would amount to COP 1,728 b and would represent 42% of total expenses in the P&L¹⁸. At the same time, the remuneration for contractionary deposits would total COP 675 b in 2024, with an annual increase of COP 321 b, resulting from the higher average amount of these operations estimated for the year. Additionally, in 2024, increases in expenses related to the issuance and circulation of banknotes and coins, corporate expenses, and pensioners are estimated at COP 182 b, COP 144 b, and COP 12 b, respectively. The higher expenses associated with the issuing bank's function would be due to higher production costs for monetary species, especially coins. Within corporate expenses, personnel and overhead expenses would account for most of their increase due to salary adjustments and increased expenditures on technology projects, respectively.

16 The estimated 2024 profits projected in the BDBR approved budget at the end of 2023 (COP 10,345 b) are higher than projected in this Report.

17 It should be clarified that, in accordance with market expectations about the path of the monetary policy interest rate for 2024, the repo remuneration rate would decrease relative to the average for 2023. As a result, the expected increase in these revenues would respond to the higher average balance.

18 The estimated annual reduction in the remuneration of these deposits, COP 2,011 b, would result from both the decrease in the average daily balance and the lower average rate of remuneration. The latter considers the monetary policy interest rate assumption, taken from the median of Banrep's monthly survey of economic analysts' expectations in June 2024. It should be clarified that in no case does the assumption of this interest rate correspond to a stance of the BDBR.

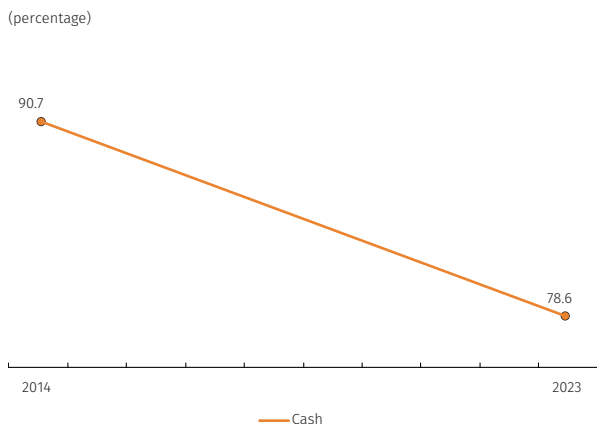
7. Payments in the Colombian Economy

Diagram 7.1
Usual Payments



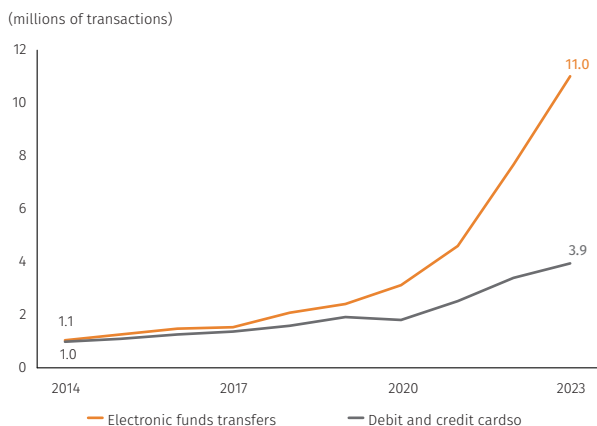
Source: Survey on banknotes and coins supply and payment instruments (2023); calculations by Banco de la República.

Graph 7.1
Payments Made in Cash



Source: Survey on the supply of banknotes and coins and payment instruments (2023); calculations by the Banco de la República.

Graph 7.2
Trends in the Use of Electronic Payment Instruments (daily average)



Sources: Banco de la República, financial institutions, ACH Colombia, and Financial Superintendency of Colombia.

7.1 Use of Cash and Other Payment Instruments

The use of cash as a payment instrument in usual purchases has decreased. According to Banco de la República's (2023) survey on the perception of the use of payment instruments, cash remains the most used payment method in Colombia, although its participation in retail transactions has registered a decline of 12.1 percentage points (pp) over the last decade (from 90.7% to 78.6%) (Graph 7.1). The value of usual payments (for food, beverages, transportation, clothing, utilities, among others) is mostly made in cash, with a smaller proportion using electronic fund transfers and debit cards (Diagram 7.1). The public attributes this result to the ease of use and speed of payment with this instrument, as well as to payment habits.

The use of electronic payment instruments, such as electronic fund transfers and debit and credit cards, increased in 2023. Electronic funds transfers have become the most widely used in this group of instruments due to the development of new payment schemes, such as payment button (PSE), instant payments (*Transfiya* and *Entre-cuentas*), and digital wallets. Over the past decade, the overall number of retail payments has shown an upward trend in the use of electronic transfers and debit and credit cards (Graph 7.2). In 2023, electronic transfers (inter and intra-bank) reached an average daily payment value of COP 23.4 t and 11.0 m transactions. Growth in value between 2022 and 2023 was 12.0% (2.3% real). Electronic fund transfers have also recorded high utilization in e-commerce, allowing payments to be received from online sales, such as those made through websites and social networks. Regarding the adoption rate (number of operations per capita), electronic fund transfers have shown increasing trend in recent years: in 2014, it represented 6 transfers per person, while in 2022, this number rose to 36. During the same period, debit cards went from 5 to 17 transactions per person, and credit cards from 4 to 8 transactions per person. Faced with the international context, Colombia has significantly increased the number of transactions per person for both electronic fund transfers and debit and credit cards, still having room to improve its position with respect to countries with higher adoption rates of formal financial services.

7.2 Progress on the Instant Payments System

The adoption of instant payments worldwide has increased. Some countries have achieved higher rates of instant transaction deepening. According to the Bank for International Settlements (BIS), there are elements of the systems' design

that explain these differences among countries. In 2023, the annual growth of instant transfers was 42%, with more than 100 countries identified as having implemented instant payments systems. It is estimated that this mode of transfers will represent 30% of total payments globally, compared to less than 15% in 2020¹. Some economies such as Brazil, India, and Thailand are seeing further deepening. According to the BIS and the World Bank, greater adoption is achieved when the system is operated by the central bank, covering several use cases, services, and functionalities, and when access is opened to financial institutions and fintechs.

Instant payments are a public policy tool. International experience shows a positive and growing effect of instant payments on access to and use of financial services, financial competition, and the competitiveness of the economy. Instant payments have served as a gateway for segments of society that had typically been excluded from financial services. In Brazil, around 30% of Pix users had no prior relationship with the financial system, and the transactional history they have generated is starting to be used by financial institutions to offer tailored loans and insurance. Recent studies show that instant transfer systems promote competition and financial efficiency by decreasing the concentration of deposits and increasing the level of savings in the economy².

Banco de la República is making progress in implementing the new interoperable instant payments system, which guarantees the possibility of sending resources between accounts seamlessly, at low cost, and with 24/7 service year-round. The architecture of the new system allows for processing transactions within and between existing payment clearing houses. The digital public infrastructure required to ensure full interoperability will be developed and operated by *Banco de la República*, and consists of three components: a centralized directory, an operational mechanism for settlement, and an instant payment clearing house.

The centralized directory stores the keys that identify all end-users in the ecosystem, as well as the accounts associated with each one. This component ensures that each key chosen by the user is unique in the ecosystem, enabling successful processing of transactions between participants from different payment systems. This component will become operational in the first quarter of 2025 and will be fed by information gathered in the federated directories of each of the instant payment clearing houses.

The operational mechanism for settlement is designed to increase efficiency and security in the market by centralizing the settlement of all instant payments in central bank money. With the establishment of this component, the settlement of instant payments will occur centrally and follow a real-time gross scheme using the accounts of financial institutions participating in the large-value payment system (CUD). It is expected to enter into operation in the second quarter of 2025.

Banco de la República's new instant payment clearing house aims to complement the market, accelerate innovation, and achieve universal access to the instant payments ecosystem. This new initiative aims to facilitate the arrival of the different actors in the industry and promoting the emergence of new cases. The start of operations for these new players is expected to occur by the third quarter of 2025.

1 ACI Worldwide (2024). "It's Prime Time for Real-Time". Real-Time Payments Adoption and Growth Around the Globe.

2 Sarkisyan, S. (2024). "Instant Payments and Competition for Deposits," Research Paper, Jacobs Levy Equity Management Center for Quantitative Financial.

Both the centralized services and the instant clearing house at *Banco de la República* will be supported by cutting-edge information systems technology. The acquisition of the new technology was conducted through a competitive process involving a diverse range of foreign firms with extensive experience in implementing instant payments systems. The selection and signing of the contract with the provider took place in December 2023, and since then, *Banco de la República* has been progressing in the technical and operational preparations, following agile methodologies that optimize development, testing, and implementation timelines

On the regulatory front, in October 2023, the Board of Directors of *Banco de la República* issued External Resolution 6 and Regulatory Circular 465, establishing the regulatory framework for the interoperability of instant transfers in Colombia. The new regulation includes technical, operational, and technological definitions, guidelines, and standards, which must be implemented by the entities managing retail-value payment systems and their participants, following a five-phase schedule between 2024 and 2025. The project is currently in phase 3, where the industry must make the necessary adjustments to its systems and applications to adopt the new standards. In the first quarter of 2025, the directories will be populated, followed by the operation of the interoperable instant payments ecosystem.

In the future, *Banco de la República* will promote the consolidation of the ecosystem by adding new functionalities and use cases that continue to favor the digitalization of payments in the economy. For the construction and prioritization of the ecosystem's development and scalability agenda, *Banco de la República* will consider, among other technical inputs, the recommendations received from the industry through the Instant Payments Interoperability Committee (CIPI in Spanish), established under the recent regulation.

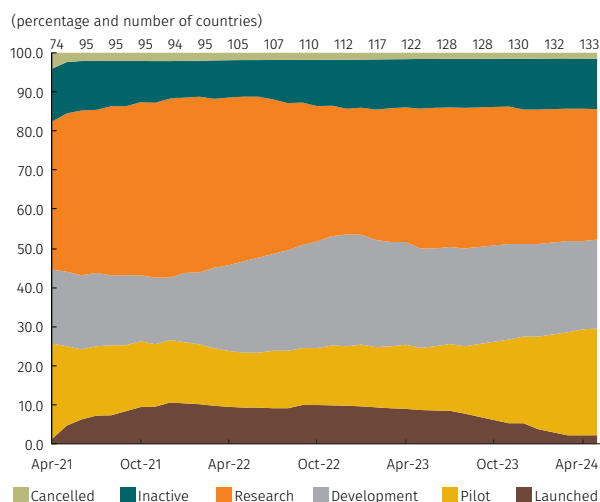
7.3 Global scanning of Central Bank Digital Currency (CBDC)

A significant number of countries (132), representing 98% of global GDP, have been assessing the possible implementation of CBDC³, with progress in pilot and development stages. However, only a few have reached the issuance stage. According to information collected by the Atlantic Council (2024), out of 132 countries, 67 are actively analyzing retail CBDC, with 52 economies in more advanced development stages (31 pilots and 21 in proof of concepts), and only three have launched (Nigeria, Bahamas, and Jamaica). On the other hand, 36 countries are in advanced experimentation stages in wholesale CBDC (19 in pilots and 17 in proof of concepts) (Graph 7.3).

The latest BIS survey of central banks regarding their work on CBDC and cryptocurrencies highlights the low probability of issuing digital currencies in the short and medium term. Compared to the previous year, the 2023 survey results exhibit lower interest in issuing a wholesale CBDC in the short term (although interest increases in the medium term, with 22% of banks), while interest in retail CBDC has declined (12% and 16% in the short and medium term respectively). Based on these probabilities, the BIS estimates that by 2029, nine wholesale currencies and five retail currencies will have been issued, reflecting the decrease in the forecast for the retail case compared to results from the previous year (ten issues by 2028).

³ CBDC is a new form of legal tender issued by central banks as part of the monetary base. Retail CBDC allows central bank money to be accessible in digital form by the public. Wholesale CBDC gives access to central bank money to eligible entities in the financial system that require digital representations of central bank money as alternatives to those currently available.

Graph 7.3
Evolution in Stages of Work on Central Bank Digital Currency^{a/}



a/ On the upper axis is the total number of countries working on the Central Bank Digital Currency (CBDC) for each date
Source: Atlantic Council (2024); calculations by the *Banco de la República*.

Results from pilots and retail CBDC issuances highlight difficulties in public adoption, as well as technical and design challenges. In the most advanced countries, such as China, the Bahamas, Nigeria, and Jamaica, public use of digital currency has been lower than expected, representing values below 1.0% of currency in circulation. Moreover, central banks have faced challenges associated with coordination with the private sector, public education, and interruptions and delays in key services, such as offline payments. While technology can be adapted to various design needs, there is no single solution that meets all requirements since scalability issues and operational risks stand out.

In the region, progress on CBDC is varied. Brazil advances in 2024 with a pilot as part of the DREX initiative (Brazilian Digital Real) for both wholesale and retail CBDC. Peru and Chile, having completed public consultation phases on a retail CBDC, are initiating phases to build proof of concepts and pilots in controlled environments. In contrast, Mexico has postponed its initial plans to issue a retail CBDC until after 2024. Other countries remain in a monitoring and research stage.

The digital euro is the most ambitious project for a retail CBDC, with three years of progress in research, design experimentation, and proof-of-concept testing. This project will require at least until 2025 for a potential decision on its launch in the European Union. The project's preparation phase began at the end of 2023, seeking to develop operating standards and the required infrastructure. The digital euro is expected to complement cash, be widely accessible, free for consumers, available offline, and offer a high level of security and privacy (ECB, 2023⁴). The European Central Bank is awaiting the legislative process, which will define its role and the scope of a potential issuance of the digital euro.

In the field of CBDC experimentation and developments, proposals based on integrated platforms stand out, such as Agorá and Drex projects, as well as Swift's CBDC interconnection initiative. Many of these projects are being developed to improve efficiencies in cross-border payments and adapt to financial innovation. The Agorá project, launched by the BIS and seven central banks at the beginning of 2024, aims to explore the functioning of a payments ecosystem where digitized (tokenized) deposits and CBDC coexist on a programmable public-private platform for cross-border payments. Brazil, for its part, seeks to develop an infrastructure with expectations about the potential efficiency benefits of asset digitization and innovation in financial services through the programmability of various functionalities (e.g., smart contracts⁵). On

4 ECB (2023). "Eurosysteem moves to the next phase of the digital euro project," October, available at: <https://www.ecb.europa.eu/press/pr/date/2023/html/ecb.pr231018-111a014ae7.es.html>

5 In DLT environments, programmability is achieved through smart contracts (contractual rules developed in code) and other computational protocols.

the other hand, Swift has advanced through several phases to develop an interconnection technology solution for CBDCs, in collaboration with central banks and financial institutions, to promote interoperability between CBDC of different countries. This initiative also aims to explore interconnection with tokenized asset platforms and automated functionalities for international trade. The possible successful development of this technological solution in the coming years has the potential to facilitate the exchange of currencies, assets, and goods and services, contributing to greater efficiency and security in cross-border payments.

Banco de la República has been studying international developments regarding CBDC and the relevance of issuing one in Colombia. The Bank's strategy for achieving interoperability of electronic payments targets coverage, efficiency, and access, similar to what is sought with a retail CBDC. The analysis concludes that, for now, there are no sufficient reasons for issuing a retail or wholesale CBDC (Shaded section 5)⁶.

In line with international trends, Banco de la República has been advancing an experimentation agenda with distributed ledger technology (DLT)⁷ and wholesale CBDC. Use cases include cross-border payments, asset digitization, and the integration of these platforms into the Bank's large-value payment system. This experimentation has been aimed at evaluating efficiency gains in transaction processing and scalability, as well as the analysis of costs, risks, and challenges (Shaded section 5). In summary, the Bank will continue to study CBDC developments and strengthen its experimentation agenda to evaluate its potential.

6 *Banco de la República* (2024). "Pertinencia y riesgos de emitir una moneda digital de banco central en Colombia", available at: <https://www.banrep.gov.co/sites/default/files/publicaciones/archivos/pertinencia-riesgos-moneda-digital-colombia.pdf>

7 DLT is a data storage technology shared across several nodes or computers, which can be located in various jurisdictions. Digital representations of different assets can be issued, stored, and transferred on DLT platforms.

Shaded Section 4

Relevance and Risks of Issuing a Central Bank Digital Currency (CBDC) in Colombia

A CBDC is a new form of legal tender and is part of the central bank's liabilities, along with cash and the reserves of financial institutions in deposit accounts with the central bank (monetary base). The CBDC is considered a means of payment (legal tender issued by the central bank) with its own access, corporate governance, and operations rules. Retail CBDC allows central bank money to be accessible to the public in digital form. Wholesale CBDC provides access to central bank money to eligible financial system entities that require digital representations of central bank money as alternatives to those currently available.

Central banks have multiple motivations for considering the possible issuance of a CBDC. These can be grouped into three categories: promoting access to electronic payments and financial inclusion; facilitating competition, efficiency, and resilience of the payment system; and maintaining access to central bank money in the digital era to safeguard the monetary and financial system (Kosse & Mattei, 2023).

The risks associated with the retail CBDC depend on its design; however, operational and reputational risks can be significant for the central bank. An inadequate design may lead to financial disintermediation, reduced credit provision, higher interest rates, and elevated financial, operational, and legal risks. Moreover, it could reduce the effectiveness of monetary policy by shifting loanable funds to the CBDC and requiring a more active lender of last resort policy in stressful situations, as it could increase the risk of bank runs¹. Conversely, a well-designed CBDC may result in its introduction being neutral or yielding benefits to financial stability, monetary policy, and welfare (Martínez-Ventura et al., 2023; Richards, 2020; MAS, 2021; BRI, 2022).

The analysis conducted by *Banco de la República* indicates that there are currently no reasons for issuing a retail CBDC in Colombia (*Banco de la República*, 2024). The risks (and costs) of implementing a CBDC are significant, and the intended benefits can be achieved through alternative policies. Specifically, Colombia has achieved high levels of access to transactional deposit accounts and has updated regulations to foster competition and achieve greater transparency in the payment services market (Decreets 1692 of 2020 and 1297 of 2022). Likewise, *Banco de la República* has taken on the responsibility of promoting interoperability in instant electronic payments by developing centralized infrastructures and their regulation (Article 104 of Law 2294 of 2023). In addition, instant payment systems seek to achieve objectives similar to those of a retail CBDC: they have the potential to reduce reliance on cash and reach broad sectors of the population at low cost, as seen in Brazil, India, Thailand, and Costa Rica, among others (Frost et al., 2024). In the future, as is already happening in some regions of the world, it will be feasible to interconnect national instant payment infrastructures with those of other jurisdictions and improve cross-border payments.

1 As some authors argue, the increased risk of bank runs would be contained by public deposit insurance schemes.

The wholesale CBDC has exhibited international potential in developing cross-border payment systems and settling transactions of innovative financial services infrastructures. *Banco de la República* will continue to advance its wholesale CBDC experimentation agenda and participate in initiatives of multilateral entities such as the BIS, the World Bank, and the Inter-American Development Bank in this matter. It will also continue to monitor developments in CBDC (wholesale and retail) and its future opportunities.

Banco de la República's experimentation in Distributed Ledger Technologies (DLT)² and wholesale CBDC:

Lift challenge: A proof of concept conducted with the Central Bank of Brazil and two commercial banks (Itaú Colombia and Itaú Brazil) to simulate cross-border payments using multiple wholesale CBDCs.

E-bond phase II: A proof of concept with Davivienda and the IDB. The project involves the blockchain³ issuance of a digitized (tokenized) private debt bond and the automation of the entire transactional chain in the primary and secondary markets to study the issuance of securities in DLT and gains in efficiency and risk management. The blockchain platform will interoperate with *Banco de la República's* large-value payment system, enabling delivery versus payment functionalities.

CBDC and Securities: The construction of a scalable blockchain prototype in a controlled test environment, aimed at issuing digitized securities and CBDC to evaluate benefits in several use cases with simulated participants. This experimentation is supported by MinTIC, Ripple, and Peersyst.

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2 Distributed ledger technology is a data storage system shared across multiple nodes or computers, which can be located in different jurisdictions. When any type of transaction is performed, it will be executed in all nodes to update the distributed information. Digital representations of different assets can be issued, stored, and transferred on DTL platforms.

3 Blockchain technology is a type of DLT technology in which information is stored in blocks, following an immutable information chain once the information has been validated by the participating nodes.

Annex

Investment Portfolio Management Policies for Foreign Reserves

According to best practice recommendations, foreign reserves should be managed based on liquidity, security, and profitability criteria. In this regard, it is essential to: (1) have sufficient liquidity in foreign currency, (2) have strict policies for managing the different risks faced by transactions, and (3) generate reasonable risk-adjusted returns, subject to liquidity and other risk constraints. The following explains how these rules are applied in managing Colombia's foreign reserves.

1. Risk Management Policies

Banco de la República has a risk management framework designed to identify and assess the risks to which transactions are exposed to keep them at low levels. Some of the principal risk management policies are as follows:

Liquidity Risk: Investments are made in financial assets with permanent demand in the secondary market, and the portfolio is divided into tranches. This structure allows for the rapid and cost-effective conversion of reserve assets into cash and enables quicker liquidation of specific tranches.

Market Risk: Investments are made in a limited group of eligible assets, adhering to strict investment limits on duration, margin duration, currency composition and sector. This approach ensures that the portfolio's value exhibits moderate sensitivity fluctuations in market interest rates.

Credit Risk: Investments are limited to assets with high credit ratings, as these investments have a low probability of payment default. The minimum credit rating for governments and government-related entities is A-. For private issuers, the minimum rating is A+ for exposures to individual issuers and BBB- (investment grade) when investing through funds. Historically, the percentage of issuers with these ratings that have experienced defaults in the following year is close to 0.0%. If the credit rating of an issuer in which the portfolio is directly invested falls below the minimum allowed, the exposure is liquidated within a short period. Additionally, maximum exposures are limited per sector and issuer to limit the impact of credit events on the portfolio's value.

Exchange Rate Risk: The impact of exchange rate risk is mitigated through the "foreign exchange adjustment" equity account referred to in paragraph 4 of Article 62 of Decree 2520 of 1993 (*Banrep's* Bylaws). This account increases in years when reserve currencies strengthen against the Colombian peso and decreases in years when they weaken. Therefore, currency fluctuations have no impact on the comprehensive income statement. *Banrep*, like most central banks worldwide, holds currencies other than the US dollar in its currency composition to cover the country's payments abroad, which occur in multiple currencies. It is important to note that currency exchange rates are highly volatile and often lack defined long-term trends. This makes it very difficult to forecast their behavior reliably.

Counterparty Risk: To mitigate counterparty risk, transactions are settled using delivery vs payment mechanisms. This requires that counterparties for fixed-income trading be market makers and that the counterparties for foreign currency trading have high credit ratings. Delivery vs payment mechanisms seek to ensure that the exchange of securities for cash or the exchange of payments in a foreign currency transaction

occurs simultaneously, eliminating the possibility of default by either party. Foreign currency counterparties must have a minimum credit rating of A- if they have an International Swaps and Derivatives Association (ISDA)¹ agreement; otherwise, the minimum rating is A+.

ESG-Related Risks: Environmental, social, and governance (ESG) factors are those associated with issues that can impact the environment and an issuer's ability to operate successfully. Considering these factors in the investment of foreign reserves is essential as inadequate management by an issuer can affect its ability to generate long-term returns and/or result in market, credit, legal, or reputational risks, among others. Consequently, *Banrep* incorporates ESG factors into its investment processes and risk monitoring of foreign reserves through strategies that align with the security, liquidity, and profitability criteria defined in the legal mandate assigned to *Banrep* for the management of foreign reserves.

2. Investment Portfolio Tranches

The investment portfolio is divided into three tranches: the short-term, medium-term, and gold tranche.

The short-term tranche aims to cover potential liquidity needs for the reserves over a twelve-month horizon. Currently, this tranche comprises working capital and a passively managed portfolio. Working capital is the portfolio that receives resources from foreign exchange market interventions, and its investments are concentrated in very short-term dollar-denominated assets. Given that the objective of this tranche is to provide immediate liquidity for foreign exchange market interventions, the working capital is concentrated in deposits and investments that can be liquidated within one day at a very low cost. As of 30 June 2024, the value of the short-term tranche was USD 34,763 m, of which USD 1,191 m corresponds to working capital and USD 33,572 m to the passively managed portfolio.

The passively managed portfolio is the main component of the short-term tranche. This portfolio is characterized by having a longer duration and an expected return profile that exceeds that of the working capital, a currency composition that seeks to replicate the performance of the country's balance of payments outflows, and a return similar to its benchmark index². The passively managed portfolio is invested in multiple currencies and in instruments aligned with a benchmark index defined under the constraints that the portfolio's expected return, excluding the currency component, is positive over twelve months with a 95% confidence level and that the expected value of a potential loss does not exceed 1.0%.

The medium-term tranche seeks to increase the expected return on foreign reserves in the long term while preserving a conservative portfolio with an expected return profile higher than that of the short-term tranche and its benchmark index. Its objective is to maximize the risk-adjusted return in US dollars, the currency in which foreign reserves are valued, for the portion of the portfolio considered less likely to be used within a twelve-month period. Thus, the goal is to achieve the maximum return subject to the constraints that the expected return in US dollars of this tranche is positive with a 95% probability and that the expected value of a potential loss does not exceed 1.0% over a three-year horizon. Currently, the medium-term tranche mainly comprises actively

¹ The framework agreement established by the International Swaps and Derivatives Association (ISDA) is intended to determine the terms and conditions governing over-the-counter derivatives traded between entities.

² The following section explains the concept and composition of the benchmark index.

managed portfolios that seek to generate a higher return than the benchmark index³. At the end of the first half of 2024, the value of the medium-term tranche amounted to USD 21,136 m.

The last tranche corresponds to investments of foreign reserves in gold. This metal allows diversifying the investment portfolio, since its price behaves differently from that of the securities in which the short- and medium-term tranches are invested. As of June 2024, the market value of the gold tranche in the reserves amounted to USD 349.8 m.

3. Benchmark Indexes

To manage the reserves investment portfolio, *Banco de la República* defines theoretical portfolios or benchmark indexes⁴ for the short- and medium-term tranches. Different indexes are constructed for each tranche to reflect their investment objectives. The indexes serve as a reference framework to measure the management of each portfolio. The following explains how the two benchmark indexes are constructed.

To construct the short-term tranche index⁵, a target currency composition is first determined. Once the currency composition is established, the portfolio that maximizes risk-adjusted return⁶ and meets the loss constraints defined for this tranche is sought. The currency composition of this index seeks to replicate the performance of the country's balance of payments outflows⁷. The goal is for currencies other than the dollar to appreciate during periods when the dollar value of the country's external payments increases, which implies that the value of these currencies may decline against the dollar during periods when the dollar value of external payments decreases. As of June 2024, the currency composition of the short-term tranche index was 81% US dollars, 7.0% Australian dollars, 8.0% Canadian dollars, and 4.0% euros. The loss constraints defined for the short-term tranche are: (1) to achieve positive returns over a twelve-month horizon with 95% confidence, excluding the exchange rate effect, and (2) that the expected value of a potential loss over a twelve-month horizon does not exceed 1.0% of the tranche's value.

The construction of the medium-term tranche index follows a similar procedure with two key differences: no currency composition constraint is imposed, and the loss constraints are defined over a longer horizon. Firstly, no currency composition constraint is imposed since the goal of this tranche is to maximize the risk-adjusted return in US dollars. Secondly, the constraints for achieving positive returns with 95% confidence and for the expected value of a potential loss not exceeding 1.0% of the tranche's value are defined over a three-year horizon to reflect the lower probability of using

3 The External Management Program section explains that one of the eight active portfolios is managed directly by *Banco de la República*, and the remainder are managed by external administrators. It also provides an explanation of how this program operates.

4 In capital markets, a benchmark index refers to a basket of assets with predetermined weightings according to specific rules that define their composition. Generally, an index attempts to replicate the behavior of a financial asset market broadly and serves as an indicator of the performance of other investment portfolios in that market. For example, some of the most well-known benchmark indexes in the stock market are the MSCI COLCAP in Colombia or the S&P500 and Dow Jones in the United States (the Bank uses only fixed-income market indexes).

5 This benchmark index does not apply to working capital, since there are no reference portfolios that adequately measure the instruments allowed in this portfolio.

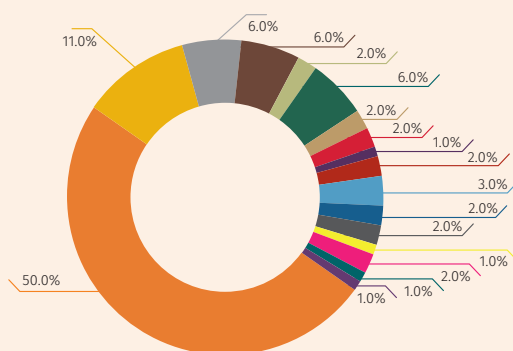
6 The detailed description of the methodology for the construction of the benchmark index can be found in the boxes "Technical Explanation of the Methodology for the Construction of the Benchmark Index" and "Market Risk Constraints in the Optimization Process" in the 2013 and 2019 *International Reserve Management Reports*.

7 See the Box "New Foreign Exchange Composition of the International Reserves Portfolio" in the *Report of the Board of Directors to the Congress of Colombia* in March 2012 for a detailed explanation of the foreign exchange composition methodology of the reserves.

the resources of this tranche in the short term. When constructing the portfolio that maximizes the risk-adjusted return in dollars, investments in currencies other than the dollar are allowed.

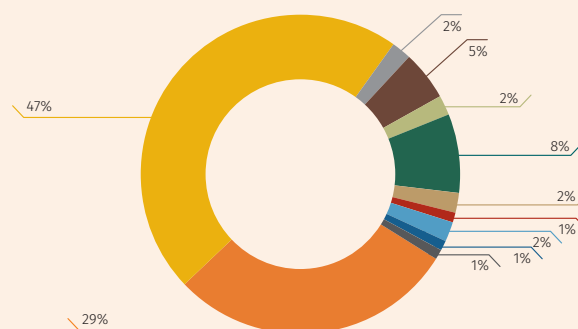
Graph A1.1
Composition of Benchmark Indexes in the Short- and Medium-Tranche
(as of 30 June 2024)

A. Short- tranche



- U.S. Government bonds (0-1 years)
- U.S. Government bonds (1-5 years)
- U.S. Government bonds (5-10 years)
- U.S. Government bonds (+10 years)
- AAA-AA bonds from supranational entities and governments
- U.S. government bonds tied to inflation (1-10 years)
- Australian Government bonds (0-3 years)
- Australian Government bonds (3-5 years)
- Australian Government bonds (5-10 years)
- Australian Government bonds (+10 years)
- Canadian Government bonds (0-1 years)
- Canadian Government bonds (1-5 years)
- Canadian Government bonds (5-10 years)
- Canadian Government bonds (+10 years)
- German Government bonds (0-1 years)
- German Government bonds (1-5 years)
- German Government bonds (5-10 years)

B. Medium- tranche



- U.S. Government bonds (0-3 years)
- U.S. Government bonds (3-5 years)
- U.S. Government bonds (+5 years)
- U.S. government bonds tied to inflation (1-10 years)
- U.S. mortgage-backed bonds
- Bonds from supranational entities and governments (1-5 years)
- German Government bonds
- UK Government bonds
- Japanese Government bonds
- Australian Government bonds
- Canadian Government bonds

Source: Banco de la República.

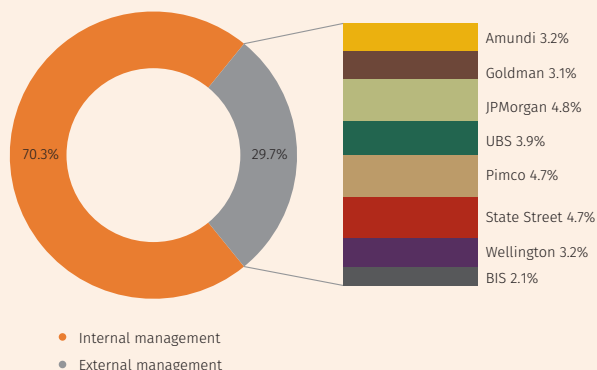
As of June 2024, the benchmark indexes defined for both tranches have a moderate level of market risk, with an effective duration of 2.92 for the short-term tranche index and 3.42 for the medium-term tranche index. Graph A1.1 exhibits the approved benchmark indexes for the short- and medium-term tranches⁸.

4. External Management Program

Banco de la República directly manages the short-term tranche, a portion of the medium-term tranche, and the gold tranche. The remaining resources of the medium-term tranche are managed by external portfolio managers. At the end of June 2024, the portion of the investment portfolio managed internally amounted to USD 39,542.5 m (70.3% of the total investment portfolio), while the external management program totaled USD 16,707.1 m (29.7% of the total investment portfolio).

⁸ The indexes published by ICE data Indices are used for the different sectors that make up the benchmark index

Graph A1.2
Investment Portfolio Management
(as of 30 June 2024)



Source: Banco de la República.

The main purposes of using external managers are to generate returns exceeding those of the benchmark index and to improve portfolio diversification. In this regard, the selected firms participating in the program have a high capacity for analyzing financial markets and a sophisticated infrastructure that can be used to define investment strategies and train *Banrep* officials in the management of international investments, which is another objective of the external management program.

Private companies participating in the program are selected through competitive processes and are subject to ongoing evaluation. Based on the performance results of each manager since their hiring, the amount managed may be adjusted, or their participation in the program may be reviewed. Currently, the private companies participating in the external management program include: Amundi Asset Management, Goldman Sachs Asset Management, L.P., J.P. Morgan Asset Management (UK) Limited, Pacific Investment Management Company LLC, State Street Global Advisors Trust Company, UBS Asset Management (Americas) Inc., Wellington Management Company LLP (Graph A1.2). The resources managed by these entities are held in *Banrep*'s custody accounts and the contracts of the managers can be terminated when deemed necessary. Investments in funds managed by the Bank for International Settlements (BIS) are also considered part of the external management program. Access to these funds is restricted to central banks and multilateral entities, with the aim of investing in assets appropriate for global foreign reserves in a cooperative effort among different countries⁹.

⁹ Currently, investments are made in a fund of securities issued by the Chinese government (USD 892.9 m) and a fund of securities issued by non-financial corporations (USD 277.7 m).

This Report was coordinated, edited, and designed
by the Publications Management Section of
the Administrative Services Department with font
Fira Sans 10.

August 2024