

Colombia

Talking Points
on the Economy

Third Quarter 2004



COINVERTIR
INVEST IN COLOMBIA CORPORATION



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Colombia's business climate is becoming more attractive. According to the World Bank's report "Doing Business in 2005: Removing Obstacles to Growth", Colombia was the world's second most successful investment climate reformer country between 2003 and 2004. Furthermore, the business and industrial community's confidence in the country's economic future is at its highest level since 1994, demonstrating attractive investment conditions.

The health and reactivation of the financial sector support the overall good economic performance. After the crisis of previous years, the financial sector has reached important solvency and soundness levels, which suggest good growth prospects.

For the fourth quarter of 2004 and for 2005, the low interest rates, the economy's liquidity, the stronger willingness to use credit, the increase in companies' profits, the potential opportunities of the Free Trade Agreement- FTA with the United States (currently under negotiation), and in general the recovery of the private disposable income due to improved employment conditions; are elements that will favor the economic growth. The Government projects a 4.0% growth by the end of 2004, figure higher than the 3.8% growth rate forecasted in March.

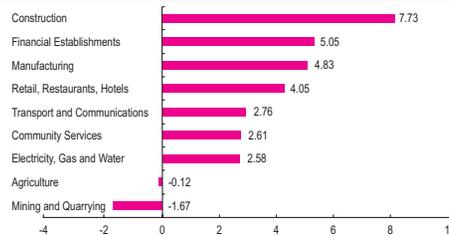
GDP Growth, Second and Third Quarters of 2004

In the second quarter of 2004, the Colombian economy grew 4.3%, compared to the same period in 2003. This growth was driven by the construction sector with a 9.3% annual growth on the supply side, and by the investment which recorded an 18.1% growth on the demand side.

During the third quarter, the gross domestic product (GDP) grew 2.4% compared to the third quarter of 2003. This growth was also driven by the construction sector, which grew 7.7%. The dynamism of the construction sector can be explained by the performance of the building construction sub-sector that grew 31.4%; while the civil works sub-sector decreased 28.6%, which is consistent with the Government's fiscal adjustment.

Other sectors that contributed to the economic growth during the third quarter were the financial sector, with a 5.1% annual growth and industry with 4.8%. The good performance of the financial sector came as a result of the growth in financial intermediation services (11.5%) and in services to companies (5.8%); while the industry's performance was driven by the growth in transportation equipment (42.4%) and machinery and power supply (15.9%).

Graph 1
GDP by Sectors, Annual Variation
(III Quarter 2004) (Percentage)



Source: National Statistics Department (DANE).

It is important to note that despite the economic decline in the third quarter of 2004, the Colombian economy has been showing positive results as of September, with a year to date annual growth of 3.52%.

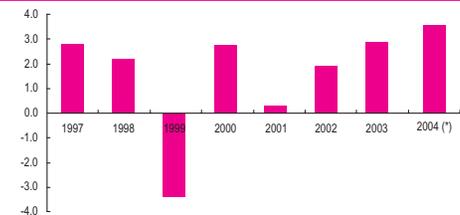
Economic Activity Indicators

Indicators show that the Colombian economy maintains its dynamism. As of September of 2004, imports of capital goods increased 9.3%, as compared to the same period in 2003, being construction material imports the most dynamic, with a growth of 33.8%. This indicator suggests that private investment will continue to boost the internal demand.

New car sales posted an annual growth of 21.7% in September of 2004, as compared to the 5.4% variation recorded in the same month of the previous year. In this way, private consumption became another important economic driving force.

Also for noting is the recovery of the private disposable income, which came as a consequence of the unemployment decline and the improvement in employment quality. In September, the urban unemployment rate for the main 13 cities stood at 14.9%, compared to 16.1% in the same month of the previous year. At national level, the unemployment rate declined from 13.9% to 12.5%. Urban under-employment declined from 33.1% to 31.7%, while national under-employment declined from 33.1% to 31.6%.

Graph 2
Real Private Disposable Income
Annual Variation (1997-2004) (Percentage)



Source: Central Bank.

The economy's good performance was supported by low and stable interest rates. In September, the active interest rate reached 8.6% and the passive interest rate was 1.7% in real terms.

Graph 3
Real Active and Passive Interest Rate
(1999-2004) (Percentage)



Source: Central Bank.

Between January and September of 2004, credit establishments' profits grew 53.7% compared to the same period in 2003, reaching COP\$ 2.1 billion (b). Profits of private domestic banks grew 45%, while profits of foreign banks increased 121%. The consumption portfolio quality indicator¹ also showed positive results, with an annual reduction of 10% in September of 2004, moving from 5.8% to 5.2%.

The stronger dynamism of the financial system is consistent with the good performance of the economy's real sector, the improvement of the labor market conditions, the dynamism of the internal demand and the favorable international financial environment for emerging economies, among others.

Monetary and Foreign Exchange Policy

In Colombia, the Central Bank's intervention interest rates are the main monetary policy instrument within the inflation target strategy. During the third quarter of 2004, the Central Bank had no need to alter interest rates, due to the overall good performance of the macroeconomic variables.

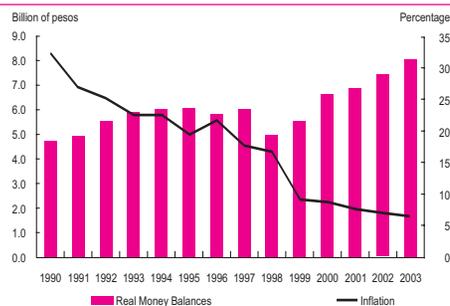
In September, the annual inflation continued to decline and stood at 6.0%, similar to the one recorded in March (6.2%) and in June (6.1%), as a result of the performance of tradable goods and regulated services inflation. As for tradable goods, during the third quarter of 2004 the inflation declined from 4.3% in June to 3.8% in September, accompanied by an exchange rate appreciation. During the quarter under study, the regulated services inflation declined from 11.8% in June to 9.1% in September, as a result of the downward adjustment of water supply charges and the lower increases in fuel and transportation prices.

Mid-term inflation prospects have not changed significantly. During the last quarter, inflation expectations remained close to ceiling of the 5.0%-6.0% target range set by the Central Bank for 2004. Inflation prospects for 2005 suggest a slight decline in tradable goods inflation, which is consistent with the peso appreciation; and a slight increase in non-tradable goods, as a result of the gradual narrowing of the product gap with respect to its trend. However, the target inflation range for the next year of 4.5%-5.5% is lower than the one for 2004.

Between January and September of 2004, the inflation stood at 4.6%, which along with the unchanged inflation expectations and the exchange rate appreciation trend, indicates that it is highly likely that the inflation target for 2004 will be met.

It is important to note that the monetary policy has boosted confidence in the Colombian currency, which has been reflected in an important increase in the money demand. This increase was accompanied by a wide monetary liquidity: in September the monetary base reached COP\$ 14.7 b, with an annual growth of 15%, and the broad M3 monetary aggregate showed an annual upward trend of 15%.

Graph 4
Real Money Balances (*) and Inflation
(1990-2004)
(Billion of Pesos and Percentage)



(*) M1/P, where M1 is the effective in hands of the public and P is the price level.
Source: DANE, Central Bank.

In the exchange front, the better interchange terms for main export commodities; the increase in remittances sent from abroad; the growing capital inflows into emerging economies (Colombia included); and the increased confidence of foreign and domestic investors in Colombia, supported by better security conditions, accentuated the exchange rate appreciation trend. During the third quarter of 2004, the exchange rate decreased 3.9%, from COP\$ 2,699.6 on June 30 to COP\$ 2,595.2 on September 30, and the year to date appreciation as of September reached 6.6%.

Graph 5
Nominal Exchange Rate Evolution
(2001-2004)
(Pesos per Dollar)



Source: Central Bank.

In response to this scenario, the Central Bank continued with the policy of accumulating international reserves to reduce the pressure for a higher exchange rate appreciation. From August through September the Central Bank auctioned US\$ 400 million (m) in options for foreign reserves accumulation.

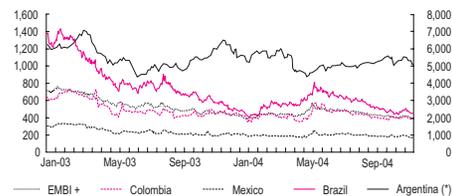
It is important to mention that the exchange rate appreciation trend has also been experienced by other Latin American countries. The United States' current account deficit, the low return on investments in the United States and Europe, and the stronger growth dynamics in emerging economies; have generated increased capital inflows into these countries, which has strengthened local currencies. These capital inflows are reflected in the reduction in the country risk premium, which for Colombia stood at 400 basic points, 84 points below the spread recorded the previous year.

¹ Business Opinion Survey of the Foundation for Higher Education and Development (FEDESARROLLO).

² The quality of the portfolio refers to the ratio between the non performing loans and the gross loan portfolio.

³ Includes departments, municipalities and decentralized territorial entities, regional companies and FNR.

Graph 6
Spreads Sovereign Debt (2003-2004)
(Basic Points)



(*) Right axis.
 Source: DANE, Central Bank.

Fiscal Policy

During the first half of 2004, the Colombian Government continued with its adjustment policy. The fiscal deficit for the consolidated public sector was 0.02% of GDP, very close to the fiscal equilibrium.

This equilibrium can be explained by the central national Government's adjustment, and by the decentralized sector's surplus. The former had a deficit equivalent to 2.5% of GDP, 0.4% less than the one obtained in the first half of 2003, as a result of increased tax collection; while the latter improved the regional and local component¹, which recorded a surplus of 0.9% of GDP.

The Government continues to be committed to meeting the fiscal deficit target of 2.5% of GDP agreed with the International Monetary Fund. This target is 0.2% points lower than the deficit recorded in 2003 (2.7% of GDP).

External Sector Balance of Payments

During the first half of 2004, the balance of payments current account recorded a deficit of US\$ 1.07 b (2.4% of half-year GDP), which was US\$ 209 m higher than the one obtained in 2003. The capital account recorded a net income of US\$ 1.49 b, US\$ 1.15 b higher than the previous year.

The current account deficit was a result of the deficits from factors' income (US\$ 2.06 b) and from non-factors goods and services balance (US\$ 600 m), partially off-set by net income from current transfers (US\$ 1.58 b). It is important to note that the 1.6% of GDP current account deficit in the second quarter of 2004 was lower than the one recorded in the first quarter of the same year (3.2%).

The recorded net capital inflow can be explained mainly by direct investment inflows. During the first six months of 2004, Colombia received US\$ 1.44 b in foreign direct investment, a figure US\$ 607 m higher than the one obtained in the same period in 2003. By sectors, this investment was mainly destined to mining and quarrying activities (US\$ 601 m), oil (US\$ 502 m) and transportation and communications (US\$ 93 m).

During the first half of 2004, international reserves showed a variation of US\$ 801 m, and a balance of US\$ 11.59 b at the end of June, partly as a result of net foreign-currency purchases made by the Central Bank through US\$ 700 m in reserve accumulation options

Trade Balance

The favorable external situation continued to boost Colombian exports. Traditional and non-traditional exports grew 21.2% and 23.2%, respectively, during the first 9 months of 2004, due to the increased demand generated by world growth, particularly in the United States, Japan and China; and to the high commodities' prices, which allowed favorable interchange terms for Colombia.

During the 9 month period, the trade balance posted a surplus of US\$ 723.8 m, as a result of exports for US\$ 11.86 b and imports for US\$ 11.14 b. The surplus obtained was higher than the one recorded in the same period in 2003 (US\$ 96.3 m), as a result of a higher growth rate in total exports (22.2%) than in total imports (16.6%).

Among non-traditional exports, the most important sales were vehicles and auto-parts with a 203.4% growth, plastics with 40.9%, and apparel with 29.0%. The main export destinations were the Andean Community, the United States and the European Union.

The growth of traditional exports was driven by sales of ferronickel with an increase of 67.3%, and oil and its derivatives with 20.0%. The main export destinations were the United States, the European Union and the Caribbean countries.

Regarding imports, the most important purchases were raw materials and intermediate products which grew 23.0%; capital goods and construction materials with a 9.3% growth, and consumer goods with 13.9%. These imports came mainly from the United States, Venezuela, Mexico and China.

It is expected that the increasing international prices of export commodities continue offsetting the exporters' income in pesos, given the exchange rate appreciation; and favoring the interchange terms for Colombia, which increased 17.0% annually during the first half of 2004. Particularly, according to the International Energy Agency (IEA), 2004 and 2005 forecasts for oil prices increased to US\$ 40.9 per barrel and US\$ 42.1, compared to the US\$ 6.9 and US\$ 37.0 forecasted in the previous quarter.

Graph 7
Interchange Terms for Colombia
(1990 - 2004) (June 1990=100)



Source: Central Bank.

The outlook for Colombian exports is encouraging. There are good prospects for Colombia to continue to strengthen its position in the North American market, due to the Free Trade Agreement (FTA) under negotiation with the United States. In addition, there is an initiative for 2005, to create a "South American Community of Nations", between Mercosur, the Andean Community of Nations (CAN) and Chile. This integration initiative gives Colombia the opportunity to take full advantage of its productivity and privileged location, to increase and diversify the export supply of both goods and services.

Table 1

| | | COLOMBIA: Key Data | | | |
|--|----------------------------|--------------------|-----------|----------------------|--|
| ITEM | Units | Latest Data Period | Data | Data One Year Before | |
| Total Foreign Investment | | | | | |
| Direct | US\$ million | Jan. 04 - Mar. 04 | 1,438.00 | 831.00 | |
| Portfolio | US\$ million | Jan. 04 - Mar. 04 | 86.00 | -357.00 | |
| Demand and Unemployment | | | | | |
| GDP | % variation year to year | Jul. 04 - Sep. 04 | 2.43 | 4.17 | |
| Production Index (MMS) (*) | % variation year to year | Sep. 04 | 5.08 | 3.78 | |
| Retail Sales | % variation year to year | Sep. 04 | 6.03 | 0.17 | |
| Investment | % variation year to year | Apr. 04 - Jun. 04 | 8.98 | 49.07 | |
| National Unemployment Rate | (%) | Oct. 04 | 12.40 | 13.60 | |
| 13 Main Cities Unemployment Rate | (%) | Oct. 04 | 14.10 | 15.40 | |
| Prices and Interest Rates | | | | | |
| Consumer Price Index | % variation year to year | Oct. 04 | 5.89 | 6.58 | |
| Producer Price Index | % variation year to year | Oct. 04 | 5.81 | 5.31 | |
| Savings Interest Rate (90 days) | Monthly average (%) | Oct. 04 | 7.68 | 7.82 | |
| Lending Interest Rate | Monthly average (%) | Oct. 04 | 15.21 | 15.47 | |
| Exchange Rate | | | | | |
| Nominal Exchange Rate | Pesos/dollar US\$ | Oct. 04 | 2,580.70 | 2,876.20 | |
| Nominal Devaluation | % annual variation to date | Oct. 04 | -10.71 | 3.98 | |
| Real Exchange Rate (ITCR) | 1994=100 | Oct. 04 | 124.65 | 137.67 | |
| Real Devaluation | % annual variation to date | Oct. 04 | -9.45 | 5.52 | |
| Peso/Yen Monetary Units | Peso/Yen | Oct. 04 | 23.75 | 26.27 | |
| Peso/Euro Monetary Units | Peso/Euro | Oct. 04 | 3,230.40 | 3,368.50 | |
| Trade | | | | | |
| Exports | US\$ million | Jan. 04 - Sep. 04 | 11,864.30 | 9,705.20 | |
| Traditional Exports (FOB) | US\$ million | Jan. 04 - Sep. 04 | 5,448.49 | 4,499.21 | |
| Non-Traditional Exports (CIF) | US\$ million | Jan. 04 - Sep. 04 | 6,415.77 | 5,205.94 | |
| Imports | US\$ million | Jan. 04 - Sep. 04 | 11,941.80 | 10,241.20 | |
| Other | | | | | |
| M1 | % variation year to year | Oct. 04 | 12.62 | 13.62 | |
| M3 | % variation year to year | Oct. 04 | 15.75 | 10.61 | |
| Net International Reserves | US\$ million | Oct. 04 | 12,284.23 | 10,585.54 | |
| Colombia General Stock Exchange Index | July 2001=1000 | Oct. 04 | 3,742.60 | 2,158.20 | |
| Fiscal Deficit (Central Government) | % of GDP | Jan. 04 - Jun. 04 | 2.50 | 2.90 | |
| Fiscal Deficit (Non - Financial Public Sector) | % of GDP | Jan. 04 - Jun. 04 | 0.03 | 1.60 | |

Source: Central Bank, National Statistics Department (DANE) and Colombia Stock Exchange.

Table 2

Main Latin American Economic Indicators

| | Colombia | | Argentina | Brazil | Chile | Ecuador | Mexico | Peru | Venezuela |
|--|----------|---------|-----------|----------|---------|---------|----------|---------|-----------|
| | 2004(*) | 2003 | | | | 2003 | | | |
| Real GDP Growth (%)* | 4.0 | 3.9 | 8.7 | -0.2 | 3.2 | 3.0 | 1.2 | 4.0 | -9.5 |
| Population (millions)* | 45.3 | 44.6 | 38.4 | 176.2 | 15.7 | 13.3 | 103.3 | 27.1 | 25.5 |
| GDP (US\$ billions) | 94.9 | 78.6 | 129.4 | 492.4 | 72.4 | 26.9 | 626.0 | 61.0 | 84.7 |
| GDP per Capita (US\$) | - | 1,764.0 | 3,650.0 | 2,710.0 | 4,390.0 | 1,790.0 | 6,230.0 | 2,150.0 | 3,490.0 |
| GDP per Capita Growth (%) | - | 9.4 | 6.0 | -1.2 | 2.0 | 0.2 | -0.3 | 2.4 | -11.2 |
| Consumer Prices Variation | 5.5 | 6.5 | 3.7 | 9.3 | 1.1 | 6.1 | 4.0 | 2.5 | 27.1 |
| Fiscal Balance (% of GDP)* | -2.5 | -2.7 | 1.6 | -1.0 | -0.4 | -0.4 | -0.6 | -1.8 | -7.0 |
| Total External Debt/GDP (%) | 41.4 | 49.2 | 112.1 | 47.8 | 57.2 | 61.8 | 22.4 | 49.5 | 37.4 |
| Exchange Rate (LC/US\$ eop) | - | 2,877.8 | 2.9 | 2.9 | 599.4 | - | 11.2 | 3.5 | 1,596.0 |
| Nominal Interest Rate (savings) | - | 7.8 | 10.5 | 23.3 | 3.2 | 5.3 | 5.1 | 3.1 | 17.2 |
| Current Account (% of GDP) | -1.8 | -1.8 | 6.1 | 0.4 | -1.4 | -3.3 | -1.8 | -2.1 | 8.6 |
| Foreign Direct Investment (US\$ million) | 1,483.0 | 1,762.0 | 1,103.0 | 10,144.0 | 2,982.0 | 1,637.0 | 10,731.0 | 1,332.0 | 2,531.0 |
| Foreign Direct Investment (% of GDP) | 1.6 | 2.1 | 0.8 | 2.1 | 4.0 | 6.0 | 1.7 | 2.1 | 3.0 |

(*) Forecast.

Source: ECLAC, World Bank and Central Bank.



Mission

COINVERTIR promotes, facilitates and consolidates Foreign Direct Investment in Colombia as a factor of development.

Characteristics

- Autonomous, mixed-economy entity, established under Colombian private law.
- Staffed by a small group of highly qualified professionals from different disciplines and managed with an entrepreneurial spirit.
- Acts as liaison between the public and the private sectors in order to achieve competitive and stable conditions for foreign investment.

Activities

COINVERTIR works toward its objectives through four main activities:

- Promotes Colombia as an investment site.
- Provides accurate and up-to-date information and assistance to potential investors.
- Provides investor aftercare.
- Works in the improvement of the Country's investment climate.

Publications

- Colombia Outlook and Investment Potential
- Colombia: Foreign Investment Guide
- Foreign Investment Report
- Directory of Legal and Consulting Services
- Legal Framework
- Practical Legal Framework
- Colombia: Regional Investment Guides
- Talking Points on the Economy

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