



Colombia

Talking Points on the Economy

First semester 2006



**PROEXPORT
COLOMBIA**



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Why do Business in Colombia?



Strategic geographic location: easy access to the North American, European, Asian and Latin American markets.

Macroeconomic stability: economic growth above the Latin American average.

Human resources: availability of qualified, competitive and committed labor force.

Market size:

- 41.2 million inhabitants (national census 2005, DANE)
- Third largest population in Latin America

Export platform: privileged access to more than 1.2 billion of consumers:

- Free Trade Agreements:
 - US - Colombia FTA in approval process by both national congresses
 - Andean Community, CAN (Colombia, Bolivia, Ecuador and Peru)
 - Group of Three, G-3 (Colombia and Mexico)
 - CAN - Mercosur
 - Colombia - Chile
 - Colombia - Caricom
- Tariff Preferences:
 - With the United States, ATPDEA
 - With the European Union, Andean SGP

Special foreign trade regimes:

- 10 Duty Free Z ones
- 5 Special Economic Export Z ones
- Incentives for large exporters
- Special Import - Export Systems

Export supply: unparalleled portfolio of high-value added and quality products and services in the industry, services and mining sector.

In 2005, Colombia continued showing good results in terms of economic growth. Official data indicates that the Colombian economy grew 5.13% a marker not seen in Colombia since 1995. The inflation stood at 4.85% within the inflation target goal set by the Central Bank for 2005, and 65 basic points (bp) below the inflation rate registered during 2004. Investment, with a 29% growth, was the most dynamic component on internal demand, followed by household consumption which consolidated its growth at 4.9% during the year. Foreign Direct Investment (FDI), Exports and the Colombian Stock Exchange registered historically high figures and the fiscal deficit and unemployment continued to decrease. As a result of the good economic behavior, the Central Bank estimated a 4.5% growth in the Gross Domestic Product (GDP) for 2006.

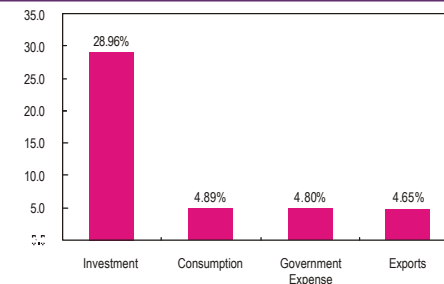
Also, after one year and nine months of negotiations, Colombia and the United States signed a Free Trade Agreement (FTA) that extends the current APTDEA preferences, which ends in December of 2006. The agreement extends benefits 99% of Colombia's products, gives clear game rules and new resolution mechanisms to controversies, as well as a access to the largest market in the world.

Since December 30th 2005, Colombia has a new Duty Free Z one Law, issued to modify Duty Free Z one special regime in order to stimulate national and foreign investment. This new law creates a unique and modern framework for investment a traction and to create job opportunities in the country's free zones by adopting tributary incentives for companies decided to establish themselves in these areas.

Colombia has the Highest Growth in the GDP since 1995

During 2005, the Colombian economy grew 5.13% compared to 2004, a growth rate not presented in the country since 1995. Such growth was stimulated by the internal demand where the most dynamic components were investment and home consumption (Graph 1). The investment performance responded to substantial increases in machinery and equipment (36%), civil works (27%) and transportation equipment (23.2%). The domestic investment amounted for 22.3% of the GDP, last time Colombia had similar levels of investment was in 1995 when it was 25.7%.

Graph 1
GDP Growth (2005)
Internal Demand Components
% Annual Variation



Source: National Statistics Department (DANE).

The good behavior of household consumption was consolidated during 2005 and contributed to the GDP's growth in 2.4 percentage points. When detailing household consumption, one can observe that its growth is mainly due to the durable goods component (9.7%), this shows the consumer's trust in the country's economy.

On the supply side, the biggest positive shifts were registered in the construction sector, with a 12.6% increase; the commerce, repair services, res-

restaurants and hotel sectors, with a 9.2% increase, and the financial intermediation services sector with an 8.5% increase compared to 2004.

Commercial Openness Rates in Colombia Reach their Historical Highs

The exports and imports, which grew 26.7% and 26.6%, contributed to Colombia's obtaining commercial openness ((Export + Imports)/GDP) rates close to 44%, rates never registered before in Colombia (Graph 2).

Graph 2
Commercial openness (1985-2005)
(X+M)/PIB



Source: National Statistics Department (DANE), Banco de la República.

Boosted by the increased growth of our main commercial partners, the exports increased from US\$16.7 billion (b) during 2004 to US\$21.1 b during 2005. This result is due to a 35% growth, in FOB, of traditional exports (coal, coffee, banana, and ferroniquel) and 19.5% in non-traditional exports. Vehicles, flowers and live plants, and textiles and confections were the registered the greater growth in their exports during 2005 with 59.1%

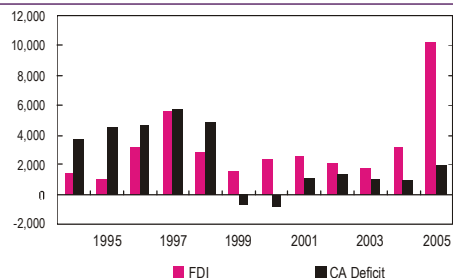
In 2005, added up to US\$21 b exhibiting a 26.6% growth. The Colombian peso valuation (14% in 2004 and 4.4% in 2005) and the positive evolution of private investment, thanks to the increased

trust of consumers, explain the increase in external purchases current expansion. In fact, the increase in the imports was encouraged mainly by the productive sectors. Imports of raw materials and capital goods for the industry were the areas which registered the major increases.

A Small and Sustainable Balance of Payment's Current Account Deficit

During 2005, Colombia registered a US\$1.9 b Current Account deficit which amounts for 1.6% of the GDP and is similar to the 1.23% and the 0.97% of the GDP registered on 2003 and 2004 respectively. This is explained by the debits accounted for as interests, revenues, and capital dividends. The commercial and services balances are close to fiscal equilibrium, the first one with a 0.2% surplus over the GDP and the latter with a 1.7% deficit over the GDP. It is important to highlight that the flow of FDI is higher than the Current Account deficit; this demonstrates that the unbalance in the Current Account is small in relative terms and sustainable in the long term (Graph 3).

Graph 3
Flows and the Current Account Deficit
(1994-2005) US\$ million



Source: Banco de la República.

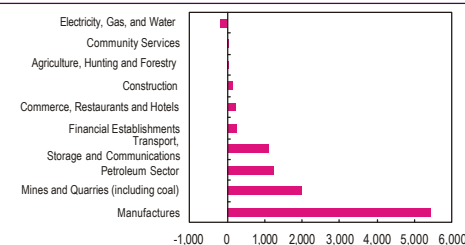
Overcoming all forecasts, the FDI flows surpassed 8% of the GDP during 2005 by increasing from US\$3.1 b in 2004 to US\$10.1 b Excluding the

value of the purchase of Colombian brewery company Bavaria by SABMiller, the value of the FDI flows was US\$5,477 m, which represents the highest figure since 1997, when most of privatizations in Colombia took place.

Foreign Direct Investment Surpasses 8% of GDP's Value

The most important FDI flows were received in: manufactures (5.4 b), mines and quarries (2 b), petroleum (1.2 b); and in the transport, storage and communications sectors (1.1 b). The economic growth of the country, the improvement in public order and legal security are factors that have, without a doubt, contributed to the rising trend observed in the FDI towards Colombia. It is expected that the Free Trade Agreement with the United States, the privatizations and the new projects that the Government offers, along with the positive change in Colombia's image abroad, will favor a higher increase in the FDI flows (Graph 4).

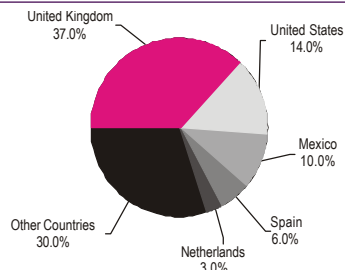
Graph 4
FDI Flows in Colombia by Sectors
(2005) US\$ million



Source: Banco de la República.

As for FDI origin, the most important FDI flows on 2005 came from the United Kingdom and the United States with 37%, 14%, respectively. Other important countries were Mexico (10%), Spain (6%) and the Netherlands (3%) (Graph 5, overleaf).

Graph 5
FDI Flows in Colombia by Country of Origin
(2005) (*) % share



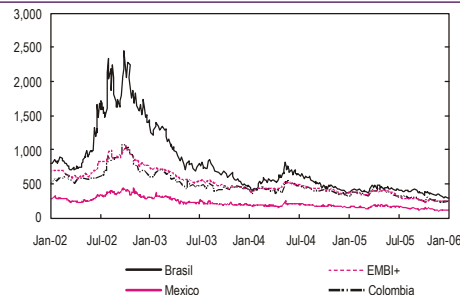
(*) Total: US\$10,192 million.
Source: Banco de la República.

External Debt: Standard and Poor's (S&P) and Moody's improve Colombia's

Standard & Poor's (S&P) and Moody's, two of the three main risk rating agencies, improved Colombia's external debt Outlook in the long term. S&P improved its outlook grade from stable to positive, on February 22nd, 2006, and Moody's modified its outlook grade from negative to stable, on March 9th, 2006. This is the outcome of a lower amount of external debt, which decreased from US\$39.453 b to US\$38.37 b between 2004 and 2005.

By the end of 2005, the consolidated public sector registered a deficit of US\$24.4 m, an amount close to fiscal equilibrium not seen a decade ago. This outcome is attributable to the surplus registered by the decentralized sector (GDP's 4.5%), achieved mainly by resource accumulation on social security funds and well managed territorial public finances. The improvement in the fiscal environment was perceived by investors; the Colombian country risk premium, measured by the EMBI, decreased on 187 bp since January 2004. This is an improvement greater than the ones faced by countries like Mexico (77 bp) and Brazil (147 bp) (Graph 6).

Graph 6
Emerging Market Bonds (EMBI)
Basics points



Source: JP Morgan, DNP.

Monetary and Exchange Rate Policies

In 2005 the annual inflation rate was 4.9% 64 bp below that registered in December of 2004, which placed it within the goal range set by the Central Bank (between 4.5 and 5.5%).

During the first trimester of 2006, inflation has continued its decreasing trend, registering variations of 0.54% on January, 0.66% on February and 0.7% on March. Consequently, inflation expectations continue to decrease; the expectation survey for inflation and exchange rate made by the Central Bank in March 2006 indicates an inflation close to 4.2% in December 2006. This proves that the 2006 inflation expectations are aligned with the inflation goals set for 2006.

Regarding the exchange rate, the Central Bank has continued with its discretionary intervention policy, by means of which it acquired US\$4,658 b in 2005. During 2005, from the US\$4,658.4 b acquired, US\$3,250 b was sold to the Government in order to prepay the debt and the rest (US\$ 1,408.4 b) was accumulated in the international reserves. The intervention has taken place in order to avoid an

excessive valuation which generates adverse effects on the economy tradable sectors and has proven to be successful since throughout 2005, the rate exchange showed great stability (Graph 7).

Graph 7
Exchange Rate Evolution
COP/US\$ (2005 - IQ 2006)



Source: Banco de la República.

Good Perspectives for 2006

In the external juncture during 2006, no important changes are foreseen. The world economy will continue to grow at a good pace, boosted once again by the United States and the Asian economies.

It is expected that, the global demand dynamics and the growth in Asia particularly, will maintain the favorable exchange terms for Colombia even if the North American economy displays some slow down. Added to this is the growth of several of our commercial partners, especially those who benefit from the high petroleum prices and the abundant external capital flows.

In this context, it is probable that the Colombian economy continue its growth rhythm around 4.5% in 2006, boosted in good part by household consumption and by the non-tradable sectors, although a positive growth in non-traditional exports is also expected.

Table 1

COLOMBIA: Key Data

ITEM	Units	Latest data period	Data	Data one year before
Total Foreign Investment				
Direct	US\$ million	Jan. 05 - Dec. 05	10,192.00	3,117.00
Portfolio	US\$ million	Jan. 05 - Dec. 05	-167.00	743.00
Demand and Unemployment				
GDP	% annual variation	Jan. 05 - Dec. 05	5.13	3.96
Production Rate (MMS)(*)	% annual variation of date	Jan. 06	5.9	2.8
Retail Sales	% annual variation of date	Dec. 05	9.11	8.67
Investment	% annual variation	Dec. 05	28.96	13.3
National Unemployment Rate	(%)	Jan. 06	13.2	14.00
13 Main Cities Unemployment Rate	(%)	Jan. 06	16.1	14.2
Prices and Interest Rates				
Consumer Price Index	% annual variation	Feb. 06	4.8/5	5.5
Producer Price Index	% annual variation	Feb. 06	2.06	0.04
Savings Interest Rate (90 days)	Monthly average (%)	Feb. 06	6.2	7.64
Lending Interest Rate	Monthly average (%)	Feb. 06	11.85	13.18
Exchange Rate				
Nominal Exchange Rate	Peso/dollar US\$ average	Mar. 06	2,262.36	2,353.71
Nominal Devaluation	% annual variation	Mar. 06	4.4	14.00
Real Exchange Rate (ITCR)	1994 = 100	Feb. 06	117.95	121.95
Real Devaluation	% annual variation	Feb. 06	-4.4	-14.00
Peso/Yen Monetary Units	Peso/Yen	Feb. 05	19.41	22.85
Peso/Euro Monetary Units	Peso/Euro	Feb. 05	2,710.02	3,213.16
Trade				
Exports (FOB)	US\$ million	Jan. 05 - Dec. 05	21,187.00	16,788.00
Traditional Exports	US\$ million	Jan. 05 - Dec. 05	10,366.00	7,679.00
Non-traditional Exports	US\$ million	Jan. 05 - Dec. 05	10,825.00	9,109.00
Imports (CIF)	US\$ million	Jan. 05 - Dec. 05	21,204.00	16,745.00
Other				
M1	% annual variation	Jan. 06	15.25	13.23
M3	% annual variation	Jan. 06	18.04	15.24
Net International Reserves	US\$ million	Feb. 06	14,933.04	12,779.62
Colombia General Stock Exchange Index	July 2001=1000	Feb. 06	11,080.24	5,240.17
Fiscal Deficit (Central Government)	% of GDP	Dec. 05	4.9	5.5
Fiscal Deficit (Non-Financial Public Sector)	% of GDP	Dec. 05	1.4	1.4

(*) Monthly manufacturing survey

Source: Banco de la Republica, National Statistics Department (DANE).

Table 2

Main Latin American economic indicators

	Colombia		Argentina	Brasil	Chile	Ecuador	Mexico	Peru	Venezuela
	2005(*)	2004							
Real GDP Growth (%)	5.13	4.00	9.0	4.9	6.1	6.9	4.4	4.8	17.9
Population (millions)*	46.0	45.3	38.7	179.1	15.4	13.0	105.0	27.5	26.0
GDP (US\$ billions)	102.5(*)	97.5	153.1	603.8	94.1	30.3	676.5	68.6	109.0
GDP per cápita (US\$)	2,228.3(*)	2,152.3	3,956.1	3,371.3	6,110.4	2,330.8	6,442.9	2,494.5	4,192.3
GDP per cápita Growth (%)	3.5	2.3	7.8	3.6	4.9	5.4	3.1	3.3	15.8
Consumer Prices Variation (%)	4.8	5.5	6.1	6.6	1.1	2.8	4.7	3.7	21.7
Fiscal Balance (% del GDP)	0.0	1.3	2.6	-1.5	2.2	2.3	-0.3	-1.1	-2.8
Total External Debt / GDP (%)	38(*)	36.3	118.9	37.4	47.5	59.4	20.9	46.8	35.9
Exchange Rate (LC / US\$ eop)	2,319.3	2,628.4	2.9	2.9	609.4	-	11.3	3.4	1,891.3
Nominal Interest Rate (savings)	7.8	7.8	2.6	15.4	1.9	3.8	7.2	3.0	12.6
Current Account (% of GDP)	-0.9	-1.0	2.2	1.9	1.5	-0.5	-1.1	0.0	12.7
Foreign Direct Investment (US\$ millions)	10,192.0	3,052.0	4,100.0	18,200.0	7,602.0	1,160.0	16,601.0	1,816.0	1,500.0
Foreign Direct Investment (% of GDP)	8.3	3.1	2.7	3.0	8.1	3.8	2.5	2.6	1.4

* Forecast.

Source: Economist Intelligence Unit, Eclac, Banco de la Republica, DNP.

PROEXPORT

With the clear objective of motivating a greater flow of foreign investment in Colombia, the Colombian government appointed Proexport to be responsible for all the promotional activities in this field; an activity previously performed by Coinvertir.

Therefore, since January of 2005 Proexport took charge of all the support offered to potential investors in Colombia, as well as to established investors. In the same way, Proexport will identify investment obstacles with the purpose of improving them. These efforts aim to promote and facilitate investment opportunities within the country.

In order to achieve this goal, Proexport created the Investment Division. This Division will offer the following services:

- Promote Colombia as an ideal investment country
- Provide up-to-date information relevant to the investment process.
- Provide all the necessary assistance to potential investors.
- Provide investor aftercare
- Work in the improvement of the Country's investment climate.

Publications

- Surprising *Colombia: Guía de Inversión Extranjera*
- *Colombia: Panorama y Potencial de Inversión*
- *Directorio de Servicios de Consultoría Legal*
- *Marco Legal*

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