



I N F L A T I O N R E P O R T
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BANCO DE LA REPÚBLICA

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PRESENTATION, SUMMARY AND CONCLUSIONS

INFLATION ASSESSMENT AT SEPTEMBER 2002

✕ Annual consumer inflation was 6.0 % at the close of the third quarter of 2002, less than in June of this year (6.2%) and in September 2001 (8.0%). After a slight rise during June and July, consumer inflation declined to 6.0% in the two months thereafter, thanks to an improvement in food prices.

✕ Inflationary pressure in the third quarter came primarily from the transport group and miscellaneous expenses, owing to the rise in gasoline prices and added devaluation. Expanded annual growth in prices for financial services and jewelry also exerted pressure. Price increases for the other groups in the market basket slowed during this period.

✕ Food inflation at the end of the third quarter was lower than in June (9.2%), despite considerable upward pressure from potato prices, which registered 8.0% annual growth in June and 51.3% in September. The reduction in food price inflation in September compared with June is due to less of an increase in the price of meat and meat by-products and in the price of vegetables and legumes.

✕ In terms of individual items, potato prices were the most important factor in third-quarter inflation. This product alone accounts for more than 33.0% of accumulated inflation during the quarter, and is expected to continue to play a significant role in accelerating consumer inflation, at least during October and November. According to the Bank's forecasts, the annual increase in the consumer price index (CPI) for potatoes could be close to 100% by the end of the year. However, next year, high prices should boost supply and allow for lower prices in the future. This factor, coupled with the end of the cattle retention phase and the onset of the liquidation phase, point to the prospect of a drop in real food prices as of the second half of 2003.

✕ These two factors should offset the upward effect generated by the presence of El Niño. The intensity of this phenomenon in the second half of 2002 and the first quarter of 2003 is expected to be slight. A farm business opinion poll taken by the Center for Livestock and Agricultural Studies (CEGA) shows producers are more optimistic about the second half of 2002. A recovery in overall investment and production, excluding coffee and livestock, is expected. This should result in a good supply of food at the start of 2003

✕ Judging by the core inflation indicators, inflationary pressure originating with demand has been controlled, The average of the three core inflation indicators declined throughout the third

quarter, closing at 5.1% in September. This is 0.2 percentage points less than in June 2002 and 1.9 percentage points below the average in September 2001.

✕ The acceleration in devaluation has had only limited impact on certain segments of consumer prices, and its effect on overall consumer inflation is still not evident. In fact, inflation in tradable goods declined from 6.0% growth in June to 5.4% in September.

✕ Even so, increased devaluation has pushed producer prices up considerably. In terms of the annual variation, the producer price index (PPI) rose substantially between June (2.9%) and September (6.8%). The same was true of the imported component of the PPI (from 1.6% at June to 10.7% at September) and final consumption, which is closest to the CPI market basket (from 4.6% at June to 6.3% at September).

✕ GDP growth rose slightly during the second quarter of the year. According to DANE, annual growth in this period was 2.2%. This represents an increase over the start of the year (0.5%).

✕ However, on this occasion, a simple comparison between annual growth rates in the first and second quarters can be misleading. The outcome was affected by the fact that the Easter holiday fell during the first quarter, which is unusual. To avoid this statistical noise, the entire first half of the year should be examined in terms of GDP performance. Annual growth during the period was 1.4%. This is an increase over the second half of 2001 (1.0%) and the fourth quarter of that year (1.1%). These figures clearly show the economy has been more dynamic this year than at the end of 2001.

✕ The acceleration in demand during the first half of the year is explained by three factors: more private consumption, added growth in total exports of oil and coffee, and an import substitution process derived from a decline of 2.8% in imports during this period compared with the first half of 2001. The other components of demand; that is, public spending and private investment, contracted or slowed. In the case of private investment, the only high point was the annual growth in building construction (approximately 22.0%). The other components of private investment declined sharply.

✕ A slight acceleration in growth is expected again in the second half of 2002, which would raise GDP growth for the entire year by 1.6%. This is compatible with the government's latest projections. It is estimated that more growth in the second half of the year could be supported by an increase in the force of domestic demand, particularly private and public consumption. In the case of private consumption, these expectations are based on the acceptable performance shown recently by indicators for certain sectors, namely automobile sales and credit card purchases. As to public consumption, increased growth could originate with more spending for security and the budget additions scheduled for the coming months.

✕ Other sources of demand, such as exports and investment, are not expected to contribute to growth. Exports will continue to be affected by the recession in Venezuela. Moreover, ATPA will play only a marginal role during the remainder of the year. Investment will face greater uncertainty over midterm macroeconomic stability and the cutback in sources of external funding, which will make growth difficult. Positive growth is anticipated only in the case of building construction.

✕ On a broader front, prospects for growth are now more indecisive than during the last quarter. The closure of external capital markets and the considerable need for internal financing on the part of the public sector impose a tight limit on the amount of private spending that can be funded. However, the extent to which this margin is widened or narrowed depends on how soon the financial markets reopen and, particularly, on how the public sector resolves its financing problems for 2003 and subsequent years.

✕ The economy continues to operate below its potential, as suggested by considerable unused installed capacity, high unemployment and the estimates on product gap. Given projected growth, this situation is not likely to change substantially in the months ahead, which is why demand-pull inflation is not expected to threaten this year's inflation target.

✕ Because inflation has stayed at around 6% and the inflation target is likely to be met by the end of the year, the Board of Directors decided not to alter interest rates during the third quarter. At the end of September, the Lombard expansion rate was 9.0%, the auction expansion rate, 5.25%, the auction contraction rate, 4.25% and the Lombard contraction rate, 3.25%.

✕ The representative market exchange rate (TRM) was Col\$2,828.1 per dollar at the end of September, with 21.3% annual devaluation and 17.9% for the quarter. The accelerated pace of devaluation during the past three months activated intervention mechanisms to control exchange volatility. The first auction of call options was held on July 29 with a quota of US\$180 million, which was exercised in its entirety. However, the pace of devaluation continued and Banco de la República convoked another auction of call options on August 1 with a quota of US\$180 million. On that occasion, US\$109.5 million in options were exercised. A similar auction for US\$180 million was held on October 2, with US\$124.5 million in options exercised by the time this report was written. No put options to accumulate reserves were exercised during the period in question.

✕ The demand for liquidity rose quickly during the last three months, particularly because of the demand for cash. The additional demand for cash is an exogenous shock, as suggested by the interest-rate stability throughout the year.

✕ Banco de la República has satisfied the growing need for liquidity without generating monetary surpluses that jeopardize the inflation targets, since an exogenous shock has been adapted to the demand for cash. Liquidity is provided through repo expansion quotas and the permanent purchase of government treasury securities (TES). Banco de la República purchased Col\$829 billion in TES during the third quarter and Col\$1,069 billion during the year to date. A portion of the purchase in the last quarter; that is, Col\$130 billion, was acquired through the auction system and directed to financial intermediaries who are not part of the electronic transaction system (SEN), including brokerage firms and trust companies. These two types of financial institutions were authorized to conduct transitory expansion operations with Banco de la República.

✕ The increased demand for liquidity, compared with the expected levels in the reference line approved during March, obliged the Board of Directors of Banco de la República to calculate a new reference line for the remainder of the year. The new line was adopted at the end of September; it assumes 28.3% average annual growth in the monetary base during the fourth quarter of 2002.

✕ Annual growth in the monetary base at September was 26.0%, an increase over June (17.6%). As to M3, growth in September was 8.8%, which is less than in June (9.1%) but exceeds the rate observed in July and August. M3 growth continues to be sustained by the increase in cash, current accounts and savings accounts. The demand for time certificates of deposit continues to decline. Changes in the composition of M3 during the course of the year towards more liquid assets are explained by decisions on holdings in both the private and public sectors.

✕ Growth in the portfolio remained slow in nominal terms and declined in real terms. By September, annual growth of this aggregate was 1.6%, as opposed to 0.2% three months earlier. Commercial and consumer credit accelerated between June and August, increasing by 6.1% in August. Mortgage loans continued to decline in annual terms, although part of this situation is explained by securitization of the portfolio in the second quarter.

✕ The interbank rate at the end of the third quarter was 5.3%, which is practically the same as in June (5.4%). The 90-day interest rate on term deposits (DTF) also remained unaltered, fluctuating slightly at around 7.9%. The tendency in lending rates was downward, in spite of stable borrowing rates and broad liquidity made available by Banco de la República. Credit card rates and those on ordinary loans saw the largest quarterly growth, with respective increases of 104 and 36 basis points (bp). The other rates – consumer, prime and treasury – dropped in the last three months. In September, the credit card rate was the highest (29.0%) and treasury loans the lowest (9.3%).

✕ The increase in certain lending rates coincided with a sharp comeback in TES rates on the secondary market as of July. The third quarter saw a major disinvestment in public debt paper in favor of assets denominated in foreign currency. This helped to accelerate devaluation. This shift in resources was prompted mainly by the turbulence on Latin America's financial markets and by uncertainty stemming from the government's fiscal situation and fewer expectations of economic growth at regional and local level. Inasmuch as TES rates are the main reference in the market at this time, if the increase continues, higher borrowing and lending rates could be expected in the midterm.

✕ The rise in TES interest rates for all maturities was associated with a major increase in the country's risk premium, measured by the spread on the 10-year national debt. This indicator was 1,002 bp, on average, at September, which is 469 bp above the level observed in June. A number of countries in the region also saw their risk premiums increase substantially

✕ Given the figures at September, the Bank's inflation forecast is still at around 6% for the end of 2002. This assumes an additional reduction in core inflation during the fourth quarter to about 4.8%, on average. Most inflationary pressure in the months ahead will come from food prices, which should increase by about 9.2%.

✕ Forecasts for 2003, based on the transmission-mechanism model, point to 5.5% total inflation. With the combined forecast method, the outcome for total inflation in 2003 is even lower (4.6% for September).

✕ As to inflation excluding food, the center lane of the transmission- mechanism model predicts 6.6% for the third-quarter average in 2003. Due to the acceleration in devaluation by

September and the increase in economic growth anticipated for the second half of 2002 and the early part of 2003, this new forecast is 70 bp higher than the outcome in June.

✕ Less total inflation for the fourth quarter of 2003 and the outcome for core inflation depend on a positive trend in food inflation during the coming year. According to the models used by the Bank, currently high food prices and those expected for this year should pave the way for a surge in agricultural supply that could help to straighten prices next year.

✕ On this occasion, the uncertainty surrounding the forecasts is considerably higher than it was in the second quarter, as potentially important price shocks are foreseen. The likely shocks next year include expansion in the value-added tax base, an adjustment in real rates for electricity, and elimination of the gasoline subsidy. In the case of the VAT reform, uncertainty is mounting because no one knows how extensive it will be. This depends of the text approved by Congress.

✕ The growing climate of uncertainty is also due to the behavior of external debt markets for the region's economies. How long these markets will be closed and the sources of funding the government obtains will depend largely on the trend in the exchange rate and the growth rate, and therefore on inflation in the next three months. In the past month, the government made good progress in its effort to secure financing, primarily from multilateral banks.

✕ With the exception of isolated cases, the increase in devaluation to date has not translated into higher prices for consumers, as suggested by the limited inflation in tradables in the CPI market basket (5.4%) and their downward trend throughout the year. Up to now, inflationary pressure has been on producer inflation.

✕ However, 2003 can expect to see inflationary pressure of some magnitude due to devaluation so far this year. Cumulative devaluation in 2002 (23.4%) is already enough to push prices up. Moreover, the devaluationist phase has lasted long enough (more than three months) to influence the cost structure of companies in a way that could result in price changes, unless the exchange rate declines substantially in the near future compared with its current level.

✕ The country's monetary policy faces a number of imponderables. There is the possibility of direct shocks to inflation (VAT, energy and gasoline). Also, there is the question of how long external financial markets will be closed, how long it will take to reach a new agreement with the IMF, the extent of funding for the government and midterm tax scenarios.

✕ However, many of these factors will have only a transitory effect on inflation. The high indexation characteristic of the Colombian economy, which has halted rapid reductions in inflation in the past, can contain it and keep expectations stable under the present circumstances.

✕ In short, the international economic environment has become more uncertain. This is evident in the increased volatility of exchange rates, higher financial costs and the difficulty in access to international markets. Moreover, growth prospects for the country's trading partners have declined, particularly in the case of the United States and Venezuela. However, the latest indicators of economic activity confirm the slow recovery in domestic spending. Available forecasts indicate the

inflation target of 6% will likely be met. In view of this fact, the Board of Directors decided not to change the Bank's intervention interest rates.

Board of Directors

Banco de la República

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DETERMINANTS OF INFLATION

A. MONETARY AND CREDIT AGGREGATES

1. Monetary Policy Guidelines

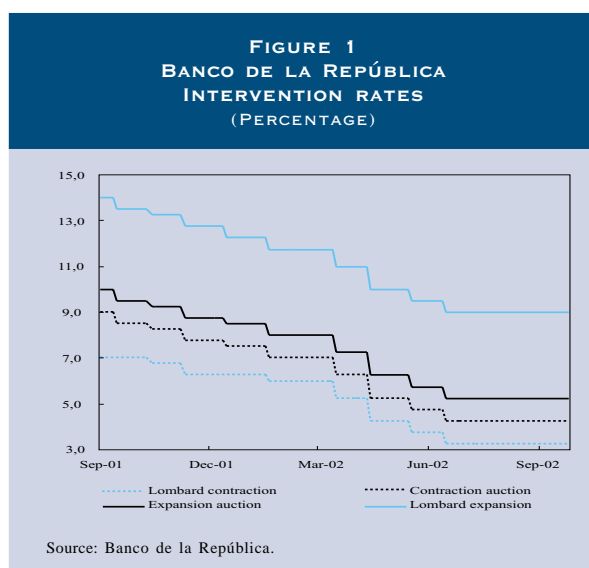
The third quarter of the year saw no change in the Bank's intervention interest rates. Accordingly, at the end of September, the Lombard expansion rate was 9.0%, the auction expansion rate, 5.25%, the auction contraction rate, 4.25% and the Lombard contraction rate, 3.25%. (Figure 1).

The acceleration in devaluation as of late May set the stage for call-options¹ to be auctioned on two occasions in the third quarter to control exchange rate volatility². On July 29, US\$180 million (m) were auctioned. Although these options were exercised in full within two days thereafter, the exchange rate continued to rise and another auction for US\$180 m was held on August 1. Options from

that auction in the amount of US\$109.5 m were exercised during the following month (Table 1). Devaluation of the exchange rate in the July-September period did not provide the condition required to exercise the put options³ on international reserves called monthly by Banco de la República.

The demand for liquidity remained high throughout the third quarter, especially in July and August. This was reflected in the use of one-day repo expansion quotas set by Banco de la República. For example, on July 24, 25 and 26, and on August 6, the demand for resources exceeded the quota set for those days. The result was a series of temporary increases in the expansion auction rate. As to the average repo expansion quota defined for July, August and September, demand was 81.6%, 82.9% and 64.4%, respectively. For its part, the repo contraction quota was underused, with respective requests of only 24.7%, 30.9% and 63.7% (Table 2).

Banco de la República continued to offer the economy permanent liquidity through definitive purchases of public debt paper (TES) to replace its stock. Col\$913.7 billion (b) in these securities matured during the course of the year up to September. As to the Col\$1,069 b in TES purchased during the course of this year, Col\$828.7 b were acquired between July and September (Table 3). These purchases were made through the electronic



¹ Option to sell international reserves.

² Auctions of call options to control volatility are activated when the representative market rate (TRM) exceeds the 20-day moving average, plus 4.0%.

³ Option to purchase international reserves.

TABLE 1
AUCTION OF CALL AND PUT OPTIONS ON
INTERNATIONAL RESERVES

Date	Quota Auctioned	Amount exercised in US\$m	TRM	Amount exercised in Col\$b
Exercise of Put Options				
02-Jan		27,5	2.291,2	63,0
15-Jan		22,5	2.297,3	51,7
January total	50,0	50,0		114,7
05-Feb		1,5	2.266,6	3,4
February total	50,0	1,5		3,4
08-Mar		50,0	2.289,8	114,5
March total	50,0	50,0		114,5
First-quarter total	150,0	101,5		232,6
02-Apr		68,0	2.264,6	154,0
05-Apr		32,0	2.269,4	72,6
April total	100,0	100,0		226,6
May total	100,0	0,0		0,0
June total	100,0	0,0		0,0
Second-quarter total	300,0	100,0		226,6
June total	100,0	0,0		0,0
August total	50,0	0,0		0,0
September total	50,0	0,0		0,0
Third-quarter total	200,0	0,0		0,0
Exercise of Call Options to Control Volatility (Sale)				
29-Jul		117,0	2.596,3	303,8
31-Jul		63,0	2.625,1	165,4
July total	180,0	180,0		469,1
01-Aug		69,0	2.636,3	181,9
02-Aug		17,0	2.640,4	44,9
06-Aug		23,5	2.663,8	62,6
August total	180,0	109,5		289,5

Note: Data at September 27, 2002.
Source: Banco de la República.

transaction system (SEN), except those on August 21 in the amount of Col\$130 b, which were acquired through the auction system. Financial agents not involved in the SEN, such as brokerage firms and trust companies, took part in these last purchases. The Board of Directors

authorized brokerage firms and trust companies to conduct transitory expansion transactions with Banco de la República.

2. Monetary Aggregates

a. Monetary Base

As mentioned earlier, the demand for liquidity has been high in recent months. This is evident in the behavior of the monetary base. Since May, the monetary base - especially cash - has increased steadily and more than expected. Actual levels exceed those implicit in the reference line presented to the Board of Directors in March. Specifically, growth in the monetary base⁴ and cash during the third quarter accelerated sharply from respective rates of 17.6% and 20.7% in June to 26.0% and 30.7% in September (Figure 2).

The recent trend in the monetary base reflects a shock on the demand for primary money, particularly cash. As mentioned in earlier reports, this shock is associated with factors such as less inflation, lower interest rates in the face of relatively high transaction costs, and the effect of the tax on financial transactions (three per thousand).

In response to the significant rise in demand, Banco de la República increased its offer of primary money without generating monetary surpluses that jeopardize the inflation targets for this year and the next. This action was based on the general assessment of the economy presented in this report, and particularly on the models for inflation forecasts, which are also described herein. With this in mind, the Board of Directors adopted a new reference line in October. It is based on the assumption that the fourth quarter will see 28.3% average annual growth in the monetary base and 29.8% in cash. The respective figures for the end of the year are 28.4% and 31.9%.

⁴ Mention of annual growth refers to growth in the average monthly balance of monetary aggregates.

TABLE 2
USE OF QUOTAS ON ONE-DAY EXPANSION AND CONTRACTION REPOS (*)
(COL\$ BILLIONS)

	Expansion			Contraction		
	Quota	Use	%Use	Quota	Uso	%Uso
January	565,9	293,7	51,9	1.300,0	271,1	20,9
February	920,0	432,8	47,0	1.050,0	243,0	23,1
March	1.018,8	647,7	63,6	529,4	140,5	26,5
I Quarter Average	834,9	458,1	54,9	959,8	218,2	22,7
April	727,5	325,3	44,7	1.210,0	781,1	64,6
May	769,6	396,3	51,5	804,3	550,2	68,4
June	800,0	575,8	72,0	725,0	307,2	42,4
II Quarter Average	765,7	432,5	56,5	913,1	546,2	59,8
July	991,7	809,2	81,6	835,4	206,3	24,7
August	1.361,1	1.128,8	82,9	683,3	210,9	30,9
September	1.030,0	663,5	64,4	892,5	568,5	63,7
Promedio III trimestre	1.127,6	867,2	76,9	803,8	328,6	40,9

Note: Data at September 27, 2002.

(*) Auction transactions. The figures refer to the average of the monetary month.

Source: Banco de la República.

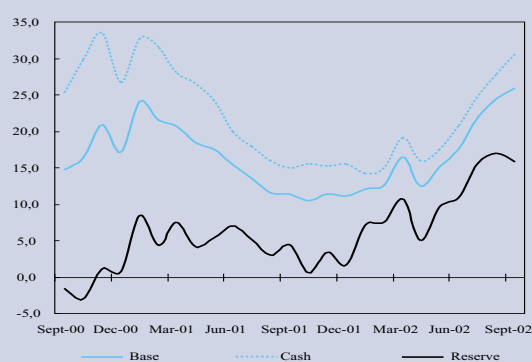
TABLE 3
DEFINITIVE TES B PURCHASES
(COL\$ BILLIONS)

	SEN	Auction(*)	Total (SEN + Auctions)
April	26,6	0,0	26,6
May	117,0	0,0	117,0
June	96,3	0,0	96,3
July	148,1	0,0	148,1
August	407,5	130,0	537,5
September	143,1	0,0	143,1
Total	938,6	130,0	1.068,6

(*) Banco de la República auctioned Col\$130 b in TES on August 21 to financial intermediaries that are not part of SEN, including brokerage firms and trusts companies.

Source: Banco de la República.

FIGURE 2
MONETARY BASE AND ITS USE
(ANNUAL PERCENTAGE CHANGE IN THE MONTHLY AVERAGE)



Source: Banco de la República, Economic Studies Division (SGEE).

b. M3

Annual growth of the broadest monetary aggregate; that is, M3, declined during July and August due to a systematic drop in time certificates of deposits.

However, September saw an increase in annual growth of this aggregate to 8.8% by the end of the month. This was due to a hefty rise in cash, checking accounts and savings accounts, which offset the decline in time certificates of deposit (Figures 3 and 4). The foregoing illustrates a shift in M3 composition towards the possession of more liquid assets.

According to an analysis of M3 by sectors, recomposition of this aggregate during the course of the year is the result of portfolio decisions in both the private and public sectors. In effect, the inclination in the private sector has been to liquidate time certificates of deposit in favor of more investment in TES and increased current account and savings balances. On the other hand, the public sector has increased its deposits in current and savings accounts. Generally speaking, the trend is towards more growth in public M3 to the detriment of private M3 (Figure 5).

The monetary multiplier declined sharply in July and August, thanks to M3 recomposition towards more liquid assets and with higher reserve requirements. This reduction was not offset entirely by the recovery in September. The monetary multiplier went from 6,239 to 6,006 between June and September, due to an increase in the cash coefficient (from 0.125 to 0.134) (Figure 6).

The acceleration in monetary base and M1 growth has been accompanied by an increase in the public's perception of liquidity. A survey of expectations conducted by Banco de la República in July of this year indicates the perception of liquidity in the economy rose in relation to what it was three months earlier. In the July survey, 66.3% of those polled saw liquidity as being high. This is 3.3 points above the percentage registered in the April survey and is the highest for this question in the history of the survey. On the other hand, 61.7% of those polled said current availability of liquidity in the economy would likely continue for the next six months (Figure 7).

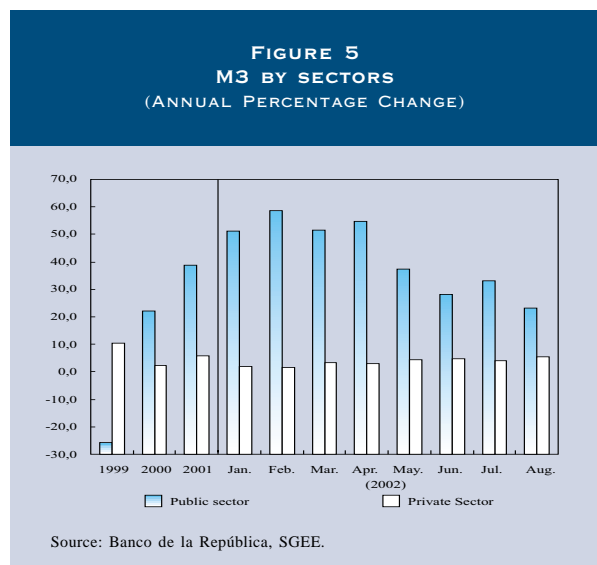
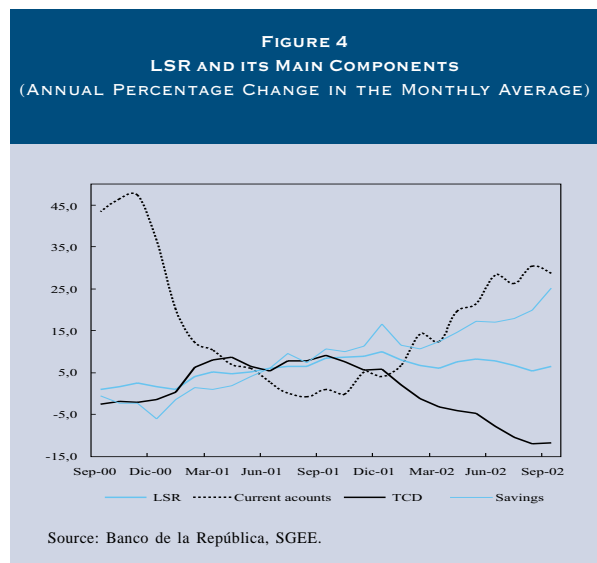
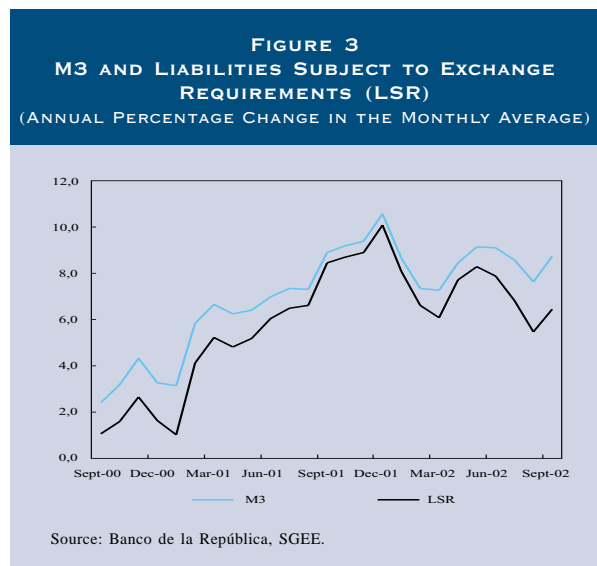
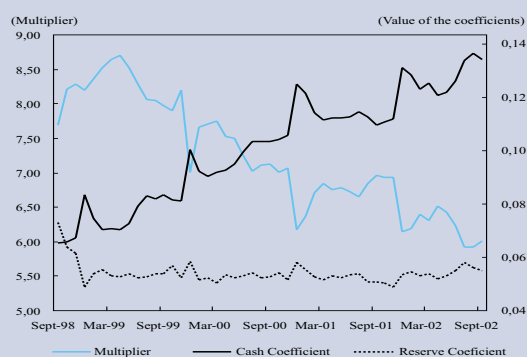


FIGURE 6
M3 MULTIPLIER AND ITS COMPONENTS



Source: Banco de la República, SGEE.

c. Credit and portafolio

During the third quarter, the financial system's portfolio in domestic currency continued to expand, but at a very slow pace. Even so, the last two months saw a slight acceleration in growth, which could signal a break in the trend. Annual growth in this aggregate at September was 1.6%, which represents an increase over June (0.2%). Better portfolio performance in the last quarter was possible thanks to less of a decline in the bank mortgage portfolio and more growth in the rest of the portfolio in the financial system (Figure 8).

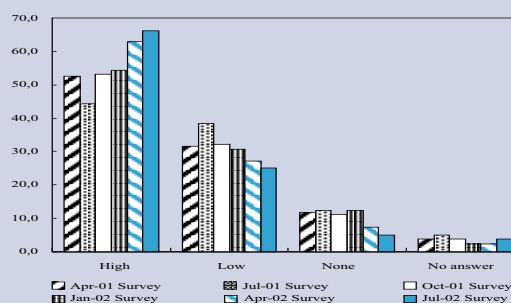
The poor portfolio performance described above was due, in part, to the statistical effect associated with portfolio withdrawals against the balances of financial intermediaries⁵. In August, the nominal gross portfolio in domestic currency corrected by these withdrawals⁶ registered an annual increase 5.2%, which is more than in June of this year (4.8%).

⁵ These withdrawals originated with the liquidation of several financial institutions, the writing off of unproductive assets, reductions for goods received as payment, securitization and portfolio sale to institutions outside the system, and reliquidation of the mortgage portfolio.

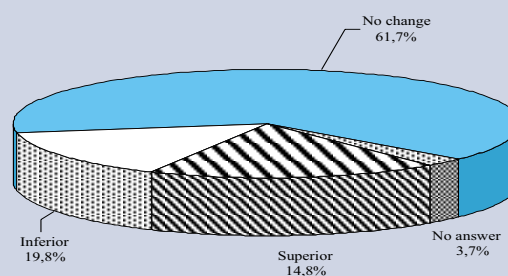
⁶ The corrected portfolio is the same one had the withdrawals in question not occurred.

FIGURE 7
LIQUIDITY IN THE ECONOMY
JULY 2002 SURVEY
(PERCENTAGE)

(A)
PERCEPTION OF LIQUIDITY
(AT THE TIME THE SURVEY WAS CONDUCTED)

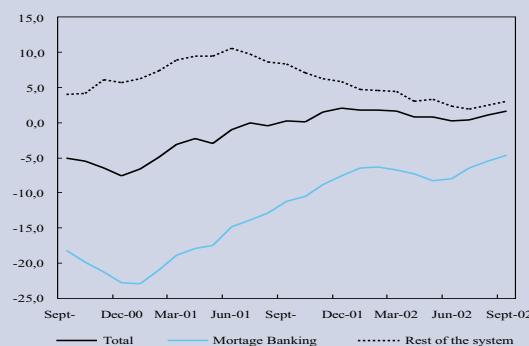


(B)
TREND IN LIQUIDITY FOR THE NEXT SIX MONTHS
(FROM JULY 2002)



Source: Banco de la República, Survey of Expectations, July 2002.

FIGURE 8
NOMINAL GROSS PORTFOLIO OF THE FINANCIAL
SYSTEM IN DOMESTIC CURRENCY, WITHOUT FEN
(ANNUAL PERCENTAGE CHANGE IN THE AVERAGE MONTHLY
BALANCE)



Source: Banco de la República and the Banking Authority

From an economic standpoint, the slow pace at which this aggregate has grown in recent years is explained by determinants associated with supply and demand. An important factor on the supply side

has been the financial system's increased preference for treasury securities (TES) (Figure 9). These are regarded as low risk and were highly profitable up until mid-2002. Accordingly, they constituted a very attractive alternative in view of the expansion in credit. The crisis in the state-owned banking system provoked a sharp reduction in credit from this source. On the other hand, the limited demand for credit is explained by slow growth in the economy and investment.

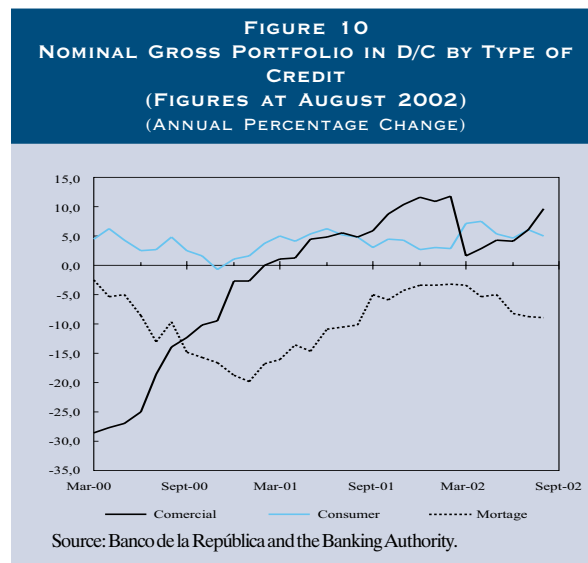
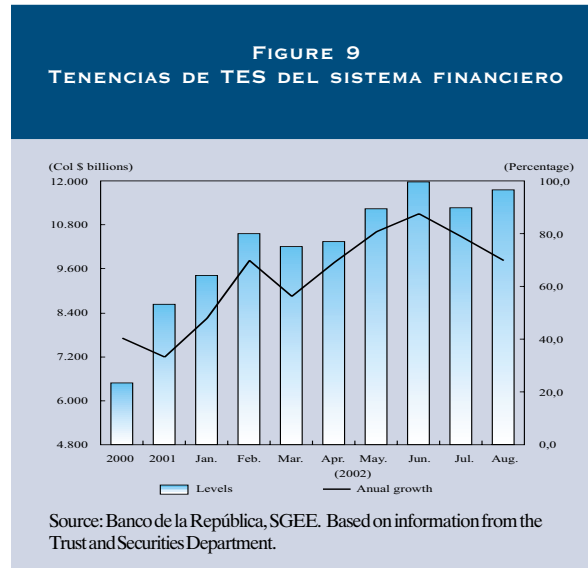
Figure 10 illustrates the trend in the portfolio, per type of credit (commercial, consumer and mortgage)⁷. The figures up to August show an important rise in consumer credit between June and August, with an increase in growth from 4.1% to 9.7%. Mortgage loans and commercial credit saw no major changes in August compared with the rates registered in June of this year.

As to how agents view the availability of credit, when Banco de la República surveyed expectations in July of this year, 53.8% of those interviewed regarded availability as high. This is 21.7 percentage points more than the proportion observed a year earlier and 1.9 percentage points above the proportion in April of this year. As to the next six months, 66.3% believe credit conditions will remain the same (Figure 11).

3. Interest rates

In the third quarter, the nominal interbank rate declined slightly to around 5.3%. This is similar to the rate observed at the end of the second quarter (Figure 12). The real equivalent in September was -0.7%, the lowest rate since January 2000.

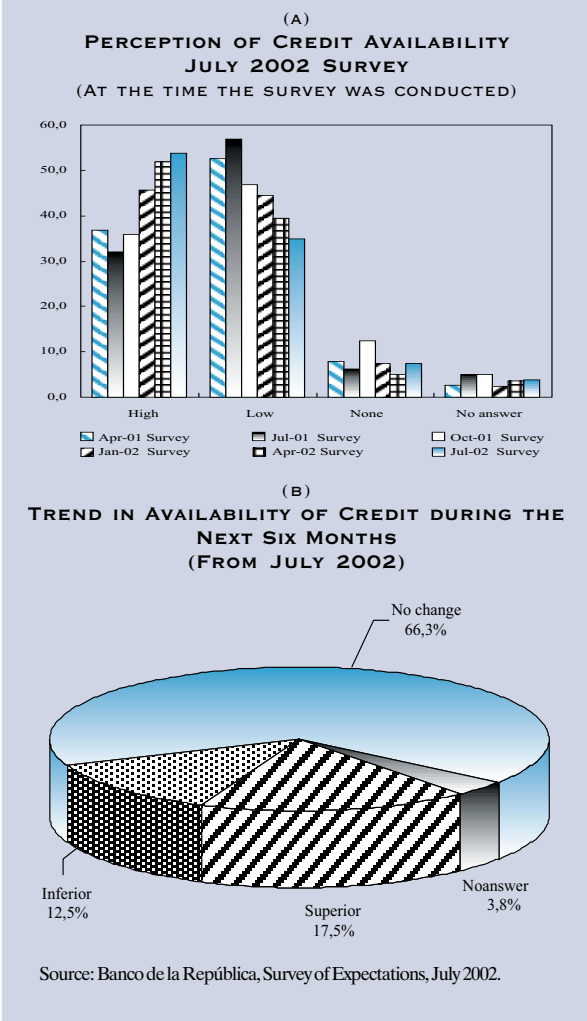
⁷ In January, the Banking Authority changed its criterion on risk structure and classification by type of loan when it included microcredit as a category. The addition of this new category modifies the concept of consumer credit and explains why it grew less in February 2002. This also explains the increase in commercial credit. Therefore, a better analysis of performance per type of loan can be achieved by adding consumer credit (which includes microcredit) to commercial credit. In August, this aggregate rose by 6.1%, which exceeds the rate of growth observed in June (4.5%).



During the first two quarters of 2002, all nominal interest rates in the financial system declined steadily and significantly, except for a few short-lived rebounds. This trend continued in the third quarter, but was less intense. As to the interest rate on time certificates of deposit, July witnessed a reduction but there have been no signs of a change since August, despite less volatility in the interbank rate and an increase in available liquidity (Figure 13).

With respect to lending rates, the last three months saw a new decline (between 30 and 40 basis points) in interest on consumer credit and treasury loans.

FIGURE 11



However, interest on ordinary loans, the prime rate and credit card interest rose by 36, 30 and 105 bp, respectively, ending the downward trend observed in the first half of the year (Figure 14).

With less reported inflation, the trend in real interest on loans and deposits between June and September was also mixed. Although the real interest rate on deposits declined, lending rates either increased or remained constant. Consequently, while the real rate on deposits went from 2.0% in June to 1.9% at the close of September, real interest on loans rose during the same period, thanks to an increase of 132 bp in credit card interest and an increase of 63 bp in interest on ordinary loans.

Nominal interest on deposits declined throughout the first nine months of the year, regardless of maturity. Figure 15 shows the trend in the yield curve for the basic rate set by the Banking Authority (TBS). The decline in interest rates was more pronounced for longer maturities (360 days) and less for shorter ones. Consequently, the slope of the TBS yield curve, measured as the difference between yield at 360 and 30 days, leveled out to the point where it was 3.5% in September. This is 90 bp below the rate registered at the end of 2001 and suggests the market does not expect additional cuts in interest on deposits in the coming months..

FIGURE 12
INTERBANK INTEREST RATE
 (PERCENTAGE)

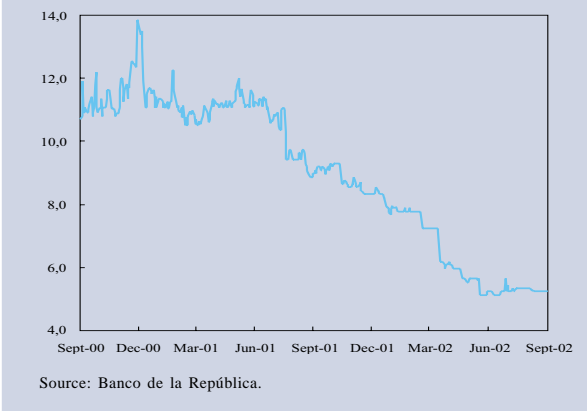


FIGURE 13
90-DAY CERTIFICATES OF DEPOSIT
 (PORCENTAJE)

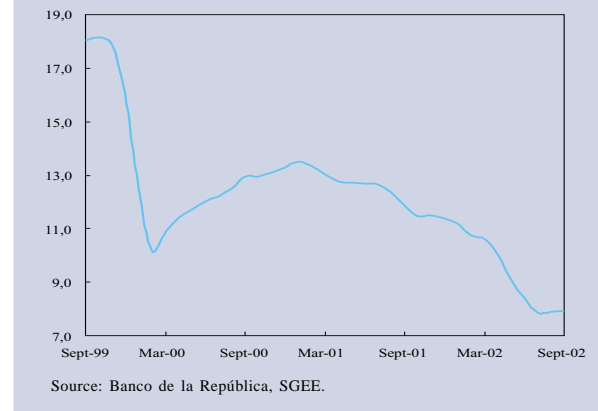
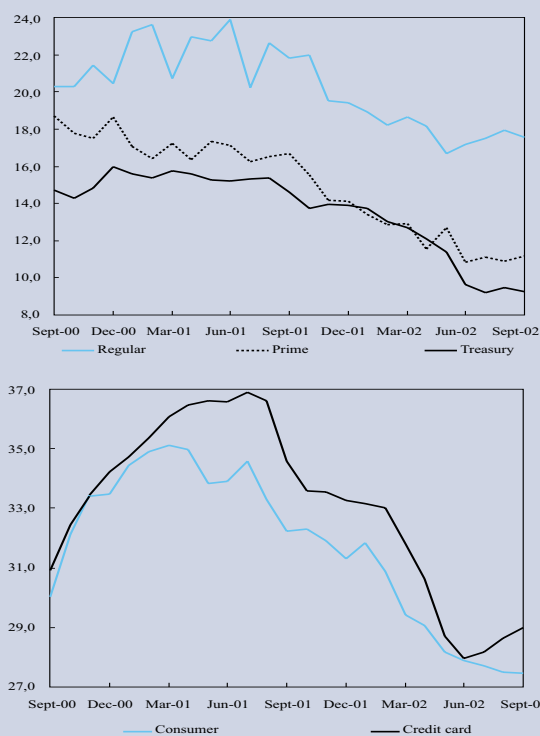


FIGURE 14
INTEREST RATE BY TYPE OF LOAN
(PERCENTAGE)



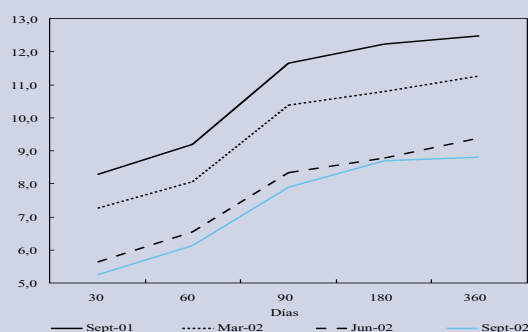
Source: Banco de la República.

Figure 16 shows the trend in the yield curve for interest on TES traded through the SEN (secondary market). After a series of continuous declines in the first six months of 2002, the yield on the domestic national debt saw sharp increases as of August for all maturities, placing interest rates in the SEN at historic highs.

At the same time, this market saw less liquidity because of the shift in resources from fixed income to the exchange market. This change in investor preference is the result of growing uncertainty sparked by the government's difficulty in financing its operations for 2003. It also responds to growing risk aversion in Latin America's financial markets, due to the change of government in Brazil, the serious economic and political crisis in Venezuela, and a less favorable assessment of the country's prospects for economic growth.

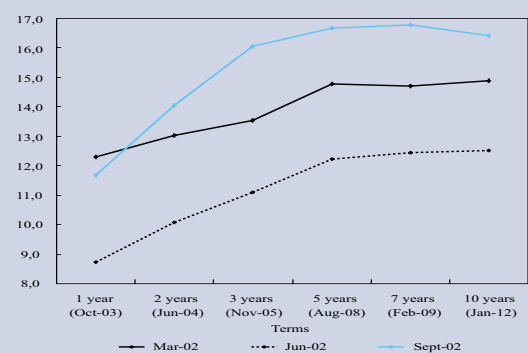
The yield on three-year and 10-year bonds increased

FIGURE 15
STRUCTURE OF TBS MATURITIES
(PERCENTAGE)



TBS: Basic rate set by the Banking Authority.
Source: Banking Authority. Calculations by Banco de la República.

FIGURE 16
TES YIELD CURVE 1/
(PERCENTAGE)



1/ Data according to SEN.
Source: Banco de la República.

by 463 and 332 bp, respectively, between June and September. In September, the yield on one-year bonds fluctuated at around 14.0%, with an increase of 400 bp during the same period. As a result, the TES yield curve - measured as the difference between the yield on a 10-year bond and interest on a one-year bond- rose sharply from 260 bp in March to 470 bp in September.

The quarterly survey conducted by Banco de la República in July shows market agents anticipate interest on deposits will begin to increase gradually in the coming quarters. The two previous surveys (January and April) produced similar findings. In particular, the July survey indicated market agents

expected the rate on time certificates of deposit to be 8.6% by December, which is 62 bp above the current level. However, it should be noted that previous surveys showed no expectation that interest rates would decline during the first half of the year. On the contrary, they always pointed to an increase (Figure 17).

4. Yield Differentials

As explained in the preceding section, the yield on public external debt securities (TES) rose sharply as of August for all maturities. At the same time, the yield on United States treasury bonds declined, also for all maturities. This was due to the market's growing preference for safer assets.

While interest rates on Colombian bonds at 10 and two years were close to 16.4% and 14.0%, respectively, the yield on equivalent United States bonds was 4.0% and 2.0%, in that order

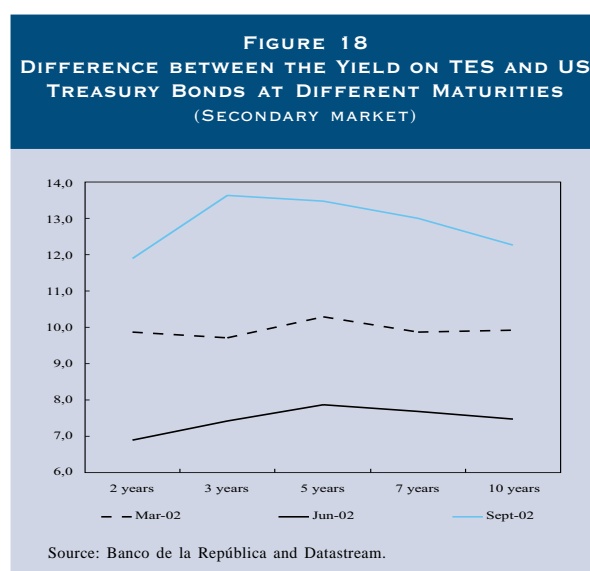
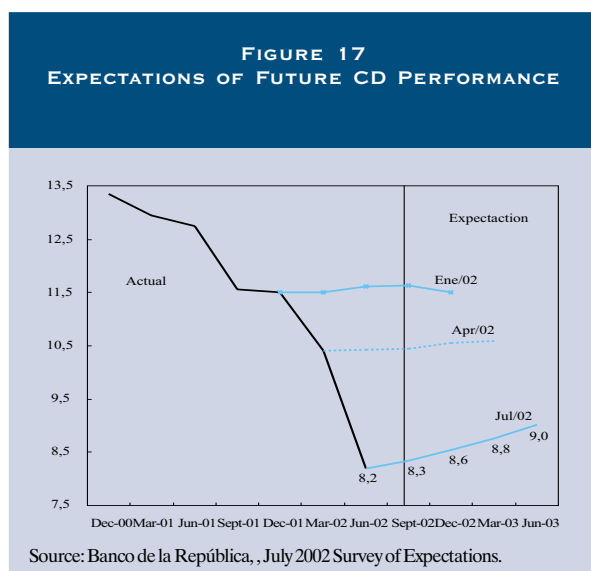
Consequently, the relevant yield differential for Colombian investors expanded in favor of local investments, breaking the trend observed since the end of last year. In part, this reflects the higher premium investors demand to maintain investments in the country (Figure 18).

5. Nominal Exchange Rate

After remaining relatively stable during the first half of the year, the Colombian peso depreciated sharply against the dollar in the third quarter. In September, the representative market rate reached a historic high when it closed at Col\$2,828.1 per dollar, or 429 pesos above the exchange rate in June. Annual devaluation was 21.3% and 23.4% for the year to date (Figures 19 and 20).

The upward trend in the representative market rate (TRM) during the last three months was associated with recomposition of the public's holdings, with public debt paper (TES) and Yankee bonds being liquidated in order to enter the exchange market. As Figure 21 illustrates, the market's increased demand for foreign currency could not be absorbed entirely by liquidation of the financial sector's own cash position. This translated into a higher TRM.

The representative market rate was also affected by more demand for foreign currency on the part of the real sector to comply with foreign remittances and to prepay debt. This situation was the result of increased risk aversion among investors faced with deteriorating financial and political conditions in Latin America and uncertainty over the actual state of Colombia's public finances at the national level.



As of June, exchange rate volatility provided the condition required for Banco de la República to intervene in the exchange market on two occasions. Call options in the amount of US\$360 m were auctioned, with US\$289.5 m exercised (See Section 1. Policy Guidelines). Yet, even so, there was no substantial correction in the exchange rate, which continued to rise. Consequently, put options were not exercised in the third quarter to accumulate reserves.

The survey of expectations conducted by Banco de la República in July shows economic agents expect an exchange rate of Col\$2.568.9 per dollar by December. Compared with the value in September, this would be a decline of 239 pesos in the TRM to 12.1% annual devaluation. For March and June 2003, agents expect 15.7% and 9.6% annual devaluation (Figure 22).

6. Real Exchange Rate

As measured by RERI-1 (1994 = 100), an index constructed with Colombia's producer price index and those of its 20 trading partners, the real exchange rate averaged 126.2 in September, the highest level since 1997. Accordingly, this indicator experienced 11.7% quarterly devaluation and 6.2% real annual devaluation. On the other hand, if the real exchange rate is measured by RERI-3 (1994=100), which uses on the consumer price index, real devaluation in the third quarter was 14.5%, while annual devaluation was 5.3% (Figures 23 and 24).

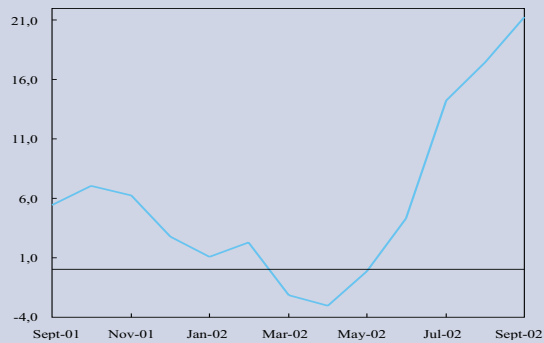
The changes in the RERI reflect the trend in nominal devaluation of the Colombian peso against the currencies of its major trading partners and the gap between domestic and external inflation. By June, the RERI had experienced pressure towards revaluation, because external devaluation was significantly higher than external inflation and nominal internal devaluation was very low. Nevertheless, as of July and particularly in August and September, the acceleration in nominal devaluation pulled the real exchange rate up sharply,

FIGURE 19
REPRESENTATIVE MARKET RATE
(PESOS PER DOLLAR)



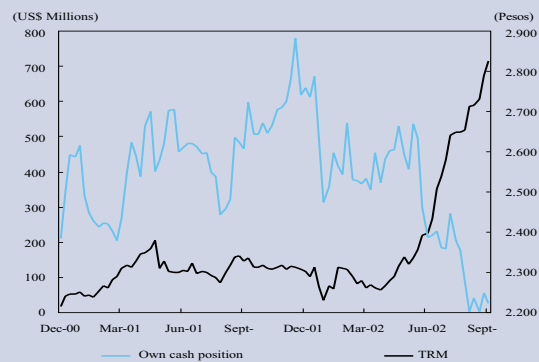
Source: Banco de la República.

FIGURE 20
ANNUAL NOMINAL DEVALUATION
(END OF MONTH PERCENTAGE)



Source: Banco de la República.

FIGURE 21
OWN CASH POSITION OF THE FINANCIAL SYSTEM
AND THE REPRESENTATIVE MARKET RATE



Source: Banco de la República.

as it was not accompanied by an upsurge in domestic inflation. The revaluationist tendency of the index in the first half of the year was offset entirely, to the point where the RERI registered a historic high in September.

7. Asset Prices

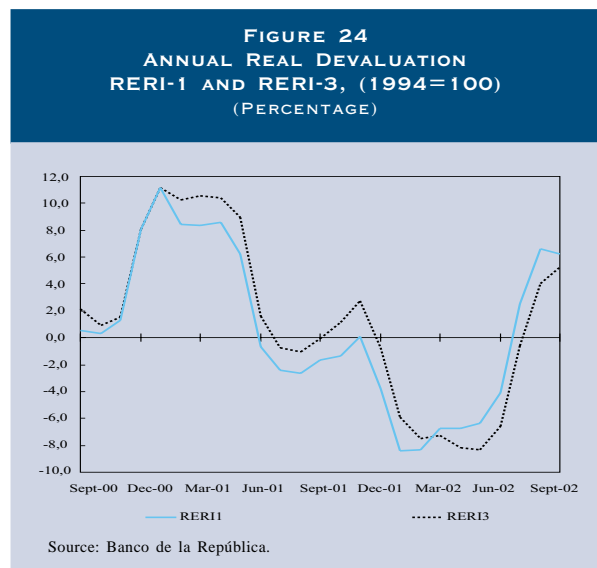
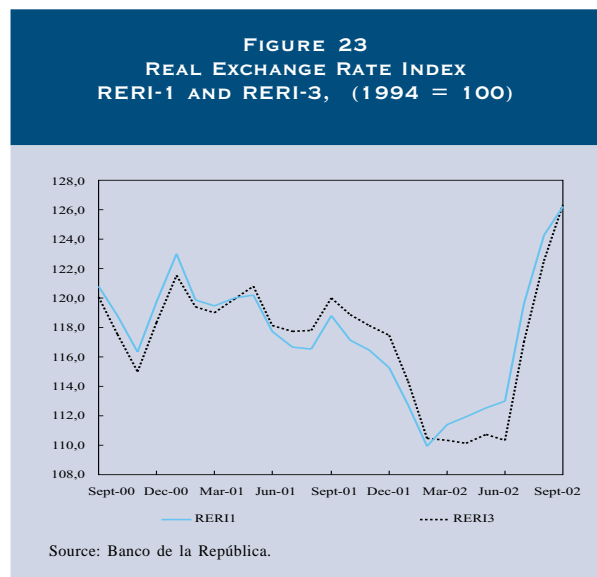
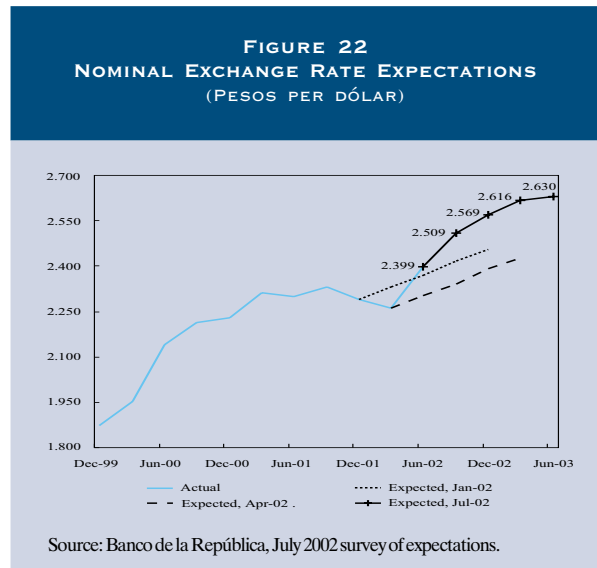
The focus in this section is on two variables that describe the trend in prices of certain assets in Colombia. The first is the General Index of the Colombian Stock Exchange (IGBC). It measures, in an aggregate way, the prices of the stocks most representative of the market. This is done by means of a basket of stocks selected in function of their turnover and frequency.

The IGBC remained relatively stable during the third quarter of 2002, fluctuating within a range of 1,175 to 1,275 points. Its annualized quarterly yield fell sharply during the period, from 59.3% in June to 10.9% in September. While this is still better than the yield on other financial assets, the decline essentially reflects the agitated situation on internal public debt markets and with the dollar. This has diverted resources away from the variable income market, while negatively affecting its rate of return (Figure 25).

Another variable that sheds light on assets prices in Colombia is the housing price index. Since 1994, the National Department of Planning (DNP) has calculated this index monthly for Bogota. Figure 26 shows housing price inflation in Bogota. At the end of August, the last month for which figures are available, housing prices in Bogota continued to exhibit a negative level of growth well below the rate of consumer inflation. However, the downturn in the index has eased in last three months. For example, in August, the annual increase in housing prices in Bogota was -2.5%, 70 bp more than in June but 846 bp less than annual growth in the consumer price index (CPI) during the same month.

8. Monetary-condition Indicator

In the third quarter of 2002, the monetary-



condition indicator of aggregate demand (ICM) remained below the base period (1998:01). This suggests the rein on monetary policy is not a tight as at the start 1998. Lower interest rates and devaluation in the third quarter of the year (Figure 27) explain the current position of the indicator.

B. SUPPLY AND DEMAND

1. General Considerations

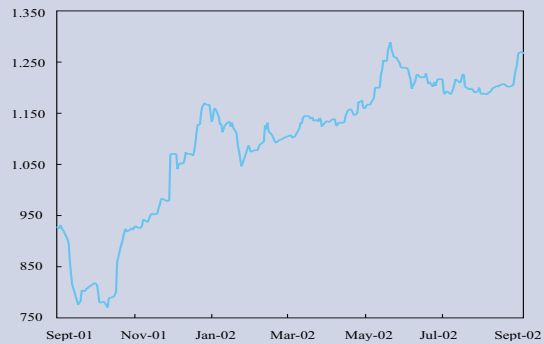
Annual growth during the second quarter of the year (2.2%) was better than expected, even excluding the seasonal effect of the Easter holiday. A comparison between annual growth of the economy during the first six months of the year (1.4%) and the second half of 2001 (0.9%) also shows better economic performance in the course of 2002.

The second-quarter increase in activity is explained by improved performance in farming and livestock production, private construction and financial institutions. As to demand, the most dynamic components were final consumption (household and government) and total exports.

Taking into account economic performance in the first half of the year and the trend in certain indicators of consumption and production, the government decided to modify the growth target for 2002 to 1.6%. It was 2.5% initially. However, in the wake of poor economic growth during the first quarter of 2002 (0.5%), the target was lowered to 1.2%.

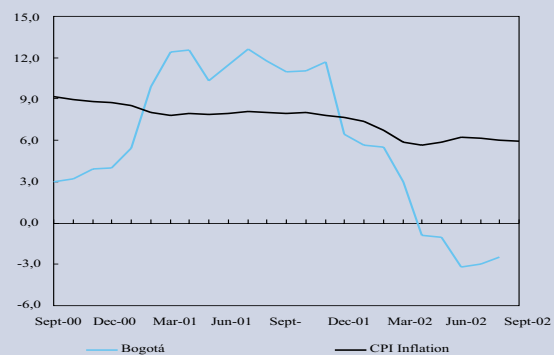
As to the remainder of the year, the economy is expected to grow at a similar or slightly higher rate than in the first six months, based on the increased momentum in domestic demand (consumption in particular). External demand will continue to be affected by the decline in exports to Venezuela and by the downturn in coffee and oil production. For example, oil production during the second half of 2002 will compare with a relatively high base,

FIGURE 25
GENERAL INDEX OF THE COLOMBIAN STOCK EXCHANGE



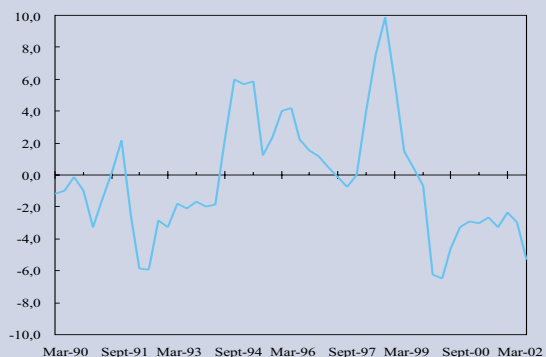
Source: Colombian Stock Exchange.

FIGURE 26
ANNUAL CHANGE IN THE BOGOTA HOUSING PRICE INDEX AND CPI INFLATION



Source: National Department of Planning (DNP)

FIGURE 27
MONETARY-CONDITION INDICATOR (MCI)
(PERCENTAGES)



Source: Banco de la República, SGEE.

TABLE 4
BALANCE OF PAYMENTS CURRENT ACCOUNT
(US\$ MILLIONS)

	January-June		Change	
	2001 (p)	2002 (p)	Absolute	(%)
Current Account (A + B + C)	(1.024)	(802)	223	
Income	8.931	8.375	(557)	(6,2)
Outlays	9.956	9.176	(779)	(7,8)
A. Non-factor goods and services	(576)	(388)	187	(32,5)
Income	7.393	6.959	(434)	(5,9)
Outlays	7.968	7.347	(622)	(7,8)
1. Goods	74	317	243	329,7
Income	6.342	6.100	(242)	(3,8)
Outlays	6.269	5.783	(485)	(7,7)
2. Non factor services	(649)	(705)	(56)	8,6
Incomes	1.051	858	(192)	(18,3)
Outlays	1.700	1.564	(136)	(8,0)
B. Factor earnings	(1.458)	(1.361)	97	(6,6)
Income	405	311	(94)	(23,1)
Outlays	1.862	1.672	(190)	(10,2)
C. Transfers	1.009	948	(61)	(6,1)
Income	1.134	1.105	(28)	(2,5)
Outlays	125	157	33	26,1

(p) Provisional.

Source: Banco de la República.

inasmuch as there were no serious problems with law and order in the second half of 2001 to affect this activity⁸.

2. External Demand and the Current Account

The current account deficit declined in the first half of 2002 from US\$-1,024 m to US\$-802 m (Table 4). This is the result of fewer imports (-7.7%), which offset the drop in net transfers (-6.1%) and exports (-3.8%).

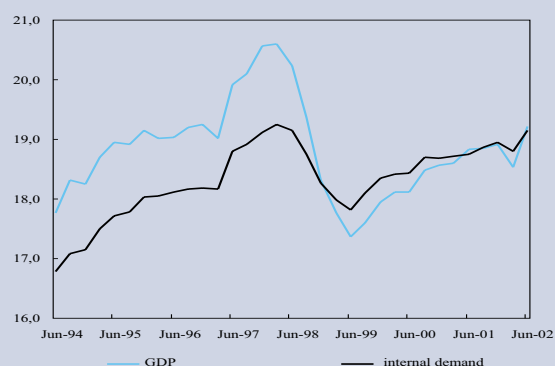
It appears the trade surplus registered in the first half of the year is not due to less consumption, but to a recomposition of consumption in favor of non-tradables and to the drop in imports associated with less investment (Figure 28).

According to the National Bureau of Statistics (DANE), the value of total exports has fallen in recent months. By February, cumulative exports for the 12 months had declined at an annual rate of 6.4%; in August, the rate was 7.5%. This was due to a downturn in traditional exports (-13.6% in the same period) and in non-traditional ones as well (-2.4%), particularly non-traditional industrial exports. (-1.0%) (Figure 29). The figures showing weaker external demand were particularly unfavorable in August (when total exports registered an annual decline of 21.4%).

The drop in sales to the United States (-17.0% annually in the last 12 months) and to Venezuela (-9.8% during the same period of time) explains the reduced momentum in non-traditional industrial exports and was due to less economic activity in those countries. On the other hand, August saw a

⁸ Oil production was virtually paralyzed in the first half of 2001 due to terrorists attacks on the Caño Limon-Coveñas pipeline

FIGURE 28
GDP VERSUS INTERNAL DEMAND
DESEASONALIZED SERIES
(COL\$ TRILLION, 1994)



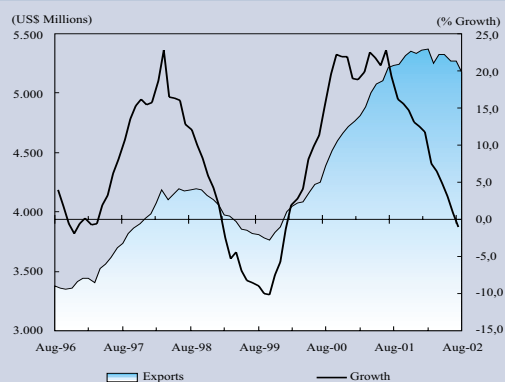
Source: DANE.

decline in exports to Ecuador. This is a cause for concern, as the force of sales to that country had compensated for fewer exports to Colombia's other major trading partners (Figure 30).

The trade surplus should continue to grow throughout the remainder of the year, mainly because of the downturn in imports of consumer goods associated with devaluation during the third quarter and the added slowdown in imports of capital goods, especially transport material and equipment and machinery. On the other hand, exports are not expected to recover their growth, since the economic crisis in Venezuela has worsened (non-traditional industrial exports to that country declined by 54.1% in August). Moreover, sales to Ecuador are being jeopardized by a «saturation» effect and by possible protectionist measures. Coffee production and oil production are expected to decline as well. Approval of the Andean Trade Preference Act (ATPA) is a positive factor and should boost exports to the United States. However, as far as the rest of the year is concerned, it probably will not be enough to compensate for the negative factors mentioned earlier.

Owing to prepayment of the private debt up to the third quarter of this year, the factor-income balance could be less negative as a result of fewer outlays for interest. On the other hand, net transfers should

FIGURE 29
NON-TRADITIONAL INDUSTRIAL EXPORTS
LAST 12 MONTHS



Source: DANE.

continue to decline. This is because remittances from workers will be less vigorous, due to fewer prospects for growth worldwide, and because the «bulk» of donations through Plan Colombia have already entered the country.

3. Consumption

In the second quarter of 2002, consumption continued to be the component that contributed the most to GDP growth (Table 5). This is expected to be the case during the rest of the year as well.

a. Households

Household consumption slowed in the second quarter, mainly because of the decline in consumption of semi-durables such as clothing and footwear. However, indicators suggest the likelihood of better performance in the third quarter of the year. According to Fenalco, commercial sales in the current quarter were the best of the year to date (Figure 31). Real credit card sales rose by 16.8% in the third quarter compared with the same period in 2001, and new vehicle sales in Colombia saw a 52.1% increase between July and September in contrast with the same period last year.

Other indicators, such as imports of consumer goods, had declined slightly by July. This tendency is expected to grow, given devaluation as of June, which could prompt a recomposition of demand in

favor of goods produced inside the country. In general, household consumption is expected to continue to grow during the second half of the year at a rate similar to the one in the first six months, if not more. The new tax on net worth is not expected to have a major negative effect on household consumption during the remainder of the year.

b. Government

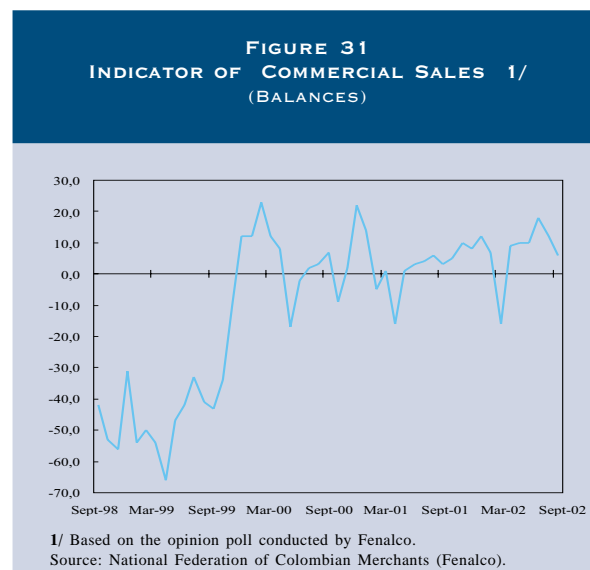
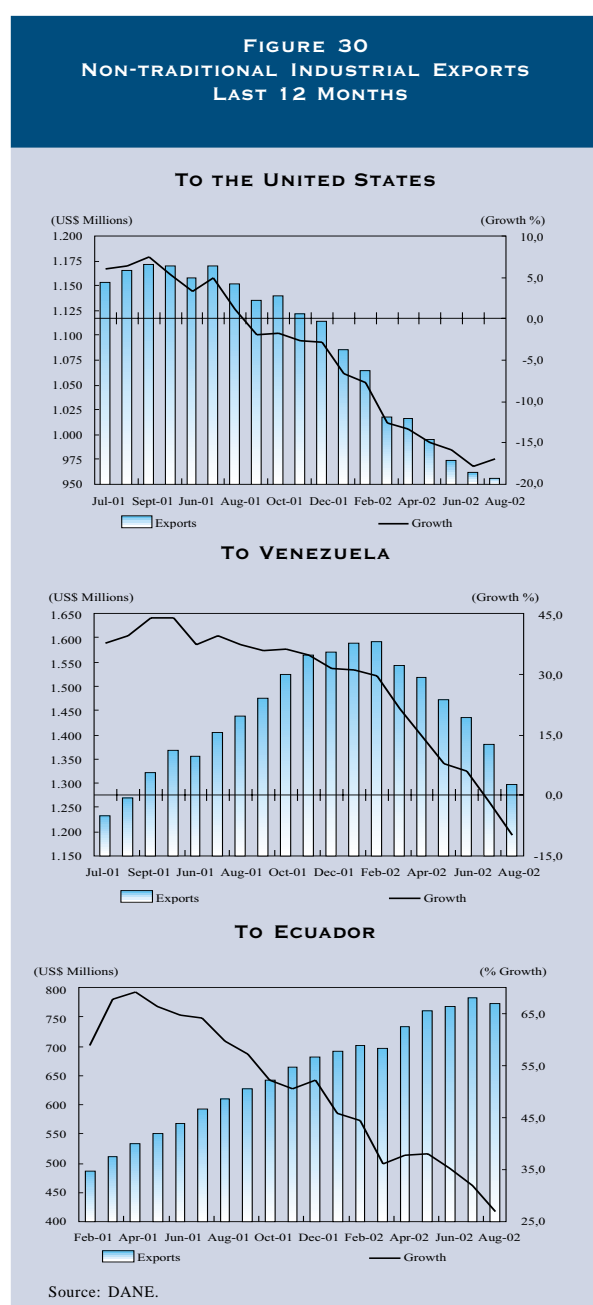
There was a significant rebound in government consumption during the second quarter of

the year compared with the first (Table 5). This was because payments held back during the first quarter of 2002 were made in the second quarter, and because of changes in the remittance schedule.

According to the central government's preliminary balance for the first half of 2002⁹, operating expenses rose by 7.6% compared with the same period in 2001. Inasmuch as annual growth in the first quarter of the year¹⁰ was – 14.0%, the second quarter was a period of expansion in public spending. This change in the growth trend can be explained, in part, by the change in the schedule for transfers when Law 715/ 2001 took effect. According to the Finance Ministry, public consumption is expected to increase by 2.1% for the year as a whole. This implies 2.5% growth in the second half

4. Investment

Total investment as a means of gross capital



⁹ «Gobierno Nacional Central. Primer Semestre de 2002 (Balance Preliminar)», (Central Government. First Six Months of 2002 – Preliminary Balance) CONFIS Advisory Document No. 9, October 3, 2002.

¹⁰ According to «Gobierno Nacional Central. Primer Trimestre 2002 (Preliminary Balance)» (Central Government. First Quarter of 2002 – Preliminary Balance). CONFIS Advisory Document No. 5, June 21, 2002.

TABLE 5
GDP FROM THE STANDPOINT OF DEMAND
(ANNUAL PERCENTAGE CHANGE)

	2000 (p)		2001 (p)				2002 (p)	
	Annual	I	II	III	IV	Annual	I	II
Gross domestic product	2,74	1,98	1,79	0,79	1,05	1,40	0,52	2,21
Totale Imports	8,63	11,27	19,62	10,32	4,33	11,23	(5,81)	0,19
Total final supply	3,57	3,36	4,36	2,21	1,55	2,86	(0,49)	1,88
Final consumption	2,49	1,31	1,14	0,97	1,83	1,31	1,84	1,89
Household 1/	3,65	1,64	1,28	0,53	1,72	1,29	2,32	1,52
Final internal household consumption 2/	4,00	2,30	1,44	0,52	1,78	1,51	1,03	2,02
Non-durables 2/	3,82	0,82	(0,13)	(1,83)	0,53	(0,16)	0,35	0,54
Semi-durables 2/	15,28	4,97	4,67	1,78	1,05	3,06	2,86	(2,22)
Public utilities 2/	1,60	2,27	2,17	2,54	2,93	2,48	2,31	2,02
Durables 2/	5,90	4,76	4,15	3,92	8,17	5,27	9,16	15,42
Government	(0,74)	0,36	0,73	2,25	2,14	1,37	0,46	2,97
Gross capital formation	11,79	17,42	27,78	10,43	0,46	13,52	(12,60)	(0,32)
Change in inventory 3/	(540,29)	67,26	167,84	(22,23)	(71,98)	6,66	(62,24)	(16,61)
Gross fixed capital formation	(0,84)	6,85	13,41	12,77	12,14	11,30	0,44	2,65
Agriculture, forestry, hunting y fishing	3,10	4,15	(1,41)	11,47	7,57	5,26	7,89	7,47
Machinery and equipment	4,22	17,69	35,94	18,98	10,08	20,13	1,85	(6,05)
Transport equipment	8,65	33,59	33,38	46,23	36,81	37,39	(17,14)	6,35
Building	(11,10)	6,98	10,06	8,46	17,90	10,92	23,63	21,25
Civil works	0,22	(11,58)	(9,28)	1,26	4,52	(3,97)	(17,37)	(3,98)
Subtotal: internal final demand	3,70	3,55	4,65	2,32	1,63	3,02	(0,43)	1,54
Total exports	2,92	2,41	2,81	1,60	1,14	1,98	(0,79)	3,73
Total final demand	3,57	3,36	4,36	2,21	1,55	2,86	(0,49)	1,88

(p) Provisional.

1/ Includes foreign purchases of goods by residents and excludes domestic purchases by non-residents.

2/ Pertains to final consumption within the country by resident households.

3/ Calculations by Banco de la República, SGEE.

Source: DANE.

formation (GCF) declined by 0.3% in the second quarter of the year compared with the same period in 2001 (Table 5). However, setting aside the change in stock or inventory, the annual increase in investment was 2.7%, measured as gross fixed capital formation (GFCF). This exceeds the increase in the first quarter of the year.

Based on figures from DANE, the change in inventory between April and June was estimated at -16.6%. This implies a 47.9% decline during the first half of the year, primarily due to reduced coffee inventories. However, this does not rule

out the possibility that companies may have cut back on their inventories, as suggested by the results of the Fedesarrollo business opinion survey and the ANDI combined industrial opinion survey (EOIC).

The momentum in building construction and investment in transport equipment explains better GFCF performance in relation to the first quarter of the year. The decline in investment in civil works during this quarter was substantially less than in the period between January and March 2002. This was due to reasons similar to those indicated in the section on government

consumption. Payments for public investment dropped by 31.0% in the first quarter of the year and rose by 26.2% between January and June, compared with the first six months of 2001.

Third-quarter GFCF growth is not expected to surpass the rate observed during the second quarter of 2002. In July, imports of industrial capital goods registered a 7.0% decline for the last 12 months (Figure 32). Less investment in goods of this type is associated with the standstill in industrial production (See section 5 in this chapter) and with expectations generated by announcements of cuts in taxes on purchases of capital goods and imports (elimination of tariffs and a reduction in the value added tax). This could prompt some members of the business community to postpone investment projects until the situation is clear and measures have been approved. As to investment in transport equipment, no major imports for the Bogota mass transit system are anticipated for the rest of the year and most of the military aid in the form of equipment provided through Plan Colombia was imported last year. Consequently, growth rates superior to those registered in the second quarter are not likely to be forthcoming.

Building construction will continue to be the most dynamic investment component. DANE says the 12-

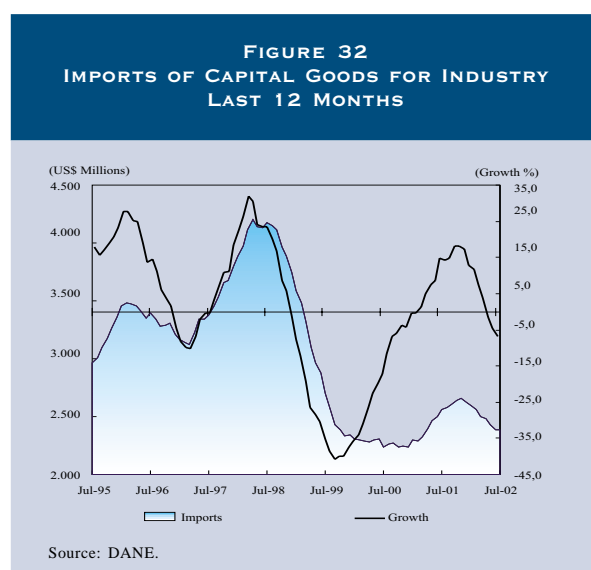
month increase in building permits by August was 23.7% (Figure 33). Real loans disbursed to homebuilders rose by 92.1% during the same period, according to information for August provided by the Colombian Savings and Loan Association (ICAV). The current administration's housing policy calls for continuing the incentives that kept performance in the sector up during the last six quarters. These incentives include an increase in financing through low-cost housing subsidies and special savings accounts (e.g., scheduled savings or accounts to promote construction), as well as an insurance policy to protect against inflation¹¹.

Investment in civil works is expected to be somewhat more dynamic in the second half of the year than in the first, but without «propelling» total investment. Inventories will likely continue to decline as a result of reductions in the stock of coffee, given expectations of less growth in production during the coffee year, which begins in October, and the strategy adopted in conjunction with other coffee-growing countries to destroy reserves of poor-quality coffee.

5. Industrial production

Industrial production in the second quarter of the year, excluding coffee processing, bounced back compared with the three previous quarters and registered 1.7% annual growth. This is according to figures from the new DANE monthly manufacturing sample (NMMM) for July. However, part of this recovery may be due to the statistical effect associated with the Easter holiday.

As to the trend in industrial production for the remainder of the year, NMMS figures show 2.7%



¹¹ CONPES Document 3200. «Bases de la política de vivienda 2002-2006: Ajustes al programa de subsidio familiar de vivienda e incentivos de oferta y demanda para créditos de vivienda en UVR» (Fundamentals of the 2002-2006 Housing Policy: Adjustments in the Family Housing Subsidy Program and in Incentives to Encourage Supply and Demand for Home Loans in UVR).

annual growth at July. This implies -0.6% annual growth for the year to date (cumulative production between January and July). The upswing in industrial production coincided with extraordinary annual growth in real industrial sales on the order of 6.8% for the same month. As a result, during the course of the year (January to July 2002 versus January to July 2001), industrial sales have increased by 0.2% (Figure 34). Considering the poor performance of non-traditional industrial exports up to August and the good performance reflected in the trade indicators, most of the momentum in industrial sales and production can probably be attributed to domestic demand.

As to company inventory levels, available indicators suggest they are not increasing. On the one hand, industrial sales had outpaced production by July. On the other hand, August figures from the business opinion survey (EOC)¹² showed export and non-export companies had less stock (Figure 35) than at the beginning of the year. According to the August edition of the combined industrial opinion survey (EOIC), industries reported having less stock on hand than at the start of the year.

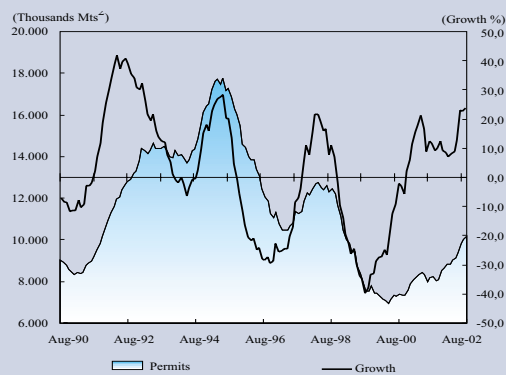
Another interesting variable is the favorable trend in company orders by August (according to the EOC and the EOIC), particularly in the case of export companies (Figure 36). This last factor, which contrasts with the decline in non-traditional industrial exports and the poor outlook for economic growth in Venezuela, points to the likelihood of more growth in the production of tradables. Increased devaluation is one reason for this situation.

The third quarter of the year saw an annual increase of 2.7% in the demand for energy (Figure 37). Although this is less than the increase in the first quarter of 2002 (3.3%), it is a good sign of performance in the area of industrial activity.

¹² The EOC reports the «balance», which is the difference between positive and negative answers.

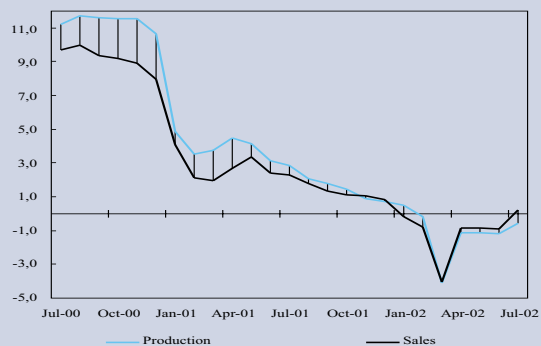
Considering the growth in domestic sales (according to the trade indicators) and positive reports from export companies (according to the surveys by Fedesarrollo and Andi), third-quarter industrial performance should be positive. Apparently, a more forceful domestic market than in the last six quarters may have offset the decline in external demand. On the other hand, approval of the Andean Trade Preference Act (ATPA) and the extension of its benefits to include new products will have a favorable effect on certain industrial lines during the remainder of the year. Textiles and footwear are two examples. However, other lines will be

FIGURE 33
BUILDING PERMITS
IN THOUSANDS OF SQUARE METERS
(LAST 12 MONTHS)



Source: DANE.

FIGURE 34
PRODUCTION VERSUS INDUSTRIAL SALES
ANNUAL GROWTH YEAR TO DATE
(PERCENTAGE)



Source: DANE.

hampered by poor economic performance in Venezuela. One example is the automobile industry, which would have benefited from trade with that country.

C. WAGES AND EMPLOYMENT

1. Industrial wages

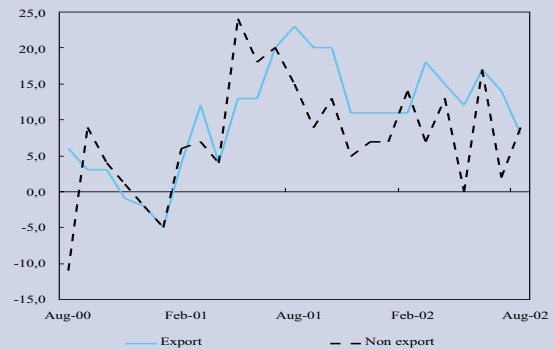
By July 2002, nominal wages in the industrial sector had risen slightly compared with December 2001. In July, the annual variation in nominal wages of industrial workers for the last 12 months was 8.5%, or 0.4 percentage points above the increase registered in December the year before. This slight rise contrasts with the decline in inflation during the same period (1.7 percentage points), which increased real wages.

Benefits paid to workers in the industrial sector exhibited a trend similar to the one in nominal wages. At July 2002, annual growth for the last 12 months in benefits paid to all workers (manual laborers and white-collar workers) was 6.9%, which is 0.5 percentage points more than by December 2001.

Given the rise in wage adjustments and benefits paid to workers, labor compensation in the industrial sector rose by 7.8% in the last 12 months, or 0.4 percentage points above the variation registered in December 2001. However, a more detailed look at the evolution of compensation for industrial employees and workers shows dramatic differences (Figure 38). While compensation for white-collar workers was adjusted in accordance with inflation, compensation for manual laborers registered more of an increase, specifically 3.1 percentage points above the rate of inflation registered in July 2002.

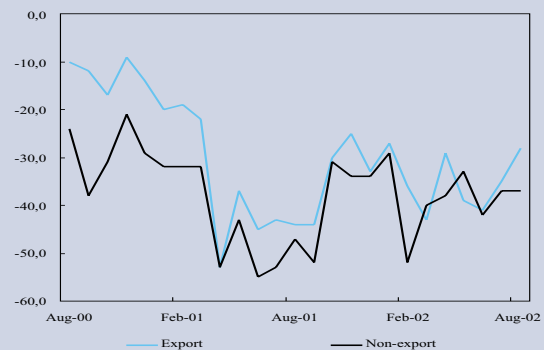
Despite an increase in real wages for workers throughout the year (at July, the annual variation for the last 12 months was 1.6%), real unitary labor costs (CLUR) did not increase, thus continuing the trend of the last three years. This was because the recovery in industrial productivity was equivalent

FIGURE 35
INDICATOR OF CURRENT INVENTORY 1/
(BALANCES)



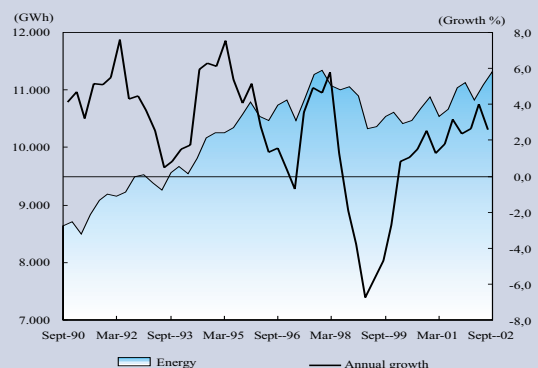
1/ The balances are based on the business opinion survey (EOE).
Source: Fedesarrollo, EOE.

FIGURE 36
INDICATOR OF CURRENT ORDERS 1/
(BALANCES)



1/ The balances are based on the business opinion survey (EOE).
Source: Fedesarrollo, EOE.

FIGURE 37
QUARTERLY DEMAND FOR ENERGY



Source: ISA.

to the increase in real wages (Figure 39). The stability of the CLUR in recent quarters does not suggest the likelihood of inflationary pressure in the short term.

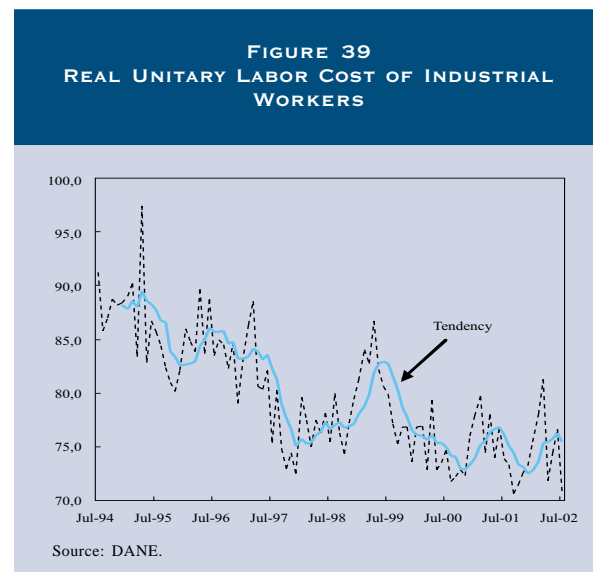
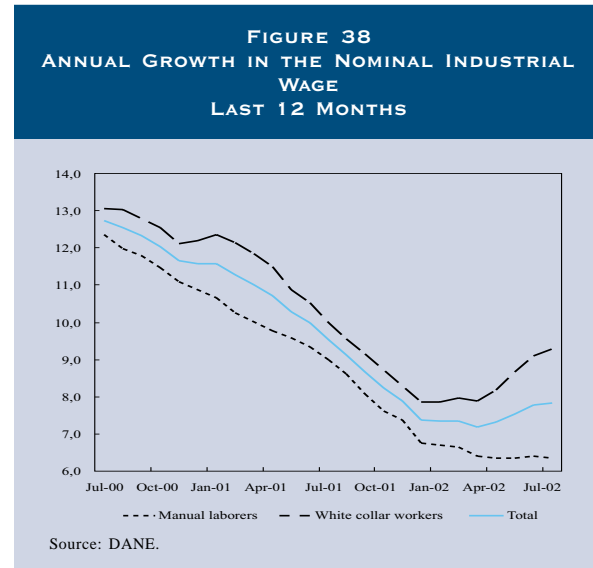
2. Employment

By August, unemployment in the 13 major urban areas was 18.1%, which is similar to the rate observed in the same month the year before (Figure 40). Unemployment nationwide was 16.0%; that is, 1.3 percentage points higher than the year before. Although the current year has seen an increase in jobs (the employment rate was 0.5 percentage points higher than in August 2001), it was only enough to absorb the increase in the population's participation in the job market. Hence, the unemployment rate is the same as it was the year before.

The increase in jobs is associated with the positive trend in labor-intensive activities throughout the year, such as commerce and construction. In the case of commerce, merchants had increased their work force by 2.6% during the year up to July. This is according to the monthly retail sample (MMCP).

The situation is different in the industrial sector. The DANE NMMM for July 2002 showed industrial employment continues to decline. The annual variation in total employment (white-collar workers and manual laborers) for the year to date is -5.3%. When broken down by job categories, the reduction in industrial employment is more dramatic for permanent jobs (-7.0%) than for temporary ones (-2.0%). ATPA could help to reverse this trend in the coming months, once it becomes effective.

As to employment during the rest of the year, the Bank's expectation survey in July showed mixed results. With respect to evolution of the work force in the next three months, 13.7% of those surveyed indicated they were willing to hire more employees. This is an increase of 3.7 percentage points compared with the affirmative replies in April. As to evolution of the work force in the next six



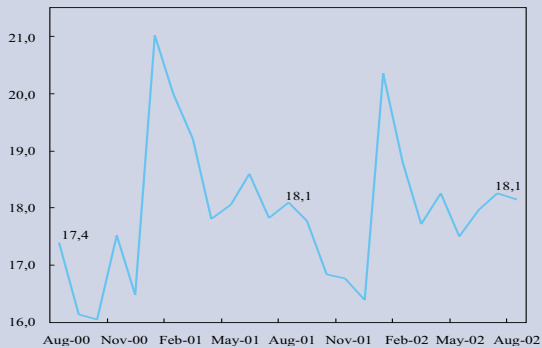
months, the response was negative. The number of employers who plan to reduce their work force increased by 3.7 percentage points (Figure 41).

3. Negotiated Wage Increases

Table 6 shows the percentage of workers covered by collective bargaining agreements reported to the Ministry of Labor and Social Security. They are classified according to one-year and two-year negotiated wage increases.

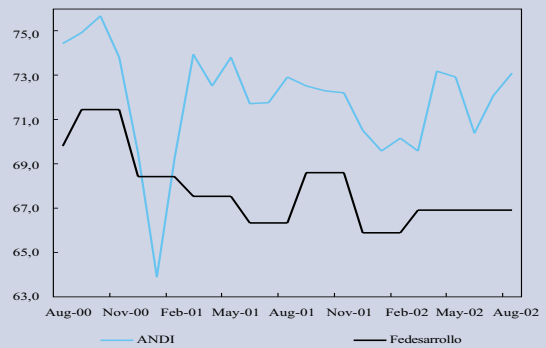
The top part of Table No. 6 shows the percentage of workers in government-owned and private

FIGURE 40
UNEMPLOYMENT RATE FOR 13 CITIES
(PERCENTAGE)



Source: DANE, Permanent Home Surveys (ECH)

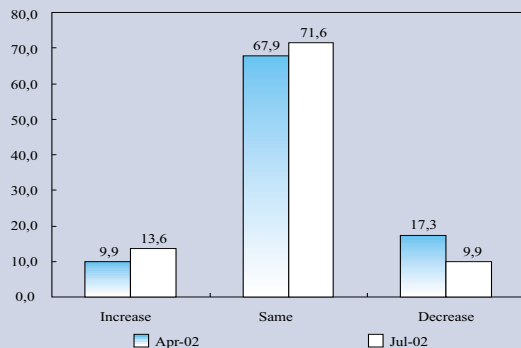
FIGURE 42
USE OF INSTALLED INDUSTRIAL CAPACITY
(BALANCES)



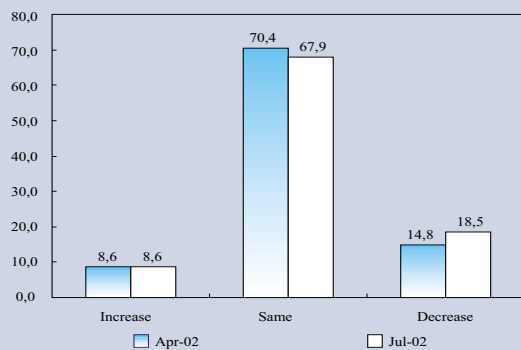
Source: ANDI and Fedesarrollo.

FIGURE 41
EVOLUTION IN COMPANY WORK FORCE
(PERCENTAGE)

IN THE NEXT THREE MONTHS

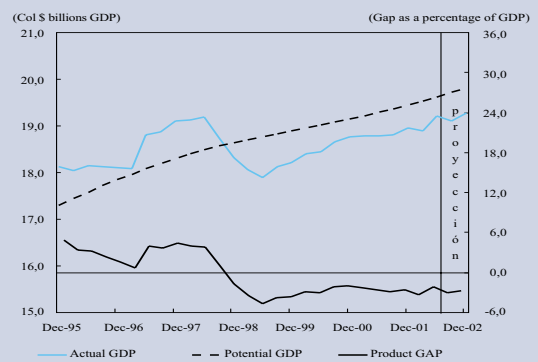


IN THE NEXT SIX MONTHS



Source: Banco de la República, Survey of Expectations, July 2002.

FIGURE 43
PRODUCT GAP
(BILLIONS OF 1994 PESOS)



Source: Banco de la República, SGEE.

companies covered by different ranges of one-year wage settlements reached during the first

nine months of the year. The largest group (46.4%) was in the 8.0% to 10.0% range. This proportion is substantially lower than the one observed last September (68.6%). Another important segment (22.7%) managed to secure wage increases in the [10.0 to 12.0] range, which is similar to what was reported a year earlier (23.7%). Compared with the same period in 2001, the [6.5-8.0] range experienced the biggest reorganization, with an increase from 5.0% to 20.9% of the beneficiaries at present. This may reflect less expectation of inflation on the part of economic agents, as well as the increased credibility of Banco de la República.

The lower half of Table No. 6 shows the percentage of workers covered by two-year wage settlements negotiated between January and September 2002. The largest share is concentrated in the ranges between CPI inflation and CPI + 5 points and CPI + 2.5 points. These include nearly 84.0% of the workers covered by negotiated wage agreements. This percentage is up slightly from September (78.5%). The proportion of workers who negotiated increases below 6.5% at two years is now higher (7.9%) than it was three months ago (2.7%).

D. USE OF INSTALLED CAPACITY AND PRODUCT.

There has been no variation in use of installed

capacity and the product gap as analyzed in the last report. The indicators provided herein on use of installed capacity are slightly below the average for August. According to the latest opinion survey by Fedesarrollo (EOE), use of

TABLE 6
PERCENTAGE OF NEGOTIATED WAGE-INCREASE BENEFICIARIES
(JANUARY-SEPTEMBER 2002)

One-year Negotiated Settlements					
<6,5	[6,5-8,0]	[8,0-10,0]	[10,0-12,0]		
10,1	20,9	46,4	22,7		
Two-year Negotiated Settlements					
<6,5	[6,6-11,0]	IPC	[IPC + 0,5-IPC + 2,5]	SML	Otros
7,9	7,0	42,9	40,9	0,5	0,7

SML = : Minimum wage provided for by law
Source: Ministry of Labor and Social Security

TABLE 7
CONSOLIDATED PUBLIC SECTOR DEFICIT 1/
FIRST SIX MONTHS

Item	Col\$ billions		Percentage of GDP	
	2001	2002 (pr)	2001	2002 (pr)
Electricity	259,0	76,0	0,1	0,0
FAEP	325,0	(424,0)	0,2	(0,2)
Ecopetrol	890,0	1.414,0	0,5	0,7
Telecom	185,0	31,0	0,1	0,0
Other entities 2/	410,0	613,0	0,2	0,3
Social security	406,0	587,0	0,2	0,3
Regional and local	(24,0)	936,0	(0,0)	0,5
National coffee Fund	34,0	(85,0)	0,0	(0,0)
1. Subtotal: Decentralized public sector	2.485,0	3.148,0	1,3	1,5
2. National government	(4.383,0)	(6.321,0)	(2,3)	(3,1)
A. Total non-financial public sector (SPNF) (1 + 2)	(1.898,0)	(3.173,0)	(1,0)	(1,6)
B. Cash profit and loss - Banco de la República	709,0	563,0	0,4	0,3
C. Cash profit and loss - Fogafin	64,0	270,0	0,0	0,1
D. Financial sector restructuring cost	(813,0)	(753,0)	(0,4)	(0,4)
E. Adjustments	(343,0)	248,0	(0,2)	0,1
F. Total consolidated public sector (A + B + C + D + E)	(2.281,0)	(2.845,0)	(1,2)	(1,4)

(pr) Preliminary
1/ Deficit (-) or surplus (+)
2/ Includes EPM and Emcali
Source: Confis.

installed capacity in June-August 2002 was 3.1 percentage points less than the average for the same months in the last eleven years. The ANDI indicator was 1.4 percentage points below the average for August in the last eight years (Figure 42).

The product gap, estimated according to the availability of productive factors (production approach), confirms the existence of considerable unused installed capacity in the economy as a whole. By the second quarter of 2002, the gap was

equivalent to 2.7% of GDP and is expected to remain at this level for the rest of the year (Figure 43). In other words, there should be no inflationary pressure from demand throughout the remainder of 2002.

E. FISCAL SITUATION

Fiscal performance in the consolidated public

TABLE 8
CENTRAL GOVERNMENT
CASH TRANSACTIONS: JANUARY – SEPTEMBER (PR)
(BILLIONS OF PESOS)

	2001	2002	Annual growth 2002/2001
I. Total revenue (A + B)	23.179,0	23.679,0	2,2
A. Tax revenue	19.285,0	19.575,0	1,5
Income tax	8.117,0	8.188,0	0,9
Internal VAT	5.365,0	5.798,0	8,1
External VAT	2.280,0	2.283,0	0,1
Assessment	1.588,0	1.517,0	(4,5)
Gasoline	864,0	719,0	(16,8)
Financial transactions	1.044,0	1.038,0	(0,6)
Others	27,0	32,0	18,5
B. Other income	3.894,0	4.104,0	5,4
II. Total expenditure (A + B + C)	28.233,0	30.776,0	9,0
A. Interest	6.679,0	7.391,0	10,7
External	2.375,0	2.824,0	18,9
Internal	4.304,0	4.567,0	6,1
B. Operating expenses	17.959,0	19.980,0	11,3
Personal services	4.392,0	4.697,0	6,9
General expenses	1.137,0	1.198,0	5,4
Transfers	12.430,0	14.085,0	13,3
C. Investment	3.595,0	3.405,0	(5,3)
III. Cash deficit (-) or surplus (+) (I - II)	(5.054,0)	(7.097,0)	40,4
IV. Financing (A + B + C + D)	5.054,0	7.097,0	40,4
A. Net external credit	5.802,0	(474,0)	(108,2)
Disbursements	9.024,0	2.468,0	(72,7)
Retirement	3.222,0	2.942,0	(8,7)
B. Net internal credit	3.651,0	4.605,0	26,1
Disbursements	10.666,0	11.483,0	7,7
Retirement	7.015,0	6.878,0	(2,0)
C. Sale of assets	181,0	0,0	(100,0)
D. Others	(4.580,0)	2.966,0	(164,8)
V. Deficit as a percentage of GDP	(2,7)	(3,5)	

(pr) Preliminary.

Source: National treasury.

sector during the first half of the year and central government cash operations up to September are reviewed in this report.

1. Consolidated Public Sector

The first six months of 2002 closed with a deficit of Col\$2.845 b in the consolidated public sector, which is equivalent to 1.4% of annual GDP. As illustrated in Table 7, this is due to the non-financial public sector debt (equivalent to 1.6% of GDP), the cost of restructuring the financial sector (equivalent to 0.4% of GDP), and the cash surplus reported by Banco de la República and Fogafin (0.3% and 0.1% of GDP, respectively). By June, the accumulated deficit was Col\$700 b above the target set by the government in its agreement with the International Monetary Fund (IMF).

With respect to the various sectors, the figures show a deficit in central government finances equal to 3.1% of GDP and a surplus in the decentralized sector equal to 1.5% of GDP. The government's fiscal situation deteriorated by 0.8 points of GDP compared with the first half of 2001. This was due to limited growth in tax revenue, because of slow economic activity. Compared with the CONFIS projection for the first six months of 2002, tax revenues declined by more than Col\$700 b, particularly revenue from income tax, external VAT and customs duties.

Highlights in terms of fiscal performance in the decentralized sector include an increase in the Ecopetrol surplus, from 0.5% to 0.7% of GDP during the period in question, and utilization of Col\$424 b in resources from the Oil Savings and Stabilization Fund (FAEP), which were employed by Ecopetrol and the regions. In addition, the fiscal balance of regional and local entities as a whole showed a surplus equivalent to 0.5% of GDP.

2. Government Cash Transactions

Cash transactions registered by the central

government at the end of September showed a deficit of Col\$7,097 b, which is 3.5% of GDP. This includes Col\$23,679 b in income as opposed to Col\$30,776 b in cash payments (Table 8).

Income and expenditure rose by 2.2% and 9.0%, respectively, compared with the period between January and September 2001. In spite of less revenue from certain taxes, total tax revenue increased by 1.5%, thanks to a nominal rise of 8.1% in internal VAT. Customs duties and the taxes on gasoline and financial transactions were the items showing the worst performance during the period, with reductions of 4.5%, 16.8% and 0.6%, in that order. The trend in tax revenue was associated with the drop in imports and elimination of the «special tax on customs services». Less revenue from the gasoline tax is primarily the result of a reduction in the rate, which went from Col\$564.95 per gallon in January-September 2001 to Col\$527.12 per gallon during the same period in 2002.

With respect to payments, those on investments declined by 5.3% as opposed to an increase of 11.3% in operating expenses and 10.7% in interest payments on the debt. As to operating expenses, personal services rose by 6.9%, general expenses by 5.4% and transfers by 13.3%.

The cash deficit was financed with internal credit and use of the General Treasury portfolio. As to sources of funding, net external credit was negative by Col\$474 b, with Col\$2,468 b in disbursements and Col\$2,942 b in debt retirement. Net internal credit increased to Col\$4,605 b, thanks to Col\$11,483 b in disbursements and Col\$6,878 b to retire the debt. TES B placements increased to Col\$10,799 b, with Col\$5,158 b of this amount pertaining to auctions and Col\$5,641 b to mandatory or agreed investments.

II

THE INTERNATIONAL CONTEXT

The world economy has suffered a crisis of confidence in recent months. By September, it had occasioned a drop in stock indexes worldwide and less debt demand on the part of non-investment grade issuers, as is the case of corporations and governments in emerging countries. For many Latin American countries, particularly those with governments in transition, nervous markets spelled a temporary shutdown in sources of external financing.

More aversion and less willingness in the market to finance spending have added to doubts about the soundness of world economic recovery. Uncertainty mounts as new figures on economic performance in the United States are released. They suggest far

less vigorous growth than was anticipated a few months ago and reveal growing external and internal imbalances. It is not clear how these imbalances will be adjusted. Less possibility of economic growth in the United States has reduced prospects for growth in the other industrialized countries and in the world economy as well, given the carry over effect of the North American economy (Table 9).

Although the United States economy continued to expand in the second and third quarters of the year, it did so at a rate well below initial expectations. Forecasts for growth in the fourth quarter are equally modest, as private spending on consumption and investment is expected to decline.

TABLE 9
ANNUAL RATE OF ECONOMIC GROWTH AND FORECASTS FOR COLOMBIA'S MAJOR TRADING PARTNERS

	2001	2002		2003	
		Current	Previous	Current	Previous
World					
United States	0,3	2,4	2,7	3,1	3,6
Euro area	1,5	1,3	1,4	2,9	2,3
Japan	(0,3)	(0,8)	(0,5)	1,0	1,1
Latin America					
Argentina	(4,4)	(14,7)	(13,4)	1,1	0,5
Brazil	1,5	1,2	2,1	2,6	3,6
Chile	2,8	2,0	2,9	3,6	4,7
Ecuador	5,6	2,4	3,8	3,3	4,0
Mexico	(0,3)	1,6	1,6	4,0	4,4
Perú	0,2	3,4	3,3	3,2	3,7
Venezuela	2,8	(5,7)	(3,8)	0,3	0,7

Observation: The headings «current» and «previous» refer to September 2002 compared with April 2002.
Source: Datastream based on the forecasts in *Consensus Economics* (September 2002).

There are a variety of reasons why the world's largest economy is likely to grow less. To begin with, the recent trend in the stock market and the impact of accounting irregularities have produced a negative wealth effect, undermining consumer confidence and halting the upswing in private investment. Secondly, the force of consumer spending is being jeopardized by a high rate of household borrowing. This could cause problems with economic stability in the future, if a weakened economy prevents households from receiving an adequate and growing flow of income. Finally, instability in the Middle East and the possibility of a war with Iraq could also have a negative impact on consumer confidence and spending.

The economies in the euro area and the Japanese economy continue to recover. However, prospects for growth in these countries are limited by the standstill in their internal demand and the anticipation of fewer exports, given weak prospects for growth in the United States and recent revaluation of the euro and the yen.

Latin America has also suffered a drastic reduction in its economic prospects. Capital markets in the region faced serious agitation in the third quarter. This was due mainly to the contagious effect of the political situation in Brazil, uncertainty about economic recovery in the United States, and added risk aversion on the part of local and international investors in response to the high government debt in various countries. Considerable exchange volatility and an increase in risk premiums further complicated the situation.

A. GENERAL OUTLOOK

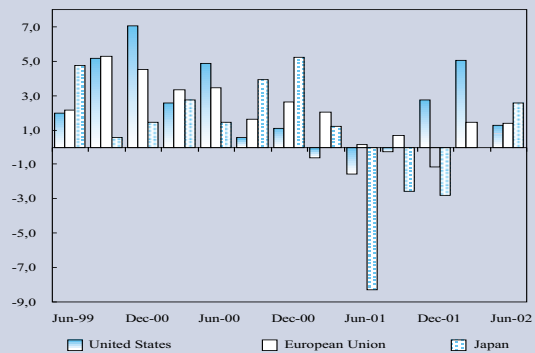
Weak growth in the United States is the primary obstacle to global economic recovery. This is evident with low growth in the second quarter and with downward revisions of growth figures in the past. In effect, the United States Department of Commerce has revised growth figures downward

since 1999, demonstrating beyond a doubt that the boom in the late nineties was less spectacular than announced initially and that the economic recession in 2001 was more profound and prolonged than first reported. The downward revision in figures translated into low estimates of growth in productivity, questioning the real counterweight of stock market indexes and the sustainability of the extent of private borrowing.

The annual increase in real GDP in the United States during the second quarter of the year was 1.3%, as opposed to 5.0% in the first quarter¹³ (Figure 44). While all the components of aggregate demand registered positive growth in general terms, the sharp slowdown was due to less private investment in housing, the drop in private and public consumption, and more imports.

The third quarter continued to see signs of weakness. In its report on September 11, the Federal Reserve Board¹⁴ announced that eight of the 12 economic districts into which it divides the United States saw a decline in manufacturing activity and a weak increase in orders during July and August. As an example, industrial production declined in

FIGURE 44
ANNUALIZED QUARTERLY GROWTH IN GDP
UNITED STATES, EURO AREA AND JAPAN
(PERCENTAGE)



Source: Datastream.

¹³ The revised figure for growth in the first quarter of the year is 1.1 percentage points less than the one announced initially.

¹⁴ Information from the *Beige Book*, Federal Reserve Board.

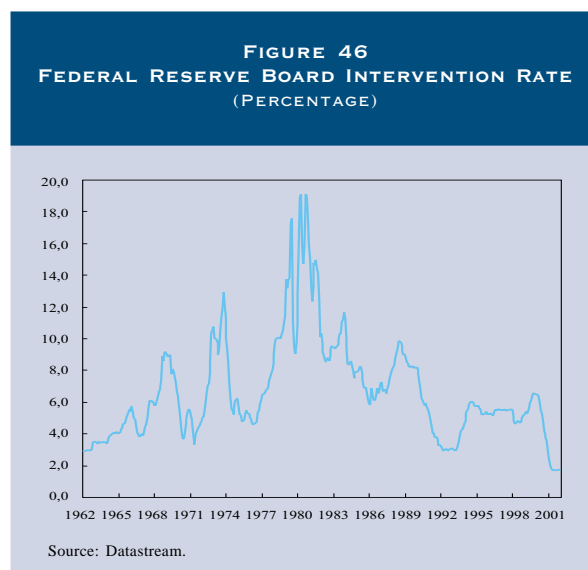
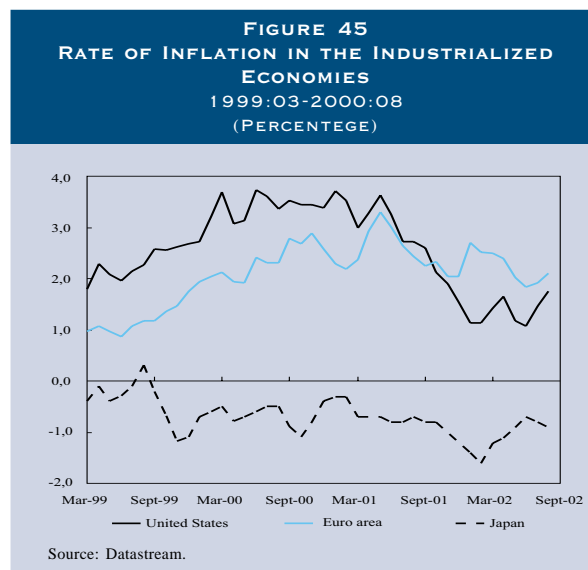
September for the first time in eight months, while the NAPM index¹⁵ fell to 49.5, denoting a slowdown in production. Moreover, consumer confidence was at its lowest point since November 2001. The unemployment rate at the end of August was 5.7%, 0.8 percentage points higher than during the same period in 2001, while jobless claims continued to rise. This is evidence of a weak labor market.

As to prices, annual inflation was 1.5% in July and 1.8% in August (Figure 45). Core inflation in the same two months stabilized at around 2.5%. In an environment of stable prices, with less prospect of economic growth and limited use of installed capacity, which was lower in August than anytime since 1983, no significant outbreaks of inflation are anticipated with respect to costs or demand during the course 2002.

In view of weak economic recovery and good results for inflation, the Federal Reserve Board kept its intervention rate at 1.75% (Figure 46). This nominal level is equivalent to a negative real interest rate, something not seen at any time during the nineties. As to the short term, a number of international analysts anticipate no change in the intervention rate and foresee increases only during 2003. This is despite the increase in inflationary pressure expected from fuel prices.

There are important threats to prospects for future growth in the United States, due to the rising external deficit, the projected increase in the fiscal deficit, and growth in the extent of private borrowing (Figure 47). Since May, partially in response to these imbalances, the dollar has devaluated sharply against the euro and the yen. Devaluation slowed to a more moderate pace towards the end of the third quarter, indicating the dollar may have reached a new floor in the short term (Figure 48). In principle, a weaker dollar should help to correct the external imbalance. However, as it also reflects

¹⁵ The NAPM index measures the level of manufacturing activity. A reading below 50 points is interpreted as a contraction in the economy as a whole.



less inclination on the part of the markets to finance US consumption and investment, it could suggest the need for an adjustment in private demand. If this happen, it would have a negative impact on midterm growth.

In the last two decades, the private-sector debt, household borrowing in particular, has accelerated to historically high levels (Figure 49). Behind this trend one sees relatively low nominal interest rates throughout most of the nineties, an increase in household wealth, partially because of real estate prices, and strong growth in real income. Nevertheless, none of these factors would appear

to be enough to sustain additional borrowing in the short term. International analysts believe this will translate into less household consumption which has been the driving force of growth in the United States economy during the past year.

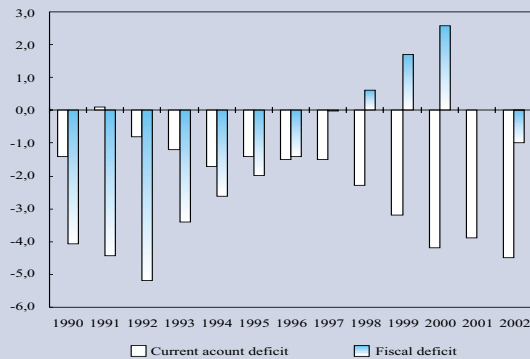
The capacity of economic authorities to apply a counter-cyclical policy is now limited by the current administration's commitment to tax reductions and by the fact that the fiscal surplus has vanished. For the first time since 1996, the projection for the fiscal deficit this year is -1.0% of GDP. Likewise, monetary policy has little room to boost growth through additional cuts in interest rates, which are already the lowest of the last 50 years (Figure 46). This leeway is even less when considering the possibility of inflationary pressure from higher oil prices. Also, the growing fiscal and current account deficits could necessitate higher interest rates for the future in order to make them financiaible.

These factors combined make it difficult to anticipate the possibility of growth rates in the near future similar to those in the nineties. This hampers the capacity of the United States to pull other economies towards recovery. International analysts agree the US economy will end the year with approximately 2.4% growth and will grow by 3.1% in 2003. These forecasts are 0.3 and 0.5 percentage points less than those already presented in this report (Table 9).

Second-quarter growth in the euro area countries was also slow. Annualized growth in this quarter was 1.4% , a figure similar to that of the first quarter. A rise in exports, a sharp decline in imports and a slight recovery in private consumption (Figure 44) aided economic growth.

The end of the third quarter saw no major changes in this trend. Available surveys showed no significant increase in production, while retail sales declined, growth in employment remained slow and consumer confidence dropped in September. Indicators to date, coupled with recent negative developments on the financial markets, higher oil

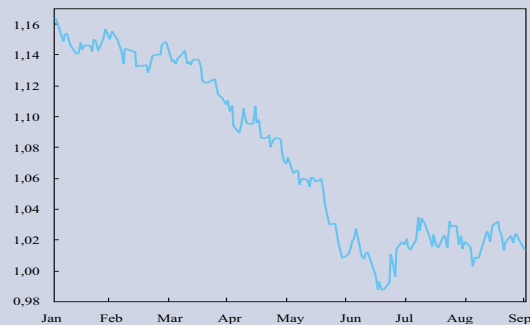
FIGURE 47
UNITED STATES CURRENT ACCOUNT AND FISCAL DEFICITS
(US\$ BILLIONS)



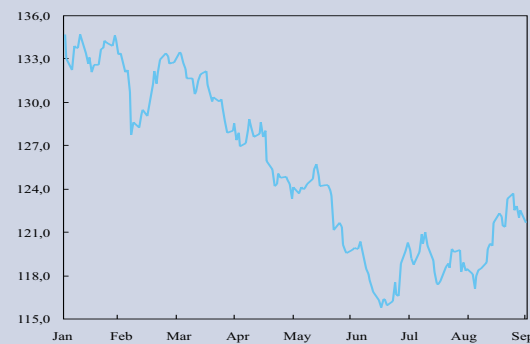
Source: Datastream.

FIGURE 48
EXCHANGE RATE
EURO AREA AND JAPAN: 2002

EUROS PER DOLLAR



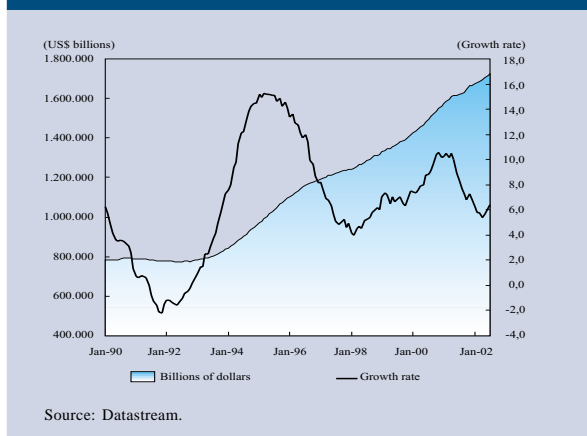
YENS PER DOLLAR



Source: Datastream.

prices and revaluation of the euro, which could reduce the region's export potential, suggest that economic growth will not recover during the remainder of the year. International analysts

FIGURE 49
CONSUMER CREDIT IN THE UNITED STATES



reduced their growth projection for 2002 by 0.1 percentage point with respect to the forecast three months ago, placing it at 1.3%. A slight acceleration is expected in 2003, which would put growth at around 2.9% (Table 9).

Recent figures on inflation in the euro area indicate that currency has stabilized at about 2.0%. Euro inflation was 2.1% by August, while core inflation has remained at 2.4% since last June (Figure 45). In addition, wage-increase agreements were around 2.5% during the second quarter, confirming fewer expectations of inflation and business confidence that the inflation target set by the European Central Bank (ECB) will be met. On the other hand, weak economic growth, coupled with revaluation of the euro, is expected to further stabilize inflation (Figure 48). Were these predictions to materialize, they would clear the way for a less restrictive monetary policy on the part of the ECB. However, this would not rule out the possibility of a cut in intervention rates before the end of the year.

Annualized growth of the Japanese economy in the second quarter of the year was 2.6%, as opposed to practically no growth in the first quarter (Figure 44). Once again, growth responded primarily to increased exports, although private and public consumption also exhibited positive growth rates. Private investment, however, continued to decline, although at a slower pace than in the last six quarters.

The Japanese economy appears to have begun a process of gradual recovery, even if it is relatively fragile. Leading indicators such as investor confidence and machinery orders have increased. Use of installed capacity continued to rebound, while industrial production registered 6.5% growth in July. This is the highest rate since last November.

However, prospects for short-term growth are highly dependent on development of the export sector. Given this scenario, external demand that is possibly weaker than originally anticipated, coupled with higher oil prices and revaluation of the yen, may have reduced possibilities for a rapid and profound recovery. Therefore, prospects for economic growth in 2002 and 2003 are less than what was indicated in the last *Inflation Report* (Graph 48 and Table 9).

The slight improvement in Japan's economic growth in recent quarters made it possible to correct some of the deflationary trends observed since late 1998. As a result, the Central Bank of Japan was able to maintain its monetary target in the 10-to-15-billion yen range, along with its willingness to provide ample liquidity to help financial markets recover their stability. Given the prospect of less external demand, especially from the United States, international analysts marginally reduced their growth projections for this economy in the short term. Japan is, therefore, expected to see -0.8% growth in 2002 and 1.0% in 2003 (Table 9).

B. LATIN AMERICA

The third quarter witnessed a sharp drop in prospects for economic growth in most Latin American countries. On the external front, reports of weak growth in the United States and the other industrialized economies, coupled with more limited prospects for the coming year, cloud the region's economic outlook. This spells fewer exports and lower prices for export commodities. Investor risk perception was also strongly affected by political

events, particularly the uncertainty over Brazil's elections, and by signs that several countries, Uruguay in particular, might have trouble meeting their external obligations in the months ahead. The combination of these factors made for turbulent financial markets and virtually closed sources of external funding for the region. It also revealed structural weaknesses, particularly with respect to the size and sustainability of the national debts in Latin America. This, in turn, has heightened the risk perception of the region, provoking a major increase in the spread on the national debt in most countries and accelerating devaluation of the different currencies (Figure 50 and Table 10).

The sentiment of the markets during the remainder the year will depend largely on the outcome of political events in Brazil. The first round of presidential elections gave the victory to the Worker's Party candidate, Luiz Inacio Lula da Silva, and there is every indication he will win the second round by a wide margin. Lula's election does not necessarily imply additional problems, provided his administration remains committed to healthy macroeconomic policies. However, international analysts believe the markets will remain nervous for some time and, if Lula is victorious, they will probably continue to chastise Brazil in terms of external financing.

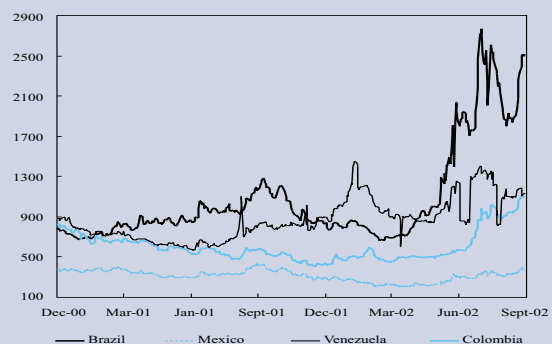
Even if events in Brazil are resolved in a positive way, the possibility of serious problems in other countries cannot be ruled out. The most critical situations would occur in Venezuela and Ecuador, overshadowing the favorable tendencies these economies could derive from higher oil prices.

The political situation in Venezuela continued to be the most sensitive obstacle to the country's macroeconomic performance. Political instability increased with the incidents in April and with the passage of rather unorthodox legislation against private property. Scandals over misappropriation of resources from the Macroeconomic Stability Investment Fund, the deterioration in public

finances, and rumors of a new coup d'état did not help either. In this scenario, the government's ability to secure internal financing has been drastically reduced, while the flow of foreign capital into the country has declined. This caused the bolivar to devalue sharply. Inflation has risen and the spread on the national debt has worsened. There is also a serious paralysis in investment and consumption. Accordingly, the markets expect the government will face liquidity problems in the months ahead. This would complicate efforts to meet its external liabilities, even though oil prices are up and the country's debt is not high.

Venezuela is in the midst of its second recession in the last three years, with no quick recovery in sight. The annual reduction in real GDP was -9.9% in the second quarter and a number of economic indicators show the economy continued to decline up to September. There is nothing to indicate the political situation will improve in the near future. This is a principal source of economic instability. Consequently, and in view of the negative perception of the country on international financial markets, international analysts have drastically reduced the forecast for Venezuela's economic growth during the next two years. The economy is now expected to contract at a rate of nearly 5.7% in

FIGURE 50
SPREADS ON 10-YEAR NATIONAL DEBT
LATIN AMERICAN COUNTRIES (*)
 (BASIS POINTS)



(*) Figures to September 29, 2002.
 Fuente: Datastream.

TABLE 10
DEVALUATION OF LATIN AMERICAN CURRENCIES
AGAINST THE US DOLLAR

	Quarterly (*)	Annual	Year to date
Argentina	(2,0)	274,4	274,8
Brazil	33,5	41,6	62,7
Chile	9,2	8,1	13,3
Mexico	2,5	7,3	11,5
Perú	3,5	4,4	5,7
Venezuela	9,0	98,4	92,2
Uruguay	46,8	100,9	86,3

(*) Devaluation in September versus June (end of period).
 Source: Datastream.

2002, which is 1.9 percentage points less than the rate forecast three months ago. And, in 2003, it might grow by only 0.3% (Table 9).

With respect to Ecuador, although its economy continued to improve during the second quarter of the year (at a rate of 3.2%), the country seems to have entered a stage of slower growth in recent months. The Ecuadorian economy faces three hurdles. To begin with, more of a risk perception on international financial markets has sharply reduced the flow of capital into the country. This has been complicated by less likelihood of a new agreement with the International Monetary Fund. The inability of the outgoing administration to institute most of the institutional reforms needed to support economic growth is also a problem, as is the frailty of relations with the United States. Secondly, a high and persistent rate of inflation - the highest in the world measured in dollars - has generated a loss of exchange competitiveness, undermining the country's trade balance in spite of good oil prices. Lastly, there is the question of

¹⁶ The total external debt is now estimated at close to 76% of GDP, while the internal debt is around 14% of GDP.

the large debt in the public sector¹⁶, which costs the country more than 8.0% of GDP in annual service, coupled with the lack of measures to close the fiscal gap, even despite more oil income. These three factors, as a whole, overshadow prospects for Ecuador's economic growth to the point where international analysts have lowered growth forecasts for 2002 and 2003 by 1.4 and 0.7 percentage points respectively (Table 9)

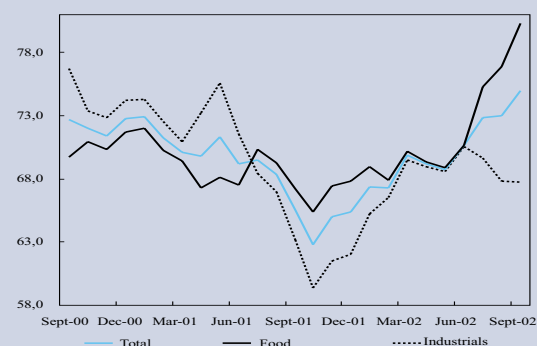
Considering the forecasts for Colombia's major trading partners, overall economic growth weighted by the volume of Colombian foreign trade in 2002 is 1.0%. This is below the rate forecast last quarter (1.4%).

C. COMMODITY PRICES

The upward trend in *The Economist* price index for major commodities observed since October 2001 continued during the third quarter, following a brief interruption in April and May of this year. The index rose by 6.2% between June and September 2002. This is 14.4% above the level registered during the same period the year before (Figure 51).

Third-quarter growth in the commodity price index

FIGURE 51
MONTHLY INDEX OF MAJOR COMMODITY PRICES
 (1995 = 100)



Source: *The Economist*.

was primarily due to food. The average food price subindex rose 13.7% in the quarter and 19.4% in September. The annual variation in the price subindex for industrial goods was 7.3% in September, even though this index declined during the quarter (-4.0%).

The rise in the food price subindex during recent months is largely a reflection of inventory reductions motivated by weather¹⁷. However, as inventories remain high, even with the reductions, and these factors are temporary in nature, some analysts expect this tendency to wind down in the coming months. On the other hand, a continued decline in the industrial price subindex is expected, due to moderate projections for overall growth. Therefore, no commodity price increases are anticipated for the coming months, with the exception of oil, which will be discussed later.

The recent food-price increases have not been transferred to inflation in countries such as the United States and those who are members of the euro area. Their inflation rates have declined in the last few months, and no increase is expected in the short term. The goods imported into Colombia do not reflect the rise in food prices either, as suggested by stability of the implicit price index at low levels. This index is calculated Banco de la República (Figure 52)¹⁸.

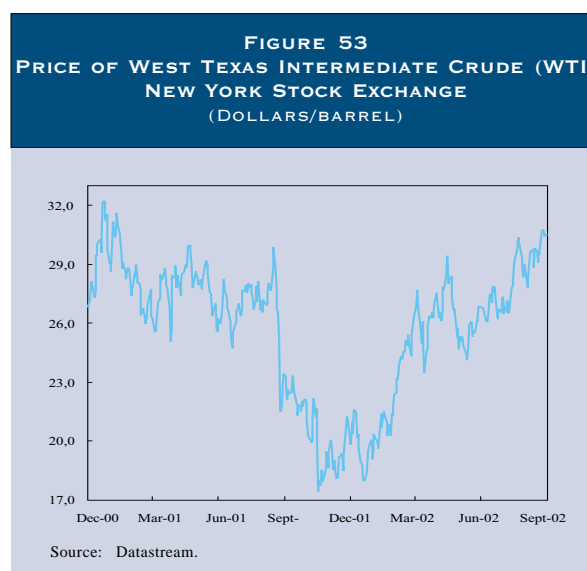
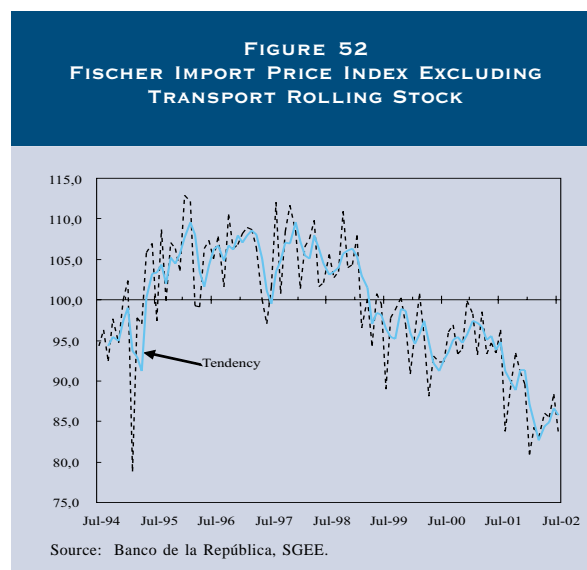
1. Oil

International oil prices rose during the third quarter. In the last week of September, they were above the price band set by the Organization of Oil Exporting

¹⁷ Adverse weather conditions in the United States, Canada and Australia have reduced the supply of grain, depleting inventories and pushing prices up.

¹⁸ The implicit price index is the Fischer variety and is estimated according to the two-digit Cuode classification. Implicit prices are calculated by dividing the value of imports by their volume. Performance of the index depends on the relative weight of each group as a share of total imports.

¹⁹ The limits of the price band for the OPEC crude basket are US\$22 and US\$28 per barrel. In terms of the WTI indicator in the United States, these prices are equivalent to approximately US\$25 and US\$30 per barrel.



Countries (OPEC)¹⁹. The average price of West Texas Intermediate (WTI) was US\$29.00 per barrel during the quarter, which is 7.8% more than in the second quarter of the year and 5.9% higher than the price registered in the third quarter of 2001 (Figure 53).

As mentioned in previous reports, oil prices this year, especially in the third quarter, have been influenced by two factors. The first is the effect of cutbacks in production quotas ordered as of January 2001 by OPEC and several non-OPEC countries²⁰. These reductions

²⁰ The OPEC reductions are equivalent to approximately five million barrels per day. Reductions by the non-OPEC countries amount to nearly 462,000 barrels per day.

have begun to be reflected in crude inventories, which have declined significantly during the course of the year, especially in the United States²¹. The second factor is the uncertainty generated by the conflict in the Middle East. Unease in this respect has increased in recent months due to the possibility of United States military action against Iraq.

However, in spite of the foregoing factors, OPEC did not alter its production quotas during the third quarter, basing its decision on moderate overall growth projections for the end of the year. OPEC says the price increase originates largely with a «war premium» and that prices to date have not always exceeded the price band. Accordingly, the cost of oil during the remainder of the year will depend on crude inventories and on the fate of the conflict between the United States and Iraq. Crude inventories could continue to decline during the last three months of the year. Coupled with uncertainty over a possible United States attack on Iraq, this could keep international prices high. Oil prices in the coming months are, therefore, expected to be around US\$29 per barrel, which would imply an average price of US\$26 per barrel for the year.

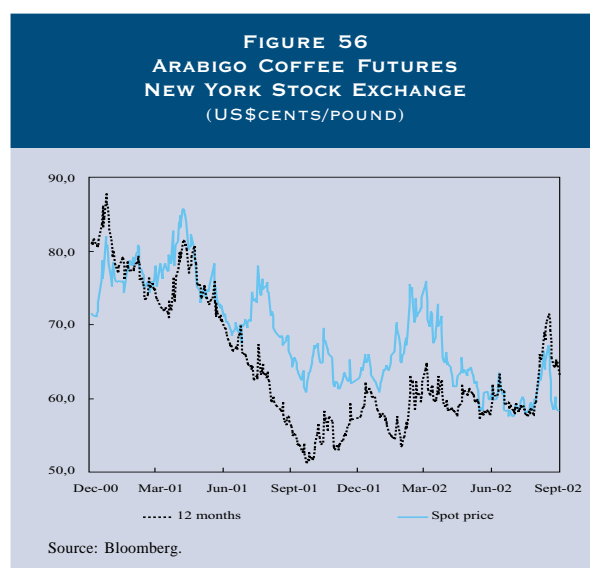
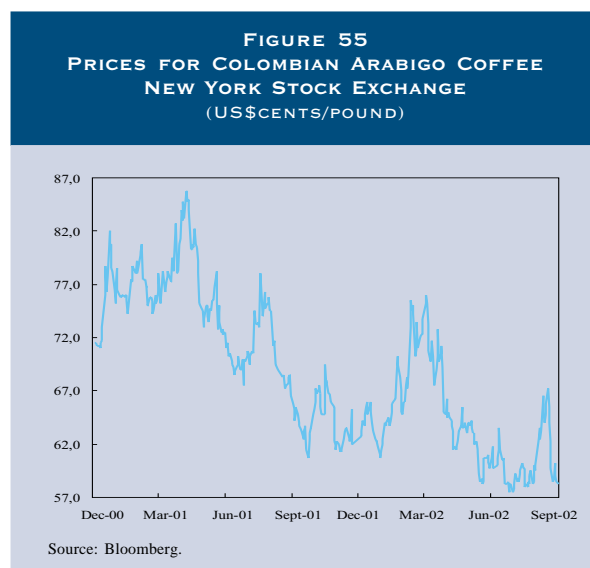
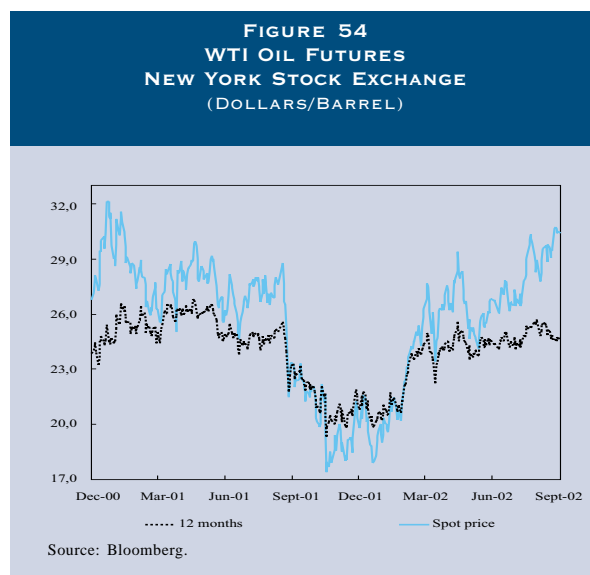
Despite higher oil prices during the quarter, prices for one-year futures on the New York stock Exchange remained relative stable during this period. In fact, one-year futures were quoted at US\$24.8 per barrel at the end of September, which is very similar to the price at the end of June (US\$24.7 per barrel) (Figure 54).

2. Coffee

The coffee market continued to register an excess supply during the third quarter of the year. This

²¹ According to the October report of the International Energy Agency, crude supplies in the United States declined by 52 million barrels in even months. This figure is exceeded only by the drop in supplies during December 1990 and January 1991 after the Iraqi invasion of Kuwait, and in December 1999.

²² The price referred to in this section is for Colombian arabigo coffee quoted on the New York Stock Exchange.



maintained the downward trend in prices observed since 1999, in spite of a slight rise in the first half of September. Accordingly, the price of coffee²² averaged US\$60.3 cents/pound between June and September. This is 15.0% less than the average price in the third quarter of 2001 and 7.2% less than the average price in the second quarter of this year (Figure 55).

Following the trend in coffee prices, futures on the New York Stock Exchange rose temporarily at the start of September. This increase later reversed itself, although not entirely, and one-year futures quoted at the end of the month (US\$63.3

cents/pound) were 5.6 cents above what they had been three months earlier (Figure 56).

At present, there is nothing to indicate coffee prices will recover, except for drastic weather changes in some of the major coffee-producing countries (primarily Brazil). On the other hand, Brazil's increased competitiveness, due to recent devaluation of the *real* and low production costs, is one element in recent months that has reduced the possibility of a short-term drop in coffee supplies. For the year as a whole, barring any abrupt weather changes in the near future, the average price of coffee is expected to be US\$65 cents/pound.

III

EVOLUTION OF INFLATION

A. GENERAL ASPECTS

Annual consumer inflation was 6.0% at the end of the third quarter of 2002, the same as the inflation target for this year. After a second-quarter increase, annual inflation declined in July and August, stabilizing in September at a level that proved to be lower than annual inflation last June (6.2%) and in September 2001 (8.0%) (Figure 57 and Table 11).

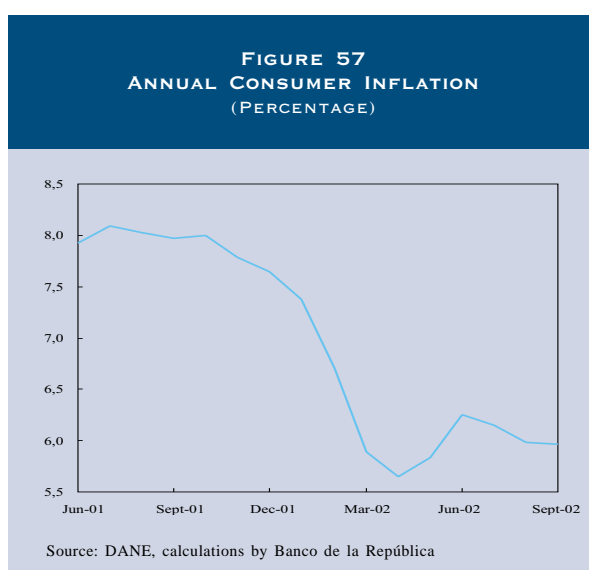
The third quarter of 2002 saw 6.0% average annual inflation. This rate is 0.2 percentage points below the estimates published by Banco de la República in its June report²³. Average inflation excluding food was 5.0% in the third quarter, coinciding with the projection in the last report. In the case of food inflation, the estimate three months ago (9.1%) was 0.5 points above the average for the third quarter (8.6%). The overestimate on food inflation is due

mainly to less pressure from meat prices compared with the estimates in the June report.

According to the expectation survey conducted by Banco de República in July, private agents were pessimistic about the level of annual inflation at September. While the consumer price index (CPI) closed out the third quarter with an annual increase of 6.0%, agents expected annual inflation at September to be close to 6.4%. They also maintained their inflation outlook for three, six, nine and 12 months with respect to the previous expectation survey. However, the same survey showed less confidence in the credibility of the inflation target. Compared with the survey in April (69.2%), a lesser percentage of those interviewed in July (53.8%) believed the target would be met.

Inflationary pressures registered in the third quarter came primarily from certain foods (potatoes in particular), from adjustments in gasoline prices during the quarter, from the sharp devaluation in the exchange rate, and from recovery in the mark-up on medicines and banking services. In contrast, demand-related factors continued to lower inflation, as evidenced by favorable CPI performance, particularly for rentals, clothing, entertainment, culture and recreation, education and health care. At September, these groups showed annual price increases near or below the inflation target of 6%.

The next two months could see a temporary rise in inflation above the target, due to possible pressure from food prices, especially potatoes, and from



²³ The quarterly inflation forecasts in this report are geometric averages. Therefore, the quarterly average is the geometric average of the monthly values.

TABLE 11
INFLATION INDICATORS
(ANNUAL PERCENTAGE CHANGE)

	Dec-01	Mar-02	Jun-02	Sept-02
I. CPI	7,6	5,9	6,2	6,0
Food	10,5	7,2	9,2	8,6
Housing	4,3	3,8	4,2	3,8
Clothing	2,6	2,2	1,1	0,9
Health care	10,9	9,3	9,7	8,9
Education	10,2	9,3	6,7	6,4
Culture and recreation	7,1	7,0	5,9	4,7
Transportation	8,9	5,8	5,0	5,1
Sundry expenses	7,6	6,7	6,8	7,7
II. Core inflation 1/	6,7	5,6	5,3	5,1
CPI excluding food	6,5	5,3	5,0	4,9
Nucleus 2/	7,4	6,0	5,8	5,6
CPI excluding staple foods, fuel and public utilities	6,1	5,4	5,1	5,0
III. PPI	6,9	3,6	2,9	6,8
By economic use or destination				
Intermediate consumption	5,8	2,9	1,2	6,2
Final consumption	8,5	4,3	4,6	6,3
Capital goods	5,7	2,4	2,8	10,8
Construction materials	7,4	5,0	5,0	6,4
By origin				
Domestically produced and consumed	7,7	4,4	3,4	5,5
Imported	4,6	0,8	1,6	10,7
Exported 3/	(7,9)	(7,1)	(2,4)	15,5
SBy Industrial origin (ISIC)				
Agriculture, forestry and fishing	7,6	2,4	2,1	6,8
Mining	(1,3)	1,7	2,1	22,4
Manufacturing	7,0	3,9	3,2	6,3

1/ Average of the three core inflation indicators calculated by Banco de la República.

2/ CPI excluding 20% of the weight of the items exhibiting the most price volatility between January 1990 and April 1999.

3/ Total PPI does not include exported goods. It is calculated with the weighted sum of goods produced and consumed domestically and imported goods.

Source: Banco de la República, SGEE. DANE, PPI and CPI calculations

scheduled increases in fuel and energy prices. However, the expectation is that annual inflation will begin to slow by the end of the year, thanks to less of an increase in potato prices and the continuation of slight adjustments in demand-pull inflation. At any rate, a certain amount of pressure from the sharp devaluation observed as of mid-2002 is not ruled out.

B. CORE INFLATION

Core inflation, measured as the average of CPI

excluding food, the inflation nucleus and CPI excluding staple foods, fuel and public utilities, was 5.1% in September. This is 0.2 percentage points below the rate in June 2002 and 1.9 percentage points below core inflation in September 2001. Compared with June, there was a slowdown in the growth of all core inflation indicators. The inflation nucleus was the indicator that declined the most, having gone from 5.8% in June to 5.6% in September, while the increase in CPI excluding food and CPI without staple foods, fuel and public utilities declined by 0.1 percentage point (Table 11 and Figure 58). Accordingly, the year to date has seen no major demand-pull pressure and this trend will

likely continue in the fourth quarter. By the end of 2002, core inflation is expected to be almost one percentage point below the inflation target.

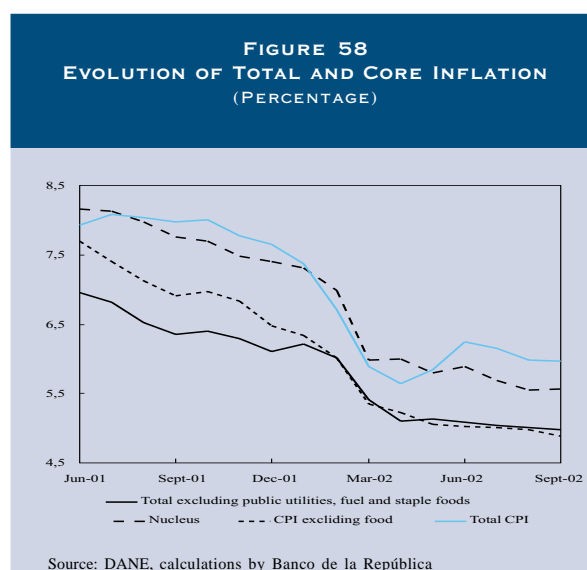
1. On the positive side

The positive trend in core inflation (inflation excluding food) in the third quarter reflects a slowdown in the annual variation in prices for housing, clothing, health care, education and recreation (Table 11 and Figure 59). In turn, less of an increase in the components of core inflation is associated with weak demand. The limited amount of installed capacity being used by Colombian industry and the negative gap in GDP with respect to potential product continued as the primary manifestations of this situation in the third quarter (Chapter I).

Another factor contributing to the slowdown in core inflation was the continued decline in mark-up. Figure 60 shows an approximation to these margins, measured as the ratio between CPI excluding public utilities and PPI final consumption. The reduction observed as of the second quarter of 2002 is partially why the acceleration in producer inflation in the last three months has yet to translate into consumer inflation.

The third favorable factor is low external inflation. In the short term, it is feasible this situation could be maintained due to low growth forecast for the United States, Europe and Asia. As a result, there is expected to be less pressure on the prices of major commodities. This would offset, in part, the impact of exchange devaluation on producer and consumer prices.

No significant increase in the cost of manpower is anticipated for the rest of this year and the next. According to information on wage agreements from the Ministry of Labor, and as indicated in the latest expectation survey conducted by Banco de la República, inflationary pressure from wages either declined or will remain stable this year and in 2003



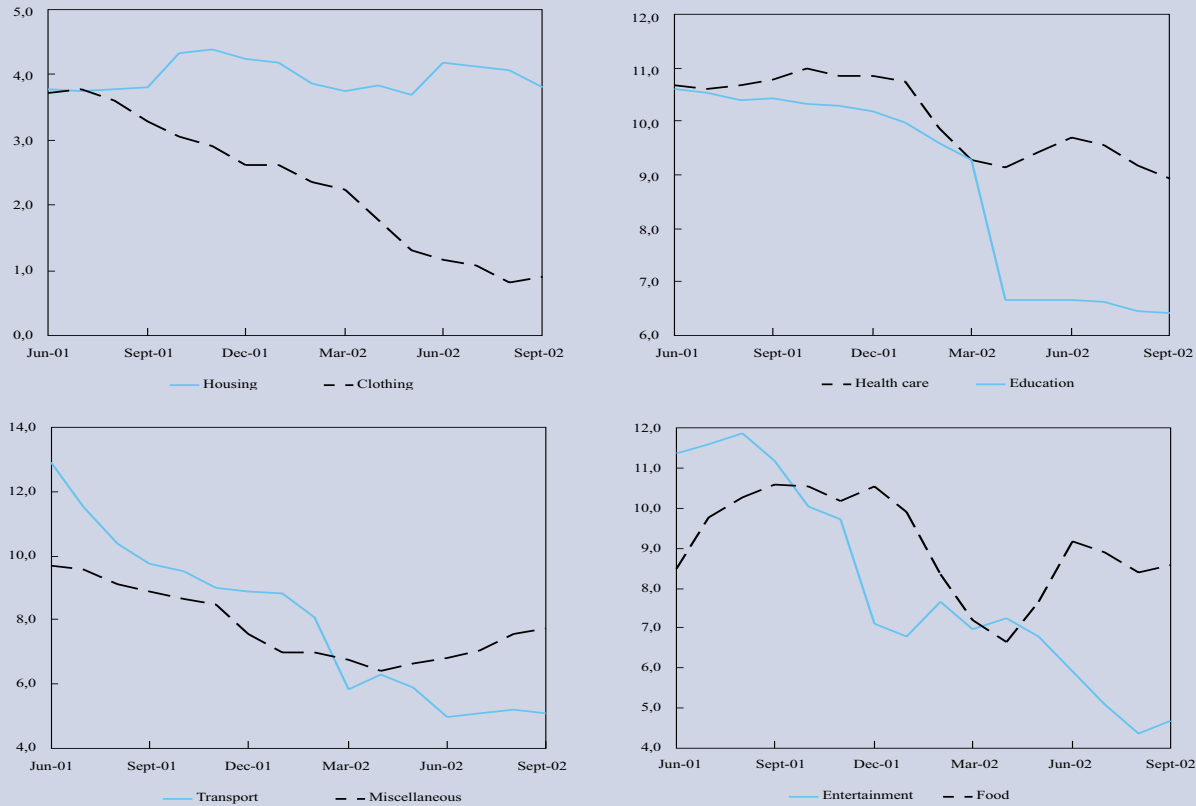
(Chapter I). Expectations of lower labor costs are even more encouraging for next year, considering that wages in the public sector would be frozen for two consecutive years as a result of the tax adjustment program (Chapter I). To the extent that wages in the public sector are a reference price in the labor market, a freeze on them could result in lower wage increases in the private sector.

Finally, as noted in the June report, the positive trend in core inflation is also a reflection of the monetary policy adopted by the Board of Directors of Banco de la República. Its approach is in keeping with inflation targets and with the goal of long-term price stabilization. As a result, the policy has acquired credibility and has helped to temper expectations of inflation among economic agents.

2. On the negative side

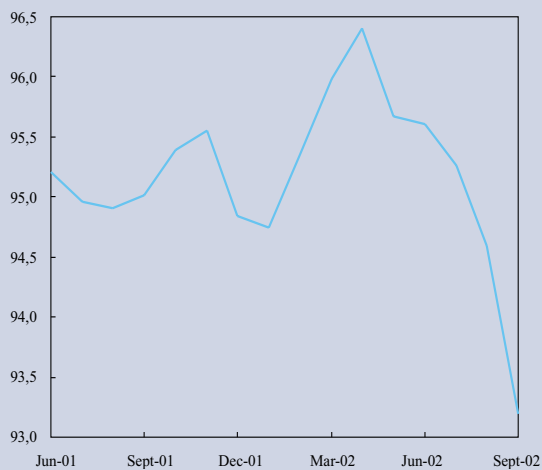
In contrast, transport and sundry expenses pulled inflation up in the third quarter. As to transport, the marginal upswing in annual inflation from 5.0% to 5.1% is explained largely by scheduled gasoline-price increases in the past. The Ministry of Mines and Energy froze gasoline prices for certain months. However, the new administration is considering a return to the scheme whereby internal prices are set according to the international price of crude oil measured in pesos. Inasmuch as the price of crude

FIGURE 59
ANNUAL CPI INFLATION BY GROUPS
(PERCENTAGE)



Source: DANE, calculations by Banco de la República

FIGURE 60
RELATIVE PRICES
CPI EXCLUDING PUBLIC UTILITIES/PPI FINAL
CONSUMPTION
(DECEMBER 1998=100)



Source: Banco de la República, SGEE.

has remained high and the exchange rate has devaluated substantially, fuel is expected to continue to accelerate inflation during the rest of the year and in 2003. Adjustments in the internal price of gasoline equivalent to 10.0% are expected to translate into additional inflation increases of 1.0%.

With respect to other transport expenses (namely, transport input), the increase in prices declined from 5.3% in June to 5.1% in September. However, despite this slowdown, the rest of the year and 2003 are expected to see prices in this subgroup accelerate, although slightly behind the momentum in fuel prices. This is already evident in the basket of the producer price index (PPI).

Annual inflation in sundry expenses rose between

June (6.8%) and September (7.7%), when increased devaluation in the exchange rate began to be transferred to a variety of the products in this group (liquor, cleaning supplies and watches). This tendency is likely to continue up to the end of the year, as imported goods are a major component of sundry expenses. Banking services also contributed to more of an annual variation in CPI sundry expenses between June and September of this year.

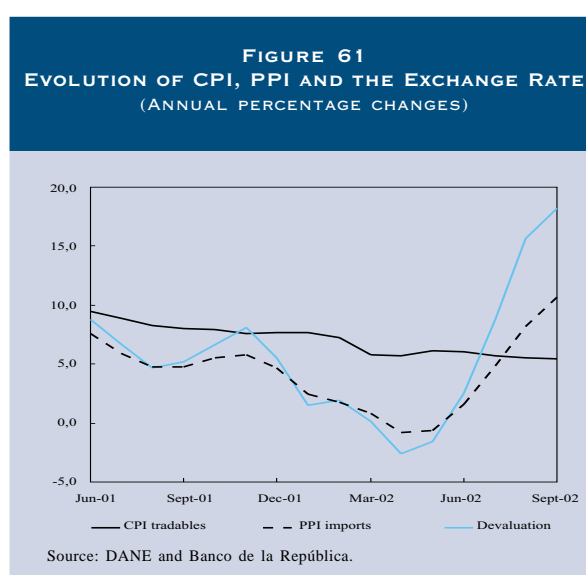
Among the most important factors pushing up core inflation in the third quarter were the non-labor costs captured by inflation in PPI imported goods. The increase in PPI imported goods soared when the price of the dollar took off last May but has yet to be transferred to consumer inflation (Figure 61).

A more detailed analysis of the PPI shows inflationary pressure from costs is probably backed up. In effect, the annual PPI variation between June (2.9%) and September (6.8%) was significant, especially for PPI imported goods, which went from 1.6% growth in June to 10.7% in September. Final consumption, which is the PPI component closest to the consumer market basket, did not accelerate as much (Table 11).

C. TRANSITORY INFLATION

The third quarter of the year saw a change in food inflation, following a conspicuous increase in the second quarter. Food inflation at September (8.6%) was 0.6 percentage points less than the rate in June 2002 (9.2%). In contrast to the second quarter, food prices, on average, helped to slow total annual inflation between June and September.

Less food inflation at the close of the quarter is the direct result of a slowdown in the growth in meat and vegetable prices, which helped to offset the sharp rise in potato prices (from 8.0% in June to 51.3% in September). The lesser increase in CPI meat products is associated with moderation in the cattle retention phase. According to FEDEGAN,



the Colombian cattle industry could feasibly enter a liquidation phase in the second half of 2003, characterized by a high slaughter rate and a downturn in real prices.

However, in spite of the foregoing, food inflation in the last quarter of the year is expected to increase again as a result of potato prices. In terms of the outlook for 2003, food inflation should be less than average inflation. This would depend on several factors: namely, less of an increase in meat prices, a decline in potato prices, the increased value of loans extended during the last eight months to boost production, at least in the first eight months of the year, and better expectations on the part of agricultural investors. These expectations are reflected in the latest agricultural business opinion poll conducted by the Center for Livestock and Agricultural Studies (CEGA).

When the June report was written, it was not known if El Niño would be a factor in the second half of this year. According to the United States National Oceanic and Atmospheric Administration (NOAA), this phenomenon began at the beginning of the third quarter. For now, the uncertainty focuses on its duration and intensity. NOAA forecasts suggest it will last until the start of 2003 and be moderate-to-low in intensity. As indicated in June, El Niño will have a negative impact on agricultural

production (estimated in a decline of 5%), with a slight effect on the rise in food prices.

As indicated herein, international oil prices remain a source of inflationary pressure. According to predictions by the International Energy Agency, this pressure should continue for the rest of the year, when the international price of crude oil is expected to increase from an average of US\$28.4 in the third quarter to an average of US\$30.4 in the fourth quarter. In light of estimates by that agency and OPEC, this scenario of high crude prices is likely

to persist in 2003 and could be aggravated by a war in the Middle East (Chapter II).

Another source of inflationary pressure is the tax reform bill introduced by the new administration. As mentioned in the June report, a change in VAT could constitute an upward shock on inflation. However, it would be transitory and, as such, would not provoke a change in the country's monetary policy.

IV

INFLATION FORECASTS

In the last three months, Colombia was exposed to a number of external and internal shocks that make it difficult to assess the midterm economic outlook or to forecast inflation and growth for the coming year. On the external front, there are obstacles associated with recovery of the United States economy and the virtual closure of capital markets for Latin America. At the internal level, and partially as a result of events outside the country, there are problems associated with long-term sustainability of the national debt and the difficulties the government could face when trying to finance the fiscal deficit in the years ahead.

However, at the time this report was written, progress in negotiations with the IMF and greater assurance of financing for 2003 had adjusted the spreads on the national debt and the exchange rate. This situation could continue in the coming months, depending on international developments and how the legislative agenda works out.

A. EXTERNAL SHOCKS

Some of the external shocks were already present at the end of the second quarter and were pointed out the June edition of *The Inflation Report*. Such is the case with the confidence problems that are affecting the United States economy as a result of corporate scandals at the beginning of the year. These problems led to a drop in stock indexes and have been aggravated by mediocre economic

performance since July. The most recent figures for the United States economy show a setback in investment and discouragement among consumers, who have been the principal source of growth in demand for the last year and a half. Added to this are concerns about the situation in Iraq and how it could upset oil prices.

Recent months have seen a major increase in aversion to risk on the part of United States investors, further aggravating the drop in stock indexes. Increased aversion to risk in the United States financial market made non-investment grade corporate bonds and government bonds issued by emerging countries, particularly the Latin American countries, less appealing to investors.

The run towards safer assets was also manifest in less demand for assets denominated in dollars to the benefit of those denominated in euros and yen. The result was devaluation of the dollar against these two currencies. Consequently, recent months have seen a change in the direction of capital flows. As of the mid-nineties, they were directed from Europe and Japan to the United States, making it possible to finance increased borrowing in the United States and a growing current account deficit. This is no longer the case.

Less availability of foreign capital in the United States has come at a time when the private sector debt is much larger than it was in the mid-nineties (Chapter II) and when the country's current account deficit is the highest since 1992 (4.6% projected for 2002).

In addition, the tax reduction policies of the Bush administration and the decline in government revenue resulting from last year's recession originated a fiscal deficit for the first time in six years. It is projected at 1% for 2002, and a number of analysts believe this gap will be difficult to close in the coming years.

Therefore, the new savings generated by the public sector in previous years, which facilitated private-sector borrowing without exerting pressure on interest rates, will likely decline this year and in the years ahead. This means the Fed's policy of lowering interest rates will face midterm difficulties.

If interest rates come under more pressure, companies and consumers will see an increase in the cost of financing. This would occur at a time of considerable uncertainty over future earnings and income, given the collapse in stock indexes and serious questions about profits from productivity during the last five years. Consumers will feel the effect through a decline in available income once financial costs are deducted, which could hurt their spending capacity.

Private consumption in the United States has remained relatively strong to date, thanks to interest-rate cuts and the fact that real estate prices have not fallen. Real estate constitutes a substantial portion of household wealth, and good real estate prices offset the drop in stock prices. As a result, the wealth of United States consumers has remained relatively stable.

In the case of Latin America, the growing preference for low-risk assets on financial markets signified an interruption in capital flows towards various countries. This situation has been aggravated by political instability and economic uncertainty in countries with considerable weight in the region, such as Brazil and Venezuela.

Furthermore, Latin America was closed out of the capital markets at a time of hefty national debt and a high fiscal deficit in countries such as Uruguay, Brazil, Ecuador and Colombia, among others. This nourished fears that some governments may be insolvent. Exchange speculation was generated as a result. The turbulence has spread throughout the region and is even infecting countries with more solid economies, such as Chile and, to a lesser degree, Mexico.

As detailed in this report, the complicated external situation can affect growth and inflation in Colombia through a variety of channels. These include real repercussions, via its effect on exports, and a financial repercussion, through the impact on capital flows, the exchange rate and the interest rate.

B. INTERNAL SHOCKS

Figures on the public sector for the second quarter of the year show a higher fiscal deficit than the one outlined in the financial program decided with the IMF. They clearly indicate the public sector deficit for the entire year will exceed the target agreed on with the IMF. The markets received this news with reservation, as it casts doubt on the public sector's ability to reduce its need for net financing at a time when the national debt has increased to a troubling level (49.6% of GDP)²⁴.

The fiscal deficit has grown worse because central-government tax revenue in 2002 has not lived up to expectations. Less economic growth since the end of last year is one reason why. However, the fiscal shortfall is also due to higher debt service in pesos attributed to the acceleration in devaluation that began midway through the second quarter of this year.

²⁴ This figure refers to the net external and internal debt in the non financial public sector forecast for the end of 2002.

Uncertainty over the fiscal situation, coupled with high aversion to risk on external markets, occasioned a major reduction in the demand for government debt securities as of August. This applied to TES and those sold on the external market, lowering the price of these instruments and raising interest rates. Between July and August, the interest rate for TES sold on the secondary market rose by almost 300 bp, on average, for one to ten-year maturities. The national risk premium on Colombian debt paper issued at 10 years increased by more than 400 bp to approximately 1,000 bp at the end of September.

The measures proposed by the new administration to halt fiscal deterioration and to meet the need for additional military spending include a temporary net worth tax of 1.2%. Collection of this levy began in September and will extend into the coming year. Among other measures, the government plans to expand the value-added tax (VAT), to increase the income tax rate temporarily, and to freeze central government spending. The spending reforms will be presented to the primary constituency for approval by means of a referendum. The measures also include an initiative to eliminate the subsidy on gasoline and to stabilize electrical companies financially by updating their real rates. The government is considering a process to restructure the state in a way that will generate significant fiscal savings in the midterm (Chapter II).

All of these reforms, whether proposed or already in effect, constitute major shocks for the real sector, the dimensions of which are difficult to quantify. Due to their impact on demand, or directly through their impact on prices, they represent inflationary shocks that were not considered in previous reports and will have an effect in the years ahead.

Government announcements on financing for 2003 have changed the behavior of the markets, as has support for the administration's economic program from multilateral agencies and the

proximity of a new agreement with the IMF. This was reflected recently in an important reduction in the exchange rate, in TES rates, and in spreads on the national debt. The reforms are being debated in Congress and, depending on the outcome and on developments in the international environment, this improvement in expectations could be sustained in the months ahead.

On the other hand, even if external funds are sufficient to service the debt, strict compliance with the disbursement schedule is crucial to avoiding short-term liquidity problems. Next year, a portion of the government's internal financing could come from higher rates and shorter terms than the ones at present. Coupled with the difficulties on the external front, this adds to the uncertainty of forecasts on inflation and other macroeconomic variables such as the exchange rate.

C. THE ASSUMPTIONS BEHIND THE INFLATION FORECAST

The increase in nervousness and mistrust on international financial markets has forced analysts to lower their economic growth projections for the industrialized economies and for many emerging ones. This price report uses the 2002 and 2003 growth forecasts for the US economy published in *Consensus Forecast*: 2.4% and 3.1% respectively. These are lower than the ones in the June report (2.7% and 3.6%). At that time, the forecasts presented in the first quarter report had already been corrected downward.

As detailed in Chapter II, the new reduction in the outlook for short-term and midterm economic growth in the United States necessitates lowering forecasts for the other industrialized economies and for emerging ones as well, since the United States leads global economic performance. It is difficult to imagine Japan or the European

Union being able to propel world economic growth, at least in the short term. In the case of Japan, this is due to chronic problems with its financial system; in the European economy, it is because of structural constraints, especially in the labor market.

As to the Latin American economies, the impact of reduced economic growth in the United States is reflected in less external demand and a decline in terms of trade. On this occasion, the region has also been shut out of the capital markets. If this situation is prolonged, it will imply less capacity to finance investment and consumption during the remainder of the year and in 2003.

Both these shocks substantially reduce prospects for growth in Latin America (Chapter II). In the case of Colombia's two major trading partners in the subregion: Venezuela and Ecuador, the outlook is further complicated by political unrest. In Venezuela, product declined in the first half of the year and devaluation of the bolívar accelerated, affecting the demand for Colombian goods. Previous reports warned of this situation, which is expected to continue throughout the year, with no substantial improvement in sight for 2003. Growth in the Ecuadorian economy during the first six months of 2002 was acceptable. This allowed Colombia to maintain a good rate of exports to that country. However, difficulties are anticipated for the rest of the year and could halt midterm growth.

In both Venezuela and Ecuador, rising oil prices throughout the year, coupled with expectations of a protraction in high prices if there is military action in Iraq, have not been enough to eliminate doubts about the structural weakness of their economies or to recover their prospects for growth.

For Colombia, the complicated external scenario, both in the industrialized economies headed by the United States and in the Andean economies, affects inflation and growth through a variety of channels,

some of which were identified in earlier reports. The principal effect on growth is in the form of fewer possibilities for an increase in Colombian exports, due to weak external demand. This was already evident with the decline in the value of non-traditional exports resulting from the drop in sales, primarily to Venezuela and the United States. Additional problems on this front are expected in the second half of the year because of fewer sales to Ecuador. This market could be near the saturation point for Colombian products. There have also been constant announcements of protectionist measures, some of which could be in effect by the end of the year²⁵.

At present, the only factors favoring an increase in Colombia's non-traditional exports are derived from the acceleration in devaluation during the last three months and approval of the extended Andean Trade Preference Act (ATPA). However, added devaluation will not necessarily open up new markets under the present circumstances, particularly when several of Colombia's major competitors in the external market, such as Brazil, Argentina, Venezuela, Chile and Mexico, have also seen their currencies devalue considerably. ATPA is likely to enhance possibilities for textile and clothing exports to the United States, but its effect will not be immediate and probably will not be sufficient in the short term to offset the drop in exports to other countries²⁶.

With weak external demand, the primary source of growth in the coming months will be internal demand. According to figures on growth during the first half of the year, private consumption and investment, mainly in construction, were the best performing components of demand.

²⁵ By invoking the protective instruments of the Andean Pact, Ecuador could levy additional tariffs on Colombian products equal to the devaluation in the Colombian peso in recent months.

²⁶ According to ANDI estimates, the Andean Trade Preference Act could represent US\$350 million in additional exports during 2003 and 2004. It is estimated they could amount to US\$1 billion in 2006.

Sector indicators for the third quarter show private consumption has continued to expand at a rate above the average rate of economic growth. The same can be said of private investment, primarily because of the recovery in home building. Considering the government's additions to the budget, an increase in public spending on security is anticipated and could have a positive effect on domestic consumption in the short term.

Given the foregoing, and in line with government forecasts, the consideration in this report is that growth during 2002 as a whole might be slightly higher than was anticipated three months ago. The government recently increased its growth projection for 2002 to 1.6%, which is 0.4 percentage points above the projection three months ago. This is assuming that GDP will increase at a rate of 1.8% in the second half of the year, or somewhat more than in the first six months, maintaining the slight acceleration in growth registered during the second quarter. Growth in the second half of the year would be supported by an increase in domestic consumption (public and private) and by more investment in building construction. The growth rate for the other components of private investment and exports is expected to decline (Figure 62).

Growth throughout the remainder of the year and in 2003 is not expected to generate demand-pull inflation. The economy continues to operate below its potential, as indicated by low use of installed industrial capacity (Chapter I). Judging by the high rate of unemployment and by the rise in the global participation rate, there is still an important surplus of manpower on the job market. Finally, product gap estimates developed by Banco de la República show GDP in 2002 has been 2.6% below potential GDP. Assuming, as the government has done, that the economy will grow by 2.5% in 2003, the gap would remain negative.

Nevertheless, estimates on the extent and pace of potential GDP growth are usually surrounded by quite a bit of uncertainty. A decline or standstill in

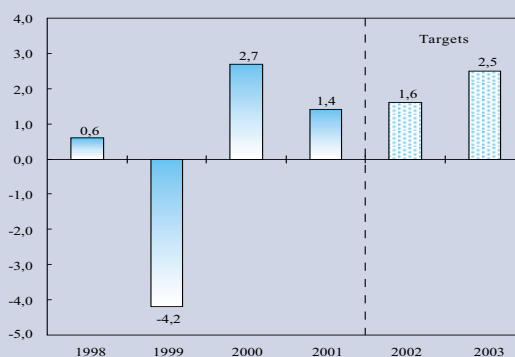
investment, as has been the case in Colombia during the last five years, tends to lower the country's potential for long-term growth. This is difficult to incorporate into estimates of product gap. The same applies to an exodus of skilled labor, as may now be happening in Colombia.

Aside from its impact on growth, the international turbulence can affect inflation by way of the exchange rate. If uncertainty about the strength of economic recovery in the United States continues and if the political transition in various Latin American countries is not resolved satisfactorily, the financial markets will likely remain highly adverse to risk and reluctant to finance the debt of corporate issuers or countries in the region. Less availability of external capital will keep pressure on the Latin American currencies, thereby risking inflationary pressure.

Although Colombia is not immune to contagion, in recent weeks the government has taken steps on the external and internal fronts to protect the economy from external scares. On the external front, it is trying to secure US\$1,842 million in foreign funding

²⁷ This sum (US\$1,842 million) does not include the IDB emergency window. The bulk of this amount; that is, US \$1,554 million, would be earmarked for the government, with US\$288 million allocated to the rest of the public sector.

FIGURE 62
GDP GROWTH AND GOVERNMENT TARGETS
(PERCENTAGE)



Source: DANE and DNP.

from multilateral banks ²⁷. This would be enough to service the external debt throughout 2003. On the internal front, it is seeking approval of the tax reform mentioned earlier and a two-year freeze on central government spending. These two measures are expected to lower the deficit in the public sector next year to 2.5% of GDP, a level compatible with long-term financial solvency for the country.

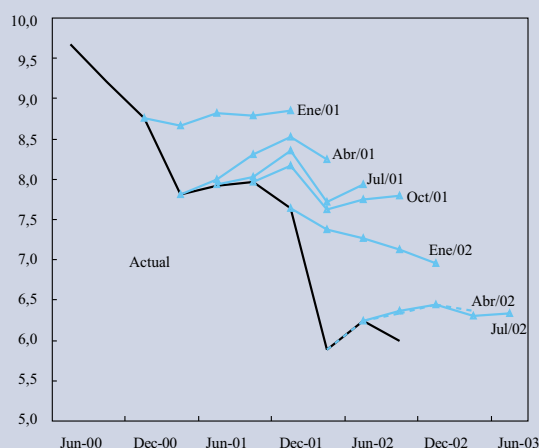
As to this report, it is assumed the government's strategy will have a favorable effect on exchange stability. However, this does not rule out a step backward in the nominal exchange rate, if the external events that closed the capital markets disappear or are curbed.

In spite of predicted exchange stability, this report considers the possibility that current devaluation will have some impact on inflation. The devaluation-inflation passthrough depends on four factors: the extent of devaluation, how long it lasts, the point in the economic cycle when it occurs, and the trend in external prices. Forecasts of slow economic growth in and the prospect of moderate external inflation (Chapter II) somewhat mitigate the impact of devaluation on inflation. However, the extent of devaluation by September (23.4% year to date at the end of the period) and its duration (since May) are already enough to generate some limited or individual inflationary pressure in the coming quarters.

In addition to growth and devaluation, the trend in inflation, especially in 2003, can also be affected by labor costs. With high unemployment, there is not likely to be much inflationary pressure on this front. Announcements of a freeze on the majority of wages in the public sector could temper wage increases in the private sector.

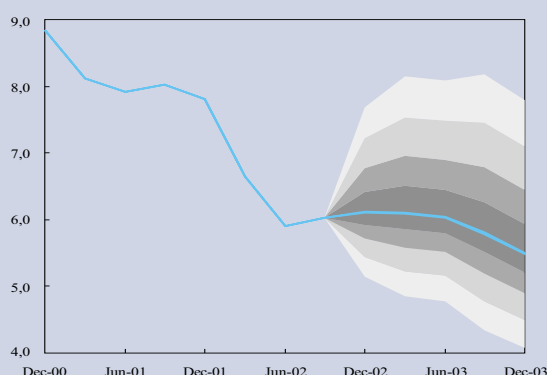
Indicators of inflation expectations among economic agents continue to show confidence in inflation near 6% by the end of 2002 and for the first half of 2003. According to the latest expectation survey

FIGURE 63
ACTUAL INFLATION AND EVOLUTION OF INFLATION EXPECTATIONS
(ANNUAL INFLATION)



Source: Banco de la República, Expectation Survey, July 2001.

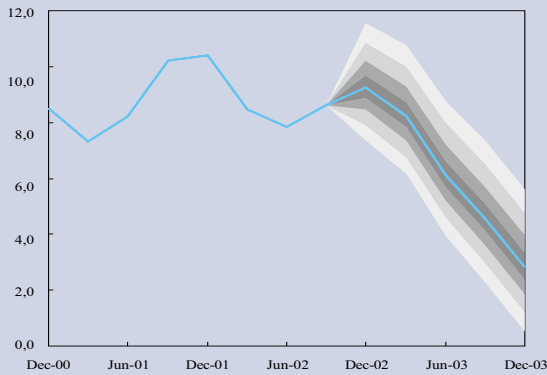
FIGURE 64
TOTAL CONSUMER INFLATION PROJECTED FOR
2002 AND 2003
(CENTRAL SCENARIO AND RISK BALANCE)



Period	90%							50%							25%							Central								
	1	2	3	4	5	6	7	1	2	3	4	5	6	7	1	2	3	4	5	6	7	1	2	3	4	5	6	7		
Dec-02	5,1	5,7	5,9					6,1	6,4	6,8	7,7					5,1	5,7	5,9					6,1	6,4	6,8	7,7				
Mar-03	4,8	5,6	5,9					6,1	6,5	7,0	8,2					4,8	5,6	5,9					6,1	6,5	7,0	8,2				
Jun-03	4,8	5,5	5,8					6,0	6,4	6,9	8,1					4,8	5,5	5,8					6,0	6,4	6,9	8,1				
Sept-03	4,3	5,2	5,5					5,8	6,3	6,8	8,2					4,3	5,2	5,5					5,8	6,3	6,8	8,2				
Dec-03	4,1	4,9	5,2					5,5	5,9	6,4	7,8					4,1	4,9	5,2					5,5	5,9	6,4	7,8				

Source: Banco de la República.

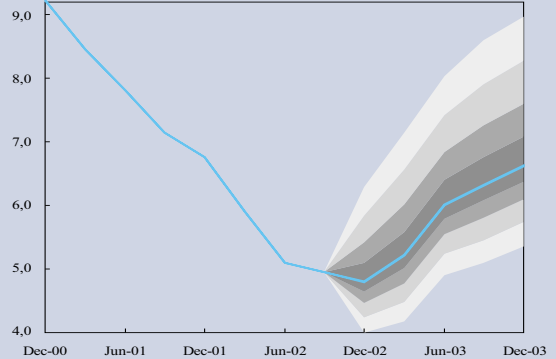
FIGURE 65
FOOD INFLATION PROJECTED FOR 2002 AND 2003
 (CENTRAL SCENARIO AND RISK BALANCE)



Period	90%							
	50%				25%			
	Central							
Dec-02	7,4	8,5	8,9	9,2	9,7	10,2	11,6	
Mar-03	6,1	7,4	7,8	8,2	8,7	9,3	10,8	
Jun-03	3,9	5,2	5,7	6,1	6,6	7,2	8,8	
Sept-03	2,3	3,6	4,1	4,5	5,1	5,7	7,3	
Dic-03	0,5	1,9	2,4	2,8	3,4	4,0	5,6	

Source: Banco de la República.

FIGURE 66
PROJECTION FOR INFLATION EXCLUDING FOOD
 2002 AND 2003
 (CENTRAL SCENARIO AND RISK BALANCE)



Period	90%							
	50%				25%			
	Central							
Dec-02	4,0	4,5	4,6	4,8	5,1	5,4	6,3	
Mar-03	4,2	4,8	5,0	5,2	5,6	6,0	7,1	
Jun-03	4,9	5,6	5,8	6,0	6,4	6,8	8,0	
Sept-03	5,1	5,8	6,1	6,3	6,8	7,3	8,6	
Dic-03	5,4	6,1	6,4	6,6	7,1	7,6	9,0	

Source: Banco de la República.

conducted by Banco de la República, the average of those interviewed expect the rate of inflation to be 6.4% by December of this year and 6.3% by June 2003. There is no significant change in expectations compared with the survey in April, even though the July survey coincided with a transitory surge in total inflation (Figure 63).

D. INFLATION PROJECTIONS

Total consumer inflation projected for the fourth-quarter average is 6.1%. This is slightly above the projection presented three months ago (5.8%) but consistent with the target of 6% set for December

by the Board of Directors of Banco de la República (Figure 64).

The slight increase in the consumer inflation forecast is explained almost entirely by a projection for end-of-the-year food inflation (fourth-quarter average of 9.2%) that is above the rate forecast in the June report (8.2%) (Figure 65). As was anticipated in earlier reports, the CPI for food products saw major increases in recent months, primarily due to the price of potatoes and several other perishable items. These prices are now slightly above the forecast presented in the June report, and the indicators point to additional increases in the weeks ahead. This necessitates raising the forecasts for the end of the year.

As to inflation excluding food, the forecasts for 2002 did not change substantially compared with those

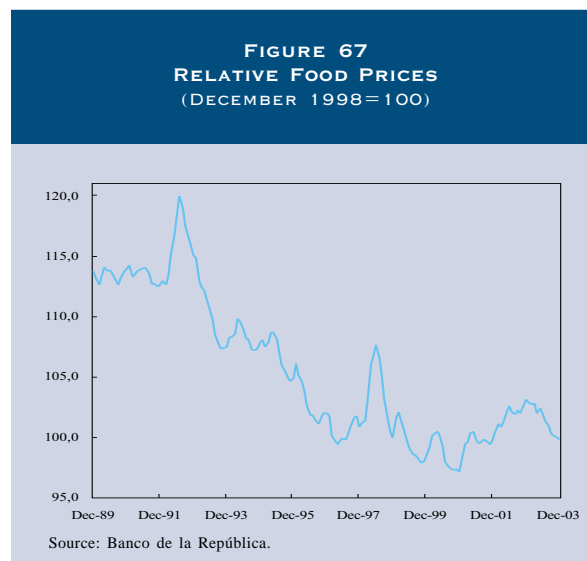
developed three months ago. At present, Banco de la República expects core inflation to continue to decline gradually throughout the remainder of 2002, as it has in recent years. Accordingly, the forecast for annual CPI inflation excluding food is 4.8% for the fourth-quarter average this year, which is practically the same as the rate forecast in June (4.7%) (Figure 66). Although the increase in devaluation in recent months has been transferred to producer prices, primarily to the basket of imported goods, the remainder of the year is not expected to see a transfer to consumer prices that would sidetrack the CPI excluding food from the course projected by the Bank.

With respect to next year, forecasts for inflation excluding food increased in response to the rise in the exchange rate by September. The central path of the transmission-mechanism model predicts 6.6% average fourth-quarter annual inflation excluding food. This is 1.8 percentage points above the rate projected three months ago (Figure 66).

Transmission of devaluation into inflation depends heavily on factors such as demand, external inflation and inflation expectations. Furthermore, to the extent that a prudent monetary policy limits the magnitude of devaluation, its effect on prices tends to concentrate on a short period of time and to manifest itself as a transitory upsurge in inflation.

In spite of the higher forecast for inflation excluding food, total inflation projected for 2003 maintains a downward trend. According to forecasts based on the transmission-mechanism model (TMM), inflation should be near 6% during the first half of the year, before adopting a downward course during the second half. For the fourth quarter of this year, the central path of the model predicts 5.5% total CPI inflation, on average, which is less than expected for the end of 2002 (Figure 64).

The decline in consumer inflation next year depends



on a reduction in inflationary pressure from food (Figure 65). There are two reasons why good performance on this front is likely. To begin with, the start of the year is expected to coincide with the end of the cattle retention procedure and the onset of a new liquidation phase. This would imply growth in the supply of meat and price increases that are more moderate. Because meat and meat substitutes are a major component of the consumer market basket, low prices for these products will do much to relieve inflationary pressure from food. Also, currently high prices for a number of perishables, including potatoes, should encourage planting at the end of the year and the beginning of 2003. This would allow for a larger supply as of the second half of the year, which should lower prices to an important degree, as it has in past years.

This being the situation, the central path of the TMM indicates only 2.8% food inflation for the fourth quarter of 2003, which is not much different from the forecast implicit in the projections for total inflation published in the June report. In this case, relative food prices would return to a level similar to the average for the last five years (Figure 67). These projections assume moderate interference from El Niño at the end of 2002 and the start of 2003.

E. THE RISKS

According to the June edition of *The Inflation Report*, currently high risk perception on the capital markets, which is associated largely with the political situation in Brazil, could pose a problem for price stability in Colombia. Part of this risk had materialized by the time this report was written; namely, the closure of capital markets for Latin America and the subsequent depreciation of regional currencies.

The region, and Colombia in particular, could continue to be locked out of the capital markets on a short and midterm basis. This would imply added pressure on the exchange rate. Yet, no one knows how long the capital markets will be closed. This depends on a variety of circumstances, including the way the political transition in Brazil is resolved and evolution of the Colombian government's economic and legislative agenda. Previous episodes, such as the Mexican crisis in 1995 and the Russian crisis in 1998, withdrew capital from the region for a period of no more than six months. Were this to occur again, pressure exerted on the exchange rate from this front would disappear in the fourth quarter of 2002 or at the start of 2003, helping to consolidate the reduction in Colombia's rate of inflation.

During the rest of the year and the next, inflation and macroeconomic stability in Colombia also face a risk posed by the central government's fiscal situation. A permanent and credible solution to constant imbalances in the public sector is a necessary condition for midterm price stability. It calls for restructuring spending and income in a way that makes the long-term public debt sustainable. It also assumes the government can secure enough external financing to meet next year's payments on the external debt.

During its first months in office, the new administration has moved in the right direction. Congressional approval of the tax and pension reform bill is crucial to accomplishing the fiscal objectives for the next two years, as is grass-roots support for the referendum on this measure and other reforms.

Solutions to the fiscal problem have repercussions that could result in transitory inflationary pressure on prices in general. Broadening the VAT tax base is an example, as is eliminating the subsidy for gasoline. An adjustment in electricity rates can also cause inflationary pressure.

It is important to point out that the tax reform, elimination of the gasoline subsidy and the adjustment in electricity rates change prices only once. Accordingly, they do not affect core inflation, nor do they depend on the approach of monetary policy. The only way they can affect core inflation is through their impact on expectations of inflation.

The presence of El Niño poses an additional risk. Although the moderate nature of this phenomenon appears to predict no major upsets for the rainfall cycle in Colombia's food producing areas, the possibility of localized drought can not be ruled out. This would reduce agricultural supply and lead to temporary price increases higher than those anticipated.

The center paths of total inflation, food inflation and inflation excluding food are accompanied by upward-biased risk balances to incorporate current uncertainty over inflation. Compared with the forecasts in the June report, the asymmetry has increased in the case of inflation excluding food, trying to embody the possible inflationary effect of changes in the VAT and prices for gasoline and electricity, as well as uncertainty over the exchange rate (Figures 64, 65 and 66).

The following is a review of the latest macroeconomic projections developed by local and foreign analysts with respect to the Colombian economy in 2002 and 2003. At the time local analysts submitted their projections, they were already aware of official statistics on inflation for the third quarter of 2002.

PROJECTIONS FOR 2002

Table 1 outlines the projections for 2002. The most important change in the forecasts made by local analysts in the last quarter concerns expectations of devaluation by the end of the year. Three months ago, local analysts – on average - anticipated a nominal exchange rate of Col\$2,512 by December 31. This would imply 9.2% devaluation by the end of the period. The new forecast is Col\$2,754, which is equivalent to 19.7% devaluation. The increase in anticipated devaluation is explained by the financial turbulence in Latin America during the third quarter, as evidenced by the generalized increase in spreads and larger devaluation in a number of countries in the region.

After devaluation, the fiscal deficit was the variable that changed the most in terms of its forecast compared with the June report. On this occasion, local analysts modified their forecasts to include the government's announcement that the fiscal deficit in the non-financial public sector (NFPS) would be around 4.0% for this year. In response, they raised their forecast by 0.6 percentage points compared with the one presented three months ago. This is equivalent to a deficit of 3.9% of GDP.

**TABLE 1
MACROECONOMIC PROJECTIONS FOR 2002**

	Date of projection	Real GDP Growth %	CPI Inflation %	Nominal exchange rate (end of)	Nominal DTF %	Deficit (% of GDP)		Unemployment rate %	
						Fiscal	1/Current		
						Acct.			
Local analysts									
	Revista Dinero	18-Oct-02	1,3	6,2	2.750	9,5	(4,1)	(2,6)	16,5
	Suvalor-Corfinura	09-Oct-02	1,3	5,7	2.650	9,0	(3,4)	n.d.	n.d.
	ANIF	10-Oct-02	1,7	6,0	2.780	8,5	(4,2)	(1,5)	16,3
	Fedesarrollo	21-Oct-02	1,7	6,0	2.835	10,7	(4,0)	(2,7)	16,3
	Average		1,5	6,0	2.754	9,4	(3,9)	(2,3)	16,4
International analysts 2/									
	Goldman Sachs	17-Oct-02	1,3	7,0	2.500		(3,8)	(2,4)	
	IDEA global	18-Oct-02	1,5	5,7	2.480		(3,6)	(2,4)	
	J. P. Morgan	08-Oct-02	1,5	6,1	n.d.		(4,1)	(1,9)	
	Salomón Smith Barney	25-Sep-02	1,6	6,2	2.657		(3,4)	(2,8)	
	Deutsche Bank	10-Oct-02	0,9	6,0	2.753		(6,2)	(2,3)	
	Merrill Lynch	09-Ago-02	2,2	6,5	2.525		(3,0)	(3,0)	
	Average		1,5	6,3	2.583		(3,6)	(2,5)	

n. d. Not available

1/ Calculation of the average fiscal deficit does not include the Deutsche Bank forecasts, as it refers to the central government deficit and not to the deficit in the non-financial public sector.

2/ Report ¿Cómo nos ven afuera?, SMT, September 20 to October 18, 2002.

As to the other variables, the average forecast was similar to the one presented in the June report. Local analysts still expect inflation to be 6.0%. In other words, they remain confident that the target set by the Board of Directors of Banco de la República will be met.

Foreign analysts, in keeping with their local counterparts, substantially modified their forecasts for the nominal exchange rate at year's end and the fiscal deficit in the non-financial public sector. As to expected devaluation, the average forecast increased from 6.0% to 12.2% and the forecast for the non-financial public sector fiscal deficit increased from 2.9% to 3.6%.

PROJECTIONS FOR 2003

Table 2 shows the projections for 2003. Average inflation, as forecast by local analysts, decline by 0.5 percentage points (5.7%), while the average forecast by foreign analysts was 0.3 percentage points less (5.5%). Hence, the analysts continue to reduce their inflation expectations for next year.

With respect to economic growth, both local and foreign analysts (2.4% and 2.2% respectively) still expect the coming year to be better than 2002. However, foreign analysts present a forecast substantially below the one offered in the previous report (3.2%). This reflects the economic slowdown worldwide and current uncertainty over the outcome and effects of the situation on the external and internal fronts.

As to the exchange rate in 2003, local analysts raised their devaluation expectations compared with those presented in the June report. Based on the average forecast for the exchange rate at

TABLE 2
MACROECONOMIC PROJECTIONS FOR 2003

	Date of projection	Real GDP Growth %	CPI Inflation %	Nominal exchange rate (end of)	Nominal DTF %	Deficit (% of GDP)		Unemployment rate %	
						Fiscal	1/Current		
						Acct.			
Local analysts									
	Revista Dinero	18-Oct-02	2,2	7,0	2.970	13,0	(3,1)	(3,6)	16,0
	Suvalor-Corfinura	09-Oct-02	2,5	5,4	2.850	10,5	(2,1)	n.d.	n.d.
	ANIF	10-Oct-02	2,5	5,5	2.985	11,0	(2,8)	(1,4)	16,0
	Fedesarrollo	21-Oct-02	2,4	5,0	3.045	10,0	(3,6)	(2,2)	16,0
	Average		2,4	5,7	2.963	11,1	(2,9)	(2,4)	16,0
International analysts 2/									
	Goldman Sachs	17-Oct-02	2,0	5,0	2.585		(4,7)	(2,3)	
	IDEA global	18-Oct-02	2,5	5,5	2.680		(3,0)	(2,6)	
	J. P. Morgan	08-Oct-02	1,5	6,0	n.d.		(3,2)	(2,0)	
	Salomón Smith Barney	25-Sep-02	1,5	5,7	2.834		(3,0)	(3,0)	
	Deutsche Bank	10-Oct-02	2,2	5,0	2.891		(4,7)	(4,2)	
	Merrill Lynch	09-Ago-02	3,5	6,0	2.650		(2,8)	(3,2)	
	Average		2,2	5,5	2.728		(3,3)	(2,9)	

n. d. Not available.

1/ Calculation of the average fiscal deficit does not include the Deutsche Bank forecasts, as it refers to the central government deficit and not to the deficit in the non-financial public sector

2/ Report '¿Cómo nos ven afuera?', SMT, September 20 to October 18, 2002.

the end 2002, local analysts expect 7.6% nominal devaluation in 2003. Three months ago, they expected this rate to be 6.4%. Foreign analysts expect devaluation to stay at 5.6% in 2003.

Finally, in the case of the fiscal deficit, local analysts foresee an adjustment of one percentage point in GDP when comparing the deficit expected in 2002 with the forecast for 2003. On the other hand, foreign analysts expect an adjustment of only 0.3 percentage points.

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