Inflation Report

March 2003

Banco de la República

ISNN - 1657-7973

Presentation, Sumary and Conclusions

- Continuing price pressures over the first quarter of 2003 caused inflation to outstrip the 5%-6% target range set for the year by the Board of Directors of the Banco de la República. Annual consumer inflation was particularly high in March, running at 7.6%, up by 60 basis points (bp) on December 2002 and 170 bp on the previous March. Producer inflation rose even more steeply, ending the quarter at 11.5%.

- Higher inflation in the first quarter followed an unexpected price surge at the end of last year that had prevented the 6% target for 2002 from being met. That surge had resulted largely from a negative supply shock in perishable foods (mainly potatoes) and higher world prices for some agricultural imports. It was also associated to some extent with faster devaluation and the effect of this on tradables prices.

- Inflation had speeded up at the end of last year within a loose monetary-policy setting-created by a mid-year reduction of 325 bp in intervention rates-, and in the midst of strong devaluationary pressures. Higher devaluation and failure to meet the inflation target led to rising inflation expectations.

- Given this state of affairs, the Board decided in January to raise the Bank's intervention rates by 100 bp. And in February it announced its readiness to use up to $1billion of the country's international reserves to intervene in the exchange market. Accordingly, two one-month call-option auctions were arranged for March and April to deaccumulate reserves by $200 each time.

- Price trends did not change overmuch during the first quarter. Prices continued to rise partly because of the presence of negative shocks in food supply and world food prices, to which were added shocks from VAT expansion and from rising utility and fuel charges.

- The different indicators of core inflation have also accelerated, bearing out the fact that the recent pick-up in inflation has not been caused exclusively by the supply shocks referred to above. Non-food inflation rose by 115 bp between December and March, to 6.6% by the end of the quarter, while the average of the three core-inflation indicators used by the Bank was 7.1% in March, far above their 6.3% average in December.

- Inflationary pressures from devaluation have, in turn, become more evident in recent months, with tradables inflation running at 8.9% in March, up from 6.6% in December. This occurred despite the fact that the exchange rate's rising trend was interrupted from mid-February, which suggests that a very high rate of devaluation was implicit in its level at the end of March, with delayed effects on inflation.

✠ Besides devaluation, the main risk today for price stability is a possible upsurge in inflation expectations. Indicators of inflation expectations, such as the differential between fixed-rate TES securities denominated in pesos and those denominated in Real Value Units, rose from 6.5% in November to 10% in March of this year. Moreover, although the supply shocks that have affected prices are transitory, there is a risk that in the absence of suitable action by the Banco de la República their effects may persist through higher inflation expectations.

✠ Inflation does not so far appear to stem from demand. The prices of various nontradable goods and services such as rent and education have been rising by less than 6%. The economic upturn at the end of last year and the further reactivation expected for this year should not generate any large inflationary pressures. Capacity utilization has been below historical average levels and is not expected to change substantially over the next few months. Lastly, the productivity gap, as estimated by the Bank, is negative and will remain so for a good while even if growth rises sharply.

✠ The Bank thinks that the government's 2% growth forecast for 2003 is achievable and may even be surpassed, given the favorable signs shown by various sectoral indicators, such as industrial production and sales in January and February, electricity consumption and consumer and commercial credit to March.

✠ Growth will continue to be driven by private domestic demand over the first half of 2003, for external demand will still be suffering from the stalling of trade with Venezuela, at least in the coming months. Private domestic demand, in terms of both consumption and investment, continues to be boosted by low interest rates, falling unemployment, a greater availability of credit and an improvement in internal security, judging from the perceptions of consumers and businessmen. In the second half of the year, external demand may once more play a major role if exports to Venezuela manage to recover, and if the Andean Trade Promotion and Drugs Eradication Act (ATPDEA) allows Colombian businessmen to compete successfully in the United States market

✠ On the exchange front, the intervention announced by the Board in February for deaccumulating -currency reserves succeeded in stabilizing the exchange rate around 2,960 pesos to the dollar by the end of the first quarter. The supply of foreign exchange was also boosted by foreign markets' perceiving Latin America as less of a risk, as evidenced by a large reduction in country-risk premiums since January. In April, as this Report was being drafted, Colombia's risk spread continued to fall sharply, allowing the peso to appreciate.

✠ The raising of intervention rates in January did not lift the chief market lending or deposit rates. But it did temporarily push up treasury paper (TES) rates, reflecting higher funding costs for investors as well as persisting inflation expectations

✠ Higher inflation and stabile nominal rates led to a reduction of real market interest rates. In March the real DTF deposit rate was 0.1%, down from 0.7% in December and far below its historical average, while the real interbank rate was -1.1%, remaining negative for the tenth month in a row.

✠ The broader monetary aggregate (M3) expanded at an increasing pace over the first quarter, registering a 11.4% rate of annual growth in March, which was still compatible with expected nominal GDP growth for 2003. Since January recovery in M3 has gone hand in hand with a pick-up in sales of term certificates of deposit, breaking last year's declining trend. At the same time, credit provided by the financial system continued to recover, driven by commercial and consumer loans; the overall annual growth at the end of the first quarter was 7.0% in nominal terms.

✠ Actual Inflation in the first quarter was higher than the rate forecast by the Bank in December. The forecasting error is explained by underestimation of both food and non-food inflation. Regarding the latter, the Bank's forecasting did not fully take into account the effect of devaluation and the repercussions of some temporary shocks, such as the price increases of utilities and fuel, that occurred sooner than envisaged in the December 2002 Inflation Report.

✠ On the basis of inflation figures registered in March, the Bank's central model forecasts an average headline inflation rate of 7.2% for the fourth quarter of 2003. This is an upward revision of the 6.1% rate predicted in December, because of higher projections for both food and non-food inflation. Food inflation is projected to average between 6% and 7% in the fourth quarter of 2003, while non-food inflation may average between 6.5% and 7.5%.

✠ The upward revision of non-food inflation is explained by the fact that accumulated devaluation to March is now expected to have a greater impact on tradables prices, and by higher inflation expectations. Similarly, a greater shock is envisaged from the rise in utilities prices, consistent with this subgroup's price behavior so far this year. All the same, it is important to point out that, if the exchange rate remains stable, the pressures described above, particularly those associated with devaluation, should begin to wane in the second half of the year, thereby allowing non-food inflation to fall.

✠ At a meeting held on April 28 the Board of Directors reviewed the state of affairs described above and saw strong signs that the monetary policy then being pursued would not serve to keep inflation expectations under control. The Board also considered that low interest rates were not helping exchange-rate stability, since real intervention rates were negative and the other relevant interest rates were very low in real terms. These circumstances, the Board felt, could cause:

- Inflation expectations to be passed on to new contracts, thereby prolonging the temporary price shocks (from the VAT expansion and higher utilities and fuel charges); and
- The Colombian economy to start operating at inflation rates increasingly far removed from the long-term target set by the Board.

✠ Although the exchange rate has recently become stable, accumulated devaluation is still high and poses the risk of continuing to pass through to prices, which are being pushed up by rising inflation expectations. Moreover, possible future developments in the external sector, especially a decline in nontraditional exports this year or in oil exports in 2004, may generate new devaluation expectations that would adversely affect the path of inflation.

✠ Consequently, to counteract higher inflation expectations and keep the exchange rate stable, the Board considered that its structure of intervention rates needed to be raised by 100 bp from April 29. The new rates are: Lombard expansion rate 11%, auction expansion rate 7.25%, auction contraction rate 6.25%, and Lombard contraction rate 5.25%. The Board also decided to hold an auction to deaccumulate reserves by means of options worth $200 m, to be exercised in May.

Board of Directors of the Banco de la República

Inflation Report

March 2003

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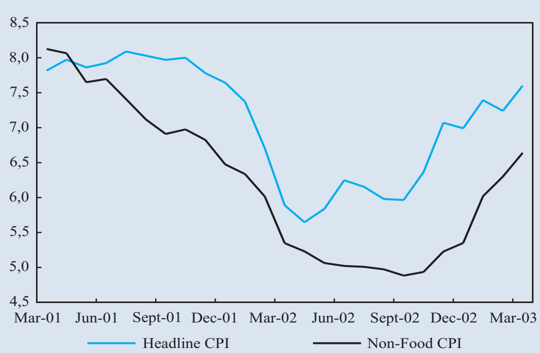
Recent Inflation Behavior

Annual consumer inflation was 7.6% at the end of the first quarter of 2003, up by 0.6 percentage points on December 2002 and higher than the 5%-6% target range set for the year by the Board of Directors of the Banco de la República (Figure 1). Core inflation also overshot the inflation target, in contrast to its behavior in 2002. Non-food inflation went up from 5.4% to 6.6% between December and March, while the core-inflation indicators' average rose from 5.6% to 7.1% (Table 1).

Food inflation showed a declining trend relative to its year-end level but at a slower pace than was forecast in the December 2002 Inflation Report. It is expected to continue to drop throughout the year.

The current rise in inflation is not associated with demand pressure, for the Colombian economy is still operating below capacity. Much of the rise is explained by food behavior, and by two other supply factors: higher external prices for imports of primary inputs and accelerating devaluation. These two factors emerged in the second half of last year and have become increasingly important. As the exchange rate becomes stabilized, or moves within a lower range than at the start of the year, as it has been doing recently, prices rises for tradables should become smaller over the rest of 2003 than earlier in the year. Nor are external prices for imported materials expected to continue rising. Hence, the impact of the two factors on inflation should prove transitory.

Figure 1
Headline consumer inflation and non-food inflation
(Annual rates)



Source: DANE (State Statistical Agency). Calculations by Banco de la República.

SIn fact, the main concern about inflation continues to be the creation of expectations. If expectations of higher inflation pass through to new contracts, the temporary negative price shocks will become permanent and the Colombian economy might start to operate with inflation rates increasingly far removed from the long-term goal of price stability. Available data to March indicated that inflation expectations, as measured by the differential between fixed- and variable-rate TES securities, might be rising despite the January increase in intervention rates. The evidence suggests that monetary policy needs to be further modified, otherwise the inflation targets for 2003 and 2004 will be at stake and it will be more costly to return to a path of falling inflation after the transitory shocks.

As this report was going to press, the National Statistical Agency (DANE) published inflation figures for April, which show a rise in food inflation to 10.8%, from 9.9% in March. Despite this fact, food inflation

Table 1
Inflation indicators
(Annual growth)

	Mar-02	Jun-02	Sept-02	Dec-02	Mar-03
I. IPC	5,9	6,2	6,0	7,0	7,6
Food	7,2	9,2	8,6	10,9	9,9
Housing	3,8	4,2	3,8	4,1	5,6
Clothing	2,2	1,1	0,9	0,7	0,9
Health care	9,7	8,9	9,2	9,7	
Education	9,3	6,7	6,4	6,5	4,9
Entertainment, culture & recreation	7,0	5,9	4,7	5,3	4,1
Transport	5,8	5,0	5,1	5,9	9,5
Diverse expenditures	6,7	6,8	7,7	9,0	9,0
II. Core inflation 1/	5,6	5,3	5,1	5,6	7,1
Non-food CPI	5,3	5,0	4,9	5,4	6,6
Nucleus 2/	6,0	5,8	5,6	6,2	7,8
CPI excl. food staples, fuel & utilities	5,4	5,1	5,0	5,3	6,8
III. PPI					
By economic use or destination	3,6	2,9	6,8	9,3	11,5
Intermediate consumption	2,9	1,2	6,2	9,9	13,1
Final consumption	4,3	4,6	6,3	7,3	7,5
Capital goods	2,4	2,8	10,8	15,6	19,6
Building materials	5,0	5,0	6,4	7,8	11,7
By origin					
Domestically produced and consumed	4,4	3,4	5,5	7,1	8,3
Imports	0,8	1,6	10,7	19,0	21,7
Exports 3/	(7,1)	(2,4)	15,5	28,5	34,7
By industrial activity (ISIC)					
Farming, forestry & fishing	2,4	2,1	6,8	9,2	7,8
Mining	1,7	2,1	22,4	33,3	37,7
Manufacturing	3,9	3,2	6,3	8,6	11,6

1/ The average of the three core-inflation indicators calculated by the Banco de la República.
2/ CPI excluding 20% of the weight of items showing the greatest price volatility between January 1990 and April 1999.
3/ Total PPI does not include exports. It is calculated from the weighted sum of domestically produced and consumed goods, and imports.

Sources: Economic Studies Division (SGEE) of the Banco de la República, and DANE's PPI and CPI Lists is expected to be on a declining path over the rest of the year. Non-food inflation has stopped rising for the first time since October but still exceeds the target range, by 0.6 percentage points. The other core-inflation indicators have gone up slightly: the inflation nucleus to 7.9%, and inflation excluding food staples, fuel and utilities to 7.0%.

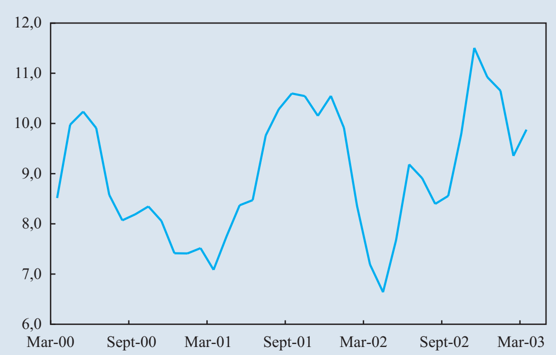
In contrast, for the private sector, the internal debt outweighs the external debt as a source of financing. The first six months of 2002 saw private internal and external debt holdings decline in real terms. The first fell by 3.9% while the second, valued in pesos, declined by 3.2%. The reduction in the private external debt was also due to a decline in the dollar-denominated debt (US$467 m).

A. TRANSITORY INFLATION

Food inflation was 9.9% in March, one percentage point lower than in December (10.9%) (Figure 2). As expected, this fall resulted from a price decrease in perishables, especially potatoes, but it was smaller than forecast, owing to inflationary pressure from processed foods, some of which (beverages, oils and fats) continued to rise in price, possibly because of devaluation and higher prices for imported inputs.

In general, food inflation is expected to fall further over the rest of the year, for the following reasons:

FIGURE 2
CPI FOOD INFLATION
(ANNUAL RATES)



Source: DANE. Calculations by Banco de la República.

i) Greater planting of several crops, such as potatoes and rice, will lower prices, though seasonal factors may push them up temporarily in the second quarter.

ii) Meat prices are expected to fall. The National Stockbreeders' Federation reports that in 2003 Colombia's cattle-raising cycle will enter a stage of intensive slaughter, which should increase supply and hence lower prices.

iii) According to the US National Oceanic and Atmospheric Administration, the climatic condition known as El Niño will disappear in May and should therefore no longer affect farm productivity, with the result that there will be less pressure on food inflation.

Despite these factors, food inflation is expected to fall more slowly than was envisaged in the previous Inflation Report, largely because of the effect that devaluation and the world prices of farm goods will have on costs and consumer prices.

Other transitory inflation pressures, arising from higher utility and fuel charge, have also produced a greater-than-expected impact. Fuel, gasoline and gas prices have continued to be linked to world oil prices and devaluation. Although the world price of oil is expected to fall more steeply in the coming months than was envisaged in the previous Inflation Report, this is not likely to make domestic-price increases any smaller. For the internal price still lags behind the external reference price, having remained frozen for much of 2002. Moreover, given the announced schedule of increments in utility charges and a higher gasoline surcharge, both items tare expected to generate inflationary pressures over the next two or three quarters.

B. CORE INFLATION

In the first quarter of 2003, all three core-inflation indicators calculated by the Bank continued to accelerate strongly. Core inflation-measured as the average of the Consumer Price Index (CPI) excluding food, the inflation nucleus,[1] and the CPI excluding food staples, fuel and utilities-stood at 7.1%, up by 1.4 percentage points on December 2002. The biggest rise was in the inflation nucleus (from 6.2% in December to 7.8% in March), while the other two indicators (non-food CPI, and CPI excluding food staples, fuel and utilities) each rose by 1.3 percentage points (Table 1 and Figure 3).

Some indicators directly connected with demand inflation were unaffected by transitory shocks or devaluation and registered very low levels of average annual inflation in the first quarter. They included entertainment, culture and recreation (4.5%), clothing (0.9%), and unregulated non-public services (4.3%) (Table 1 and Figure 4).

At 6.3%, non-food inflation in March was higher than the Bank's forecast of 5.8%. Four factors accounted for this underestimation by the Bank.

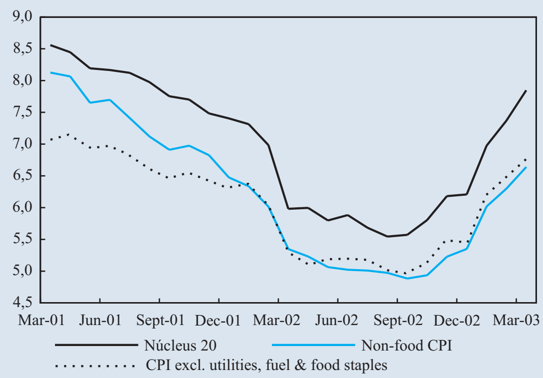
First, the impact of devaluation on headline inflation was underestimated. Tradables inflation jumped from 6.6% in December to 8.9% in March, and the producer price index (PPI) for imports continued to grow at two-digit rates, to 21.7%, some 5.8 percentage points higher than in December. The fact that core inflation and producer inflation have accelerated despite exchange-rate stability suggests that the exchange rate at its current level has a very high rate of implicit devaluation, with lagged effects on inflation, and/or a higher "pass through". However, as stated in previous Reports, the effect of devaluation will be transitory if the exchange rate remains stable. Non-food inflation could therefore start to weaken in the second half of the year, particularly in the fourth quarter.

Second, the Bank's projections of non-food inflation also underestimated the behavior of expectations. One indicator of inflation expectations is the rate differential between fixed- and variable-rate TES securities, which rose by more than the inflation target, signifying higher inflation expectations (Figure 5).

Third, rents began to pick up in the higher ranges, possibly indicating not just recovery in the property sector but also expectations of rising inflation. The item of home-occupancy expenses has been a crucial source of disinflation n recent years, because of its very low rate of inflation and large share of the CPI (22.2%). But it is unlikely to remain so any longer, for its relative price has been falling and is now at

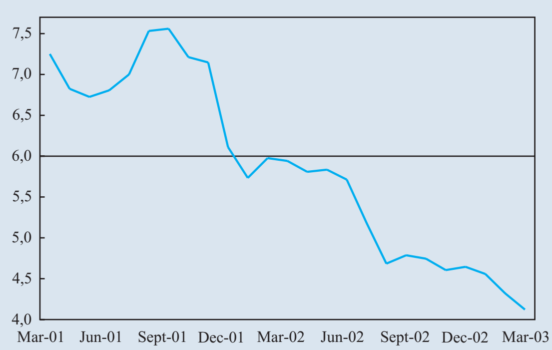
[1] The inflation nucleus is the CPI excluding 20% of the weight of items showing the greatest price volatility between January 1990 and April 1999.

FIGURE 3
CORE INFLATION
(ANNUAL RATES)



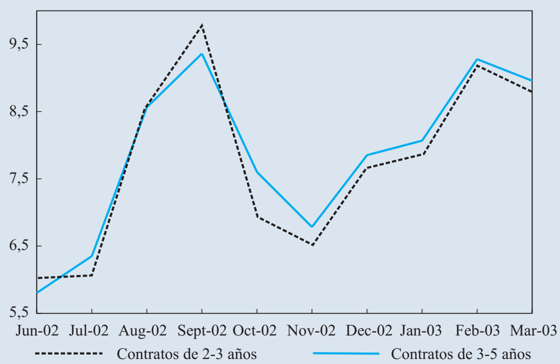
Source: DANE. Calculations by Banco de la República.

FIGURE 4
INFLATION OF UNREGULATED NON-PUBIC SERVICES
(EXCLUDING RENT)
(ANNUAL RATES)



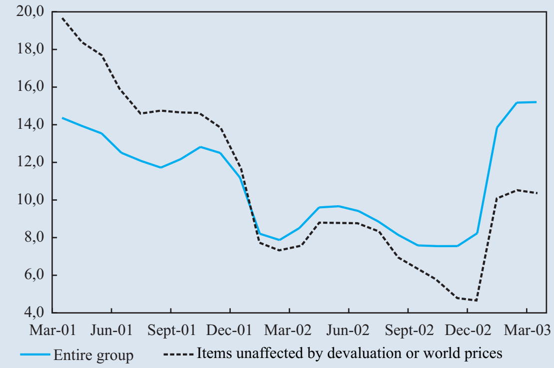
Source: Banco de la República, Economic Studies División (SGEE).

Figure 5
Inflation expectations
Estimated from TES contracts (*)
(Percentage)



(*) Differential between fixed-rate and variable-rate TES securities.
Source: DANE and Banco de la República.

Figure 6
Inflation for group of items included
in VAT reform
(Percentage)



Source: DANE and Banco de la República.

record low levels and therefore more likely to show a rising tendency again.

The last reason why non-food inflation was underestimated was that projections of this indicator, like those of the other two core-inflation indicators, did not fully absorb the transitory shocks arising from higher VAT rates, rising utility charges and mounting fuel prices. Thus, the core-inflation measures rose by more than expected because of underestimation of the size of the transitory shocks affecting the Colombian economy.

As expected, the VAT increase had a one-off impact on inflation, producing most of its price effect by the end of March. It is not therefore expected to cause any further rises in inflation over the rest of the year, and its effect should have vanished by the beginning of 2004, which should help to reduce inflation (Figure 6). As estimated by the Bank, the rise in VAT rates was passed on almost entirely to the directly taxed items of the CPI basket. Since these items weigh about 6.0% in the basket, the overall direct effect of the VAT rate increase was to push up inflation by 0.4 percentage points. Its indirect effect on consumer inflation is more difficult to gauge, amongst other reasons because the tax reform made VAT applicable to a broad range of farm inputs that affect the cost of food production.

II

Determinants of inflation

A. Monetary policy and financial and monetary variables

As stated elsewhere in this Report, headline and core inflation rose from the fourth quarter of 2002, accompanied by higher inflation expectations and devaluation. Inflation projections showed that this situation would jeopardize meeting the inflation targets for 2003 and 2004. Given this state of affairs, the Bank's Board of Directors decided in January to raise intervention by 100 basis points. Moreover, an announcement was made in February that the Bank was prepared to deaccumulate international reserves by up to $I billion. Accordingly, arrangements were made for holding two one-month call-option auctions, one in March and the other in April, each for $200 m.

The outcome of these measures was as follows:

* The interbank rate rose by 100 bp.

* Other market interest rates (deposit and lending rates) were not affected, because of ample liquidity in the economy.

* Part of the rise in intervention rates passed through to rates for TES securities, as a result of higher funding costs for investors. But inflation expectations were probably not much affected, as suggested by the fact that the rate differential between fixed-rate TES denominated in pesos and those denominated in Real Value Units remained stable.

* The exchange rate became less volatile and stabilized around 2,960 pesos to the dollar. More recently, it has shown a declining trend, hovering around 2,864 pesos in early May. In addition, the call options worth $400m offered at auction were actually exercised only in the amount of $145m.

The risk of rising inflation expectations, in the context of one of the loosest monetary-policy stances in recent history, led the Board of Directors to raise intervention rates by another 100 bp in April. And another auction to deaccumulate reserves by $200m was called for May. The effect of the latest intervention-rate increase on TES rates has been positive: TES rates have come down, further helped to do so by lower spreads on the country's sovereign debt. There has also been a reduction in the rate differential between fixed-rate TES denominated in pesos and those denominated in Real Value Units. These results show that part of the rate increase had already been taken for granted by the market and may reflect a lowering of long-term inflation expectations.

Higher intervention rates and the Bank's operations in the exchange market helped to stabilize the exchange rate. Another contributing factor was the drop in the country-risk premium on Colombia's foreign debt.
The first quarter of this year saw the monitory base growing more slowly and the broader measure of money supply (M3) expanding faster. At 11.4%, M3's rate of expansion at the end of the quarter was compatible with expected growth in nominal GDP. Its acceleration was associated with liabilities subject to reserve requirements, particularly a pick-up in term certificates of deposit and in savings accounts. Faster M3 growth translated into a broadening of financial

saving, which, together with recovery in private spending, was reflected in faster growth of credit provided by the financial system.

1. Monetary policy measures

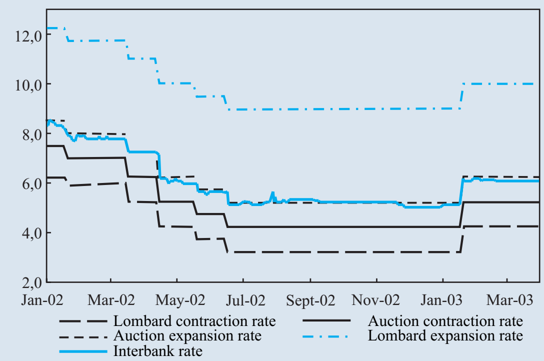
The Board of Directors took a number of measures in the first quarter to curb the pick-up in headline and core inflation and anchor inflation expectations. The first measure was to raise the Bank's entire structure of intervention rates by one percentage point effective from January 20. Thus, the Lombard expansion rate went up to 10.0%, the auction expansion rate to 6.25%, the auction contraction rate to 5.25%, and the Lombard contraction rate to 4.25% (Figure 7). As was to be expected, this measure translated into a similar increase in the interbank rate, which rose from 5.02% in December 2002 to 6.08% in March 2003. But its effect on the other market rates was minimal: the DTF deposit rate, in particular, remained stable throughout the quarter between 7.7% and 7.8%.

With devaluation remaining at levels incompatible with meeting the year's inflation target, the Board of Directors decided to supplement the intervention-rate increase and announced on February 14 that international reserves would be deaccumulated by up to $1 billion through one-month call options, starting from March. Call options to reduce reserves by $200m were auctioned in March and were exercised in the amount of $144.6 m.[2] On March 14, it was announced that a similar auction would be held in April. The Bank's intervention in the exchange market succeeded in making the exchange rate less volatile, stabilizing it around 2,960 pesos to the dollar in February and March, which helped to put it on a declining trend, down to 2,864 pesos in early May.

The Monetary Conditions Indicator shows to what extent the provision of liquidity is more restrictive (if the indicator is positive) or more expansive (if the indicator is negative), relative to liquidity in the economy during a period of reference (January 1983).[3] The Indicator's level for the first quarter of 2003 was lower than in December and still below the base period, signifying a loose monetary policy.

[2] Call options are auctioned to deaccumulate reserves when the market exchange rate exceeds its 20-day moving average.[p.23]

FIGURE 7
BANCO DE LA REPÚLICA'S INTERVENTION RATES AND INTERBANK RATE
(PERCENTAGE)



Source: Banco de la República.

2. Monetary and credit aggregates

a. Monetary base

The monetary base grew more slowly in the first quarter because of smaller expansions in cash holdings and reserves. Specifically, growth in the average monthly balance of the monetary base fell from 20.3% in December to 17.6% in March; in the case of cash holdings, the fall was from 20.9% to 18.3%, and in the case of reserves, from 18.6% to 16.1% (Figure 9).

b. M3

The broader measure of liquidity, M3, expanded faster over the first three months of 2003, reversing the declining trend it had been showing since the middle of last year. Annual growth of the M3 balance accelerated by 4 percentage points between

[3] The Monitory Conditions Indicator is the weighted sum of changes in the short-term interest rate and the exchange rate, relative to a base year. Weightings reflect the relative effects of these variables on aggregate demand or inflation. [p.23]

December and March, from 7.4% to 11.4%, a level compatible with expected nominal GDP growth for 2003.

M3's performance was associated with liabilities subject to reserve requirements, whose annual growth surged from 5.7% in December to 10.5% in March (Figure 10). As stated above, cash holdings expanded more slowly, which led to a shift in the composition of M3 toward other assets, especially term CDs and savings accounts (Figure 11). Although the CD balance still registered negative annual growth (-3.5%), it was the M3 component with the biggest first-quarter expansion (7.7%).

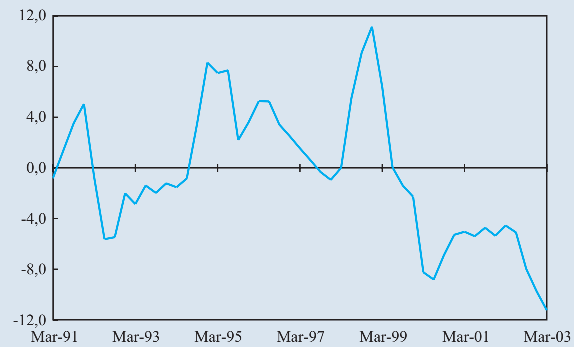
The surge in M3 was reflected by greater availability of funds in the financial system for meeting higher credit demand in the first quarter. In effect, the recovery in credit activity that had begun in mid-2002 continued apace, as evidenced by the gross portfolio's accelerated growth, which jumped from 4.1% in December to 7.0% in March (Figure 12).

The portfolio's buoyancy was produced both by non-mortgage banks, whose growth rose from 6.6% to 9.8%, and by mortgage banks, which began to register positive growth rates in January.

The loan portfolio's growing recovery since January reflects a gradual upturn in the economy, thanks to rising household consumption and higher investment. Credit demand has become very dynamic in the farming sector, too, surging in the first quarter by 60% relative to same period last year, according to the latest data from the Farm Financing Institute (Finagro).

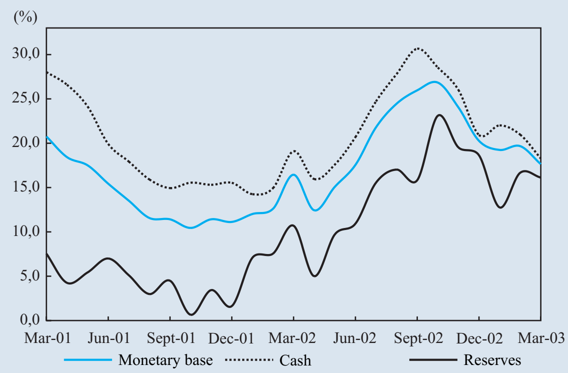
Revival of the mortgage-loan portfolio has resulted also from specific measures that have facilitated reactivation of the construction sector, including regulation of savings accounts offered by the financial system for development of the construction sector.[4] In addition, inflation insurance for mortgage-loan

FIGURE 8
MONETARY CONDITIONS INDICATOR
(PERCENTAGE)



Source: Banco de la República, SGEE.

FIGURE 9
MONETARY BASE AND ITS FORMS OF USE
(ANNUAL % CHANGE IN MONTHLY AVERAGE)



Source: Banco de la República, SGEE.

borrowers and the recently created home-leasing scheme are other incentives for further strengthening demand for mortgage loans.

According to the Bank's expectations survey conducted by in January this year, credit availability was perceived to be significantly higher than in previous surveys: at 67.9%, it was up by 32.1 and 12.3 percentage points on October 2001 and 2002, respectively.

3. Interest rates

The monetary authority's change of stance in January had no significant effect on lending rates, which ended the first quarter only slightly higher than three months

4 Holders of savings accounts in voluntary pension funds can use their money to buy new or used homes and are exempt from withholding tax on these accounts [p.25].

earlier. The aggregate lending rate calculated by the Bank stood at 15.1% at the end of March, up from 14.9% in December, and this rate excluding treasury loans was running at16.2%, up from 16.0%.

By type of loan, nominal rates for preferential loans and credit cards fell by 20 bp between December and March, while rates for consumer and treasury loans edged up, also by 20 bp, and only the rate for common loans rose significantly, by 90 bp[5] (Figure 13).

In real terms, ex post deposit and lending rates decreased over the first quarter of 2003, because of higher inflation. In March, the real DTF deposit rate was at a record low of 0.1%, down from 0.7% in December, and all ex post real lending rates, except for common loans, were also lower than in December.

The minimal effect that the Board's change of monetary policy produced on interest rates suggests that there was ample liquidity in the market. This interest-rate stability is even more striking in that it occurred in a context of revival of the financial system's loan portfolio. It should be noted that, according to a study by the Bank, it takes market interest rates about four months to absorb any variation in reference rates.[6]

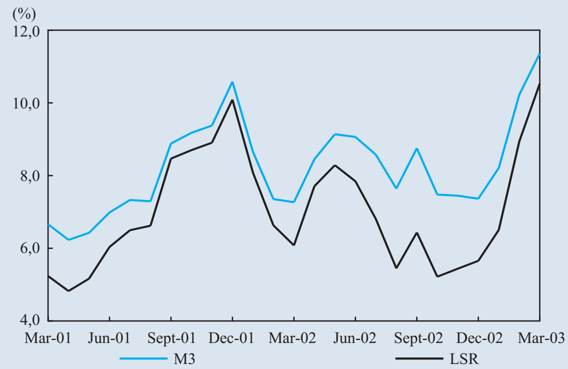
Lastly, the Bank's latest expectations survey reports higher expectations about a deposit-rate increase. The DTF rate is expected to be running at 8.6% by December; that is 0.9 percentage points higher than the actual rate in December 2002.

In the domestic public-debt market, shorter-term yields on TES securities fell over the first quarter, while longer-term yields exhibited an upward correction.

5 This rise in the common-loan rate resulted from the fact that in December a large private bank unexpectedly offered a very low rate for such loans, causing the average rate to plunge from 17.9% in November to 17.1% in December. In March, the rate for common loans was 18.0%, that is to say, only 10 bp higher than in November, but 30 bp lower than the January rate of 18.3%. [p.26]

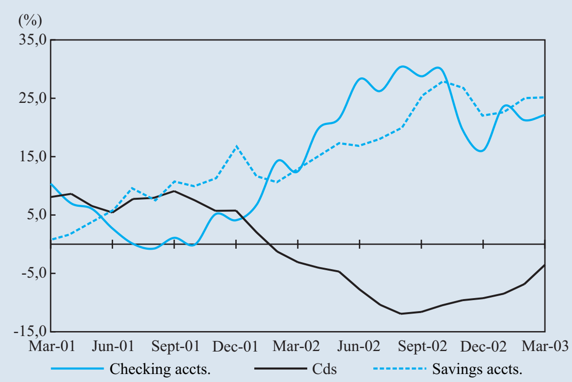
6 Juan Manuel Julio (2001), "Relación entre las tasas de intervención del Banco de la República y las tasas del mercado: una exploración empírica," in Borradores de Economía, No. 188, September 2002, Banco de la República. [p.27]

Figure 10
M3 and liabilities subject to reserve (LSR)
(Annual % change in monthly average)



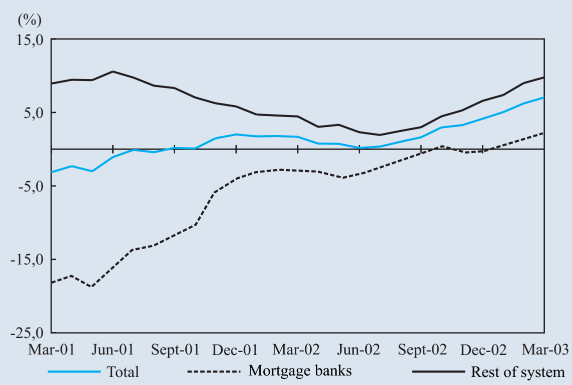
Source: Banco de la República, SGEE.

Figure 11
Components of liabilities subject to reserve
(Annual % change in monthly average)



Source: Banco de la República and Banking Superintendency.

Figure 12
Gross nominal local-currency loan balance of financial system excluding FEN
(Annual % change in monthly average)



Sources: Banco de la República and Banking.

Specifically, the rate of return on one-year securities fell y 30 bp between December and March, while returns on five- and ten-year securities went up by 55 bp and 85 bp, respectively. Thus, the slope of the TES yield curve, measured as the yield difference between one-year and nine-year bonds, became steeper as this difference rose from 391 bp in December to 506 bp in March (Figure 14).

The curve's steepening in the first quarter of 2003 resulted directly from the Finance Ministry's strategy, adopted at the beginning of the year, to reduce liquidity in the long-term public-debt market. This led to a temporary suspension of trading in securities with long maturities and eventually to an increase in their interest rates. Investors usually charge a higher premium on TES securities that lose trading volume in the secondary market. Another factor that affected the TES yield structure was the expectation of further increases in the Bank's intervention rates. Lastly, higher inflation expectations in the market have prompted agents to take short positions, thereby reducing demand for longer-term paper and raising rates.

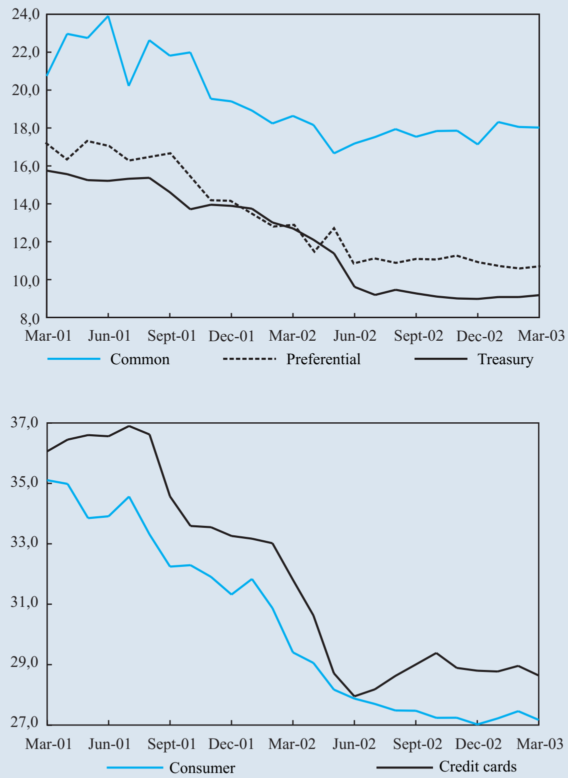
4. Yield differentials

The gap between 360-day domestic CD rates, and one-year foreign deposit rates corrected for the spread on Colombia's sovereign-debt bonds, is an indicator of the domestic and foreign yield differential (Figure 15). Movements in the indicator show that over the past two quarters peso yields have increased relative to dollar yields. The main reason for this is that the country-risk premium on bond issues of Colombian debt has been falling since October.[7] The differential's rise is also explained marginally by the reduction of interest rates in the United States.

5. Exchange rate

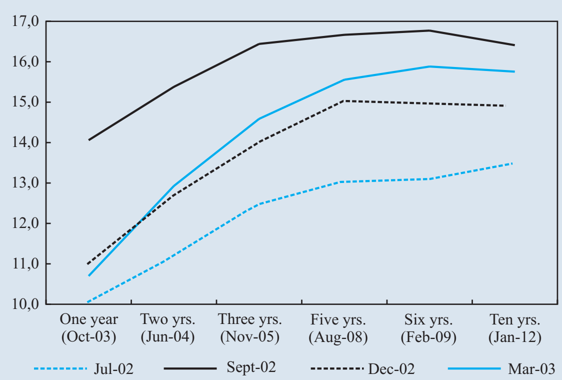
The upward trend that the nominal exchange rate began to show last November continued up to the middle of February, when the rate stabilized around 2,960 pesos to the dollar (Figure 16). At the end of the first quarter the devaluation rate was 30.8%. More recently, however, the exchange rate has fallen sharply, its

Figure 13
Nominal interest rates, by type of loan
(Percentage)



Source: Banco de la República.

Figure 14
Treasury-paper yield curves (*)
(Percentage)



(*) Data from the Electronic Transaction System (SEN).
Source: Banco de la República.

[7] Yield differentials for 2002 and 2003 have been calculated by using the spread on bonds maturing in 2004 as a proxy for the one-year spread. [p.28]

market representative rate (TRM) standing at around 2,865 pesos in early May.

The nominal exchange was stabilized by the Bank's announcement on February 14 that it was prepared to sell up to $1 billion through call options for deaccumulating reserves, and by the actual auctioning of $200m in March. A second auction of equal amount was held in April. The two auctions resulted in options being effectively exercised for only $145 m.

The exchange rate has responded also to developments in foreign capital markets, which have been favorable since the end of last year. Improved conditions in these markets have been reflected in reduction of the country-risk premium (Figure 17).

The rate of nominal devaluation for the first quarter raised the real exchange rate, as measured by the Bank's ITCR1 index,[8] to an all-time record of 139.9 (Figure 18). Compared with the index's level a year earlier, this gave a real devaluation of 25.6%.

Although the weakening of external demand is liable to increase pressure on the real exchange rate, the reopening of foreign markets would allow a larger current-account deficit to be financed. In this case, greater financing of the capital account would provide some leeway for lower exports or higher imports not to be reflected in stronger pressure on the exchange rate.

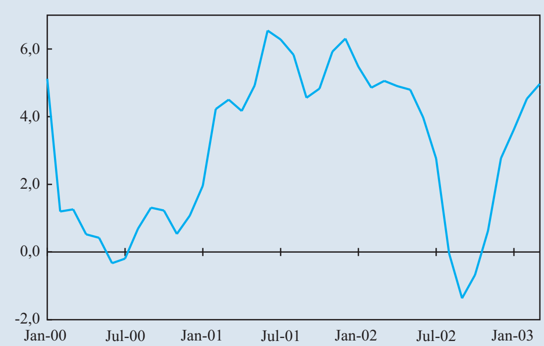
B. Supply and demand

1. Overview

Though growth has accelerated slightly since the second half of last year, the economy is still operating below capacity. It is expected to expand in 2003 by 2% (much the same rate as in the second half of 2002) or even a little faster. Since this is less than the economy's potential output growth, no inflationary pressure from demand is expected this year, and, given the present size of the output gap (3.1%), none should arise even if economic growth speeds up unexpectedly.

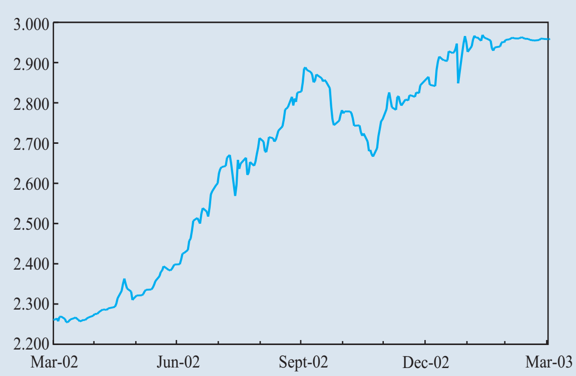
The pick-up in growth has resulted from recovery in private spending, particularly household consumption and investment in building construction. Real devaluation since the middle of last year has helped to shift the rise in private spending toward

Figure 15
Yield differential between domestic rate, & external rate corrected for country-risk spread
(Percentage points)



Source: Banco de la República.

Figure 16
Nominal market exchange rate
(Pesos / dollar)



Source: Banco de la República.

[8] ITCR1, one of the Bank's real exchange rate indices, is based on producer price indices for Colombia and its 20 trading partners. [29]

domestically produced goods.[9] Information available to date suggests that domestic private demand remained buoyant in the first quarter of 2003.

Expectations regarding external demand have weakened since the previous Report. Industrial exports to all countries other than the United States have decreased, and the crisis in Venezuela has had a particularly serious effect.

However, developments in foreign capital markets have been favorable since the end of last year and are reflected in a lower country-risk premium and in placements of public-debt bonds in international markets.

Since the private sector has reduced its net foreign borrowing in recent years, it is in a position to take greater advantage of improved conditions in external capital market. Different studies have shown that there is a close relationship between private foreign capital flows and economic growth.

2. Demand and external balance

The current-account deficit deteriorated in 2002 relative to 2001. In macroeconomic terms, this deterioration reflected greater buoyancy in domestic absorption, compared with GDP growth, a situation not seen since 1998 (Figure 19).

The external imbalance increased largely because weakening external demand caused the balance of trade in goods to deteriorate. In contrast, imports picked up substantially in the second half of 2002, especially for the industrial sector.

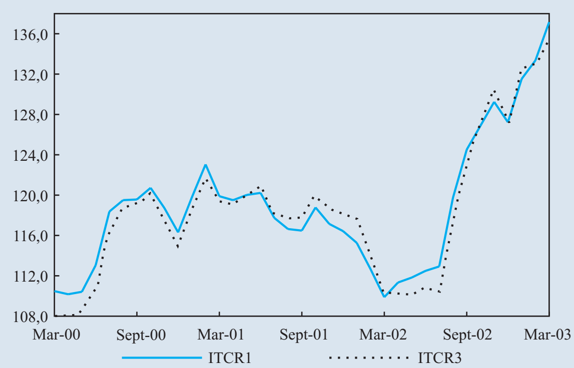
The current-account deficit for this year may widen to 2.3% of GDP; that is 0.3 percentage points higher

[9] According to information from DANE, imports of durable goods shrank by 6.0% in January, while retail sales excluding fuel and food grow by 5.7%. [p.30]

Figure 17
Colombia's country-risk spread (*) Vs. Market exchange rate

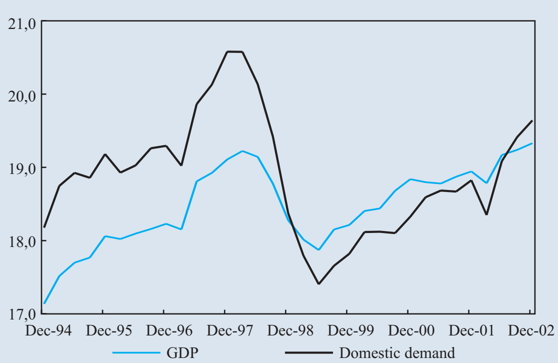
(*) From J.P. Morgan's Emerging Markets Bond Index Plus.
Source: Banco de la República.

Figure 18
Real exchange rate indices ITCR1 and ITCR3 (1994 = 100)



Source: Banco de la República.

Figure 19
GDP vs. Domestic demand, seasonally adjusted series
(Billions of 1994 pesos)



Source: DANE.

than the forecast given in the previous Report. A deficit of this size is compatible with an expected growth of 2.0% and a real average devaluation of 13.2% (Table 2).

a. Exports

The fourth quarter of 2002 saw exports of goods expanding by 3.0% relative to the same period the year before. This expansion reflected an increase in traditional exports largely caused by higher oil prices. In contrast, nontraditional exports continued to fall, especially those to Venezuela.

Available information suggests that in the first quarter of 2003 external demand for nontraditional industrial products decreased faster than was forecast in the previous Report (Figure 20). At the time of writing (April), sales to Venezuela are still stagnant, partly because of delay in approving import licenses. Sales to other trading partners[10] have been falling since November. Consequently, though first-quarter sales to the United States are expected to have improved thanks to the Andean Trade Promotion and Drugs

10 Exports to countries other than the United States, Ecuador and Venezuela. [p.32]

Table 2
Colombia's summarized current account
($Billions)

	2001(pr)	2002(pr)	Variación	
			Absoluta	(%)
Cuenta corriente (A+B+C)	(1.215)	(1579)	(363,7)	
As % of GDP	(1,5)	(2,0)	(363,7)	
Revenues	18.465	17.521	(944,3)	(5,1)
Outlays	19.680	19.100	(580,7)	(3,0)
A. Goods and non-factor services	(900)	(1.226)	(326,0)	
Revenues	14.966	14.152	(813,9)	(5,4)
Outlays	15.866	15.378	(487,9)	(3,1)
1. Goods	520	228	(292,0)	
Revenues	12.787	12.304	(482,7)	(3,8)
Outlays	12.267	12.076	(190,7)	(1,6)
2. Non-factor services	(1.419)	(1.453)	(34,0)	
Revenues	2.180	1.848	(331,3)	(15,2)
Outlays	3.599	3.302	(297,2)	(8,3)
B. Factor income	(2.607)	(2.729)	(121,9)	
Revenues	905	688	(217,1)	(24,0)
Outlays	3.513	3.417	(95,2)	(2,7)
C. Transfers	2.292	2.377	84,2	
Revenues	2.594	2.681	86,7	3,3
Outlays	302	304	2,5	0,8

(pr) Preliminary.

Sources: Banco de la República.

Eradication Act, they may not have been enough to offset the negative effects of Venezuela and other trading partners.

The outlook for nontraditional exports in the second half of the year seems brighter, because the main administrative barriers impeding exports to Venezuela should have been surmounted by then, and also because the peso's 22.7% real average devaluation since the middle of last year[11] should have made Colombian exports more competitive.

Regarding traditional exports, the first quarter saw a 1.6% increase in the number of bags of coffee exported, according to the government's Coffee Advisors. But a 10% fall is expected for the year as a whole. The value of oil exports is expected to be about the same as in 2002, assuming the average price for 2003 is equal to or slightly higher than last year's. Thus, traditional exports may behave much the same this year as last year.

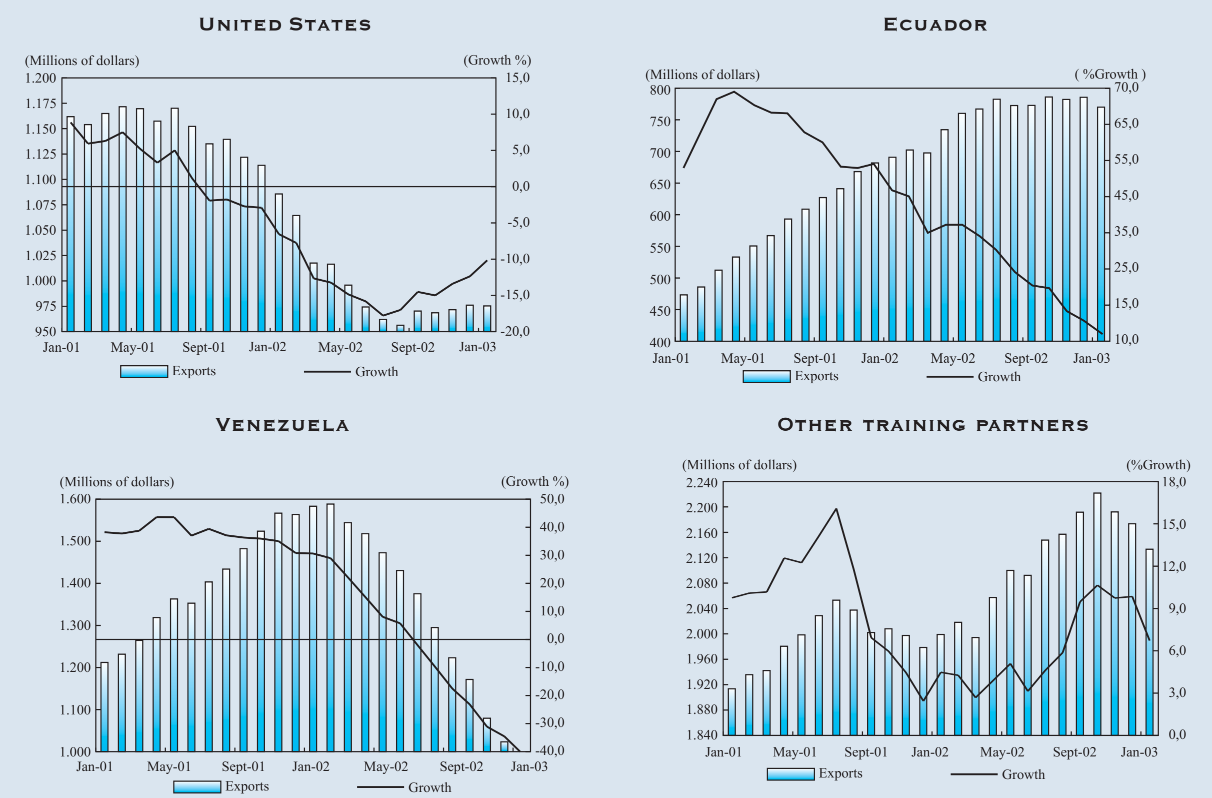
On the whole, 2003 is not expected to be a good year for external demand. The predicted fall in nontraditional exports and stagnation in overseas sales of traditional productions will bring down overall exports.

b. Private spending

Optimism about private spending in the fourth quarter of 2002 proved justified (Table 3). Private demand picked up in an environment of low interest rates, increasing consumer and investor confidence, and rising urban employment. Consumer spending in the last three months of 2002 benefited from financial establishments' willingness to provide credit. (Some

[11] Between June 2002 and March 2003. [p.32]

FIGURE 20
NONTRADITIONAL INDUSTRIAL EXPORTS
LATEST 12 MONTHS, TO NOVEMBER 2002



Source: DANE

credit-card companies charged lower interest on purchases made in December, while others offered not to charge for December purchases until February.)

The improvement in investment spending on machinery and equipment was attended by recovery in industrial production over the second half of 2002. Spending on building construction registered was buoyant all through the year (Table 3), driven by the government's policy of subsidizing low-income housing and by rising mortgage credit.

In the first quarter of 2003, households were faced with implementation of the new tax reform and the freezing of public-sector salaries. Nevertheless, available information suggests that private spending remained dynamic. Meeting the fiscal targets should help to reinforce the favorable developments observed in financial markets, which in turn should raise investors' confidence in Colombia and encourage higher capital inflows.

According to the State Statistical Agency (DANE), real industrial sales grew by 5.3% in January. Considering that nontraditional industrial exports plunged steeply in January (-32.9%), the increase in sales must have occurred in the domestic market. Moreover, other indicators, such as credit-card sales to February, the findings of the National Commerce Federation's survey of its members in March, and

Table 3
GDP growth in terms of demand
(Annual % change)

	2001 (p)					2002 (p)				
	I	II	III	IV	Annual	I	II	III	IV	Annual
Gross domestic product	2,13	1,85	1,03	0,56	1,39	(0,07)	2,08	1,94	2,03	1,50
Total imports	7,74	12,49	14,33	11,98	11,60	(8,95)	(1,76)	3,50	7,44	0,11
Total final supply	2,97	3,40	2,91	2,21	2,87	(1,46)	1,47	2,19	2,89	1,28
Final consumption	2,20	1,98	1,55	1,60	1,83	1,83	2,15	2,11	1,05	1,78
Households 1/	1,65	1,38	1,27	3,22	1,88	2,33	2,18	2,47	1,81	2,20
Final domestic household consumption 2/	2,11	1,74	1,45	3,40	2,17	1,94	1,78	2,36	1,81	1,97
Nondurables	1,90	1,38	(0,29)	1,49	1,12	0,46	0,74	1,60	0,84	0,91
Semidurables	(0,90)	(4,35)	(6,55)	(1,85)	(3,45)	2,97	(1,84)	3,90	1,96	1,74
Services	1,40	1,59	2,85	4,50	2,58	1,92	1,89	1,86	2,12	1,95
Durables	17,93	20,76	21,26	20,24	20,07	12,19	15,63	9,40	6,01	10,65
Government	3,79	3,72	2,37	(2,77)	1,71	0,45	2,09	1,07	(1,14)	0,62
Gross capital formation	5,02	9,71	13,10	9,66	9,29	(18,79)	2,13	14,64	23,40	5,22
Gross fixed capital formation	4,68	11,41	17,59	21,75	13,82	(1,05)	4,22	7,07	9,47	5,13
Farming, forestry, hunting & fishing	(1,36)	(9,74)	1,92	2,02	(1,99)	10,16	14,83	17,22	9,83	12,95
Machinery & equipment	0,98	17,07	19,83	24,05	15,23	(3,75)	(4,35)	6,02	6,09	1,17
Transport equipment	16,80	13,75	52,04	75,93	36,35	(17,53)	7,26	16,30	25,66	8,55
Building construction	10,01	10,85	7,46	15,59	10,98	23,45	21,76	20,58	25,62	22,89
Civil works	2,54	9,74	21,53	19,69	13,33	(16,97)	(3,55)	(6,64)	(5,23)	(7,86)
Subtotal: final domestic demand	2,62	3,10	3,13	2,71	2,89	(1,30)	2,15	3,98	4,34	2,30
Total exports	4,74	4,93	1,84	(0,31)	2,74	(2,22)	(2,05)	(6,80)	(4,57)	(3,93)
Total final demand	2,97	3,40	2,91	2,21	2,87	(1,46)	1,47	2,19	2,89	1,28

(p) Provisional.
1/ Includes purchases of goods made abroad by people residing in Colombia but not those made in Colombia by non-residents.
2/ Final consumption in Colombia by resident households.

Source: Supersociedades and Supervalores. Banco de la República calculations.

sales of new vehicles to March, suggest that industrial sales grew well all through the first quarter.

As regards investment spending, imports of industrial capital goods surged by 20.5% in January. As mentioned in the previous Report, the tax exemptions introduced in October 2002 for such imports may have boosted them.

Since January, indicators associated with spending on building construction have been giving positive signals about construction activity. The sector's greater dynamism has been accompanied by a pick-up in prices for new (upper-income) homes, and by a relative scarcity of middle- and high-income housing.

The upturn in real-estate activity may account for a slight acceleration of rent inflation in the CPI to March, and suggests that further acceleration may be expected over the rest of the year.

b. Private spending

Public spending contracted in the fourth quarter of 2002, in both consumption and investment (civil works) (Table 3).

As in the previous Report, the first quarter of 2003 is expected to register a sharp rise in public spending, especially on investment, because of the holding back of payments in the first quarter of 2002, without this rise jeopardizing accomplishment of the fiscal-adjustment program.

Preliminary information from the Treasury Office shows that tax revenues for the first quarter of this year were higher than expected (by 54 billion pesos according to the 2003 Financial Plan), reflecting perhaps better-than-expected economic growth and also greater efficiency by the Tax and Customs Administration.

C. Labor-market variables

There is at present no great pressure on inflation from labor variables. Unit labor costs in manufacturing continue to fall despite a pick-up in pay increases. Pay-settlement data to March show that some 80% of all workers covered by any kind of collective agreement have obtained pay increases for the year within the range of 5.5% - 8%. This is a much higher proportion of workers in this range than last year's 37.4%.

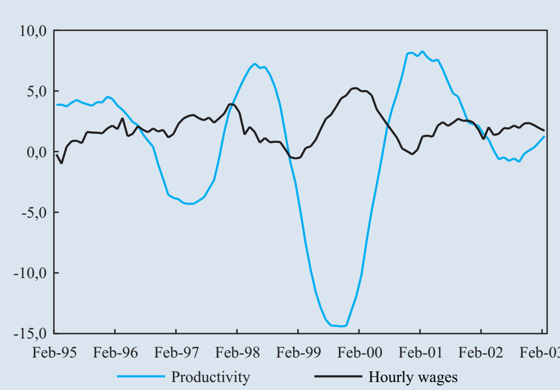
1. Industrial pay and labor productivity

Figure 21 shows accumulated variations in manufacturing workers' real hourly wages and labor productivity. As can be seen, from June 2000 to February 2002 accumulated productivity gains were consistently higher than increases in workers' real wages. Since then, real hourly wages have picked up slightly, affecting accumulated variations in unit labor costs (Figure 22).

2. Employment and unemployment

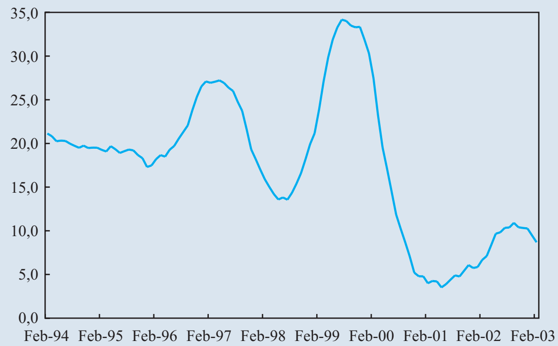
The unemployment rate for the 13 major cities was 17.8% in March, 0.1 percentage points higher than a year earlier (Figure 23). Job creation continued to be dynamic over the first quarter, with the number of employed workers rising by 4.0% relative to the same period last year (Figure 24), which suggests stronger economic activity. This positive development in the first quarter must be largely attributed to higher investment in civil works and building construction.

Figure 21
Hourly wages and productivity,
12-months'accumulated % change
(Percentage)



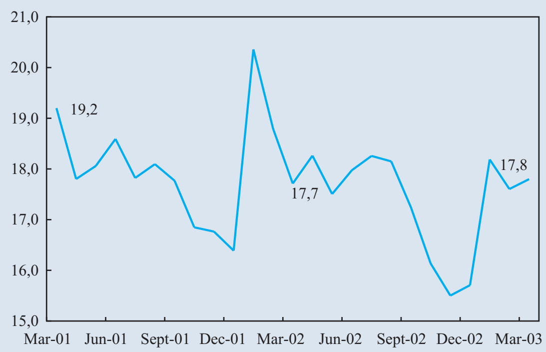
Source: DANE.

Figure 22
Nominal unit labor costs, 12-months'accumulated % change
(Percentage)



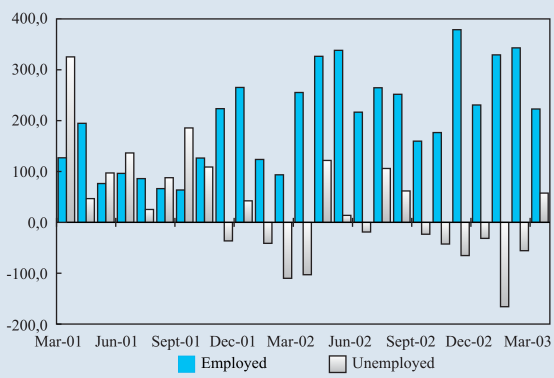
Source: DANE.

Figure 23
Unemployment rate, 13 cities
(New methodology)



Source: DANE, Continuing Household Surveys.

Figure 24
Annual rise in number of employed & unemployed workers, 13 cities



Source: DANE.

As regards industrial employment, information from the monthly manufacturing samples indicates that in January and February temporary employment grew, on average, by 4.4%, a rate not seen since the first quarter of 2002 (Figure 25). At the same time, permanent employment decreased by an average 4.55%, which means that overall industrial employment fell by 1.45%; in both cases the drop was the smallest since the end of 2001.

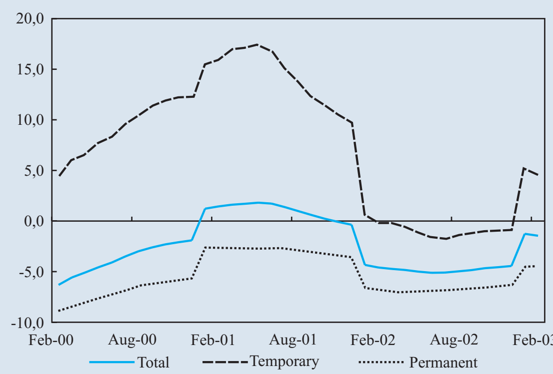
3. Pay settlements

Table 4 shows the percentage of workers covered by collective agreements reported to the Ministry of Labor and Social Security by March 2003, by range of one-year pay increases. The highest percentage of workers, 77.3%, are in the 5.5%-8% range, a far higher proportion than last year's 37.4% within this range. Moreover, very few workers have received a pay increase in the uppermost range of 10%-12%: barely 0.4%, compared with 17.4% last year.

D. Capacity utilization and output gap

The picture presented by capacity utilization and the output gap has remained the same as in the previous Report. The latest available data show that, in

Figure 25
Manufacturing employment
(Accumulated annual % change)



Source: DANE.

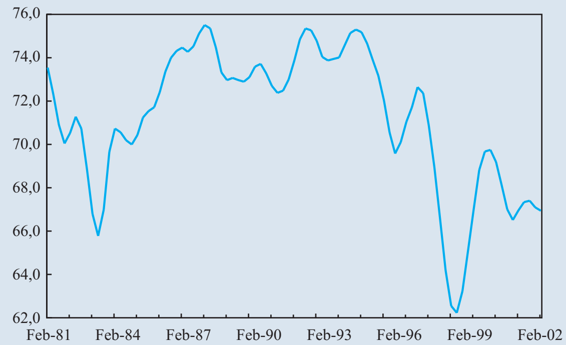
TABLE 4
ONE-YEAR PAY SETTLEMENTS, BY PERCENTAGE OF BENEFICIARIES

(January-March 2003)			
<5,5	[5,5-8,0]	[8,0-10,0]	[10,0-12,0]
1,1	77,3	21,3	0,4

(January-December 2002)			
<5,5	[5,5-8,0]	[8,0-10,0]	[10,0-12,0]
6,1	37,4	39,1	17,4

Source: Ministry of Labor and Social Security.

FIGURE 26
CAPACITY UTILIZATION, FEDESARROLLO INDEX
(TENDENTIAL COMPONENT)



Sources: Fedesarrollo. Calculations by Banco de la República, SGEE.

February, utilization of installed industrial capacity was still below historical levels. tradables. In September, their profitability level was -4.1%, versus 8.2% for companies in the tradable sector.

By breaking down Fedesarrollo's (a private research institution's) capacity-utilization series into irregular, seasonal and tendential components,[12] and taking the tendential component as a reference (Figure 26), capacity utilization in February 2003 is estimated at 66.9%. This percentage is very similar to the level a year earlier and only higher than utilization during the first half of 1983 and the recession of 1999.

[12] This operation was performed using the Census X-12 procedure. [p.37]

Moreover, it is 6.0% lower than the historical average for 1981-2003. The same exercise performed with ANDI's (a major industrial association's) installed-capacity indicator gives a similar result. ANDI's figure for February undershoots the historical average for 1990-2003 by 3.9%.

The various indicators of output gap estimated by the Bank confirm that the existence of amply spare capacity in the economy as a whole. The output gap amounted to 3.1% of GDP in the fourth quarter of 2002 and is expected to remain around this level all through this year.

For the above reasons, aggregate demand is not expected to generate any inflationary pressures in the coming quarters.

III

International context

For Colombia, the most significant foreign development in the past three months has been the improvement shown by international circles in their perception of Latin America, amid a world economic downturn. Although the developed economies' weakening has a very harmful effect on Latin America, low interest rates in both the United States and the euro zone and the fall in share prices have given emerging countries a comparative advantage in attracting international capital flows. Greater clarity about Brazil's economic policies has also contributed to restoring the confidence shown to the region's countries. In the short-term, therefore, Latin American economies have better chances of obtaining external financing than was predicted in the December Report.

The world economic downturn deepened in the first quarter of this year. The economy of the United States, the powerhouse for the world, shows no signs of recovering in the short term; in fact, the growth rate predicted for it three months ago has been revised down. Forecasts for the euro zone have remained unchanged, but at very low rates. Confidence indices are still falling in both the United States and the euro zone, and unemployment has not abated. Japan's prospects of economic expansion remain poor.

Slow growth in the advanced economies has allowed them to keep inflation under control. Some pick-up in inflation, particularly in the United States, is attributed to transitory factors connected with higher fuel prices. Consequently, analysts do not expect any shifts to tighter monetary policy in the coming months. In fact, the European Central Bank may decide to reduce its rates marginally in the next few months. In Latin America, the rising trend in inflation observed at the end of last year continued through the first quarter in some countries such as Brazil and Venezuela. Monetary policy in the region is therefore expected to become tighter than in previous months.

Generally speaking, the world economy is beset by a high degree of uncertainty and fragility. The previous Report saw the possibility of war between the United States and Iraq as the greatest risk factor. The war started on March 19 and, by the time this Report was going to press, it had ended as rapidly as markets had expected, with victory for the coalition forces. Thus, uncertainty about the future availability of oil diminished and oil prices, having begun to fall after the start of the war, continued to drop.

Despite the elimination of this risk factor, economic conditions continue to worsen, according to some analysts, exposing problems of a more structural nature, especially in the Unite States. The US economy is beset by large fiscal and current-account deficits, which, if not reduced gradually, will strongly affect aggregate demand in the world's biggest economy. In addition, the country's low levels of household saving and high levels of borrowing may reduce growth in consumption, particularly of durable goods.

A. Developed economies

TAlthough economic conditions in the United States did not change much in the first quarter of 2003 compared with their description in the previous

Report, expected growth for the year has been revised down slightly (Table 5). Share prices continued to fall, affecting prospects for consumption and investment, as evidenced by a further drop in the confidence index, down to a record low in March (Figure 27). At the same time, headline inflation rose, while core inflation continued to decrease (Figure 28). The dollar remained low, reflecting pressure from the current-account deficit (Figure 29).

The tax cut, high public spending, and low interest rates are presently the main factors likely to drive consumption and investment in the US. Fiscal policy is expected to remain expansionary over the rest of the year, in contrast to monetary policy, which is constrained by the low interest rates now prevailing. Fiscal measures may work in the short term, but they can cause considerable problems in the medium and long term, especially with the fiscal gap already so wide. Because of their size, the US's fiscal and current-account deficits do not provide a lasting means of recovery for the world economy. For the United States to boost world economic growth, US demand would have to expand beyond the country's potential output, widening the current-account deficit. With net external liabilities already representing 25% of GDP, this is not likely to occur.

Growth forecasts for the euro zone were left unchanged (1.8%) in the first quarter, though economic activity there grew weaker. Investment continued to fall, and consumer confidence declined further. So did industrial confidence, reflecting expectations of lower output.

Euro-zone inflation has remained relatively stable, albeit higher than the 2% ceiling of the price-stability range set by the ECB's Council. Inflation behavior in recent

Table 3
Actual and forecast growth rates

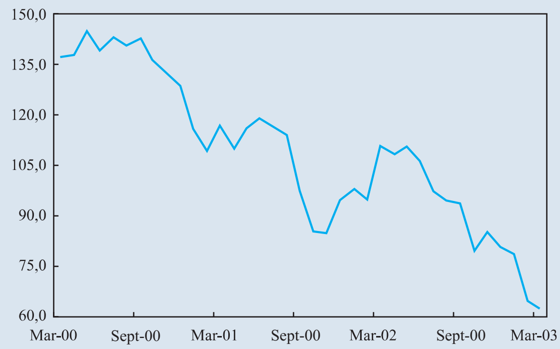
	Actual Growth	Growth forecast		
	2002	2003	2004	2003
World				
United States	2,4	2,4	3,7	2,7
Euro area	0,8	1,8	2,7	1,8
Japan	0,3	0,6	0,7	0,4
Latin America				
Argentina	(11,0)	3,4	4,0	2,0
Brazil	1,5	1,7	2,8	1,7
Chile	2,0	3,2	4,0	3,3
Mexico	0,9	2,6	4,2	3,2
Peru	5,2	3,9	4,0	3,4
Ecuador	3,0	2,7	3,6	3,0
Venezuela	(8,9)	(15,3)	6,0	0,1
Colombia	1,6	2,3	3,1	2,2

1/ Made in April 2003
2/ Made in January 2003

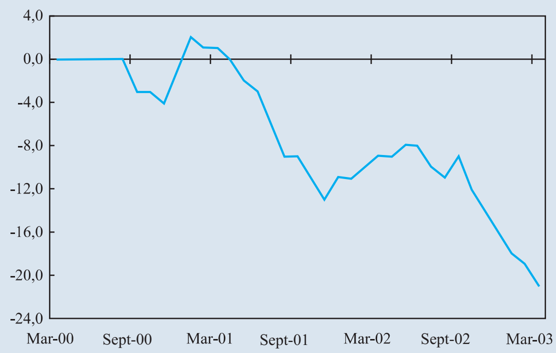
Source: IMF for actual figures; Datastream for forecasts.

FIGURE 27
CONSUMER CONFIDENCE INDICES:
USA, EUROPEAN UNION

UNITED STATES



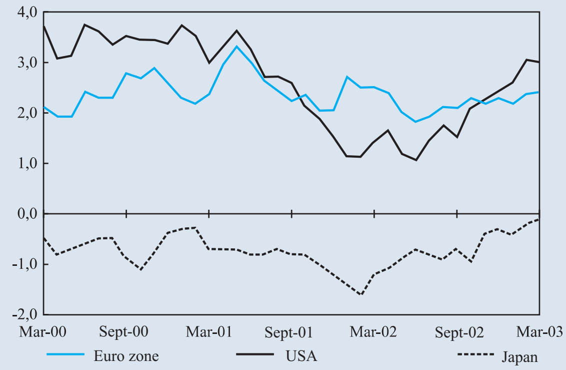
EUROPEAN UNION



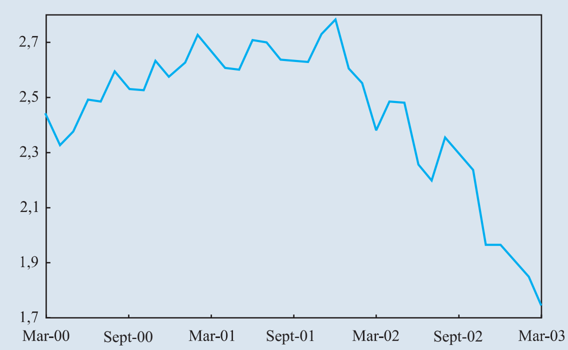
Source: Datastream

FIGURE 28
INFLATION: EURO ZONE, USA, JAPAN

INDUSTRIALIZED ECONOMIES

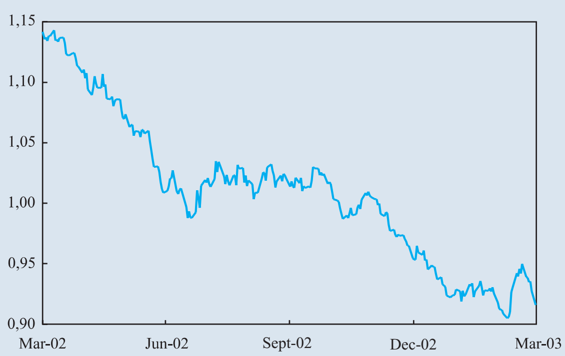


CORE INFLATION: UNITED STATES



Source: Datastream

FIGURE 29
EURO EXCHANGE RATE
(EUROS/ DOLLAR)



Sources: Datastream.

months has been determined by supply factors largely connected with higher international oil prices. The recent drop in the price of crude is likely to be reflected in inflation from April. The euro's appreciation against the dollar, and weak demand may also affect inflation in the medium term. In view of the foregoing, the ECB decided in March to reduce its intervention rate by 25b bp, to 2.5%. Monetary policy is not expected to tighten in the coming months; in fact, some analysts suggest that there is room for further marginal cuts in the interest rate.

B. LATIN AMERICA

Latin American economies improved their performance in the first quarter of this year relative to the last quarter of 2002. Most of them saw reductions both in the country-risk premiums on their debt, especially in the second half of the quarter, and in their exchange rates (Figure 30 and Table 6). But some countries, such as Mexico, Venezuela and Ecuador, are now forecast to grow less strongly in 2003 than was predicted in December.

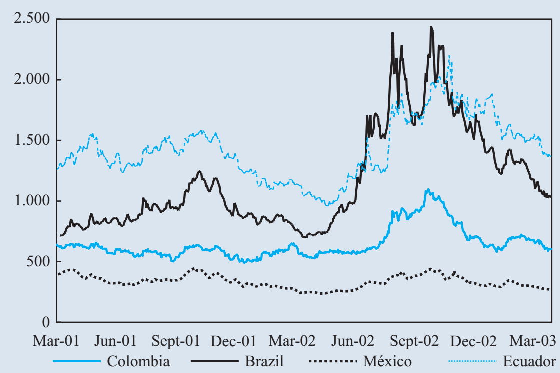
The latest information suggests that lower country-risk premiums on debt may in part be a reflection of better access to funds in the international market. In effect, low interest rates in developed countries, combined with poor economic performance and continual stockmarket losses, may have made it more attractive for agents to invest in emerging markets than in the United States or Europe, thereby making foreign financing more available to Latin American countries, at least in the short term. Another contributing factor has been a steadying of expectations about Brazil's economic policies.

In Venezuela, the political crisis abated to a certain extent during the first quarter, and oil production rose faster than the market expected, after falling significantly in early January. The bolívar's strong devaluation since the end of 2002 prompted the economic authorities to introduce a new exchange regime ('new foreign-currency administration regime'), effective from February, to restrict the purchase of dollars by market agents and so check the exchange rate's rising trend. Implementation of the system has been entrusted to the Foreign-Currency Management Commission (Cadivi), whose main responsibility is to issue permits for foreign-currency purchases under the exchange regime. In addition, the exchange rate against the dollar was fixed at 1,596 bolívars for buying and 1,600 bolívars for selling.

Even with its sharp increase in crude production, the Venezuelan economy is expected to contract by 15.3% this year, a much stronger contraction than last year's 8.9%. For the country to achieve sustained economic recovery, its political crisis will need to be resolved so as to restore consumer and investor confidence.

In Ecuador, the new government has proposed new reforms to solve the country's current fiscal problems. The reforms include freezing public-sector salaries and raising energy charges. According to the latest confidence survey, businessmen in the productive sector are cautious and do not expect interest rates to fall in the short term. The majority also think that a sustained decline in the world price of crude could add to the country's fiscal problems. The economy is expected to growth more slowly this year (2.7%) than last year (3.3%).

Figure 30
Latin american country-risk spreads (*)
(Basis points)



(*) From J.P. Morgan's Emerging Markets Bond Index Plus.
Source: Datastream.

Table 6
Cubrimiento de cartera
(Percentage)

	Quarterly rate (*)	Annual rate March 31/03
Argentina	(11,5)	1,3
Brazil	(5,3)	44,2
Chile	1,8	11,7
Mexico	3,6	19,4
Peru	(0,8)	0,9
Venezuela	15,2	76,5
Uruguay	6,2	85,1

(*) Devaluation in March 2003 relative to December 2002 (end of fiscal year).

Source: Datastream.

C. Commodity prices

World commodity prices, which had been rising slowly since the end of 2001, continued to do so in the first quarter of 2003 despite a slight downward correction in March. According to The Economist's commodity price index, prices in March were up by 1.5% on last December and by 9.8% on March 2002. By item group, the food index in March was 0.7% lower than last December but 10.8% higher than a year earlier, while the industrials index rose by 5.0% in the first quarter to end up 8.3% higher in March than twelve months earlier (Figure 31).

It is important to point out that the rise in commodity prices over the past few quarters has largely resulted from depreciation of the dollar. In euros, the overall index has dropped in the past few months (Figure 32).

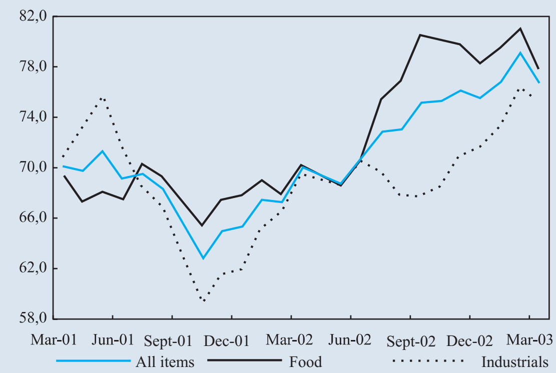
Pressure on world commodity prices is expected to ease further over the rest of the year. One reason is that climatic conditions are expected to improve and should increase the supply of agricultural products, especially grains. Another reason is that the poor outlook for world economic growth will depress the prices of metals and industrial goods.

Oil and Cofee

World oil prices rose steadily for much the first quarter, largely in response to great uncertainty about the conflict with Iraq, and the considerable drop in Venezuela's crude production. The WTI oil price averaged $34.0 a barrel in the first quarter, 57.4% higher than a year earlier and 20.1% higher than in the fourth quarter of 2002 (Figure 33).

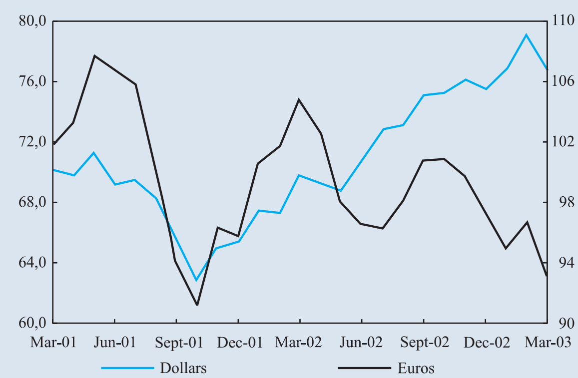
But the start of the war on March 19 caused oil prices to plummet. For three reasons, according to analysts. First, uncertainty about the war and its duration decreased. Second, Venezuela's oil production went up again faster than expected; it now appears to be approaching levels reached before the civic strike of

Figure 31
Dollar commodity price index, by item group
(1995=100)



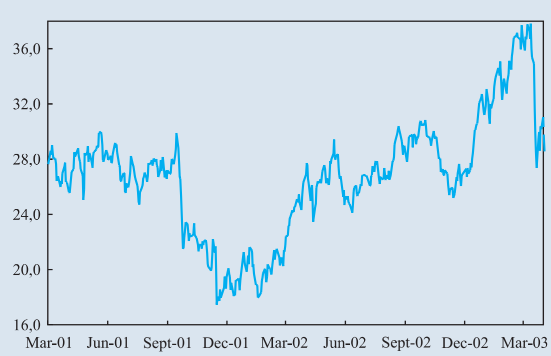
Source: *The Economist.*

Figure 32
Dollar & euro commodity price indices
(1995=100)



Source: *The Economist.*

Figure 33
WTI oil price
New York stock exchange
(Dollars/barrel)



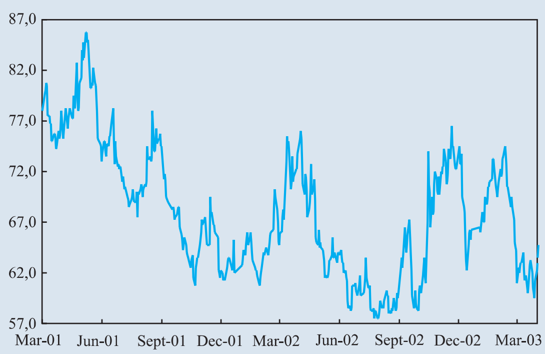
Source: Bloomberg

December 2002. Lastly, world oil demand usually falls when winter is over.

The future behavior of oil prices is highly uncertain and will depend essentially on how the Middle East conflict unfolds and how fast production is fully restored in Venezuela and Nigeria.[13] However, since the other oil-producing countries have increased their production in recent months, there is also a likelihood of oversupply. Hence, the downward revision of the oil-price forecasts for 2003 presented in the previous Report. The price of oil this year is now expected to average between $27 and $29 a barrel.

In March, the international price of coffee fell once more, though it had picked up in the fourth quarter of 2002 and again in January of this year. It averaged 69.9 cents a pound in the first quarter, 0.3% higher than in the same period last year and 3.0% lower than in the fourth quarter of 2002 (Figure 34). Supply factors are still the main determinants of coffee prices. According to the latest report of the International Coffee Organization, large harvests for the 2002/2003 coffee year made this the fifth consecutive year of overproduction. Coffee consumption continues to be weak, reducing the possibility of a price recovery. However, as mentioned in the previous Report, coffee production is expected to decrease in Brazil and other exporting countries that have been affected by persisting low prices. In that happens, the average price is likely to be higher in 2003 than it was in 2002.

FIGURE 34
COLOMBIAN ARABICA COFFEE PRICE
NEW YORK STOCK EXCHANGE
(CENTS/POUND)



Source: Bloomberg

13 Oil production in Nigeria was brought to a standstill on March 19 by political and ethnic unrest. It is expected to be fully restored by the middle of the year. [p.46]

IV

Inflation forecasts

A. Background

Headline inflation accelerated over the first quarter, to 7.6% in March, largely driven by core inflation. Since mid-1996, increases in core inflation had not occurred for more than two months running or been so large (180 bp).[14] Moreover, in March non-food inflation and the other core-inflation indicators stood far above the target range set by the Board for December 2003.

As indicated in the previous Report, some rising price trends were already apparent by the end of last year, when headline inflation overshot the annual target (6% for 2002) for the first time since 1998. The acceleration of headline inflation in the fourth quarter resulted mostly from food pressure (mainly potatoes), and from devaluation and higher import prices. Accordingly, the Bank's inflation forecasts for 2003 were revised upward to reflect the lagged effect of accumulated devaluation and higher expectations.

The further rise in inflation over the first quarter of this year still reflected costs arising from last year's accumulated devaluation. Another contributing factor has been a rapid increase in inflation expectations in the first months of the year, as suggested by some indicators and by the loss of credibility of the targets for this year and next (see Chapter I). Lastly, prices have also risen because of transitory supply shocks, which in the first months of the year included, besides higher food prices, the impact of VAT reform, the high price of fuel, and increases in energy charges. The effects of these shocks on annual inflation have begun to diminish and their decline is expected to speed up over the rest of the year, though a more lasting impact cannot be ruled out if the shocks are assimilated into expectations.

To avoid this happening and ensure that targets would be met, the Board decided to raise intervention interest rates by 100 bp at the end of January. Similarly, to help steady the exchange and thereby cause inflation to fall, the monetary authority announced in February that it was prepared to deaccumulate reserves by up to $1 billion through call options. These measures stabilized the value of the dollar without raising any market interest rates other than TES rates.

Breakdown of consumer inflation into groups and subgroups shows that inflationary pressure from demand could not have been a cause of the first-quarter rise in inflation. Although economic activity has gained momentum since the middle of last year, it was still running below potential in early 2003, and its expected growth for this year will only make a small gradual difference in this situation.

Given the improvement in external conditions and the Bank's readiness to intervene in the exchange market, the exchange rate is now expected to remain relatively stable in the coming months. But even in this optimistic scenario there are still inflationary pressures that could make it difficult to meet this year's inflation target and set a smaller one for next year.

[14] 14 The average of the three core-inflation indicators calculated by the Bank. [p.48]

B. New developments

1. On the external front

Judging by various indicators, the world economy has shown less vigor recently than was predicted in the previous Report. In fact, poor stockmarket results and the disappointing behavior of other leading economic-cycle indicators have led analysts to lower again their growth forecasts for this year, made three months ago. This has happened despite the Iraq war's favorable outcome for the US-led coalition.

In the medium and long run, the world economy's capacity to expand may be limited by structural problems afflicting the US economy, the world's biggest engine of growth for the past ten years. As discussed in detail in Chapter III, the Unites States' fiscal and external accounts currently show negative imbalances, which are liable to grow worse in future and are accompanied by increasing public and private borrowing. To correct these imbalances, financing and spending would have to be reduced, which would most probably slow the US economy's growth for some time to come.

It is a fact, however, that the above trends have favored the flow of foreign capital to emerging countries by making their assets more attractive than those of the United States. A further boost came from the very low dollar value of those countries' assets at the end of 2002, owing to their currencies' strong depreciation in recent years. The improvement in external conditions was already apparent at the end of last year, but the December Report failed to foresee how considerable it would be in the first quarter.

It is not clear today whether the improved conditions are sustainable, because the downturn in developed economies may affect foreign investors' confidence in this region. Various analysts expect that interest rates and asset yields in the US and other markets will remain depressed for the time being and favor the flow of capital to Latin America.

For Colombia, the financial markets' renewed confidence in the region may mean greater exchange-rate stability in the coming months than the December Report had predicted. In the longer term, this country's access to capital may still depend substantially on the targets of the fiscal-adjustment program being met and on public external debt being stabilized at sustainable levels.

With the reopening of foreign markets it should, in principle, be possible to finance a larger current-account deficit, if the private sector increases its net foreign borrowing or slows its pace of debt repayment. In this event, higher current-account financing would provide leeway for lower exports (particularly to Venezuela) or higher imports not to be reflected in greater pressure on the exchange rate.

To sum up, though no radical changes are discernible relative to the previous Report, external conditions are now expected to generate less inflationary pressure in the coming months, thanks to greater exchange-rate stability and flagging external demand. Similarly, the international price of oil is expected to fall faster than was predicted before, and this, too, should ease some pressures on domestic costs and prices that have been a major cause of rising inflation in recent quarters.

2. On the domestic front

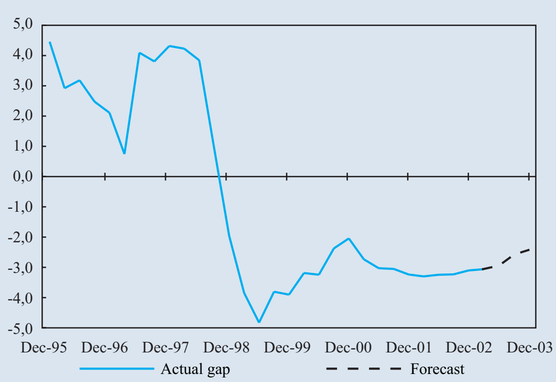
In the past two quarters, real activity has behaved as predicted by previous Reports. The pace of growth has picked up gradually since the middle of last year, sustained chiefly by recovery in private domestic demand.

This trend is expected to continue in the coming months, with private consumption and private investment still driving growth. Several favorable factors support this view, including low interest rates, lower levels of borrowing, banks' greater readiness to extend credit, some degree of import substitution, and improved perceptions of security conditions, all of which have become more pronounced in recent months.

This Report's growth forecasts for 2003 are not much different from the December Report's, and the 2% target set by the government is considered to be feasible. This view coincides with the opinion of several foreign and Colombian analysts, who predict a growth of 2.0%-2.5% for this year. It should be pointed out however that, given the dearth of available data, it is highly uncertain what the potential effect will be of the weakening now predicted in external demand, nor can it be ignored that this weakening may to some extent neutralize the favorable trend in private domestic demand and affect aggregate growth.

Expected growth for 2003 should not generate any inflationary pressure, for the economy will still be operating below its potential capacity. According to our estimates, the output gap (actual GDP less potential GDP) is presently negative by about 3.0% and is likely to remain so for several quarters, on the growth assumptions described above (Figure 35). The output gap is not a directly observable variable and is estimated with a high degree of uncertainty, so the results should be interpreted with caution. But relevant indicators such as use of installed manufacturing capacity remain at record lows, lending support to the prediction that there will be no inflationary pressure from demand in the coming months.

FIGURE 35
OUTPUT GAP



Source: Banco de la República.

Internally, as externally, the issues of fiscal adjustment and structural State reforms will continue to have a strong impact on expectations formed by businessmen and investors. Markets count on the International Monetary Fund's targets being met and the announced structural reforms being approved. Failure on either count would erode confidence among local and foreign investors and impair the country's macroeconomic stability and prospects for growth.

C. FORECASTS

The December Report's forecasting underestimated both food and non-food inflation for March.

As indicated in other Chapters of this Report, actual inflation overshot forecasts for several reasons. The major reason was that the impact of the peso's depreciation on prices turned out to be greater than expected. Although the exchange rate stabilized in March and first-quarter depreciation was low, last year's accumulated depreciation continued to be passed on to prices through costs, and with greater force than the December forecasts had anticipated. As might be expected, the impact was strongest on non-food inflation, but food inflation, too, was affected, through prices for various tradables such as cereals and oils.

Besides price pressure from depreciation, inflationary pressures from higher fuel and utility charges were also underestimated, mainly because the adjustments were made sooner than expected. Increases in public-transport charges, brought about by higher fuel prices, were not fully contemplated in the December forecasts.

By contrast, demand-related factors generally behaved according to predictions, though inflation trends for some items diverged more strongly, falling sharply in education but rising faster than expected in housing. Similarly, the VAT's direct effect in the first quarter was fully the size predicted (0.4

percentage points of forecasts). Lastly, the evidence suggests that expectations have increased alarmingly and could be fueling price rises that are incompatible with the inflation targets.

The Bank's central model now shows inflation forecasts for the end of 2003 running higher than the rates predicted last December. Headline inflation is currently forecast to average 7.2% over the fourth quarter of 2003, an upward revision of 110 bp of last December's prediction. This Report presents a first forecast for headline inflation in 2004, which is estimated to average 4.4% in the fourth quarter, depending on present and future monetary-policy stances (Figure 36).

Food inflation is expected to be satisfactory in 2003, particularly in the second half of the year. It is now forecast to average between 6.0% and 7.0% in the fourth quarter, a considerable drop from the first quarter's actual rate of 10% but somewhat higher than the previous Report's projection. A sharp drop in food inflation has been repeatedly forecast by the Bank's different models, including the central model presented here, and has been discussed in previous Reports.

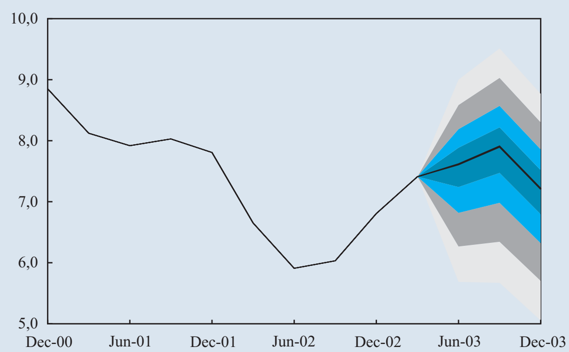
Given the high degree of heterogeneity among markets for food products, many factors and shocks may play a large part in determining food prices, making their forecasting a highly uncertain exercise. But there are several reasons today for being optimistic about food inflation in the coming months, despite its sharp rise since the end of last year:

- The cattle-breeding cycle is entering a clearance stage, which will ensure a good supply of beef and low price growth for beef and other meats.

- Prices for several perishables including potatoes have gone up very sharply in the past six months.
  This should stimulate supply and reduce prices in the coming months, as tends to happens with such products. With the rainfall regime returning to normal after the Niño's disappearance, this tendency will be stronger.

- Lastly, the effects of both depreciation and higher world prices for farm products have begun to diminish, as evidenced by lower price rises in March for oils, fats, cereals, cocoa and other items.
  They may diminish more rapidly in the coming months if the exchange rate remains stable, thereby
  helping to reduce annual inflation in these items.

Figure 36
Headline consumer inflation forecasts for 2003
(Central scenario and risk balance)



Períod	90%	50%	25%	Central	25%	50%	90%
Mar-03	7,4	7,4	7,4	7,4	7,4	7,4	7,4
Jun-03	5,7	6,8	7,2	7,6	7,9	8,2	9,0
Sept-03	5,7	7,0	7,5	7,9	8,2	8,6	9,5
Dec-03	5,1	6,3	6,8	7,2	7,5	7,9	8,8
Mar-04	3,4	5,0	5,6	6,1	6,5	7,0	8,1
Jun-04	2,4	4,0	4,6	5,2	5,6	6,0	7,2
Sept-04	2,1	3,7	4,2	4,7	5,1	5,5	6,7
Dec-04	1,5	3,2	3,9	4,4	4,8	5,3	6,5

Source: Banco de la República.

Non-food inflation shows two opposite tendencies in the short term, which makes its new forecast highly uncertain. On the one hand, demand pressure is expected to remain subdued because expected growth will still leave the output gap negative in 2003. Inflation will therefore remain close to or below the target range (5%-6%) for a large number of items such as rents, education, health care, and entertainment, culture and recreation.

On the other hand, the persistence of various supply shocks is expected to generate price rises over the rest of the year that may prevent non-food inflation from falling. Announced increases in utility charges (mostly for energy) and in fuel prices pose the biggest risk, now that the effects of VAT reform seem to have been almost entirely absorbed by inflation to March (see Chapter I).

In the case of fuel, lower world oil prices and exchange-rate stability could mean smaller price adjustments over the rest of the year than those envisaged three months ago. But, even in a scenario of lower world prices, domestic fuel prices still lag considerably behind external ones, so that large adjustments will continue to be needed to align them.

Similarly, the peso's depreciation will continue to push up prices in the next few months though the exchange rate is expected to become more stable. The previous forecasts for non-food inflation assumed that the effect of depreciation would fade over the second half of 2002. But, since it has not vanished completely, annual inflation for various groups of tradables is expected to overshoot this year's target.

Taking into account the above factors, and the risk that the detected rise in inflation expectations may push prices up, non-food inflation is now forecast by the Bank to average within a range of 6.5% - 7.5% in the fourth quarter of this year. This range is higher than last December's point forecast 6.2%.

The width of the range reflects uncertainty about how significant the trends identified above will prove to be, and how far exchange pressures are likely to drop in a context of greater exchange-rate stability. The forecast also envisages non-food inflation decreasing sometime between the second and third quarters, if the expected increases in fuel prices and utility charges fail to materialize.

Projections for non-food inflation in the medium and long term show it falling steeply, to levels more compatible with the aim of price stability. Its average for the fourth quarter of 2004 may run in the range of 4% - 5%, which covers the 4.7% rate predicted in the previous Report. Non-food inflation is forecast to fall eventually on the assumption that the output gap will continue to be negative and there will therefore be little inflationary pressure from demand. It is also assumed that the pass-through of depreciation to prices will be over, and that the exchange rate will be relatively stable. A further assumption is that expectations will be anchored at levels that are lower than the present ones and more compatible with the Bank's long-term targets. For this reason, the forecasting presumes that monetary policy will be consistent with the aim of lowering inflation expectations.

D. Risks

As stated earlier, over-expansion of demand is not a major threat to meeting this year's inflation target. The main threats are posed today, as they were three months ago, by present and future movements in the exchange rate, and buy rising inflation expectations:

* Although international financial markets have opened wider, there is still very great uncertainty about the evolution of some balance-of-payments flows. Analysts expect an upturn in capital inflows to the region, but it is not clear whether the upturn will be substantial and lasting. Nor is it clear whether capital inflows will make up for devaluationary pressures arising from the expected fall in nontraditional exports.

* The fiscal situation continues to pose a risk, because a strict adjustment program being carried out that involves considerable contingencies. Failure to accomplish any part of the program will have adverse affects on prices and growth in the medium and long run, for the country-risk premium will go up, and the exchange rate and inflation will come under pressure.

* Supply shocks are also a threat. The effect of VAT reform has now been assimilated, but increases in fuel and food prices and in energy charges continue to have repercussions. These shocks in themselves will not necessarily jeopardize long-term price stability, but are liable to do so in an economy with a long record of inflation inertia if they are incorporated into expectations. Lastly, missing the 2002 target may have exacerbated long-term inflation expectations, impairing market confidence in the monetary authority's commitment to its targets. The risk on this front is heightened by the fact that inflation currently outpaces the target range for 2003 and will take several months to abate.

Colombian and foreign analysts' forecasts for the main macroeconmic variables

The latest forecasts by local and foreign analysts for Colombia's main macroeconomic variables in 2003 and 2004 are reviewed below. Colombian analysts were aware of the official figure for this year's first-quarter inflation at the time of presenting their forecasts.

Forecasts for 2003

Table 1 shows forecasts for 2003 in detail. As in the previous Report, the biggest change has been in the analysts' forecast for inflation. Colombian analysts now predict a 6.7% inflation for 2003, up by 0.4 and 1.0 percentage points on their predictions reported three and six months ago. Foreign analysts forecast a 6.2% inflation. It is noteworthy that, though the analysts in general have been systematically raising their forecasts, these are still lower than the 7.6% annual inflation actually registered in the first quarter.

Colombian analysts have reduced their fiscal-deficit forecast reported in December by 0.2 percentage points, which seems to suggest greater confidence in implementation of the government's finances-adjustment program. And, on the strength of a better-adjusted public sector, they have also revised down their forecast for the current-account deficit, also by 0.2 percentage points.

The forecasts for economic growth and devaluation reported in December have remained unchanged. Colombian analysts continue to be more optimistic than the government about the economy, expecting a GDP growth that is 0.4 percentage points higher than the government's forecast. As regards the exchange rate, nominal devaluation is still expected to be 7.6% by the end of the year.

Table 1
Forecasts for main macroeconomic variables in 2003

	Forecast date	Real GDP %	CPI inflation %	Nominal exchange rate (year-end)	Nominal DTF deposit rate (%) 1/	Deficit (% of GDP) Fiscal 2/	Deficit (% of GDP) Currt. acct.	Unemployment %
Local analysts								
Revista Dinero	Apr-20-03	2,2	6,8	3.080	9,5	(2,8)	(1,8)	15,2
Suvalor-Corfinsura	Dec-20-02	2,4	6,0	2.950	9,2	(2,3)	n.a.	n.a.
Corfivalle	May-02-03	2,5	6,7	3.125	10,2	(2,5)	(2,1)	15,0
ANIF	Apr-16-03	2,3	6,5	3.094	10,0	(2,5)	(2,2)	n.a.
Fedesarrollo **2/**	May-02-03	2,4	7,5	3.114	10,0	(3,0)	(2,0)	15,4
Average		**2,4**	**6,7**	**3.073**	**9,8**	**(2,5)**	**(2,0)**	**15,2**
Foreign analysts 3/								
Goldman Sachs	Mar-21-03	1,5	5,5	2.612		(2,4)	(1,6)	
IDEA global	Mar-03-03	2,8	6,5	2.930		(2,7)	(2,8)	
J.P. Morgan	Mar-06-03	1,7	6,3	n.a.		(2,6)	(1,6)	
Deutsche Bank	Mar-06-03	2,2	6,3	3.108		(5,0)	(3,3)	
Average		**2,1**	**6,2**	**2.883**		**(2,6)**	**(2,3)**	

n.a. Not available.
1/ Average for the year
2/ The fiscal-deficit average does not include either Fedesarrollo's forecasts because they refer to the nonfinancial public sector, or Deutsche Bank's, because they refer to the central government, not the consolidated public sector.
3/ ¿Cómo nos ven afuera?" Report by the Banco de la República's Monetary and Reserve Division. March 31, 2003.

Forecasts for 2004

Table 2 presents in detail Colombian and foreign analysts' forecasts for next year. Both groups expect to see economic activity improving and inflation falling. But foreign analysts seem to be more optimistic than the Colombians, predicting a higher GDP growth and lower inflation than the latter. As regards the fiscal and current-account balances, foreign and Colombian analysts alike expect them to remain much the same as last year.

Table 2

Forecasts for main macroeconomic variables in 2004

	Forecast date	Real GDP %	CPI inflation %	Nominal exchange rate (year-end)	Nominal DTF deposit rate (%) 1/	Deficit (% of GDP) Fiscal 2/	Curr. acct.	Unemployment %
Local analysts								
Revista Dinero	Apr-20-03	2,5	6,0	3.295	10,0	(2,5)	(1,9)	14,7
Suvalor-Corfinsura	Dec-20-02	3,2	5,4	3.097	9,5	(2,3)	n.a.	n.a.
Corfivalle	May-02-03	3,0	6,0	3.186	10,3	(2,3)	(2,0)	14,5
Fedesarrollo **2/**	May-02-03	2,5	7,5	3.363	9,8	(2,3)	(1,7)	13,7
Average		**2,8**	**6,2**	**3.235**	**9,9**	**(2,4)**	**(1,9)**	**14,3**
Foreign analysts 3/								
IDEA global	Mar-03-03	3,5	5,5	3.100		(2,3)	(2,6)	
J.P. Morgan	Mar-06-03	3,3	5,4	n.a.		(2,3)	(1,7)	
Deutsche Bank	Mar-06-03	3,3	5,0	3.264		(2,9)	(2,9)	
Average		**3,4**	**5,3**	**3.182**		**(2,3)**	**(2,4)**	

n.a. Not available.
1/ Average for the year
2/ The fiscal-deficit average does not include either Fedesarrollo's forecasts because they refer to the nonfinancial public sector, or Deutsche Bank's, because they refer to the central government, not the consolidated public sector.
3/ ¿Cómo nos ven afuera?" Report by the Banco de la República's Monetary and Reserve Division. March 31, 2003.

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