

Highlights of Colombia

Economic analysis 2007 and forecast 2008



*Foto: David Cárdenas
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WRAP UP 2007

2007: FOURTH YEAR OF ECONOMIC GROWTH

2007 was a very favorable year for the economy in Colombia, if not one of the best ever remembered, being the fourth consecutive year of economic growth and expansion. Economic growth during the year was close to 7%, and in general, loaded with good news and concluding with indicators showing that the country has an economic situation that has not been seen in the past three decades, which shows that the country has entered into the path of sustained growth.

This recovery is based on a series of domestic and international variables that provide evidence of security and confidence in the country as an emerging economy internationally, namely, growing foreign investment, dynamic aggregate demand, moderate interest rates, growth of industrial production and services greater use of installed capacity, and growing employment rates. All of which have resulted in improvements observed in security and in the decrease of crime rates.

On the other hand, the growth of the international economy, in particular those of our main trading partners, Venezuela and the United States, together with high prices of traditional export products, gave dynamism to the economy. Similarly, the state of international liquidity, the expansion of internal credit and the lower risk rating contributed to the expansion trend of our economy.

FACTS

ECONOMIC GROWTH

Economic growth during 2007 was 6.8%, which was similar to the preceding period. Every sector of the economy contributed positively to such growth; according to DANE (The National Statistics Department) at the end of the first semester the most representative sectors included: construction (16%); manufacturing industry (13.3%), commerce, restaurants, hotels (11.2%), transportation and communications (11.2%), financial, insurance and real estate (10.16%).

The findings of the Industrial Opinion Survey (EOIC, for its initials in Spanish) for October 2007 highlight the positive performance of industry during the year, being this a powerful driver of the economic activity. Use of installed capacity reached 82.3% and orders reached, a 91.3%, figures which are a record in the national statistics¹.

INFLATION

The 4.5% inflation target set by Banco de la República (the Central Bank) was not achieved. The average inflation rate for the year reached 5.6%.

Price increases in food products, mainly due to the deviation of the demand for some of them, for bio-fuels both at the local and international level, together with the price increase in fuels, resulted in an inflation rate greater than that expected at the end of 2007.

PUBLIC FINANCING

The fiscal scenario for 2007 is consistent with the mid-term tax planning, and somewhat inferior to that agreed with the International Monetary Fund. The consolidated fiscal deficit is expected to be close to 3.5% of the Gross Domestic Product (GDP). This result is derived from regular monitoring, efforts to optimize Central Government finances, greater tax collections (including collection of the tax on equity), transfer of financial excesses by state-owned companies, particularly from ECOPETROL's democratization, and the policy for gradual elimination of the subsidy on gasoline.

The situation for 2008 is not as clear. The Minister of Finance, Oscar Ivan Zuluaga, declared that public expenditure will be subject to pressure due to several reasons²:

¹ANDI, General Industrial Opinion Survey, October 2007.

² SEMANA Magazine, November 26 2007. Interview with Minister of Finance, Oscar Ivan Zuluaga.

“expense in democratic security; lower growth of income from taxes, from 15% to 12.1%; lower expected economic growth; tax exemptions for investment in fixed assets, increasing from 30% to 40%; Government payments to the Social Security Institute in order to guarantee payments to pension beneficiaries; other pensions, and increase of transfers from the national budget to the regions (10.3%), given the new formula approved by the Congress.”

INTEREST RATES

During 2007, the Central Bank increased interest rates in five occasions in order to control inflation and “avoid the overheating of the economy”, given the increase of internal demand, consistent with the high usage level of installed capacity, as reported by the EOIC. The 90-day term deposit (DTF) rate closed at 8.95% and the interbank interest rate closed at 9.05%. Another intervention from the Central Bank on interest rates was expected for the second week of January, 2008; however, at the date of this report, it was known that the Central Bank decided not to intervene, as a response to the uncertainties about growth in the United States economy, and in the international scenario in general.

Nevertheless, concern remains over the usury rate, which represents the maximum rate for bank loans, of 31.89% at year-end, (11 percent points above the level registered in January 2007), and its subsequent effect on credit cost increase. On the other hand, the Central Bank ordered banks to freeze (clearance) deposits in checking and savings accounts, limiting liquidity and increasing the cost of money.

EXCHANGE RATE

The trend of the exchange rate has become one of the most uncertain analyses, and the lack of accuracy by expert economists confirms it. Forecasts for 2007 predicted a devaluation or, at least, currency stability, scenario which actually did not occur.

In December 2007, the exchange rate closed at P\$2,014.76 pesos per dollar. Compared to the rate at the beginning of the year, of P\$2,238.79, it represents a 10% revaluation in the Colombian currency.

The situation of the United States economy, which caused the Fed to decrease 75 basis points in the interest rates at the beginning of 2008, leads to the notion that revaluation trend of the Colombian peso will continue, at least during the next 6 months. However, experts are betting on a devaluation ranging between 1% and 15%. The average rate predicted is 6%.

BALANCE OF TRADE

As an effect, among others, of the recovery of the value of the Colombian peso versus the U.S. dollar, a deficit is shown in 2007, as occurred in 2006, in both in the trade balance, which measures exchange of products with the rest of the world, and the current account balance, which also includes accounting of services. According to DANE at October 2007 the trade deficit amounted to US\$1,515.5 million.

During the first 10 months of 2007, Colombian exports reached US\$23,716 million, which represents an increase of 17.7% compared to the same period of the previous year. Exports of non-traditional products represent 52.3% of the total exports and show a 21.8% growth, which is greater than the 13.4% growth of traditional goods exported such as coal, coffee, petroleum, and nickel.

High consumption of products in Venezuela represented a favorable opportunity for our products which resulted in over 70% increase of exports to that country, mainly of industrial goods and food products. Venezuela, along with the United States, main commercial partner, particularly for sales of traditional goods, comprise 50% of the Colombian exports. Therefore, changes in the conditions of its domestic demand shall affect proportionally the national economy.

Colombian imports grew 26.3% during the initial 10 months of 2007, reaching US\$25,231 million. 65% of Colombian purchases come from 5 markets: United States, European Union, China, Mexico and Brazil, with which, except for the first of them, a significant trade deficit exists.

INTERNATIONAL RESERVES AND EXTERNAL DEBT

The National Government, through the Central Bank, has been cautious in handling international reserves and has adopted a reserve accumulation model that allows liquidity in case of payments abroad, given the deficit in current accounts (3.5% of GDP) and the impairment of the trade balance resulting from greater increase in imports than in exports, as well as profit remittances from Direct Foreign Investments. According to information reported by the Central Bank, at December 31, 2007 the international reserves totaled US\$20,340.8 million, showing an increase of 33% with respect to the previous year.

The external indebtedness level with respect to GDP has continued with a decreasing trend. At July 2007, the foreign debt totaled US\$41,226 million, of which 65% correspond to public debt and 35% to private debt.

According to Minister Zuluaga, during 2008 the indebtedness level compared to the GDP shall be maintained, focusing the efforts towards increasing internal debt.

FOREIGN INVESTMENT

One of the most significant variables supporting the growth of the economy is Direct Foreign Investment (DFI) which has shown record levels. According to the report on the balance of payments, when petroleum is included, DFI exceeded US\$ 10,000 million in 2005, US\$6,463 million in 2006, and US\$7,045 million until November 2007. This means that DFI represents 27.2% of the GDP.

Similarly, during 2007, as a result of confidence in the economy and particularly in the Government's plan, investment from the private sector grew from 8.8% to 20.2%, a figure which also has impact on the better productivity indices shown by the industrial sector of the Country.

EMPLOYMENT

In spite of the Country's economic growth, results in terms of employment are not as promising, when comparing the 8.8% target unemployment rate for 2010 set forth in the 2006-2010 Development Plan and the record up to September 2007, of 10.7%. At the urban level, the rate reported in the first half of the year was 12.4%, showing a slight improvement compared to the results over the same period of 2006 (12.6%). Opposite is the trend of rural unemployment rate, which increased in 1.4 points during the last quarter reported by DANE, reaching 8.7%.

Through Decree 4965, the Social Protection (Labor and Health) Ministry fixed the minimum monthly legal salary in \$461,500 pesos. This corresponds to a 6.41% increase to the salary earned by about 4 million Colombian citizens.

The Minister of Finance, Oscar Iván Zuluaga clarifies that "decreasing the unemployment rate is a great challenge, and it shall be understood that in order to make it drop a single point, the economy must generate four hundred seventy thousand new jobs per year"³.

POLITICAL ENVIRONMENT

During 2007, the political scene continued, as in the previous year, being negatively affected by the possible involvement of some members of the Government and Congress in paramilitary and drug traffic affairs, in a year of elections for municipal (city mayors) and state (governors) positions. However, such cloud of bad publicity for the Country has been mitigated by the environment of trust in the economy and particularly in the Central Government, as a result of the democratic security policy and

³Javeriana Magazine, Interview with Oscar Iván Zuluaga

the economic and industrial policy continuity, which has generated favorable results in foreign investment flows and in greater private investments, stimulating the rate of growth of the economy.

Regarding the peace process, enactment of the Peace, Justice and Compensation Act has made possible demobilization of about 40,000 individuals; many of them have already gone back to civil life. On the other hand, the Government has increased its presence in several regions and violence levels have decreased.

2008 begins with new city mayors and state governors, with a very favorable local and international opinion of President Uribe, with a stronger position regarding the armed conflict and the offer of the Government to grant a zone for meeting with the armed groups, which favors the political scene and assures a better environment for business development.

Still pending for 2008 are the following issues: approval of the Free Trade Agreement with The United States; finishing the negotiations of the Trade Agreement with Canada; confirmation by Congress and the Constitutional Court of the Trade Agreement with the Central America North Triangle countries, Honduras, Guatemala and El Salvador, as well as reform of the Social Security Institute regarding health, pensions and professional risks.

In the law-making Agenda, perhaps the most significant reform is the financial one that aims at restructuring the banking system.

TAXES

The government has stated that a tax reform shall not be submitted for approval of the Congress during 2008. On the contrary, DIAN is preparing significant changes to avoid tax evasion and strengthen the tax reform approved in 2006, which came into force as from 2007. From such reform, it is important to highlight the incentives for private investment: 40% deduction for investment in productive fixed assets; income exemptions and tax discounts.

In order to foster investments, it also included a legal stability regime for large investment.

Additionally, the Government is currently negotiating double taxation treaties with other countries, which will represent better conditions for foreign investment.

PERSPECTIVES FOR 2008

After a four-year period of growth rates exceeding 5%, the economic situation experienced during 2007 influenced the perception of various economic analysts in preparing, at year-end, their forecasts about the various indices and predicting an economic growth between 5 and 6% for 2008.

The scenario is now different. Growth perspectives for the national economy are lower, given the implications of the mortgage crisis in the United States on the stock markets worldwide and, evidently, in Colombia, as well as the 75 basis points reduction in interest rates by the Federal Reserve in order to compensate the United States' economic slowdown. Growth has also been affected by some internal factors, such as the fiscal situation derived from tax revenue growing at a lower speed than expenses, the cost of credit, and the current account deficit, principally as a result of the deficit in the trade balance.

The economists have revised downwards their projections of growth between 4.5% and 5.5%. Another variable of great influence adds to this situation: the uncertainty of Colombia's trade position regarding Venezuela, its second trading partner.

Nevertheless, the Government expects that investment flows will continue and that household consumption will not decrease; therefore, in spite of these uncertain and negative factors, the economy is expected to maintain its dynamism.

COLOMBIA: MACROECONOMIC INDICATORS

GROSS DOMESTIC PRODUCT	2006	2007	2008
% Actual Growth	6.8	6.8	5.5
US\$ million	139,105	165,079	
US\$ per capita (average TRM)	3,205	3,769	
POPULATION			
Million	43.4	43.8	44
INFLATION			
CPI var. Dec-Dec (%)	4.5	5.6	4.0
INTEREST RATES			
DTF 90 Days (%)	6.82	8.95	8.97
Deposits (%)	5.95	9.05	9.05
Placement (%)	13.56	15.37	15.4
DIRECT FOREIGN INVESTMENT(DFI)	6,295	7,045	
EXCHANGE RATE (Year-End)			
December	2,239	2,015	2,136
Devaluation / (Revaluation) (%)	(1.98)	(10)	6
BALANCE OF PAYMENTS			
Balance of Trade (US\$ 000)	(143)	(1,764)	(4,398)
Exports (US\$000)	24,391	28,513.2	31,934.6
Imports (US\$000)	24,534	30,277.2	36,332.6
Net International Reserves (US\$000)	15,435	20,340.8	25,000
FISCAL DEFICIT (% GDP)			
Consolidated (IMF methodology)	(1.0)	(3.5)	(3.6)
URBAN UNEMPLOYMENT RATE (%)	12.07	11.2	10.5

Sources: Banco de la República, March and July 2007 reports. Revista Dinero, Several issues, December, January. ANDI, Encuesta de Opinión Industrial (Industrial Opinion Survey), October 2007. ANIF Reports. DANE, Balance of Trade Records, October 2007. DANE, Population Statistics. Proexport, Consolidated Commerce, Investment and Tourism Report, December 2007. Revista Semana, December 2007 and January 2008 issues. REVISTA GERENTE, January 2008. Revista Cambio, 2008 Economy, Several Authors, November 22, 2007. La República, Several Articles, December 2007, January 2008. Portafolio, Several Articles. Investor Services, Internet Report. Ministerio de Hacienda, Mid-Term Fiscal Framework, 2007.

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