Highlights Colombia

Economic Analysis 2008 and forecasts 2009

PricewaterhouseCoopers

WRAP UP 2008

In 2008, the global economic crisis affected emerging economies, and the Colombian one was not an exception. The GDP showed during the year a deceleration which is mainly explained by the effects of the global depression. The Colombian economy grew 2.5% in 2008, which is significantly lower than the 7.5% rate in 2007. Domestic consumption and government investment were the internal demand segments showing the greatest deceleration, while exportation showed the greatest dynamism. The consumption level reflected the inflation upturn and the increase of unemployment, while Government investment was affected by delays in execution of regional projects. Private investment did not show significant growth due to a reduction in availability of credits, in addition to great uncertainty about future economic performance. Exportations were mostly favored by the high prices reached by petroleum, but being slowed down by reduced sales of iron-nickel and automobiles, caused by the restriction placed by the Venezuelan Government to this-type goods.

The trend of the Colombian economy has been aligned with the behavior of Latin America emerging economies. Notwithstanding this, the monetary policy was handled adequately regarding the inflationary pressures generated by the increase in the petroleum and food prices. In addition, the Central Bank accumulated a significant amount of net international reserves, which represents savings which may be used in deceleration times. It is also worth to mention that the drop in prices of the securities has been lower than the average of the Latin American Region.

ECONOMIC GROWTH

In 2008, the sectors with largest share in the slight 2.5% increase included: financial (1%), social services (0.4%) and mining (0.3%). Such increase was offset by the 0.3% decrease in manufacturing industry.

During that year, the financial sector showed a 9.5% growth, mostly explained by the dynamism the intermediation, commission, financial administration and insurance services had. The mining sector, in turn, showed a 7.3% increase, mainly due to a large value added of crude oil and natural gas. On the other hand, manufacturing industry faced a 2% drop, and negative variances occurred in transportation equipment, raw material and products for the textile industry, petroleum by-products, fuel oil, beverages and metal products, among others.

INFLATION

Inflation reached 7.67% in December 2008, exceeding both the year's target inflation range foreseen by the Central Bank (3.5% - 4.5%), for the second year in a row, and the December 2007 figure (5.69%). The increasing trend in 2008 is mostly explained by the increase in petroleum prices, during the first nine months of the year, which directly impacts transportation costs and products for the agricultural industry, in addition to increasing food prices.

Central Bank's inflation target for 2009 is 5%. This target is reachable, considering that lower prices in the basic products, a deflationary trend at international level and a weakening of the internal demand may generate a decrease in the pressures on inflation.

INTEREST RATES

During the period December 2007 through December 2008, the 90-day fixed term deposit rate (DTF) increased from 8.98% to 10.12%; Central Bank's placement rate grew from 16.6% to 17.2%.

Despite the above, on November 19 the Central Bank reduced 50 basic points from the intervention interest rate, setting it in 9.5%. This measure, added to the deactivation of the marginal clearing, implies a change in the monetary policy standing which may extend into 2009 and entails a decreasing trend for the interest rates.

EXCHANGE RATE

During 2008, behavior of the exchange rate showed two stages: during the first half, a revaluation trend in which the US Dollar price reached a bottom value of $1,652. This trend generated concerns in the export sector in which the negative effect on revenues was felt.

During the second half of the year, the exchange rate showed devaluation, closing in December at $2,244, equivalent to 16.7% devaluation during that period. A reason for this behavior is a larger out-migration of capitals, resulting from the fact that the uncertainty generated by the global financial crisis induces the investors to sell their local currency assets in the emerging markets.

For 2009, devaluation growth expectations will continue. Factors such as a resilient uncertainty, which makes difficult to predict behavior of the capital flows; a reduction in the interest rates; a decrease of the remittances, and a decrease of the exportations, will contribute to a reduced availability of US Dollars in the exchange market.

BALANCE OF TRADE

According to the figures published by the National Statistics Administration Department (DANE, per its Spanish acronym), in 2008 the Colombian exportations increased 25.5% regarding 2007, growing from FOB US$29,991 million to FOB US$37,626 million. Approximately 76% of this variance is explained by the increase in exportation of traditional products.

Foreign sales of traditional products increased from US$14,207 million to US$20,003 million, which equals to a 40.8% growth, induced mainly by a net increase for US$4,895 in the sales of petroleum and petroleum by-products.

Exports of non-traditional products reached US$15,784 million, equivalent to an 11.6% growth regarding 2007. Major exports included live animals, chemical products, textiles and gold.

The United States were the main destination of the Colombian exports, with a 37.3% share, followed by Venezuela with 16.2%, and the countries of the European Union with 12.7%.

In 2008, imports increased in 20.6%, amounting to US$39,669 million. This variance is explained mainly by a 24.9% increase in foreign purchases of raw material and intermediate products, particularly fuel oil and lubricants. Purchases of capital goods and construction material increased in 20.6%, while purchases of consumer goods increased in 11.5%. Main origins are the United States (28.8%) followed by China (11.5%), Mexico (7.9%) and Brazil (5.9%).

During 2008, the Colombian trade balance had a surplus for FOB US$470.5 million. The largest surpluses occurred with Venezuela (US$4,951 million), the United States (US$3,312 million), Ecuador (US$713 million) and the Netherlands (US$434 million). Highest deficits occurred with China (US$3,725 million), Mexico (US$2,369 million) and Brazil (US$1,537 million).

FOREIGN DEBT AND NET INTERNATIONAL RESERVES

According to date published by Banco de la República (the Central Bank), at September 2008 total foreign indebtedness amounted to US$39,790 million, representing 19.1% of the Gross Domestic Product. In 2003, the percentage was 41.5%. Devaluation will have effect in increasing the percentage of foreign debt in the GDP. However, it is worthy to mention that, despite the economic circumstances, the sovereign risk has been less affected than in other Latin America countries.

At 2008 closing, the international reserves reached US$23.660 million regarding the US$20.600 million of 2007, which represented a net acquisition for US$3.060 million.

During then last years, a significant increase of the international reserves took place, resulting from taking advantage of the exchange rate revaluation. According to the Central Bank, accumulation of such amount would allow facing the impairment of the international environment.

DIRECT FOREIGN INVESTMENT

According to figures of the Central Bank, direct foreign investment amounted to US$8,537 million in 2008, which equals to a 26% increase regarding 2007. The petroleum sector gathered 35% of the total foreign investment, followed by the mining and quarry sector, with 20%, and the financial sector, with 13%.

The United States continues as the major issuer of the foreign investment in Colombia, with a 29% share, equivalent to US$1,166.3 million. Panama and Mexico have been increasing their share in the DFI, with a total of US$416.7 million and US$287.7 million, respectively.

In 2009, a reduction of the capital flows incoming into the country is expected, and particularly those devoted to the oil exploration, due to the expectation for lower petroleum prices. Despite the international economic recession, the Government continued making efforts to generate conditions suitable for attracting foreign investment. Incentives favoring foreign capital flows include the establishment in more competitive free trade zones, the economic stability contracts, tax deductions and exemptions for activities such as tourism, forestry and publishing. The benefits acquired through these instruments depend on the amounts of the investments, the generation of employment and the economic sector.

LABOR

During 2008, deceleration of the economy caused a reduction of employed people. Considering the last quarter of 2008, when compared to the same period of the prior year, unemployment rate increased from 9.8% to 10.5%. One of the most concerning figures in unemployment of heads of household, which reached 5.2%, which is 0.6 points m ore than in the same period of 2007. This last figure makes evident a drastic change in the economic activity and might lead to additional unemployment by other family members.

Given the uncertainty of the global economy and the impact it might have on exports and the labor market, the National Government has decided a prudent adjustment of the salary based on the year's inflation certified by DANE. As per Decree 4868 of December 30, 2008, the monthly minimum salary for 2009 was set in $496.900, which means an increase of 7.7% regarding the monthly minimum salary determined for 2007. The transportation allowance increased from $50,800 to $55,000 pesos.

POLÍTICAL ENVIRONMENT

From the beginning, 2008 was a year plenty of events of great significance for the country. Humanitarian exchange was one of the most quoted subjects. Also, the release, escape and freeing from FARC (the Colombian guerrilla) of a big amount of kidnapped people, including politicians and civilians, and the crowded marches and demonstrations against guerrilla, a civil initiative not seen in prior years. It was also a historic year for the guerrilla, and particularly the FARC organization, which faced the death of, initially, Raul Reyes, its second man in command, and, later on, Manuel Marulanda Vélez, its maximum leader, and the promotion of Alfonso Cano to that position.

Relation of Colombia with its neighbors was also in the list of the most significant subjects. Diplomatic relations with Venezuela and Ecuador faced a crisis, as a result of the Colombian troops crossing the border with Ecuador to reach the campsite of

FARC's second, Raul Reyes, who was killed during the operation. The event generated breaching of the diplomatic relations with Ecuador. In turn, Venezuela supported Ecuador's position and initiated defensive actions all along the border with Colombia. Relations with Venezuela were, however, reinstated after conversations between the Presidents of both countries at the Rio Group Summit held in Costa Rica.

The national press showed also a big deal of information regarding the strains between the high power bodies. Relations of the Executive with the high courts were surrounded by clashes between the Supreme Court of Justice and the Constitutional Court. The legislative power developed a justice reform project, which was not enacted, and a policy reform project which was finally enacted. All of the above is added to the referendum proposal for the re-election of the President Alvaro Uribe for the third period in a row, a political initiative which faces currently strong opposition and debate in Congress, contrasting with the high popularity of President Uribe.

The list also includes the scandals related to ponzy schemes at entities which collected big amounts of money from candid investors under the promise of exorbitant and irregular gains. A social and economic crisis was generated, demanding from the Government emergency measures and which gave rise to the task for developing a financial reform into its agenda.

PERSPECTIVES FOR 2009

2009 will be a year full of great economic uncertainty, which will make difficult a forecast regarding the economic horizon. Deceleration of the world's economy will result in lower growth which, on one hand, affects exports, and, on the other hand, makes difficult the access to credits for Government and private investments. This circumstance will also reflect on a reduction on the remittances coming into the country.

Performance of the Colombian economy will depend, mainly, on the deepness of the worldwide economic recession, the effectiveness of the anti-cyclic measures of the fiscal and monetary policies adopted by developed economies, and, less significantly, those adopted by the national government.

The impact of the global crisis is subject to the effectiveness of the measures that the United States and Europe take to fight back the effects of the financial difficulties on the non-financial sector. In the best scenario, the effects of improvements in the monetary and fiscal policies could become evident by the end of 2009.

A downfall in exports is expected. The United States and Venezuela, our main commercial partners, face, in case of the former, a reduction of the demand, and in the latter smaller income due to a reduction of the prices of the crude oil. On the other hand, it is feasible to anticipate a decrease of the direct foreign investment, because the credit restrictions in the financial markets could cause either cancellation or delay in some projects. These facts are added to the internal demand deceleration and increase of unemployment.

Favorable factors include certain measures foreseen by the Government to counterbalance this economy cycle. An increase of the Government demand is planned to partially offset reduction of the private demand. The 2009 Financial Plan (US$3,000 million) forecasts a 5.4% growth in the demand by the Government administrations, thus granting a high emphasis to infrastructure development.

In summary, deterioration of the international environment, which evidences the strong dependency of the Colombian economy from its commercial partners, will cause a negative impact in the economic activity affecting the labor market and, consequently, the internal demand. This cycle would be mitigated partially by a more flexible monetary policy to generate positive effects regarding inflation and interest rates control, which, in turn, would impact investment, as well as by a fiscal policy planned to partially compensate the drop of the private demand.

COLOMBIA: MACROECONOMIC INDICATORS

	2007	2008	2009(pj)
GROSS INTERNAL PRODUCT % Actual Growth	7.5	2.5	1
Constant Prices (US$ Million)	171,973		
US$ per cápita (Average market representative exchange rate)	3,619		
POPULATION Million	43.9	44.4	44.8
INFLATION Var. CPI Dec-Dec	5.69	7.67	5
INTEREST RATES DTF(Term Deposit) 90 days (Year end)	8.98	10.12	8.2
Placement	16.6	17.2	16
EXCHANGE RATE (Year end) December	2,015	2,244	2,55
Devaluation	-10	11.4	13.6
BALANCE OF PAYMENT Balance of trade (US$ Million)	(824.3)	470.5	(-1,866)
Exports (US$ Million)	29,991	37,626	34,506
Imports (US$ Million)	30,816	37,155.5	36,372
Net International Reserves (US$ Million)	20,6	23,66	22,352
FISCAL DEFICIT (% GDP) Central National Government	(1.4)	(2.3)	-3
Fooreign Debt (% GDP)	21.6	19.1	22.1
URBAN UNEMPLOYMENT RATE (%)	11.2	11.3	12.6

Sources: Banco de la República, Departamento Administrativo y Nacional de Estadística (DANE), Dirección Nacional de Impuestos y Aduanas (DIAN), Proexport, Fundación para la Educación Superior y el Desarrollo (Fedesarrollo)

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