

Highlights of Colombia

Economic Analysis 2009
and forecasts 2010

Wrap Up 2009

In 2009, the Colombian economy reached a slight growth, showing a relative strength as opposed to the external conditions. However, the effects of the global financial crisis were felt through various routes. The contraction in the external demand and the reduction in the price of raw materials had an effect on the value of the Colombian exports, whereas the restriction of the foreign financing hit the private investment, due to a greater apprehension to risk. However, it is important to consider that the investment rate did not show a drastic drop in comparison with other economies of the region. 2009 was also characterized by a stagnation of the private consumption, a reduction of the inflation, lower interest rates, a revaluation trend of the Colombian peso in front to the U.S. Dollar, and high unemployment levels.

Offsetting the above, the significant advances in the management of the public finances and a flexible monetary policy allowed a relative stability of the country's economy in the Latin American context. The strategy of the Government to increase the public expenditures by using, on a timely basis, internal and external resources, impelled some economic sectors, thus cushioning the effects in Colombia of the international economic crisis. The incentives from the government sector to stimulate the purchase of new housing have translated into a source of employment for non-qualified labor. Banco de la República (The Colombian Central Bank) reduced the intervention rate, a fact which effects quickly transmitted to the other interest rates, thus increasing the liquidity in the market.

Economic growth

According to figures of DANE (The National Statistics Administration Department), during the first nine months of the year the Colombian economy decreased 0.3% when compared to the same period of the prior year. The economy sectors which showed the greatest percentage drops included: manufacturing industry (-7.9%), commerce (-3.5%) and transportation (-1.7%). However, these unfavorable variances were compensated by growth in the construction (10.1%), mining (9.9%) and financial (3.5%) sectors.

The unfavorable behavior of the manufacturing industry was generated by the reduction of the added value of the textile sector and garments (-20.1%), other manufactured goods (-21.6%), transportation equipment (-24.1%) and basic metallurgical products (-6.3%), particularly. As far as the sector commerce is concerned, a reduction of the commerce services (-4.0%), motor vehicle repair services (-2.9%) and hospitality and restaurant services (-4.9%) occurred. Offsetting these, it is important to highlight the increase in civil works (31.2%) within the construction sector, and metallic minerals subsectors (17.1%) for the case of the mining sector.

Inflation

After two years in a row in which the inflation had exceeded the targets of the Central Bank, for 2009 this figure closed in 2%, representing an historical minimum over the last 55 years. Main factors which explain the lower increase in the inflation include the pace of increase in prices of regulated goods and services; the excess of installed capacity of the economy; the reduction of the inflation expectations; the appreciation of the Colombian peso in front of the U.S. Dollar, and the lower offer of Colombian products in foreign markets, particularly in Venezuela.

According to the report of the National Statistics Administration Department (DANE, per its Spanish Acronym), the four groups that showed growth over the Consumer Price Index - CPI- in 2009 were: education (6.3%); health (4.94%); housing (4.26%) and other expenses (3.83%). Meanwhile, the five groups that showed a growth lower than the CPI were: communications (0.89%); amusement (0.53%); transportation (0.33%); clothing (-0.30%) and foods (- 0.32%).

For 2010, the inflation target will not be located below or at the level of the figure reached in 2009. The Central Bank has fixed the inflation target between 2% and 4%, a feasible one unless the price of foods tends to increase due to the effects of El Niño phenomenon.

Interest rate

The expansive monetary policy has generated a continuous decrease of the money collection and placement interest rates. In 2009, 90-Day Fixed Term Deposit (DTF, per its Spanish Acronym) Rate reached 4%, a significant reduction regarding the 10.1% reached in 2008. Meanwhile, in 2009 the placement rate reached 10%, in front of the 17.2% of the previous year.

For 2010, expectations for the intervention interest rates stay stable. On January 29, 2010, the Board of Directors of Banco de la República decided to hold the intervention rate in 3.5%. Nevertheless, modifications will depend on the monitoring made by the Central Bank on the economic performance during the year to establish rates which stimulate the economic growth and foster a healthful financial system.

Exchange Rate

During 2009, the Colombian Peso to U.S. Dollar exchange rate showed a constant volatility; in the first quarter devaluation occurred, whereas this trend reverted from the second quarter on. At the year closing, the Market Representative Exchange Rate closed in \$2,044 (2008 - \$2,244) resulting in a revaluation of 8.9%. This behavior corresponds to a regional trend - currencies like the Brazilian Real and the Chilean Peso have shown the most significant appreciations. Among the main factors explaining this dynamics is the monetary policy of the U.S. Federal Reserve to inject greater liquidity to their financial system to face the contraction of their internal demand.

For 2010, the projections fluctuate between \$1,870 and \$2,070, remaining the exchange uncertainty. The evolution of the U.S. Dollar price is determined, to a great extent, by external factors beyond the control of the local authorities. It is possible that the appreciation of the Peso persists, associated to a good entrance of resources brought by several national and foreign companies that would undertake specific projects postponed in 2009. This dynamics would be added by greater foreign currencies entering as a result of the reactivation of the exports towards markets such as the United States and Europe. However, it will be influenced by the evolution of the commercial flows with Venezuela.

Balance of Trade

According to the figures published by DANE, in 2009 Colombian exports decreased 12.7% regarding the prior year, dropping from US\$37,625.9 million to US\$32,853 million. To a great extent, this behavior is the result of a 15.4% contraction in the external sales of nontraditional products, which passed from US\$17,623 million in 2008 to US\$14,900.4 million in 2009. The sectors that showed greater reductions were: dressmaking (- 50.3%), metals and manufacturing (- 36.6%), leathers (56.7%) and live animals and their byproducts (- 30.1%).

In the meantime, exports of traditional products amounted to US\$17,952.5 million in 2009, which is equivalent to a drop of 10.3% regarding prior year's figure. The external sales of petroleum showed the greatest reduction (US\$-1,945 million). The result obeys to a fall in prices, considering that a 23.7% increase occurred in terms of volume.

In 2009, United States and Venezuela were the main destination markets for the Colombian exports and also the markets showing the deepest reductions. Sales to the United States dropped from US\$14,052.7 million to US\$12,878.9 million, i.e. an 8.4% reduction. In the case of Venezuela, the exports dropped 33.5%, passing from US\$6,091.5 million to US\$4,049.5 million, fact that is explained partly by the restrictions to the commerce imposed by the neighboring country.

In 2009, Colombian imports amounted to CIF US\$32,897.7 million CIF, equivalent to a 17.1% drop. This behavior is the result of a contraction in the internal demand. The group that showed the most significant percent reduction was raw material and intermediate products (- 25.4%), which represent 40.1% of the foreign purchases, followed by consumption goods (- 11.9%), which represent 20.3% of foreign purchases, and capital assets and construction equipment (-9.6%), which participate with 39.5% of the foreign purchases.

Imports originated in the United States, which represent the greatest share (28.7%), dropped in 17,3%, which is explained mainly by lower purchases of cereals (-62.2%) and organic chemical agents (-35.9%).

In 2009, the country's balance of trade showed a surplus of US\$1,665.2 million. The greatest surpluses took place with the United States (US\$3,856.9 million), Venezuela (US\$3,521.6 million), and the Netherlands (US\$1,105.5 million), whereas deepest deficits occurred with China (US\$-2,529.5), Mexico (US\$-1,663.4 million) and Brazil (US\$-1,453 million).

Foreign Debt and Net International Reserves

According to data published by Banco de la República, at September 2009, the total foreign indebtedness amounted to US\$51,204 million, which is equivalent to 22.1% of the Gross Domestic Product. Out of the total figure, the private sector participates with US\$16,200 million (31.6%) while the Government participates with US\$35,004 million (68.4%). Although it is a high figure with respect to the historical data, it is considered to be in a manageable level. Increase in the obligations reflects that the good financial conditions offered by the markets in 2009 were taken advantage of.

It is important to note that the reduction of the participation of the foreign debt as a percentage of the GDP between 2003 and 2008; the short-term obligation which represents 7.1% of the total foreign debt (US\$3,659 million) only, and the balance of international reserves, which is sufficient to face a crisis period, are all factors that explain why the increase of the foreign obligations shall not send a negative signal to the international markets.

Unlike other economies of the region, the level of the international reserves remained stable, amounting to US\$24,982.9 million, which means an increase of 5.6% regarding the prior year.

Direct foreign investment

According to data published by Banco de la República, in the period January through September 2009 the figure of the Direct Foreign Investment - DFI- amounted to US\$6,446 million, which is equivalent to a 19.5% reduction when compared to the same period of 2008. At the date of preparation of this report, it is forecasted that the total DFI figure will close in 2009 in US\$6,913 million¹. It is not an encouraging figure, but it is important to consider that the world-wide economic recession affected the levels of investment in several countries. According to estimations of the UNTAD², the global DFI figure decreased about 39% in 2009.

During the first nine months of 2009, the mining and quarrel sector collected most of the foreign flows, with a 40.4% participation, followed by the oil sector, with a 34.4% participation. In the first case, a growth of 71.5% took place, whereas in the second the figure reached was 14.9%, inferior than the one reached in the same period of 2008. The United States continues leading the origin of the DFI in Colombia, with 51% participation.

During that period, the most outstanding cases in this caption were the purchase of assets of the Cementos Argos exportation business by the Brazilian company Vale do Rio Doce, and the acquisition of 31.1% of the company Kimberly Colpapel by Kimberly Clark Corp.

Labor

In spite of the relatively stable behavior of the economy in the context of the region, unemployment continued as one of the main problems; the rate reached 12%, in front of the 11.3% of the previous year.

According to the results labor market results report issued by DANE, the cities which showed the greatest unemployment indexes during 2009 last quarter were: Pereira (20.1%), Popayán (18.4%) and Quibdó (17.9%).

¹ Figure taken from the web page of the Republic Presidency's Press Secretary: <http://web.presidencia.gov.co/sp/2010/enero/19/01192010.html>

² United Nations Conference on Trade and Development

For 2010, the government has fixed the legal minimum monthly salary in \$515,000 (US\$251.6, approximately), which means a 3.6% increase on the 2009 salary. The transport subsidy increased from \$59,300 to \$61,500 (US\$30, approximately).

Unemployment will be one of the main problems to be solved during 2010. Although a slight economic reactivation exists, some companies could postpone the costs of new hirings until having a clearer perspective of the course of the economy.

Public finances

Between 2002 and 2008, the public sector generated significant savings as a result of three structural reforms: Administration, Transferences and Pension reforms. They have allowed the Government to make the necessary fiscal efforts to ensure sustainability of the public finances and respond appropriately to the effects of the global economic crisis. In 2009, public demand grew near 7% due to its counter-cyclical role.

In spite of the difficult situation along 2009, the National Government met the forecasted objectives and reached a fiscal deficit equivalent to 4.1% of the GDP, in front to the 2.3% deficit reached in 2008. According to the review of the financial plan 2010³, deficit of the Consolidated Public Sector (SPC, per its Spanish acronym) would be 2.7% of the GDP in 2009 and 3.7% of the GDP in 2010.

The goal for 2010 is a fiscal deficit of 4.5% of Gross Domestic Product - GDP. This estimation considers both the awaited reduction of income resulting from the smaller growth of the economy, and the compensation from the adjustments to the operation and investment expenses and greater income from privatizations.

Political environment

Strong political debate was the main characteristic during 2009. The two most publicized subjects more were the lack of definition regarding the possibility of re-election of President Alvaro Uribe Vélez for third period in a row, and the diplomatic relations between Colombia and Venezuela.

The first of these subjects was resolved in February 2010, when the Constitutional Court denied the possibility for the consecutive re-election of the president for a third period. The second fact outlined the deterioration of the relations with the neighboring country. The signature of the cooperation agreement that allows the use of Colombian military bases by the U.S. Army caused the freezing of the diplomatic relations with Venezuela. This agreement generated a regional debate where the Union of South American Nations (UNASUR, per its Spanish acronym) was the scenario in which the different existing ideological currents were exposed. Reestablishment of the diplomatic relations between Colombia and Ecuador was another remarkable fact in the international environment. Such separation had been caused by the incursion of the Colombian army in Ecuadorian territory to reach to the encampment of Raul Reyes, second man of the "Revolutionary Armed Forces of Colombia - FARC" guerrilla.

In the national scene, 2009 was a year of tension between the Supreme Court of Justice and the Executive given the lack of consensus regarding the election of the Nation's General Attorney and the rejection by the Court of the three-candidate short list proposed by the government. On the other hand, the Congress faced a climate on scandals and empty chairs. A significant number of congressmen elected in 2006 are being investigated by the justice for supposed relations with paramilitary groups, causing the resignation of the involved ones to their seats.

The list of news also includes the accusations against the Security Administration Department (DAS, per its Spanish acronym) for presumed espionage and possible threats against magistrates, journalists and members of the opposition, among others.

The disclosure of such intrigue generated a series of investigations and members and ex-members of this entity were captured. The National Government has already announced the total reform of DAS as a consequence of these events.

³ Document published on January 19, 2010 by the Ministry of Finance and Public Credit

The year closed with a restructuring of the national health system due to the financial difficulties it is facing and the deep weaknesses in managing the resources devoted to this sector. The next step in the announced restructuring is its examination from the constitutional standpoint.

Perspectives for 2010

A better economic performance to the one in 2009 is expected for 2010. Nevertheless, growth forecasts are moderate, varying between 2% and 2.8%. Both the National Government and the International Monetary Fund - IMF - consider a GDP variance of 2.5%. Recovery of the economic activity will be fostered mainly by the continuance of the Government investment. The Government will participate indirectly in projects undertaken by the private sector.

Although the fiscal policy will continue having a counter-cyclic role in 2010, this tool will have to face the restrictions of reduced public income which, according to Government's projections, will decrease in 1.6 percent points of GDP, due to lesser capital input and lesser tax collections.

Private consumption will just show recovery signs, thanks to a reactivation of homes' confidence and easier access to credit. Reactivation of the exports will be slow and partly depend on the pace of recovery of both the United States and the European Union. Additionally, the exporting sector will have to assume the challenge of diversifying their destinies considering the substitution of the Colombian products in the Venezuelan basket. The Colombian imports figure will also grow slowly, since it responds to the tenuous recovery of the internal demand.

The slight economic growth will contribute to the absence of demand surpluses, because of which the increase of the inflation will be moderate. The interest rates will not show significant increases, considering the need to maintain enough liquidity in the market. Regarding the exchange rate, a lower revaluation trend than the one occurred in 2009 is expected, as a result of the stabilization of the U.S. monetary policy, as well as lower income, in case the raw material prices decrease. The above indicates a series of challenges during the 2010: the need for a tax reform to improve the taxation system and to maintain the incentives on investment; the increase of competition to enter into new markets; improving the social indexes, reducing both the unemployment and the informality in the labor market.

Regarding politics, since 2010 is a year of president and congressmen elections, the scenario will be very distressed. 2010 will bring the appointment of the new Nation's General Attorney after a complex process. Simultaneously, the political environment will have the burden of a list of tasks that, more than keeping a priority order to each other, represent measures which are necessary for the country. The outcome of the justice reform, the elucidation of the "parapolítica"⁴ lawful processes and those opened against members and ex- members of the Security Administration Department - DAS, per its Spanish acronym - will be relevant subjects during this year. Also, matters such as the restructuring of the democratic security policy and the role the country will play in the regional neighborhood shall be dealt with by focusing in strengthening the country's institutions and fostering the confidence and credibility in them.

At the date of preparation of this report, the GDP figures for the 2009 last quarter were not available; however, it is estimated that a moderation on the GDP behavior would have occurred during the last three months of the year, thus causing a very low, but positive, final figure.

⁴ Parapolítica is name given to the participation of paramilitary groups in the country's politics through congressmen they helped to be elected.

Colombia: Macroeconomic Indicators

	2008	2009	2010(pj)
GROSS DOMESTIC PRODUCT			
% Actual Growth	2.5	0.1 (pj)	2.3
POPULATIONBLACIÓN			
Million	44.4	45.2	45.5
INFLATION			
% Var. CPI Dec-Dec	7.7	2	3.5
INTEREST RATES			
DTF(Term Deposit) 90 days (Year end)	10.1	4	4.7
Placement	17.2	10	5
EXCHANGE RATE (Year end)			
December	2,244	2,044	1,955
Devaluation	11.4	(8.9)	(4.4)
BALANCE OF PAYMENT (US\$ Million)			
Balance of trade	470.5	1,665.2	1,203
FOB Exports	37,626	32,853	33,977
FOB Imports	37,155.5	31,188	32,774
Net International Reserves	23,660	24,983	24,580
FISCAL DEFICIT (% GDP)			
Central National Government	(2.3)	(4.1)	(4.5)
Foreign Debt (% GDP)	18.1	22.1 (at Sept)	
URBAN UNEMPLOYMENT RATE (%)	11.3	12	11.7

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), Latinfacus Consensus.

PricewaterhouseCoopers (www.pwc.com/co) provides industry-focused assurance, tax and advisory services to build public trust and enhance value for its clients and their stakeholders. More than 163,000 people in 151 countries across our network share their thinking, experience and solutions to develop fresh perspectives and practical advice.