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Highlights of Colombia

*Economic
analysis 2011
and 2012
forecast*

pwc

Wrap up 2011

Over the last few years, the global economy has been facing the consequences of the 2008 world financial crisis. The economic recovery tries to find its way at different paces. In the case of developed countries, the beginning of recovery has become a steep slope, whereas it seems to find room for maneuvering in the emerging countries.

The United States and the Europe Union grew about 1.5% in 2011. Asian economies showed greater energy, with rates above 6.5%, except in the case of Japan. The real estate market in the United States is still at a standstill. Fears regarding public debt sustainability continued to be felt at the Euro Zone, as the fiscal tensions did in the countries of the European periphery, since it seems the confidence of agents has taken a long time to become reestablished.

Colombia is part of the group of emerging countries that have managed to resist global tensions. Despite the contraction of overseas demand from developed countries and a greater restriction of foreign lending as a result of a greater risk aversion, the economy has managed to expand thanks to public and private actions. Regarding the economic policy, achievements such the enactment of the constitutional reform of royalties, the fiscal rule and the act on macroeconomic stability are worth highlighting.

Low interest rates and inflation under control are signs of a stable economic environment. Colombian exports have not only diversified their target markets, but also profited the high prices of main basic goods such as oil and coal, among others. The high internal lending evolution rate, the growth of imports of machinery or transport equipment and the increase of construction licenses are good signs of the performance of investments. Consumption does not fall behind. A higher consumer confidence index and an unemployment rate approaching one digit after several years encourage a higher expenditure at homes, besides the improvement of social indexes such as the reduction of poverty to 37%, the increase of health cover and the increase of enrolments to the Family Compensation System, among others.

The growth of Foreign Direct Investment - FDI - has not stopped thanks to the favorable conditions that protect the investor, a low risk perception, something that becomes clear in the vote of confidence the risk rating agencies gave to the country, and the participation of Colombia in CIVETS¹.

In addition, there was great progress as to integration policies in 2011. Free trade agreements with Switzerland and Canada came into force. Free trade agreements with the United States, Europe Union, and European Free Trade Association - EFTA - were passed. Agreements with South Korea, Panama, and Turkey were broadened. Besides, there was progress in the relations with Chile, Mexico, and Peru. On the other hand, the steps taken for Colombia to join the Organization for Economic Cooperation and Development - OECD - are worth highlighting.

¹ CIVETS, acronym for Colombia, Indonesia, Vietnam, Egypt, Turkey and South Africa.

Economic growth

According to DANE², the Colombian economy grew 5.8% during the first nine months of the year compared to the same period of the prior year. This growth was due mainly to the mining and quarries industry (12.6%), followed by transportation, storage, and communications (7.2%), and commerce, repair services, restaurants and hotels (6.6%).

Inflation

The inflation rate for 2011 showed a 3.73% variance, figure which is 0.56 percent points over the 2010 inflation.

According to the results of DANE, the groups with a variance above average were food (5.27%), education (4.57%), and housing (3.78%). Communications (3.26%), transportation (3.07%), sundry expenses (2.08%), clothing (0.54%), and leisure (-0.32%) showed a variance below annual inflation.

There will be upward inflation expectations during 2012. Banco de la República (the Colombian Central Bank) keeps inflation target between 2% and 4%. However, other analysts foresee a higher range considering the economic growth and the rise of hydrocarbons prices.

Interest rates

Borrowing costs increased in 2011. The official Central Bank interest rate at the end of year was 4.75%, up from 2.9% in 2010, which points at a significant increase that reverses the downward trend seen since 2009.

The average 90-day Fixed Term Deposit – DTF - borrowing rate was 5.1% at the end of 2011, namely 1.6 percent points above the 2010 rate. This trend was more noticeable in the average credit issuance rate, which rose from 8.1 in 2010 to 11.1%. However, the impact of this rise was not so significant to the growth of loans receivable, which grew 25% in 2011.

2012 started with an increase in the official Central Bank interest rates as a preventive measure to keep credit from growing excessively.

Exchange rate

In 2011 the rate of exchange continued to be subject to the international exchange markets volatility. At the end of the year the market representative exchange rate was \$1,943, which amounts to a slight 1.5% annual devaluation. Nonetheless, during the first eight months the foreign exchange market showed a revaluation trend as a result of a greater availability of U.S. Dollars in the market, caused by a greater inflow of capital resulting from local interest rates higher than the foreign ones and larger resources generated by exports. The devaluation trend appears in

² National Statistics Department of Colombia

September, when the U.S. Dollar dropped 7.4% regarding the Colombian peso as a reaction to the uncertainty of investors regarding the Greek debt crisis and its possible spread to other countries of the European periphery.

Predicting behavior of the market representative exchange rate in 2012 is hard, with projections ranging from \$1,680 to \$2,000. It is possible that the price of the U.S. Dollar drops, considering bond purchases by the Federal Reserve³ and the European Central Bank; a lower rating of U.S. Treasury Bonds and T-bills, making investments in emerging markets more attractive; higher foreign sales; foreign investment flows; and more resources from foreign financing.

In case such a trend becomes stronger, exporter companies competing with import goods would be disadvantaged. Because of it, the economic authorities are proposing measures such as the use of hedging and accumulation of international reserves.

Balance of trade

According to the figures published by the National Statistics Department, Colombian exports rose 43%, from US\$35,974 million to US\$51,179 million, during 2011. The growth driver for foreign sales was the increase in export of traditional products, up to US\$39,786 million from US\$25,351 million, a 56.9% growth, while the variance of non-traditional produce exports was just 18.7%. The good performance of traditional produce sales is to a large extent explained by the increase of the exported volume of oil barrels, up to 230.7 million barrels in 2011 from 182.6 million barrels in 2010. In the case of non-traditional exports, the growth of foreign sales of gold (31.4%), food, beverage and tobacco (27.5%), air or space navigation (141.2%), and plastic materials (20.2%) is noticeable.

During 2011, destinations that received the most Colombian exports were the United States (38.1%), The Netherlands (4.4%), Chile (4%), China (3.5%), Ecuador (3.4%), and Venezuela (3.1%). It is worth noting that natural markets such as Venezuela (second trade partner before 2009), Ecuador and Peru have fallen back. On the other hand, greater dynamism of sales to markets such as The Netherlands, up 50.5%, and Chile, up 153.1%, is remarkable.

On the other hand, during 2011 imports amounted to US\$54,675 million in front to the US\$40,683 million in 2010, which represent a significant 34.4% increase. Groups of goods with the largest share were cauldrons and machinery (13.6%), cars and spare parts (11.9%), and electric, recording and imaging appliances and material (9.1%). The main countries where foreign purchases were made are the United States (24.9%), China (15%), Mexico (11.1%), Brazil (5.0%), Germany (4.1%) and Argentina (3.4%).

At the end of 2011, the balance of trade showed a surplus of US\$4,955.5 million, Free-on-Board (FOB). Largerst surpluses were reached with the United States (US\$8,682.5 million), The Netherlands (US\$2,232.5 million), Chile (US\$1,358.5 million) and Venezuela (US\$1,216.5 million), whereas the largest deficits were shown by the balance of trade with China (US\$-5,676.5 million), Mexico (US\$-5,144.2 million), Germany (US\$-1,344.7 million), and Argentina (US\$-1,198.5 million).

³ U.S. Central Bank system

Foreign debt and net international reserves

According to data from the Central Bank, the total foreign debt at September 2011 was US\$-72,058 million, equivalent to 21.9% of Gross Domestic Product, representing an increase of 16.42%, or US\$10,165 million, compared to the same month a year earlier. The private debt amounts to US\$ -30,648 million of the total debt, while the Government debt is US\$-41,411, out of which US\$899 million correspond to short-term debt and US\$40,512 million to long-term debt. The needs for foreign financing relate to profiting foreign interest rates lower than local interest rates.

The Congress passed a US\$87,000 million budget for 2012, with US\$20,421 million, namely 23% of total budget, are devoted to the debt service.

Using these resources to make investments that increase the competitiveness of the country, and getting profits from the good economic conditions to reduce, in the long term, the percentage of the perpetual debt in relation to the GDP, as well as to ensure macroeconomic sustainability, is considered an optimum objective.

At the end of 2011, foreign currency reserves reached US\$32,302 million, a 13.5% increase in relation to the 2010 figure (US\$28,463.5). According to the Central Bank, at September 2011 the gross foreign currency reserves were 3.1 times the short-term foreign debt balance and 2.1 times the foreign debt amortizations that are due within a year⁴.

The evolution of this variable proves the country has a cushion, which absorbs the effects of the international financial crisis.

Foreign Direct Investment

During 2011 the FDI reached the record figure of US\$13,234 million, that is, a significant 92% growth compared to the prior year.

During such period, the oil industry stands out as the activity that received most foreign capital, with a 39.9% share and a 118% growth, followed by mining and quarries, with a 20% share and a 32% growth, and trade, restaurants and hotels, with a 14.5% share and an exceptional 618% growth. The leading role of the oil activity is the result of favorable conditions for attracting capital aimed at finding new oil deposits, growing production volumes, and higher prices.

Taking into consideration new investments only, without considering capital repayments or cash flows received by the oil industry⁵, the FDI coming from The Netherlands (US\$778.2 million), Panama (US\$664.8 million), and Spain (US\$605.1 million) are worth highlighting.

A favorable investment outlook is forecasted for Colombia. The country has several tools to keep on attracting investors. There is greater confidence, which became clear with the grade three risk ratings agencies gave the country. On the

⁴ Total balance of acquired obligations payable within one year and amortizations of debts incurred at terms over one year are included

⁵ It does not include capital contributions for earnings reinvestments, neither investments in the oil industry, since a per-country itemization level is not available

other hand, according to the Doing Business report, Colombia is the third Latin-American country with a good business environment and is placed forty-second in a list of 183 countries surveyed. Also, Colombia is fifth as to protection for investors. Adding to this environment are expectations about the Free Trade Agreements that came into force and those that will start to be profited in 2012.

Employment

The unemployment rate in December 2011 was 11.8% compared to 10.8% a year earlier. This was a single-digit figure during the last four months of 2011, the figure reached was one digit. This trend is a good sign of the Colombian economy. Nevertheless, there is still a long way to go to formalize a large part of the economy, considering that underemployment increased slightly in November from 32.8% to 33.2%, that is, 7.7 million people are informal workers.

The cities with the highest unemployment indices in 2011 were Quibdó (18.6%), Popayán (17.4%) and Armenia (17.3%); whereas the cities with the lowest unemployment rates were San Andrés (7.3%), Barranquilla (8.2%) and Bogotá (9.5%).

As for the minimum monthly wage, a 5.8% increase is being received as from January 2012, being currently \$566,700 (US\$291.6), up \$31,100 (US\$16) compared to the prior year. The transportation allowance amounts to \$67,800 (US\$34.8) up from \$63,600 (US\$32.7) in 2010.

Public Finances

According to the Ministry of Finance, fiscal forecasts show an improvement of the Consolidated Government Sector balance, which in GDP terms would reach a 1.8% deficit in 2012 compared to 2.9% in 2011 and 3.2% in 2010, equivalent to savings for \$5.8 trillion pesos⁶.

The National Central Government reduced its deficit from 3.8% to 3.2% of GDP, which is good news considering \$5 trillion (0.7% of DGP) were set aside for the rainy season. As to revenues, it is worth highlighting tax collection increased approximately 25% compared to 2010. As for expenditure, the increase of public investment stands out, going from 1.9% of GDP in 2010 to 3.0% in 2011.

For 2012, it is expected to continue with the fiscal rehabilitation plan in order to reach a fiscal deficit of 1.8% of GDP in the Consolidated Public Sector and 3.0% of GDP in the National Central Government. The main issue for the year will be the submission of the tax reform. It is expected to make a change that effects a structural transformation that updates the current system and simplifies the numerous laws with tax effects that the country has.

Politics

2011 was marked by several events that determined the pace of the Colombian politics to a great extent. In short, the Government of President Juan Manuel Santos played the leading role in the Colombian politics this year. The harsh rainy season and the hundreds of thousands of victims it produced tested the

⁶ 2011 preliminary fiscal year closing and Review of the 2012 Financial Plan. December 2011.

ability of the Government and President Santos himself regarding how the emergency was addressed and how the reconstruction tasks were taken on with efficiency and transparency.

On the other hand, an ambitious legislative agenda, to say the least, managed to pass a historic law to repair the victims of the armed conflict and a new royalty act that reorganizes allocation to territory entities aiming at their efficient, transparent use. However, the failure to pass the justice and the education reforms were two setbacks of the Government during the year in this field.

The final DAS (The Colombian Security Administration Department) shutdown due to the illegal tapping of phones, the uncovering of huge corruption scandals in Bogotá involving former high-ranked government officials and the end of the good relations of President Santos with his predecessor, Álvaro Uribe, were relevant events in the country's politics. On the international side, President Santos set good relations with Venezuela's Hugo Chávez and Ecuador's Rafael Correa, while the good relations with the United States were highlighted with the FTA between the two countries being enacted.

2011 was an electoral year, with mayors and governors being elected throughout the country. These elections proved Liberal Party is in a good state, the center-left vote is consolidating in Bogotá with the election of Gustavo Petro and large capital cities such as Medellín, Cali, and Barranquilla rewarded the administration of leaving mayors by electing kindred candidates. Similarly, it was proved that traditional political classes still have power options in several regions of the country.

As usual, security made headlines during the last year. Regarding the armed conflict, the killing of FARC's top leader, a.k.a. 'Alfonso Cano', by the army was another hard blow on the guerrilla group. Similarly, the increasing presence in several regions of the country of the so-called emerging gangs (BACRIM, for its Spanish acronym), comprised to a large extent by former paramilitaries, has worried the authorities and created uneasiness in some regions. The growing perception of insecurity in the largest cities has also been a reason for concern for the local citizenry and authorities.

Politics in 2012 will be marked by relevant challenges in the Government agenda. The National Government must consolidate a security strategy to counter both emerging gangs and common crime. Likewise, it must resume knotty topics such as the justice reform or the high education reform and keep on supporting actions brought for corruption. As to the economy, the Government will have to underpin the good performance of the economy and keep on promoting the confidence of international investors despite the international economic crisis. Finally, regarding social issues, the National Government will have to prove its willingness to act by reforming such important issues as the health system or expanding its national housing plan.

2012 perspectives

There are good, though moderate, perspectives on the Colombian economy. Some slowdown risks will persist as long as the world outlook fails to clear. The country will continue to be affected by the adversities of the international economic context. However, both the public and private sector are better prepared to endure the uncertainties.

The economic authorities have worked to have room for maneuver as to fiscal and monetary issues in order to safeguard the macroeconomic equilibrium. Though the economy is not immune, at least there are tools to create policies that offset the adversities.

Economy growth rates between 4.5% and 5.5% are forecasted for 2012, as well as a slight increase of inflation, higher interest rates to control possible excesses in the growth of mortgage receivables and a lower exchange rate, taking into consideration a greater inflow of investment capitals and sales revenues. A gradual reduction of the unemployment rate would give a boost to household consumption. A lower risk perception and a favorable investment atmosphere will favor an appropriate scenario for attracting more Foreign Direct Investment.

An increase of exports is expected, especially of sales of traditional goods. Though demand from Europe and the United States has dropped, demand from some Asian countries will keep its momentum. However, it is worth considering the possible risks of a fall of commodities prices and farther promoting the diversification of markets and the increase of non-traditional exports.

Nonetheless, some duties have to be added to this favorable scenario. Some of the most relevant tasks are: the advancement of the integration policies of the Trade Agenda along with the progress in the execution of the Competitiveness Agenda, the pension reform, the tax reform, and the continuous improvement of social indexes.

Colombia:

Macroeconomic Indicators

	2010	2011	2012 (py)
GROSS DOMESTIC PRODUCT			
Actual growth (%)	5,1	5**	4,9
Constant prices (Trillions of dollars)	288,2	n.d.	n.d
Dollars per capita (average representative market exchange rate)	6.073	6.800	7.426
POPULATION			
Millions	45,5	46,2	46,6
INFLATION			
RPI variance Dec-Dec (%)	3,1	3,7	4,0
INTEREST RATES			
Interbank rate	2,9	4,8	5,5
90-day Fixed Term Deposit borrowing rate ¹ (End of year)	3,5	5,1	5,2
Credit issuance rate ²	8,1	11,6	14,0
EXCHANGE RATE (End of year)			
December	1.914	1.943	1850
Devaluation (%)	-6,4	1,5	-4,8
BALANCE OF PAYMENTS (US\$ 000)			
Trade balance (US\$ 000)	1.468,9	4.955,5	2.083
Exports (US\$ 000 FOB) (Jan-Nov)	39.819,5	56.953,5	61.931
Imports (US\$ 000 FOB)	38.350,6	51.998	59.848
Net Foreign Currency Reserves (US\$ 000)	28.452	32.299	35.320
PUBLIC FINANCES			
National Central Government (% GDP)	-3,8	-3,2*	-3,0
Consolidated Public Sector (% GDP)	-3,1	-2,8*	-1,8
Foreign Debt (% GDP)	22,4	21,9	21,0
URBAN RATE OF UNEMPLOYMENT(%) End of year	11,8	10,8	9,9

* Preliminary

** Forecast

¹ Fixed Term Deposit borrowing rate for banks

² Weighted average of consumption, ordinary, preference, and treasury credit rates

Sources: National Statistics Department (DANE), Ministry of Finance and Public Credit (Ministerio de Hacienda y Crédito Público), Central Bank (Banco de la República)



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