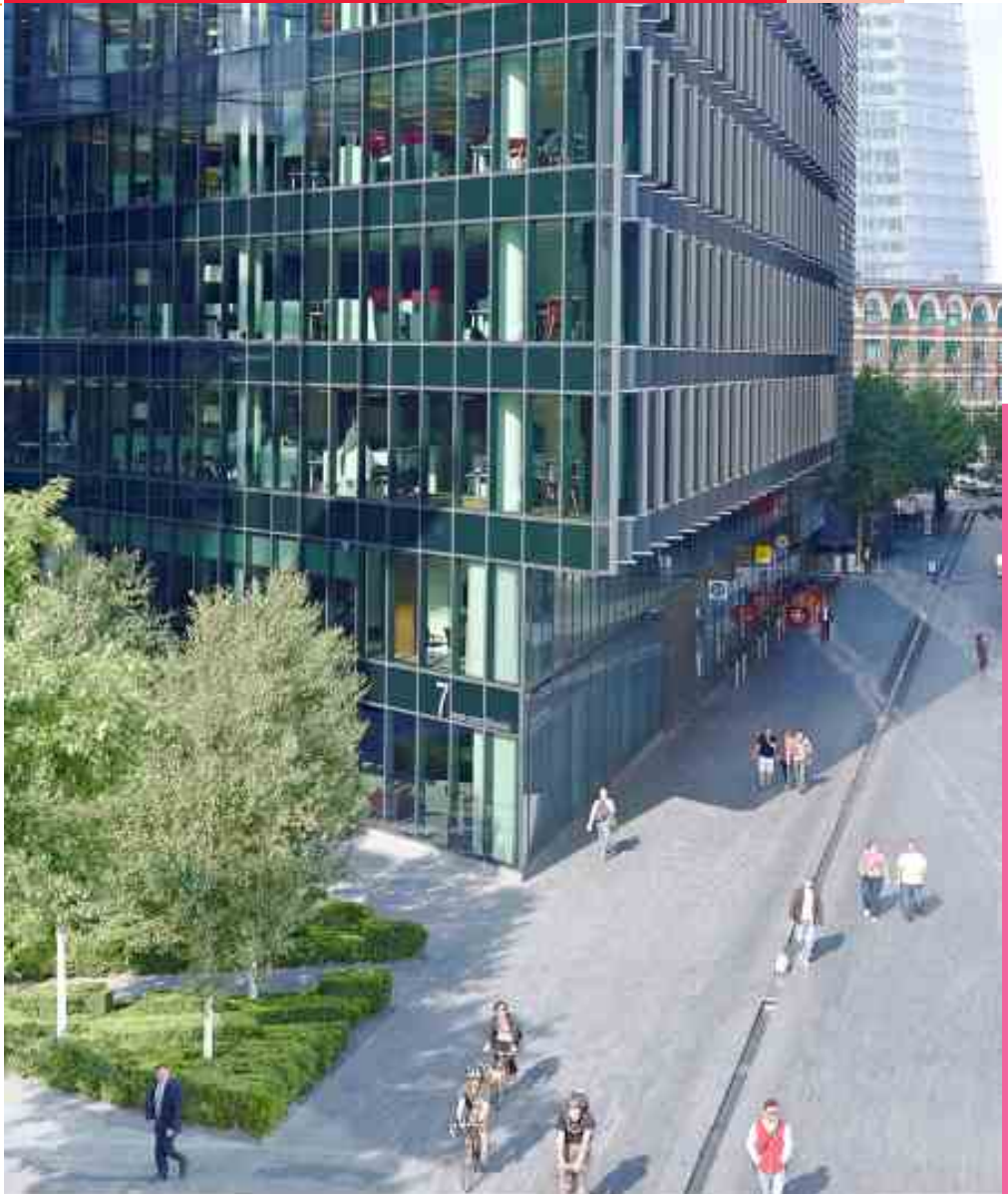


Highlights of Colombia

*2012 Financial
Analysis and
projections for
2013*



Wrap up 2012

During 2012, a slowdown was faced in the Colombian economy, expected as a result of the crisis in the Euro zone and the incipient recovery of the United States. This dynamic is not far from that shown in all other emerging economies in the region. However, as noted in the analysis of the IMF¹, Colombia has maintained a solid framework in its main economic indexes and has conducted an effective management of the macroeconomic policy.

This perspective is added with the positive reception of a financial system with good capitalization and profitability, in spite of its concentration as vulnerable point. This mix of factors has allowed the economy to have room for maneuver and offsetting the adverse effects of the economy situation in developed countries.

The 2012 GDP growth figure was foreseen to set between 3.3% and 3.9%; however, according to the report of DANE (the National Statistics Administration Department), Colombian 2012 growth rate was 4.0%.

2012 has featured an increase in consumption and government investment, a slowdown in exports and increased growth of imports. Adding to these are reduced inflationary pressure, lower interest rates, revaluation of the exchange rate, drop of crude oil prices, increase of employment rates, greater investment flows and a positive adjustment of the government finances.

Among the most outstanding economic events are the enforcement of the Free Trade Agreement with the United States, the tax reform bill recently approved, the plans to reform the pension system, and the bankruptcy of Interbolsa, the largest broker in the market.

¹ *International Monetary Fund*

Economic Growth

In accordance with reports of the National Statistics Administration Department (DANE, per its initials in Spanish), the Colombian growth figure in 2012 was 4.0%. This growth was led by sectors such as mining and quarrying (7.2%), financial and insurance entities, real estate and services to companies (5.5%), transportation, storage and communications (4.3%). Sectors showing the lowest performance include construction (0.6%) and manufacturing industries (0%), the latter showing a significant stagnation.

Inflation

Inflation rate during 2012 reached 2,44%; this figure falls within the target range foreseen by Banco de la República (between 2% and 4%) and is below the long term goal (3%). It is worth noting that this is one of the lowest variances in this century, after the 2% rate shown in 2000. Reaching this goal maintains and enhances credibility towards the Central Bank.

The three groups showing highest inflation rates include education (4.59%); health (4.27%) and housing (3.03%). Food, which holds the greatest weight within the index ranked fourth (2.52%), benefited by reduced inflationary pressures due to favorable climate conditions and decreased prices in imported supplies.

Interest Rates

During 2012 a drop in interest rates was experienced. The intervention rate² moved from 4.75% in 2011 to 4.25% in 2012. In January 2013, the Board of Directors chose to reduce this rate to 4.00%. This decision corresponds to an expansionist position of the monetary policy aiming to offset the economy's slowdown and discourage incoming capitals, which pose a revaluation pressure on the exchange rate.

In December 2012 the average 90-day Fixed Term Deposit rate (FTD) closed at 4.58% compared to the 4.76% rate in 2011, while the placement rate³ reduced from 21.2% to 19.8%.

Exchange Rate

In 2012, the Market Representative Exchange Rate (TRM, per its Spanish acronym) closed at COP1,768.23, compared to the COP1,942.70 in the previous year. The Colombian peso was the third currency in the world with highest revaluation with respect to the US dollar. The main causes for this dynamic include the large monetization processes by the mining-energy sector, greater incoming capital as a result of increased trust in the country's risk indexes, and increased world's liquidity in US dollars due to the expansionist policy of the Federal Reserve⁴.

The drop in the price of US dollars over the past three years has become a headache for Colombian exporters, Government and Central Bank. Acquisition of foreign currency by the Central Bank during 2012 did not ease the concerns for the exporting sectors, which were expecting supplementary actions, such as control over capitals, and claimed for more active purchase.

² Intervention rate refers to the mechanism by which the minimum rate for 1-day monetary expansion auctions is established.

³ Placement interest rates are those applicable for the different types of credits and products granted by financial entities to their customers.

⁴ Central US Banking System.

Trade Balance

According to the figures published by DANE, during the period January through November 2012, exports were made for USD54,689.6 million, a figure that exceeds in USD3,237.5 million the transactions observed over the same period in 2011, representing a 6.3% growth. Fuels and products from drilling industries represented 65.5% of the Free On Board (FOB) value, manufactures represented 17.6%, agricultural products, foods and drinks accounted for 11.2% and other sectors represented 5.7%. Market distribution does not show significant changes: the US was the first destination for Colombian exports, with a share of 36.4% of the total exports value, followed by China (5.3%), Spain (5.0%) and Venezuela (4.6%).

Regarding imports, during the first eleven months of 2012 the country's foreign purchases grew 7.9% with respect to the same period in 2011, changing from USD50,170.2 million Cost, Insurance and Freight (CIF) to USD54,152.1 million CIF. Manufacture represented 77.5%, fuels and products from drilling industries represented 11.6%, agricultural products, foods and drinks accounted for 10.8%, and the remaining 0.2% was comprised by products from other sectors. External purchases mainly come from the following countries: United States (24.1%), China (16.0%), Mexico (11.0%), Brazil (4.8%), Argentina (4.0%) and Germany (3.9%).

Between January and November 2012 the trade balance recorded surplus for USD3,194.0 million FOB. The balance was positive with United States (USD7,417.3 million), Venezuela (USD1,984.4 million) and Chile (USD1,040.0 million), while the greatest deficits observed correspond to balances with China (USD-5,260.0 million), Mexico (USD-4,988.3 million) and Germany (USD-1,729.5 million).

Foreign Debt

Based on the preliminary figures from Banco de la República, at October 2012 the Colombian foreign debt amounted to USD80,231 million, equivalent to 21.5% of the Gross Domestic Product (GDP) and represents a 10% increase with respect to the same month in 2011. Out of the total amount, the Government sector's share is USD45,478 million while the private sector share reached USD34,753 million. Regarding repayment terms, USD9,339 million correspond to short term commitments, while USD70,893 million are payable in the long term. Increase in private sector's foreign debt is still in line with improved credit conditions of the international markets, which offer lower interest rates than the domestic market.

Net International Reserves

At the end of 2012, international reserves reached USD37,466.6, a record level, equivalent to a 16% increase with respect to the USD32,300.4 seen in 2011. During 2012, the Central Bank made an intervention on the exchange market by purchasing USD4,843.8 million, while in 2011 those acquisitions amounted to USD3,719.9 million.

The significant extent of those operations has generated disconformities in some economy analysts, as they consider that the measure has not been sufficient to offset the drop of exchange rates. Nevertheless, Banco de la República analyses indicate that greater dollar purchases might create higher speculation and operating costs would not be offset by the benefits.

Direct Foreign Investment

During the first nine months of 2012 DFI⁵ amounted to USD11,825 million, which represents an 11% increase with respect to the same period in 2011. Government anticipates that this figure will reach USD15,000 million by the end of 2012, which is above the USD10,800 million target established. It is worth noting that the mining-energy sector concentrates the greatest share of external resources, weighing between 60% and 70%.

In 2013 a reduced capital income is expected, considering that the drop in oil prices around the globe would limit the dynamics of the sector that receives most foreign resources. Nevertheless, the drop in these flows would be offset by the increased investment in other industries, taking into consideration the incentives for foreign investment arising from the tax reform.

Employment

Between January and December 2012 the average unemployment rate reached 10.4%, the lowest rate over the past 17 years. Activities concentrating the largest number of workers correspond to commerce, restaurants and hotels (26.9%) and the occupation showing largest participation is the independent worker (42.8%).

Cities recording the highest unemployment index in 2012 include Quibdó (17.6%), Popayán (17.5%) and Pereira (16.1%); while cities with the lowest unemployment rates include San Andrés (7.5%), Barranquilla (8.3%) and Bogotá (9.5%).

The minimum legal monthly salary was subject to a 4% increase since January 1, 2013, totaling COP589.500 (USD333.38), which represents an increase of COP22,800 (USD12,89) with respect to the previous year. Transportation allowance increased from COP63,600 (USD35.97) to COP70,500 (USD39.87).

Public Finances

Projections made by mid 2012 within the Mid Term Fiscal Framework have been adjusted based on the updated Financial Plan for 2013⁶. For 2012, the projection of the fiscal deficit in the Consolidated Public Sector (SPC, per its initials in Spanish) was adjusted, varying from -1.2% to -0,1%, while the projection of the deficit in the National Central Government (GNC, per its initials in Spanish) varied from -2.9% to -2.4% of the GDP. Concerning 2013, the recent report foresees a deficit of -1.0% in the SPC and of -2.4% for the GNC.

Regarding Government revenues, the report shows a 5.6% increase in tax revenues and a 63.1% increase in capital revenues. The latter is associated to the mining energy boom that generates an increase in the extraordinary surpluses that the Nation anticipates to receive in 2013 from Ecopetrol. In the expenses section, a favorable evolution of investments between 2012 and 2013 is noted. GNC investment shows a yearly increase of 23.3%, as a result of the current Government's commitment with the dynamics of the growth drivers. Such figure translates in the highest investment-devoted budget in the country's history.

Politics

If we had to summarize the year 2012 in the five events that defined the direction of the Colombian politics, they would include: the Americas' Ibero-American Summit in Cartagena; the legislative agenda; the commencement of the peace negotiation process with the FARC guerrilla; the La Haya Court verdict, which meant surrendering maritime territory to Nicaragua; and the politics uncertainty period currently being faced by Venezuela.

The Summit in Cartagena was President Juan Manuel Santos' opportunity to consolidate his leadership in the region and increase the country's visibility in the international arena. This Summit ended with mixed results, with an enhanced

⁶ Published on February 4, 2013 by the General Direction of Macroeconomic Policies from Banco de la República

image of President Santos, but a strong rejection of his bet to discuss the legalization of narcotic drugs by the U.S.A. and Canada. This situation added to the negative, also from the U.S.A., to debate about Cuba and its inclusion in the Summit, which did not give room to issue a joint and consensual statement from the attendees.

On the other hand, the legislative agenda was signaled by the slow pace to debate the proposals made by the Executive and indications of rifts between the coalition supporting President Santos' agenda. Whilst during 2011 Congress was the President's greatest ally in his reformist agenda, 2012 was characterized by the scandal of the unsuccessful justice reform bill where congressmen took advantage of that opportunity to include articles that clearly favored their interests.

Another significant bet this year – and over the President's term in office– was the commencement of peace talks with the FARC guerrilla in La Habana. Although such discussions are still in the initial phase, the guerrilla group offered a two-month unilateral truce. On the other hand, President Santos clearly stated that peace would not be reached at any price and that the process deadline is December 2013.

Another relevant fact was the resolution of the maritime conflict with Nicaragua in response to a lawsuit filed by that country's Government in 2001. The verdict from the Court at La Haya was construed as land for Colombia and sea for Nicaragua. This meant that Colombia would keep sovereignty on the archipelago San Andrés, Providence and Santa Catalina and adjacent cays, and Nicaragua would obtain an increased portion of territorial sea at the expense of Colombia. This situation was considered as a hard kick to the Colombian sovereignty. Government's response has been to declare that the verdict shall not be accepted until the various interests –including fishing rights– of Colombian residents in the area have been assured.

Finally, the passing away of Venezuelan President Hugo Chavez in March 2013 and the proximity (in April 2013) of elections for president in that country signaled the dynamics of the eventful relations with this neighbor. The re-election of Chavez showed that 'Chavismo' (the Chavez followers) still gathers a big deal of the electors; however, for the first time in many years, a cohesive opposition movement with winning possibilities, headed by Henrique Capriles, was seen. Passing away of President Chavez and the call for elections in April 2013 create the big question regarding whether Nicolas Maduro, the heir to Chavez, will be able to keep, without Chavez charisma, the cohesion of the 'Chavismo' around himself. On the other hand, the opposition party sees in the loss of Chavez a real possibility to reach the power, which is quite possible in the midterm. The scene for Colombia looks stable with both candidates. Either one or the other share the same intention to keep good relations with Colombia, as well as the constant commercial exchange, re-established after President Santos assumed the power in Colombia.

Perspectives for 2013

For 2013, a positive growth of GDP is forecasted, but more moderate than the one shown in 2012. Consumption and Government investment will be the main drivers for growth. Regarding the trade balance, growth of exports will face a slower pace, anticipating a drop in oil prices and reduced growth of the commercial partners, while imports will grow faster considering that a lower exchange rate makes prices of imported goods lower.

Inflation rate is expected to reach the target range given the scarce pressure for price increase. At the same time, lower interest rates are expected as a result of the expansionist monetary policy of the Central Bank and significant increase in the Net International Reserves.

It is very likely that revaluation continues. In spite of a reduced monetization of the main exports of raw material, foreign currency will continue to arrive from different sources. On one hand, some companies will seek foreign credit encouraged by financing costs; on the other hand, a lower risk perception and the tax reform reducing tax burdens for foreign investments will continue fostering the arrival of foreign resources.

In this context, the Colombian economy faces the following challenges: attaining an exchange balance not affecting competitiveness of the exporting sector; executing an adequate use of resources from the good performance of commodity sales; encouraging competitiveness of the agricultural and industrial sectors; and improving the Country's infrastructure.

At the same time, growth shall lead to improvements in the main social indexes, as well as to a decrease of informal labor and higher qualification for increasing productivity of the labor force.

Colombia:

Macroeconomic Indicators

	2011	2012 (py)	2013 (py)
GROSS DOMESTIC PRODUCT			
Actual growth (%)	5,9	3,3**	4,0
Constant prices (Billions of US dollars))	193.826	n.a	n.a
Prices per capita (Dollars at constant prices of 2005)	4.210	n.a	n.a
POPULATION			
Millions	44,9	45,4	46,6
INFLATION			
Var. GDP Dec-Dec (%)	3,7	2,4	2,5
INTEREST RATES			
Intervention rate	4,75	4,25	3,9
Collection rate ¹ DTF 90 days (end of year)	5,1	5,2	4,8
Placement rate ²	14,0	12,0	10,9
EXCHANGE RATE (End of year)			
December	1.943	1.768	1.750
Devaluation (%)	1,5	-9,0	-1,0
PAYMENT BALANCE			
Exports (US\$000 FOB)	56.953,5	61931,1 (Jan-Nov)	62.704,1
Imports (US\$000 FOB)	51.998,0	59848,3 (Jan-Nov)	61.794,7
Trade balance (US\$000)	4.955,5	2082,8 (Jan-Nov)	909,4
Net International Reserves (US\$000)	32.300,4	37.466,6	39.468,3
PUBLIC FINANCES			
Central National Government (% GDP)	2,8*	2,4*	2,4*
Consolidated Public Sector (% GDP)	-2,0*	-0,1*	-1,0*
Foreign debt (% GDP)	22,9	21,5*	
UNEMPLOYMENT RATE (%) Total in country	10,8	10,3	9,8

* Preliminary

** Projection

¹ DTF for Banks

² Weighted average of credit rates for consumption, ordinary, preferential and treasury credits

Sources: DANE, Ministry of Treasury and Public Credit, Banco de la República.



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