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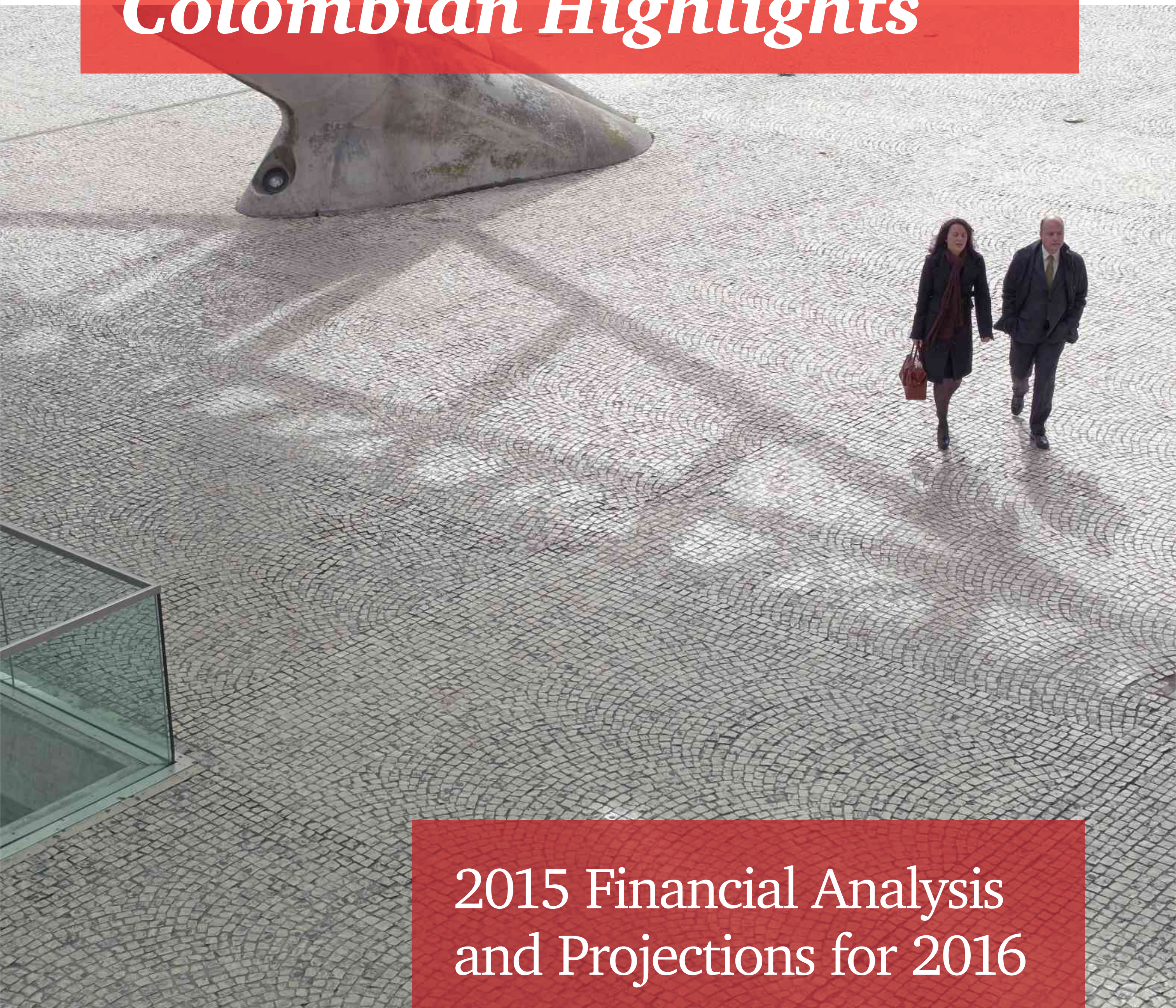
Colombian Highlights



2015 Financial Analysis and Projections for 2016

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Wrap up 2015

The Colombian economy showed a remarkable performance in 2015. Although the growth rate will be lower, it remains positive despite difficult international circumstances and the sharp fall of oil prices due to the increase in the global crude oil offer. This situation generated a negative impact on the government debt and on foreign balances, considering the importance of oil exports in the Colombian economy and their contribution to government income.

2015 was characterized by an increase in inflation indicators, a higher interest rate, a very high exchange rate due to a lower flow of foreign investment, and a lower export value injecting fewer dollars to the exchange market. Nonetheless, the domestic demand faced negative effects and the unemployment rate is at historic lows. The BBB and BBB+ investment ratings for foreign debt and domestic debt, respectively, provided by Fitch Ratings and Standard & Poor's have been confirmed; it highlights the good management of Colombian macroeconomic policy under difficult international circumstances.

Consequently, multilateral companies and the government have adjusted their forecasts downward based on the projected growth for 2015 and 2016.

Economic Growth

According to the latest report of the National Statistics Administration Department - DANE (for its acronym in Spanish), the Colombian economy grew 3.2% during July-September 2015 compared to the same period in 2014. Although it is a low figure compared to estimates provided by various economic companies at the beginning of the year, it is worth mentioning that eight out of nine industries grew positively and four of them were above the average range.

The eight following industries increased by more than 3.2%: Trade (4.8%), agriculture (4.5%), financial services (4.3%), electricity, gas and water (3.7%), social services (3.1%), manufacturing (2.5%), and transportation (1.8%). Although the exploration of mining and quarrying industry was the only one which decreased (-1.1%), this industry has a significant impact on the economy.

Inflation

The 2015 inflation rate reached 6.77%, the highest variance of the last 7 years.

This 3% increase over the rate at December 2014 (3.66%) shows the negative effects of "El Niño" phenomenon and the rising of imported assets due to the Colombian peso devaluation. In addition, the 2015 rate exceeded the target range foreseen by Banco de la República[1] (between 2% and 4%).

The groups showing highest inflation rates were food (10.85%) and other expenses (6.90%). Other groups showing an increase below the average were housing (5.38%), health (5.30%), education (5.11%), transportation (4.87%), communications (4.70%), entertainment (4.52%), and clothing (2.99%).

Interest Rates

The interest rate for intervention purposes at the beginning of 2015 was 4.50%. At the end of September, the issuer increased such rate by 0.25 percent points (4.75%). As from that moment, and for the last quarter, the Board of Directors of Banco de la República made gradual increases at a 5.75% rate until the end of the year in order to deal with inflation pressures due to the price increase of food and depreciation.

In December 2015, the average 90-day Fixed Term Deposit (FTD) rate closed at 5.22% compared to the 4.4% rate of 2014, while the monthly average placement rate changed from 10.07% in December 2014 to 12.32% in the same month of 2015.

[1] *Colombian central bank*

Exchange Rate

In 2015, the Colombian peso experienced one of the most significant devaluations in the global economy; it reached the fourth position in the ranking of currencies with the greatest loss of purchasing power around the world. The dollar fluctuated throughout the year. It amounted to COP2,392.46 in January 2015 and reached COP2,677 in March. In May, this currency fell back to COP2,360, but then exceeded COP3,000 in August and hit a record peak so far that year (COP3,238). During the subsequent months, until November, the exchange rate continued to decrease and reached COP2,819 to finally close the year at COP3,149.47. Consequently, this annual variance represented a sharp devaluation of 31.6%. The strongest explanation for the exchange rate increase is the lower inflow of dollars into the foreign exchange market on concept of sales of Colombian oil abroad, taking into account the global fall in the price of a barrel of crude oil, which came from USD49,14 at the beginning of 2015 to USD30,42 at the end of the year.

The Colombian peso has become one of the most undervalued currencies in the world. The dollar increase has various effects: it favors income of exporters and foreigners who visit Colombia, but also increases the price of imported raw materials and, therefore, has negative impacts on the price index and on all Colombians traveling abroad. The current assessment of devaluation effects in Colombia is more negative than positive. Both non-traditional exports to all destinations and income received from abroad will continue to drop (negative rates). All this can be showed in the current account deficit of the trade balance.

Trade Balance

According to figures published by the DANE, 2015 exports amounted to USD35,690.8 million FOB compared to USD54,795.3 million in 2014, which means a sharp drop by 34.9%. This result corresponds mainly to a fall in foreign exports of fuels and their derivatives (47.1%), in manufacturing (11.0%), in other sectors (31.0%), and in the group of agricultural products, food, and beverages (5.6%).

Destination countries which mainly reduced Colombian exports were the United States, China, India, Spain, and Panama, -25.3 percent points, while exports to Singapore were favored in 0.2 percent points.

Regarding the report of imports, foreign purchases decreased 15.6%; they came from USD64,028.9 million CIF in 2015 to USD54,057.6 million CIF in 2014. This result corresponds mainly to a decrease in imports of manufactured goods, which came from USD48,735.8 million CIF in 2014 to USD41,934.2 million CIF in 2015, and to a 29.7% decrease in the group of fuels and products from extractive industries, which came from USD8,525.5 million CIF in 2014 to USD5,992.0 million CIF in 2015.

At the end of 2015, the trade balance registered a deficit for USD15,907.3 million FOB. The highest surplus took place with Panama (USD2,305.2 million), while the largest deficits took place with China (USD-7,298.2 million), the United States (USD-4,928.7 million), and Mexico (USD-2,806.0 million).

Foreign Debt

According to preliminary figures from Banco de la República at September 2015, Colombia's external debt amounted to USD109,280 million, equivalent to 37.1% of the GDP, and corresponded to an 8% increase over the same month in 2014, mainly due to an increase in the long-term debt. The external debt is mainly comprised by bank loans (49%) and bonds (42%).

USD65,263 million and USD44,017 million of the total amount are generated in the government sector and in the private sector, respectively. Regarding timing, USD14,785 million correspond to short-term liabilities, while USD94,495 million correspond to long-term debt.

Net International Reserves

At the end of 2015, net international reserves amounted to USD46,731 million, equivalent to a decrease of 1.3% compared to 2014.

Direct Foreign Investment

Foreign direct investment declined 26.3% between January and September 2015 over the same period in 2014; USD9,235.3 million were registered. In the third quarter, the investment amount ranked the second lowest value of the last five years; it amounted to USD2,348 million in 2010. The decrease took place mainly due to the lowest flows invested in mining and energy companies.

Mining and energy (39%), followed by manufacturing (20%), trade, restaurants and hotels (16%), financial and business services (15%), and other sectors (10%), had the greatest impact on the reception of foreign investment flows. The United States (USD1,834.4), Panama (USD1,401.6), Switzerland (USD941.1), Spain (USD855.2), and England (USD546.7) are the major investors (a 70.5% participation). England and Spain lost their positions; they recorded over 40% falls. Bermuda, a particular case, showed a 93% increase.

Employment

According to the DANE, an 8.9% unemployment rate -the lowest figure in the last 15 years- was recorded in 2015.

Trade, restaurants, and hotels (27.5%); community, social, and personal services (19.6%); and agriculture, ranching, hunting, forestry, and fishing (16.8%) were the business lines which contributed the most to the profession during the period from October to December 2015. Their employed population percentage variances were 3.1%, 4.0%, and 4.7%, respectively.

During the said quarter, 11 out of the 23 surveyed cities reduced their unemployment rate and 12 showed a one-digit figure. Quibdó (15.1%), Armenia (13.2%), and Cúcuta (12.5%) reached the highest unemployment rates; and Bucaramanga (6.4%), Montería (7.8%), and Sincelejo (8.1%) recorded the lowest unemployment rates.

COP689,454 (USD236) were established as the minimum legal monthly salary for 2016, equivalent to a 7% increase over 2015. The transportation allowance came from COP74,000 (USD25.3) to COP77,700 (USD26.5).

Government Finance

At the date of this report, the 2015 closing fiscal balance has not been published; some agents estimate that it will correspond to 3.1% or 3.2% of the GDP -compared to the 2.4% in 2014. This increase reflects the strong impact of lower revenues on the government debt due to the drop in oil prices.

The government remains committed to a 3.6% fiscal deficit of the GDP by 2016 and reduces placements of TES[2] in the 2016 Financial Plan.

[2] *Domestic public debt securities*

Politics

The armed conflict, the legislative process, both regional and municipal elections, the crisis in the High Courts, and the relationship with Venezuela are some of the most outstanding political issues in Colombia.

Negotiations to sign an agreement between the government and the FARC guerrilla and so conclude 50 years of armed conflict reached their peak in 2015. While peace negotiations were seen abstract and distant for Colombians some years ago, many got surprised when the government announced on September 23 that a six-month term would be given to conclude the agreement and sign it. The attendance of President Juan Manuel Santos to a meeting in Havana with the negotiating groups showed a symbolic but powerful image of the progress of current negotiations: President Juan Manuel Santos shook hands with Timoleón Jiménez (aka Timochenco), the FARC leading negotiator. Despite the optimism raised, the President was hardly questioned on the feasibility of such an agreement in terms of political, economic, and social related matters. However, the government remained in its position and authorized the preparation of the entire legal framework necessary for a post-conflict scenario.

The approval of certain legal tools demonstrated the strength of Santos government at legal level and the unity of his legislators. Approving the framework to implement a peace referendum to endorse the peace agreement with the FARC, approving a reform on criminal proceedings for the military, and approving the Legislative Special Commission are estimated changes to address the post-conflict scenario. The opposition, represented by Centro Democrático, the political party of former President Alvaro Uribe, has strongly counterbalanced the peace process. This situation represents a significant portion of Colombians who see the current negotiation with suspicion and as an abdication before groups outside the law.

2015 was also a year for elections. The election of mayors and governors, as well as local councils and departmental assemblies, measured the government atmosphere. The continuity of certain important political groups in some regions was analyzed. In this context, President Santos political party kept much of its power, while the participation of former President Uribe's Centro Democrático was below expectations generated from surveys prior to elections. In Bogotá, the election of Enrique Peñalosa as the capital city mayor meant the loss of power of a left-wing party that ruled the city for 12 years.

Furthermore, the judicial branch remained a major concern for various political leaders. After strikes of the judiciary in 2014, several questions and controversies related to mismanagement in the Attorney General's Office and in the Constitutional Court went off in 2015. Judicial institutions got affected by the bad image resulting from some hires in the Prosecutor's Office and by personal-interest links of some high court judges.

Finally, the President of Colombia faced the closure of Venezuela's border as a measure of President Nicolás Maduro to stop the alleged smuggling that was generating shortages in Venezuela. After many discussions, the border remains closed and the Venezuelan government continues to militarize the border.

Perspectives for 2016

The Colombian economy will continue to strongly face unfavorable conditions in the international context. The fall in prices of raw materials, the volatility of the exchange rate, inflation pressures, and higher interest rates will affect the growth rate which, although might remain positive given the stability of Colombian macroeconomic policies, will be lower. The fall in tax revenues and the austerity in public spending foresee a tough scenario for the Colombian economy in the short term.

No recoveries in the price of raw materials are expected, at least in the long or medium term. Given the lower demand from the United States and China, some economic agents predict that the price of a crude oil barrel will drop to around USD20. Lower foreign exchange inflows from exports and foreign direct investment in the hydrocarbons industry are the ingredients necessary for the exchange rate to continue to increase.

The likely increase in interest rates by the Federal Reserve, which would subtract external capital flows from the Colombian economy, is added to the lower demand for raw materials and contributes to the dollar increase. Consequently, projection of the exchange rate for 2016 is very volatile; it ranges between COP2,500 and COP3,500.

Inflation will continue to rise due to the impact of “El Niño” on the price of food. The Board of Banco de la República is aware of the fact that it will be difficult for this variable to remain within the target range (3% - 4%) and that it might exceed 4%. As a control measure, interest rates may continue to increase and could become a counter-cyclical monetary policy that would ensure stability at price level -though they may affect domestic demand and therefore growth.

2016 will be characterized by lower investment due to interest rate increases, slowdowns in domestic demand due to higher interest rates, and higher prices. Moreover, the central government will have to face the gap left behind by oil revenues. The trade balance impairment will reveal the great dependence of the Colombian economy on exports of raw materials.

A tax reform including a VAT increase is among the most controversial government short-term measures; a path to keep public finances in order in the short term, but just a regressive measure for consumption that will have a greater impact on medium and low income population. However, current economic circumstances bring to analysis the need for long-term policies to strengthen the Colombian productive scheme; diversify non-oil export sectors; and promote innovation, service economy, and higher added value.

[2] *El Banco Central de Estados Unidos*

Colombia: Macroeconomic Indicators

	2014	2015	2016 (projection)
GROSS DOMESTIC PRODUCT			
Actual growth (%)	4,6	3,1	2,6
POPULATION			
Millions	47,7	48,2	48,7
INFLATION			
Var. Consumer Price Index (CPI) Dec-Dec (%)	3,66	6,77	4,43
INTEREST RATES			
Inter-bank rate	4,50	5,75	6,50
90-day Fixed Term Deposit[1] (Fin de año)	4,34	5,24	5,80
Placement rate[2]	10,40	12,63	n.d
EXCHANGE RATE (year end)			
December	2.392	3149	3,262
Devaluation (%)	-19,5	-24,00	-3,4
PAYMENT BALANCE			
Exports (USD 000 FOB)	54.795	35.691	n.d
Imports (USD 000 CIF)	61.088	51.598	n.d
Trade dalance (USD 000)	-6293	-15,907	n.d
Net international reserves (USD 000)	47.323	46.731	n.d
GOVERNMENT FINANCE			
Central domestic government (% GDP)	2,4	=3,1	n.d
External bebt (% GDP)	26,8	38,1	n.d
DOMESTIC UNEMPLOYMENT RATE (%) Year end	9,1	8,9	n.d

* *Preliminary*
** *Projection*
[1] *DTF for Banks*
[2] *Weighted average of consumption, ordinary, preferential and treasury credit rates*

Sources: *DANE, Ministry of Finance and Public Credit of Colombia, Banco de la República*

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