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## **International Reserves Management in the Central Bank of Colombia**

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**Conference on International Reserve  
Diversification and Disclosure**

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## **Outline of the Presentation**

1. Objectives of Reserves Management and Adequate Level of International Reserves
2. International Reserves Management and Asset Diversification
3. Disclosure Practices



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## 1. Objectives of International Reserve Management



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### Key elements in Colombian context

1. Long tradition of relatively high inflation: Yearly average above 20% between 1974 and 1999
2. Independent Central Bank since 1991
3. Inflation targeting strategy adopted in 1999. Inflation in range-target of 4%-5% in 2006 and to a long- run target of 3%.
4. Floating exchange rate regime since 1999
  - Crawling-peg regime (1968-91) and Crawling bands (1991-1999)
5. The Central Bank intervenes in local foreign exchange market, but without any explicit exchange rate target.



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**Public foreign debt represents 29.5% of GDP**

**Financial cost of public foreign debt is higher than any possible financial revenue from international reserves**

→

**International reserves holdings:**

- i) Have an opportunity cost**
- ii) Reduce risk perception of foreign lenders and, hence, the Nation's financing costs**
- iii) Allow the Central bank to intervene in the FX market**



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**Within an inflation targeting context, central bank intervention in the FX market is justified in order to:**

- Smooth out exchange rate volatility**
- Mitigate processes of unsustainable exchange rate appreciation**
- Mitigate processes of sudden and sharp depreciations**
  - create inflationary pressures
  - require sharp adjustments in the domestic interest rates.



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Then:

The Central bank accumulates international reserves when domestic currency is appreciating and sells them when domestic currency is depreciating



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**Current level of net international reserves  
(July 31, 2006)**

**US\$ 14,688 million**

- ✓ 11.5% of GDP
- ✓ 30.6% of broad money (M3)
- ✓ 1.18 times Current Account Deficit + Amortizations due
- ✓ An Opportunity Cost Model suggests that international reserves are around their adequate level for the current situation.



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## 2. International Reserve Management and Asset Diversification

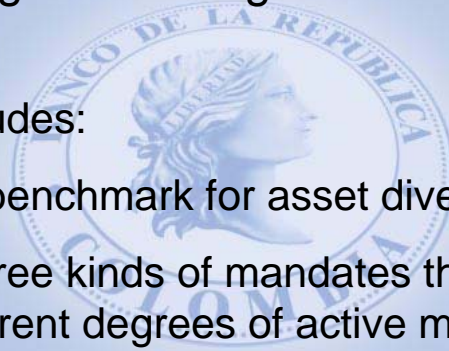


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- Management Program

Includes:

- A benchmark for asset diversification
- Three kinds of mandates that allow for different degrees of active management within a controlled risk environment





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### CURRENCY COMPOSITION OF THE BENCHMARK

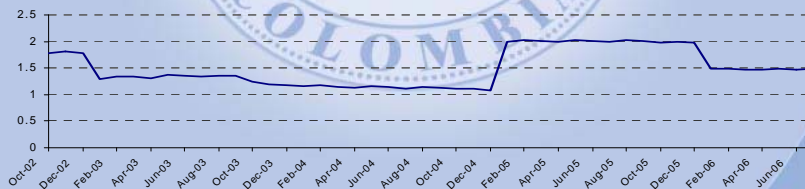
- Determined by the shares of US dollars, Euros and Japanese Yens in balance of payments outflows.
- No consideration is given to expected appreciation or depreciation of these currencies.
- Shares are:
  - US Dollars: 85%
  - Euros: 12%
  - Japanese Yens: 3%
- These shares have not been modified since 2004



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### MODIFIED DURATION OF THE BENCHMARK

- Political restriction: A loss would require budgetary allowance from Government and Congress.
- Benchmark revised once a year. Criterion: maximizing returns, subject to a loss probability no greater than 5% and a maximum expected loss of 1.8%.
- Modified duration has fluctuated between 1 and 2 years





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- Three types of Management Mandates:
  - **Passive Mandate (37% of portfolio)**  
Follows the Benchmark  
Internally managed by central bank staff
  - **Global Mandate (34% of portfolio)**  
Strategy: duration, country spreads, currency.  
Internal management (5% of portfolio)  
Three external managers (29% of portfolio): Barclays Global Investors, JPMorgan Asset Management and PIMCO
  - **Rotation Mandate (29% of portfolio)**  
Strategy: Pure USD, relative value - MBS, ABS, Corporates.  
Three external managers: Goldman Sachs Asset Management, BlackRock and Wellington Management



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- Active Management
  - Eligible Securities and Instruments (with minimum credit quality of A- or equivalent):
    - Currencies and government bonds of most of OECD countries (U.S., Euro area, Japan, U.K., Canada, Australia, New Zealand, Norway, Sweden, Denmark, Switzerland).
    - Agencies and Supranationals
    - Corporate bonds
    - Money market instruments (Commercial papers, etc)
    - MBS, ABS and CMO
    - Currency and Interest rate forwards and futures



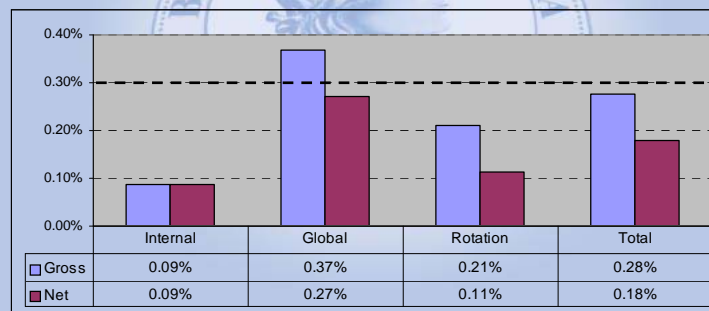
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- Evaluation Criteria for the External Management Programs
  - Evaluation Period: Three years
  - Target Excess Return: 0.30% per annum
  - Tracking Error: annualized standard deviation of monthly returns (max ex-ante = 1%)
  - Risk adjusted Return
    - Information Ratio
    - Efficiency Ratio
    - Risk Ratio



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- Active Management Program
  - ✓ Annualized Excess Return (Oct 2002 – July 2006)





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- In sum:
  - Delegated portfolios have been useful in order to improve internal active management.
  - Still, approximately 90% of portfolio return comes from the benchmark.
  - Asset diversification of the benchmark is fairly stable in Colombia
  - The criterion for currency diversification is not tied to expected gains.



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### **3. Disclosure Practices of the Colombian Central Bank**



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- Colombia joined the Special Data Dissemination Standards of the IMF since 1996 and reports the “Reserves Template” since the last quarter of 1999.
- Stocks of International Reserves and Figures of Foreign Exchange Market Intervention are published monthly, with a weeks lag



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- Information about currency and other asset composition is included in the report to Congress which is published -and widely distributed- twice a year. It also includes the main policy guidelines on International reserve management and information about delegated portfolios.
- Supportive of initiative by Banco de España and the Latina American Reserves Fund (FLAR) to start disclosing aggregate portfolio information within Latin American central banks on a monthly basis. Goal: To make same information available to the public on a monthly basis



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– **Marginal Problem: Lack of standards within the IMF in definition of net International Reserves**

-Special Data Dissemination Standards:

Government FX deposits at the central bank are included as net international reserves. They are not included if deposited in international banks.

-Western Hemisphere Department:

Government FX deposits are never included as net international reserves.

→ Need to clarify in order to improve disclosure



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**Thank you**