

Colombia

Talking Points on the Economy

*Second and Third
Quarter 2005*



**PROEXPORT
COLOMBIA**



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¿Why Do Business in Colombia?



Strategic geographic location: easy access to the North American, European, Asian and Latin American markets.

Macroeconomic stability: economic growth above the Latin American average.

Human resources: availability of qualified, competitive and committed labor force.

Market size:

- 45 million inhabitants
- Third largest population in Latin America

Export platform: privileged access to more than 1 billion of consumers:

- Free Trade Agreements:
 - FTA in process with the United States
 - Andean Community, CAN (Colombia, Bolivia, Ecuador, Peru and Venezuela)
 - Group of Three, G-3 (Colombia, Mexico and Venezuela)
 - CAN - Mercosur
 - Colombia - Chile
 - Colombia - Caricom
- Tariff Preferences:
 - With the United States, ATPDEA
 - With the European Union, Andean SGP

Special foreign trade regimes:

- 10 Duty Free Zones
- 5 Special Economic Export Zones
- Incentives for large exporters
- Special Import – Export Systems

Export supply: unparalleled portfolio of high-value added and quality products and services in the industry, services and mining sector.

Colombia is going through an exciting and outstanding time for doing business. Besides from the competitive advantages that already exist in the country, this past July the European Generalized System of Preferences (GSP) came into effect. This regime, that provides custom benefits to Colombia, will be valid until 2008 and will provide easy access for Colombian exports to the 25 country members of the European Union.

In addition, during the months of June and July two new laws and a legislative act were approved on key topics that will consolidate the confidence on Colombia's economy:

■ **Legal Stability Law** (Law 963 of 2005). This law will guarantee legal stability of local and foreign investments in Colombia. Through a contract with the government, the investor will assure that determinant norms for its investment (including wealth and income taxes) will not be changed for a period of time between three to 20 years depending on what has been agreed with the government. This law benefits any upcoming investment starting at seven thousand five hundred minimum current legal wages (7,500 MCLW), which is approximately one million U. S. dollars.

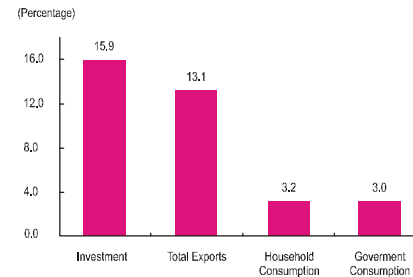
■ **Pension Reform** (Legislative Act 001 of June of 2005). This reform will contribute to guarantee the fiscal sustainability of Colombia, as it will reduce the pension liability of the country by 19% of GDP, by introducing legal instruments for the revision of pensions and eliminating the majority of special pension regimes, pension plans above 25 minimum legal wages (Aprox. US\$ 3,975 monthly) and the "mesada 14" which is an additional allowance equal to the earned salary, valid just for those affiliated to the Social Security Institute.

■ **Law on the Value Market** (Law 964 of 2005): Through this law Colombia will meet international standards when building a clear, transparent and effective regulatory framework for the market. This law will offer the investor the necessary guarantees to trust the local financial market, and will establish a better overview of negotiations, brokers, treasurers, and operators.

GDP Growth

During the first quarter of 2005, Colombian economy grew 3.6%. Growth was mainly driven by internal demand, whose most dynamic component was private investment, and by exports (Graph 1). Investment activity was reflected by substantial investment increments on machinery and equipment (34.1%), and transportation equipment (11.9%). These components suggest that the economy is definitely striving to make important efforts to increase its productivity and competitiveness to face worldwide competition.

Graph 1
GDP Growth by Demand Components
(1 Quarter 2005)



Source: National Statistics Department (DANE).

During this same period, foreign direct investment in Colombia grew significantly. Figures rose from US\$620 million (m) to US\$822 m reflecting a 33% growth compared to the first quarter of 2004. This growth is a clear reflection of the stable macroeconomic conditions and the numerous investment opportunities that the country is offering.

Important multinationals are establishing operations in Colombia with the objective of taking advantage of such opportunities. This is clearly demonstrated by the closing of the biggest deal in Colombia's history: the agreement between Bavaria and SABMiller from South Africa by US\$ 7.5 billion (b). This reflects a true confidence in

Colombia from one of the world largest beer industry players. In addition, it's important to note the entrance of Maverick Tube Corporation, one of the main American manufacturers of steel piping for industrial purposes. This corporation purchased Tubos del Caribe S.A. and Colmena S.A. in a transaction of US\$186 m. Apart from these investments, it is also worth mentioning the ones done by Phillips Morris, multinational who bought 97% of Compañía Colombiana de Tabaco - Coltabaco stock for an amount of over US\$ 300 m; and by Telefonica de España, that took over BellSouth operations and plans to invest US\$300 m to expand its client base.

The sector with the highest investment inflows at the end of the first quarter of 2005, was mining and quarrying (including coal) with an amount of US\$ 488 m. This represented 51.1% of total investment. The oil sector occupied the second place with an investment of US\$ 185 m, representing 22.9% of total investment. The increase in the oil sector obeys to the legislative changes brought by the new oil policy, which seems to have stimulated private investment. For example, during 2004, 38 new exploration, exploitation, and technical evaluation contracts were signed, and the first quarter of this year has already generated nine new contracts. The transportation, storage and communication sector also showed an important growth. It went from US\$31 m in the first quarter of 2004 to US\$47 m in the reference period. This increase represented a 51.6% growth.

For the rest of 2005, it's expected that foreign direct investment will continue with its high energy momentum brought on by the trust of companies and households in the country's macroeconomic behavior, the results generated by the democratic security policy of President Uribe's Administration, and the current oil policy that stimulates the search for new hydrocarbon reserves. Also the proximity of the closure of the Free Trade Agreement with the United States will promote the entrance of new companies in search of an export platform to the American market, as well as other markets.

Regarding the supply side some tradable goods sectors such as agriculture and livestock, showed important increases in the first quarter. This was headed by coffee production which grew 8.1% and fishing with 4.4%. Mining alone grew 5.1% as a result of the important growth on coal exploitation (6.6%) and oil extraction (0.5%). The other

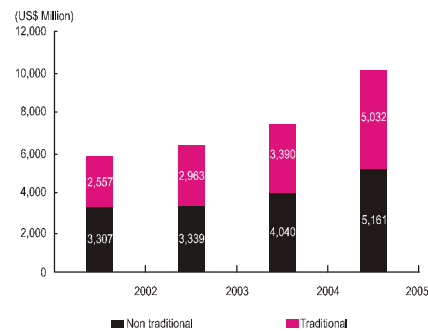
tradable sector, the manufacturing industry, registered a 1.0% reduction in the period being studied. This was partially a consequence of the lower number of working days contained in this period, due to the Holly Week. Construction activities with a 10.6% increase and commerce with a 7.3% also pushed the economic growth on the supply side.

Trade Balance

According to the latest available information of the National Statistics Department (DANE), as of June of 2005 Colombian exports grew 37.2% compared to the first six months of 2004, from US\$7.4 b to US\$ 10.2 b. Non traditional exports totaled US\$5.2 b with a 27.8% annual growth, and traditional exports added US\$5.0 b with a 48.4% growth.

The largest total exports were the result of important increments of US\$712 m in coal sales, US\$473 m in oil, US\$188 m in transport equipment and US\$165 m in flowers. The United States continued to be the main partner of total Colombian exports with a 37.6% share. Other important destinations were the Andean countries with a 18.9% share and the European Union with 14.3%.

Graph 2
Colombian Exports
January-June
(2002-2005)



Source: DANE.

It's also important to note the strong recovery of the Venezuelan economy and the improvement of the terms of trade for Colombia, a direct result of the international price increment of basic exported goods,¹ as factors that allowed a strong increase of the country's total exports. By the end of 2005 total exports are expected to continue to grow, reaching US\$20 b.²

Imports as of June of 2005 in Colombia were of US\$9.9 b CIF with an annual growth of 29.7%. The available information indicates that during the first half of 2005, the largest purchases corresponded to capital goods, mainly electrical devices and machinery, and chemical products.

Monetary and Exchange Policy

The monetary policy in Colombia has as its main objectives to maintain a low and stable inflation rate and a sustainable GDP growth near its long term trend. This implies that the monetary policy promotes the highest sustainable GDP and employment growths, in accordance with inflation goals. For 2005, the inflation target established by the Central Bank fluctuates between 4.5% and 5.5%, and for 2006 inflation target will be between 3% and 5%. The long term inflation target range is 2%-4%.

Since 1999, inflation in Colombia has shown a favorable decrease trend, in spite of the devaluation shock of the economy in 2002 and 2003, as a consequence of political crises in Brazil and economic crisis in Venezuela. The latest available data for Colombia shows that in June of 2005 consumer's annual inflation was reduced to 4.8% from 5.5% in December of 2004. Non food inflation had an even more dramatic fall, going from 5.5% to 4.3% in the same period.

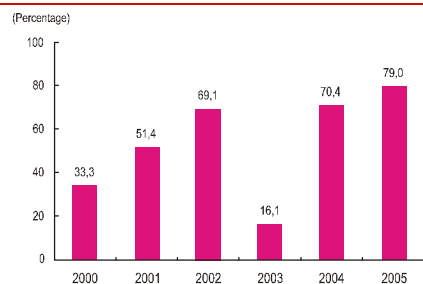
¹ Through 2005 and up until August, oil price increased considerably by going from US\$46.82 per barrel, at the beginning of the year, to US\$64.90. According to the International Monetary Fund (IMF), growths of 4.3% and 4.4% on the barrel price are expected for the years 2005 and 2006 respectively.

² With the purpose of facilitating foreign trade operations and therefore motivate exports growth, at the beginning of July of 2005, the Ministry of Trade, Industry and Tourism created the Foreign Trade Unique Window, as a mechanism to process all the payments and operations of foreign trade via Internet. Using the digital signature technological and legal security of the different transactions is guaranteed.

There are several reasons explaining the inflation's reduction:

- Higher trust on the monetary policy reflected on the behavior of the inflation expectations (Graph 3).
- Installed capacity surpluses still available in the economy.
- Accumulated appreciation of the exchange rate.

Graph 3
Inflation Target Credibility
 (Survey done on April of each year)
 (2000-2005)



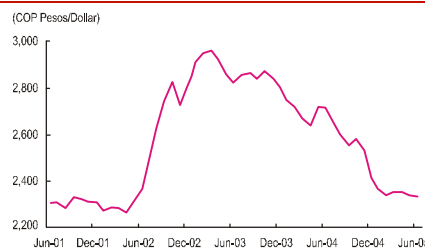
Source: Banco de la Republica.

The favorable inflation trend has been accompanied by a wide market liquidity: the intervention interest rate for expansion is currently low (6.5%) and was kept unaltered during the first half of the year. As of June of 2005 the monetary base and M3 grew at high nominal annual rates of 18.7% and 18.9% on average and the saving and lending interest rates maintain themselves at historically low levels: in the first six months of 2005 the nominal saving interest rate average 7.35%, 51 basic points (bp) lower than that registered between January and June of 2004, and the nominal interbank's interest rate was of 6.36% on average. This was 71 bp less than during the same period of 2004. At the same time, during the first half of the year, the internal public debt market was characterized by showing a decrease trend on its interest rates. For example, the interest rate for domestic public

debt bonds expiring in 2014, dropped close to 200 bp in real terms (240 bp in nominal terms), reaching a historical minimum. This shows a higher trust towards the Colombian Peso.

During the January - July 2005 period, the average nominal exchange rate of the Colombian peso leveled, with an average of COP \$2,341.3 per dollar (Graph 4). This figure was 12.7% lower to the one registered in the same period of 2004. Nonetheless, since the end of that same year the trend towards appreciation continues to dissipate, partially as a result of the policy adopted by the Central Bank. This policy is currently based on the reduction of intervention interest rates, the suspension of the contraction operations since the end of 2004, and the strengthening of the discretionary intervention in the exchange market during this current year. Since January until June of 2005, the Central Bank intervened the market in a discretionary way by purchasing foreign currency for US\$1.6 b, increasing the international reserves up to US\$13.7 b in June.

Graph 4
Nominal Exchange Rate
 (2001-2005)



Source: Banco de la Republica.

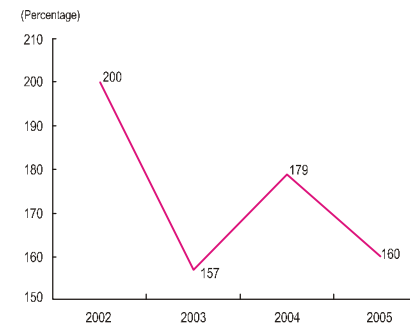
Fiscal Policy

As of March of 2005, the consolidated public sector registered a deficit equal to 0.6% of GDP, as a result of the National Central Government deficit of 2.2% of GDP, partially offset with a surplus of 1.9% of GDP on the decentralized sector.

Compared to the period January-March of 2004, income of the National Central Government increased 11.8% and expenses 22.8%. The major expenses were the result of a growth of 36.8% in operational activities and 30.8% on investment. On the operational activities, the pension payment transfers grew 146% during the first quarter of 2005. It is important to highlight that the higher investment expense was a result of the anticipation of money orders in the first months of the year. This was done with the purpose of normalizing for the rest of the year the budget execution.

This past June, a great step was taken to guarantee the fiscal sustainability. The Colombian Congress approved the pension reform that reduces the pension liability of the country and eliminates the majority of the special pension regimes. With this new measure the pension liability will be reduced by 19% of GDP, going from 179% of GDP in 2004 to 160% of GDP in 2005 after the reform. Without this reform the liability would have been equal to 162.4% of GDP in 2005 (Graph 5). This way, part of the current Stand by Agreement with the International Monetary Fund (IMF) was met. In this agreement Colombia committed to approve, during 2005, a pension reform to alleviate the fiscal load of the National Central Government.

Graph 5
Pension Liability as Percentage of GDP
 (2002-2005)



Source: National Planning Department (DNP).

Table 1

COLOMBIA: Key Data

Item	Units	Latest data period	Data	Data one year before
Total Foreign Investment				
Direct	US\$ million	Jan. 05 - Mar. 05	822.00	620.00
Portfolio	US\$ million	Jan. 05 - Mar. 05	427.00	159.00
Demand and Unemployment				
GDP	% annual variation	Jan. 05 - Mar. 05	3.61	3.96
Production Rate (MMS)*	% annual variation of date	May. 05	2.30	3.65
Retail Sales	% annual variation of date	May. 05	8.24	5.97
Investment	% annual variation	Jan. 05 - Mar. 05	15.91	5.38
National Unemployment Rate	(%)	Jun. 05	11.40	14.10
13 Main Cities Unemployment Rate	(%)	Jun. 05	14.00	15.80
Prices and Interest Rates				
Consumer Price Index	% annual variation	Jul. 05	0.05	-0.03
Producer Price Index	% annual variation	Jul. 05	-0.10	-0.40
Savings Interest Rate (90 days)	Monthly average (%)	Jul. 05	7.10	7.83
Lending Interest Rate	Monthly average (%)	Jul. 05	12.86	12.78
Exchange Rate				
Nominal Exchange Rate	Peso/Dollar US\$ average	Jul. 05	2,323.38	2,653.32
Nominal Devaluation	% annual variation	Jul. 05	-11.60	-9.30
Real Exchange Rate (ITCR)	1994 = 100	Jul. 05	115.63	128.44
Real Devaluation	% annual variation	Jul. 05	-9.97	-5.03
Peso/Yen Monetary Units	Peso/Yen	Jul. 05	20.70	23.85
Peso/Euro Monetary Units	Peso/Euro	Jul. 05	2,817.50	3,189.50
Trade				
Exports (FOB)	US\$ million	Jan. 05 - Jun. 05	10,194.00	7,340.00
Traditional Exports	US\$ million	Jan. 05 - Jun. 05	5,032.00	3,390.00
Non-traditional Exports	US\$ million	Jan. 05 - Jun. 05	5,161.00	4,040.00
Imports (CIF)	US\$ million	Jan. 05 - Jun. 05	9,966.00	7,682.00
Other				
M1	% annual variation	Jun. 05	17.02	19.85
M3	% annual variation	Jun. 05	18.45	11.37
Net International Reserves	US\$ million	Jul. 05	13,862.98	11,763.55
Colombia General Stock Exchange Index	July 2001=1000	Jul. 05	6,240.39	2,953.49
Fiscal Deficit (Central Government)	% of GDP	Jan. 05 - Mar. 05	2.20	1.70
Fiscal Deficit (Non-Financial Public Sector)	% of GDP	Jan. 05 - Mar. 05	0.30	0.10

*Monthly manufacturing survey

Source: Banco de la Republica, National Statistics Department (DANE).

Table 2

Main Latin American economist indicators

	Colombia		Argentina	Brazil	Chile	Ecuador	Mexico	Peru	Venezuela
	2005(*)	2004							
Real GDP Growth (%)	4.0	4.10	9.0	5.2	6.1	6.6	4.4	5.1	17.3
Population (millions)*	46.0	45.3	39.1	179.1	15.4	13.0	105.0	27.5	26.0
GDP (US\$ billions)	120.4	97.5	153.1	603.8	94.1	29.6	676.5	68.6	109.0
GDP per capita (US\$)	2,617.0	2,152.0	3,961.0	3,370.0	6,120.0	2,274.0	6,450.0	2,491.0	4,191.0
GDP per capita Growth (%)	-	1.6	7.8	3.6	4.9	5.4	3.1	3.3	15.8
Consumer Prices Variation (%)	5.0	5.5	7.7	6.6	1.1	2.7	4.7	3.7	21.7
Fiscal Balance (% del GDP)	-2.5	-1.2	-2.6	-1.5	2.2	1.2	-0.3	-1.1	-2.8
Total External Debt / GDP (%)	32.3	40.4	119.1	36.1	47.5	58.0	21.1	45.6	37.3
Exchange Rate (LC / US\$ eop)	2,352.0	2,628.5	2.9	2.9	609.4	-	11.3	3.4	1,891.0
Nominal Interest Rate (savings)	7.9	7.8	2.6	15.4	1.9	4.0	7.2	3.0	12.6
Current Account (% of GDP)	-2.2	-1.1	2.0	1.9	1.5	-0.4	-1.1	0.0	13.4
Foreign Direct Investment (US\$ millions)		3,005.0	4,300.0	18,165.0	7,602.0	1,200.0	16,601.0	1,801.0	1,144.0
Foreign Direct Investment (% of GDP)		3.1	2.8	3.0	8.1	4.2	2.5	2.6	1.0

* Forecast

Source: Economist Intelligence Unit, Eclac, Banco de la Republica, DNP.

PROEXPORT

With the clear objective of motivating a greater flow of foreign investment in Colombia, the Colombian government appointed Proexport to be responsible for all the promotional activities in this field; an activity previously performed by Coinvertir.

Therefore, since January of 2005, Proexport took charge of all the support offered to potential investors in Colombia, as well as to established investors. In the same way, Proexport will identify investment obstacles with the purpose of improving them. These efforts aim to promote and facilitate investment opportunities within the country.

In order to achieve this goal, Proexport created the Investment Division. This Division offers the following services:

- Promote Colombia as an ideal investment country.
- Provide up-to-date information relevant to the investment process.
- Provide all the necessary assistance to potential investors.
- Provide investor aftercare.
- Work in the improvement of the Country's investment climate.

Publications

- Surprising Colombia: Foreign Investments Guide
- Colombia: Outlook and Investment Potential
- Legal Services Directory
- Legal Framework
- Foreign Investment Report
- Colombia: Talking Points on the Economy
- Investor Services Directory

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