The Report to Congress by the Board of Directors

July 2002

Banco de la República

(The Central Bank)

Contents

31 July 2002
Bogotá D. C. (Colombia)

Honorable Chairmen and Members of the
Third Standing Constitutional Committees of
the Senate and House of Representatives
Bogota, Colombia

Dear Sirs:

Pursuant to Article 5 of Law 31/1992, the Board of Directors of Banco de la República hereby submits to the Congress of the Republic of Colombia a report on the macroeconomic results of the year 2002 to date, together with a description of the goals adopted by the Board of Directors for the current year and prospects for the various macroeconomic variables. The last section of the report contains information on the composition of international reserves and projections concerning the financial position of Banco de la República in 2002.

Sincerely,

Miguel Urrutia

Miguel Urrutia Montoya
Governor, Banco de la República

I

Introduction

The following report, presented to the Colombian Congress, offers an analysis of Colombia's economic performance and the macroeconomic policy implemented in 2002. Economic activity continued to be slow during the early months of the year, although the second quarter saw a rebound. Unemployment remained high, although it has declined and occupation has increased. The current account in the balance of payments registered less of a deficit than in the first quarter of the previous year, thanks to more of a decline in imports as opposed to exports. Annual inflation dropped during the first four months of 2002 in response to continued excess capacity in the economy, exchange stability, and the credibility of the monetary policy and its goals. May and June saw evidence of a rise in inflation due to an increase in food prices.

The latest reports to Congress emphasize various issues concerning the country's economic performance. One highlighted the fact that the financial sector is usually slow to recover after a crisis. Another dealt with the factors that explain unemployment in an economy. A third examined the dangers of public debt unsustainability in Colombia. Each of these topics was intended to alert Congress and the public to the country's primary economic problems. The overriding purpose of this report is to reflect on the role of monetary policy in growth and inflation, with several analytical comments and others on the Colombian experience in recent years. Basically, the Colombian economy is obliged to contend with two weaknesses. The first deals with potential product growth, which seems to have declined in the last few years. The second refers to the low growth in aggregate spending, which causes the economy to function below capacity.

Monetary policy has prevented potential product from being further weakened by reducing the level and volatility of inflation and making resource allocation and decisions on savings and investment more effective. It has also attempted to exert a positive impact on aggregate spending by lowering interest rates and providing abundant liquidity for household and company consumption and investment.

Chapter III offers an analysis of the macroeconomic policy applied in 2002. As in the last two years, monetary policy has been managed with an eye towards encouraging as much economic growth possible, while maintaining a commitment to the inflation target. In recent years, this policy has been managed in what can be characterized as an anti-cyclical and expansive way. Accordingly, interest rates have fallen substantially, with a positive impact on the trend in aggregate demand. Nonetheless, there are still no signs that credit will perform as hoped, simply because the financial sector is still recovering and economic agents remain cautious about getting into debt. The indicators for the financial sector continued to improve throughout the course of 2002, despite protracted and progressive deterioration in non-performing loans in the mortgage banking sector.

As to the exchange situation, the early months of this year saw considerable fluctuation. The peso continued to appreciate up until the first fortnight of May, after which the tendency has been towards devaluation. Accordingly, the nominal exchange rate at June 30 was 4.7% more than at the end of 2001. Exchange performance in the early months was influenced by low external interest rates, by pre-financing the public sector obtained abroad during 2001, and by expectations that the government would monetize is foreign currency in 2002. The exchange rate was also affected by the fact that pension funds needed to reduce the exposure of their portfolio in foreign currency. However, new conditions on external financial markets and an external-for-domestic-debt swap by the government in May reversed the trend in expectations of devaluation. The peso devaluated by 4.6% between May 15 and June 30, 2000, even though it still has a real annual appreciation rate of -4.12% .

With respect to fiscal policy, 2001 saw public income and spending rise above nominal GDP. Although the trend in public investment contributed to growth in domestic demand, increased tax revenue due to tax reform measures had an effect on available income and explains part of the slowdown in the growth of private consumption during 2001. In spite of attempts to reduce public spending, which were constrained by inflexibility of the budget, there was almost no change in the public sector deficit: 3.3% of GDP in 2000 and 3.2% in 2001. The deficit in the consolidated public sector for the first three months of 2002 was similar to the one observed during the same period the year before. The track record for central government finances was similar, with a major decline in expenses and income.

Performance of the principal economic variables in the early months of 2002 and prospects for the rest of the year are analyzed in Chapter IV of this report (as is traditionally the case). The limited extent of economic growth is associated with external and domestic factors. Among the most notable of the external factors is the downturn in terms of trade and external demand, associated with performance of the world economy. These factors were amplified by other internal ones, such as persistent unemployment and the uncertainty and violence generated by the breakdown in peace talks. As to macroeconomic prospects for the rest of 2002, weak product growth in the first quarter and a difficult international environment prompted the Ministry of Finance and Public Credit and the National Department of Planning (DNP) to revise the growth target for the year as a whole. The government's new projections point to economic growth on the order of 1.5%, although more of an acceleration in world economic recovery could increase growth to 2%. For its part, inflation is expected to remain on a course compatible with the target of 6% for the current year. According to projections on the balance of payments, the current account deficit in 2002 is expected to be 2.3% of GDP, thanks to a decline of 2.3% in merchandise exports and 2.0% in merchandise imports.

The report ends with a look at the trend in international reserves, which are at historically high levels. It also considers the financial position of Banco de la República. The new projections on income -considering the impact of the dollar’s devaluation against other currencies- indicate the Bank will increase its earnings to Col$661.7 b., compared with the estimate of Col$200.9 b. included in the March 2002 Report to Congress. However, the final outcome will depend on how the euro and the yen perform.

II

Growth, Inflation And Monetary Policy

Growth rates for the Colombian economy fell sharply as of the mid-nineties, after having been close to 5% a year. Real average growth was only 0.8% between 1997 and 2001; 2002 will probably see the same rate as the year before (1.5%). A slowdown in economic growth has been a feature of other Latin American economies as well. Chile is one example. With the region's most successful economy in recent decades, its product growth rate declined from around 7% a year in the 1985-1997 period to close to 3% between 1998 and 2001.

As was analyzed in previous reports to Congress, the generalized drop in real growth rates for Latin America's major economies suggests the existence of a negative shock common to the region, one that has influenced both the commodity and financial markets. On the commodity market, the effect of the external sector is reflected in the decline in prices for certain export products that are extremely important to the Colombian economy, such as coffee, and in less demand for Colombian products in the United States and Venezuela. On the financial market, the negative effects of the international environment were apparent in the growing expense or shortage of external credit, or in the flight of national capital. Given problems with access to international markets for Colombian companies and individuals, coupled with the limited depth and liquidity of the domestic capital market, the crunch in foreign credit and in credit from the financial market has been accompanied by a drop in the product growth rate beyond what can be attributed solely to the impairment in Colombia's terms of trade.

However, the negative external shock and its propagation, associated with the limited development and depth of the financial system, do not entirely explain the low level of product per capita, nor the recent slowdown in economic growth. The reasons for these phenomena are rooted in a variety of conditions, some associated with the factors that determine longterm economic growth and others with the economic cycle. However, the monetary policy has tried to maximize product growth by encouraging aggregate spending and achieving lower and lower rates of inflation within a target inflation scenario.

The relationship between economic growth, inflation and monetary policy is analyzed below. Several observations of an analytical nature are provided, along with others that refer to the Colombian experience in recent years. The central idea is that the Colombia economy suffers from two weaknesses. The first involves potential product growth, which seems to have diminished as of late. The role of monetary policy on this front is to lessen the level and volatility of inflation, thereby improving the effectiveness of resource allocation and decisions on savings and investment. The second concerns the slow growth in aggregate spending, which results in economic performance below capacity. In this case, monetary policy has a direct impact on aggregate spending by influencing the level of interest rates and household and company investment and consumption. The Board of Directors of Banco de la República has contributed to increased economic growth through accomplishments on two fronts; namely, by substantially reducing the level and variability of inflation rates, and by furnishing abundant liquidity at lower interest rates. This also has helped to reduce debt service for the government, households and companies.

Economic growth in Colombia is, however, less than satisfactory. After 1998, the only year to see a rise in real product above population growth was 2000. This is particularly troubling, since high rates of economic growth are the best way to improve people's standard of living, especially in the poorest sectors. Furthermore, various studies show a positive relationship between economic growth and the decline in poverty. As argued later in this report, the reasons for Colombia's low rate of economic growth are rooted primarily in the economy's vulnerability to negative shocks coming from the external sector, in the sharp rise in public spending and its limited effectiveness, in the weakness and limited development and depth of the financial system, and in the violence and institutional factors associated, among other things, with lack of effectiveness on the part of the State, little or no respect for the law, and widespread corruption.

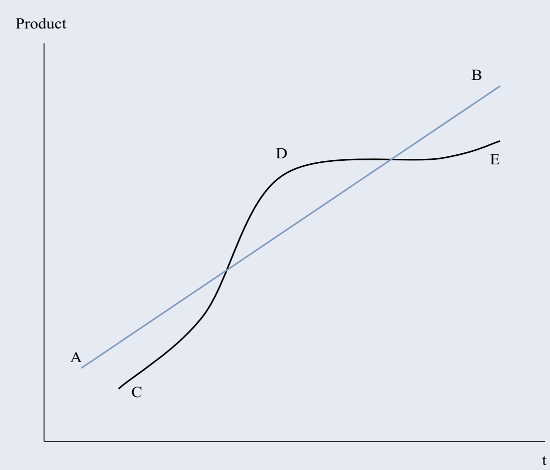
A. Basic Concepts

The link between inflation, economic growth and monetary policy is illustrated initially in Figure 1, which shows the traditional interpretation of economic cycles and the way many economists view the relationship between inflation and growth in the short and long term. Straight line AB indicates the economy's potential for growth (at full capacity). This growth is determined by supply factors, primarily by growth in the labor force and its educational level, by an increase in physical capital, by general effectiveness in the way productive resources are allocated and managed, by the capacity to absorb technological information, by the quality of institutions in the justice sector, and by the extent of deregulation or exposure to competition. For its part, the CDE curve represents the way the economy has performed, which can imply the existence of temporary short-term deviations in production with respect to its trend value.

Figure 1 supports the idea that if aggregate demand in the economy exceeds line AB (its supply capacity), inflation tends to rise. Similarly, if demand is less than the amount represented in line AB, it tends to decline. In other words, when demand is less than supply, as in points C and E, it is possible for the rate of economic growth to increase at the same time that inflation declines or does not accelerate.

Monetary policy, therefore, cannot *directly* contribute to an increase in the economy's supply capacity. The latter depends on the real factors mentioned earlier. However, it can make an *indirect* contribution to long-term economic growth, provided price stability is achieved and

FIGURE 1
RELATIONSHIP BETWEEN INFLATION, GROWTH AND MONETARY POLICY



Source: "Editorial Note" (2000) *Revista del Banco de la República*, August , No. 874.

maintained. This eliminates a basic source of confusion and uncertainty, one occasioned by price variability, and a distorting levy that taxes the poorest more heavily and negatively affects the quality of economic decisions, the competitive capacity of domestic production, and incentives to savings and investment. Inflation also prevents profundization of the capital market.

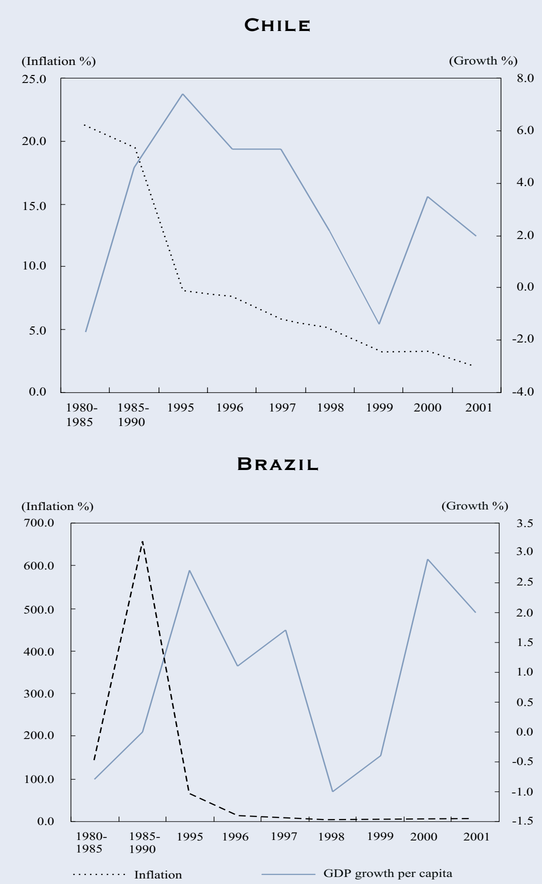
On the other hand, monetary policy can affect real demand, employment and short-term economic growth when prices and wages are rigid or adjustments in agent expectations are not immediate, as is usually the case. Under these conditions, increases in the quantity of money that affect prices quicker than wages reduce the real wage and provide temporary encouragement to supply in the economy. By the same token, changes in the quantity of money that surpass prices hikes increase real demand and stimulate productive activity. Consequently, in a situation marked by idle capacity in production factors and an expansive monetary policy, a decline in interest rates and an abundant supply of primary liquidity encourage productive recovery and the generation of employment. In contrast, when the economy is performing beyond capacity, further monetary expansion accelerates inflation and creates unsustainable macroeconomic imbalances.

The foregoing is a simplified description of the relationship between economic growth, inflation and monetary policy. In reality, the link between these three variables is more complex, as is the difference between the short term and the long term. Three additional comments are relevant for the purpose of this report:

- The extent of inflation in an economy depends not only on the difference between actual and potential product, but on the expectations of economic agents and the credibility of the Central Bank's policies. A recession is not a necessary condition, nor sufficient to lower the inflation rate. This fact is illustrated by the recent situation in Chile and Brazil. As pointed out in Figure 2, the drop in inflation in these countries was accompanied by an acceleration in their growth rates. In contrast, the serious recessions in Ecuador in 1998 and in Argentina this year have been accompanied by a sharp rise in the rate of inflation in these countries.

- In open or semi-open economies, the ability of monetary policy to affect aggregate demand has its limitations, independent of the existing exchange regime. With a fixed or semi-fixed exchange rate, monetary growth in excess of the demand for money necessitates Central Bank intervention through the sale of international reserves.

FIGURE 2
INFLATION AND ECONOMIC GROWTH PER CAPITA
1980 - 2001



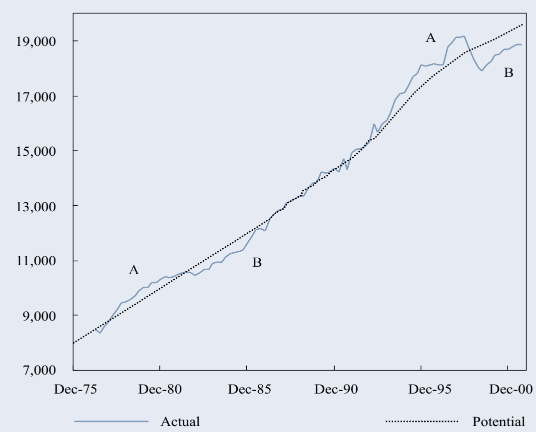
Source: Banco de la República.

This drains excess liquidity from the economy, voiding the initial effects. In an economy with a floating exchange rate, excessive monetary expansion accelerates the devaluation of domestic currency, increasing the level and expectations of inflation as a result. Higher expectations of devaluation and inflation pressure a rise in interest rates and reduce aggregate spending. So, excessive monetary expansion can result in higher inflation and less growth in product and employment, without having any capacity to reduce real interest rates in the medium and long term.

- In economies with a prolonged cycle of low economic growth, it is fundamental to consider the possible connection between the economic cycle and medium-term product growth. Three channels can be identified in this relationship. The first deals with the health of the financial system. Prolonged or profound recessive cycles weaken the financial system and disrupt the credit channel (e.g., the experience of Japan and Argentina). Under these conditions, monetary policy loses force and economic growth is inte-rrupted. The second channel refers to the political impact of the cycle. A prolonged recession increases the desire to implement economic policies that influence the efficiency of the economy and commit to long-term growth. The third channel concerns the permanent effect a temporary shock can have on employment. This primarily occurs when the unemployed lose skills and motivation, and become less attractive to employers. As will be illustrated later, these channels underscore the importance of inflation control and an austere fiscal policy.

Figure 3 offers an estimate of the breakdown in Colombia's gross domestic product, between its long-term tendency, or potential product, and the economic cycle in the 1975-2000 period. GDP values at 1975 prices are shown on the vertical line and the years on the horizontal line. The points to highlight are represented by the letters "A" and "B". The "A" points denote the periods when the economy performed in excess of its potential for production. In those years, inflation accelerated and/or the real exchange rate appreciated, and there was a high deficit in the current account of the balance of payments. The "B" points represent the years when actual product was below its long-term trend or potential. These years saw a decline in inflation and/or the elimination of macroeconomic imbalances, plus devaluation of the real exchange rate. The transition from A to B is extremely painful, with cutbacks in growth, weakening of the financial sector and rising unemployment rates. More importantly, Figure 3 shows an economy growing below a potential level, which increases at less of a rate than in the previous year. This suggests problems with the process of long-term economic growth and in the short-term cycle.

Figure 3
Actual and Potential GDP in Colombia
1975 - 2001
(1975 pesos = 100)



Source: Banco de la República.

B. Long-term Economic Growth

What factors explain long-term economic growth? There are two complementary answers. One we call *classical;* the other, *institutional*.

The classical answer emphasizes growth of productive factors (increase in the labor force, expansion in physical capital, and growth in the overall productivity of labor and capital). Long-term growth in the labor force is determined by population growth and the rate of participation in the labor force. On the other hand, an increase in capital depends on the savings rate, particularly domestic savings, since external funding is highly unstable. Finally, the overall productivity of the factors, defined as the capacity to produce more with the same amount of production factors (which is equivalent to producing the same amount with less capital and/or labor), is associated, among other things, with the capacity of companies to innovate or to improve products or production processes and to adopt new technology, the flexibility of the labor force to use capital and to respond to new demands and opportunities, general efficiency in resource allocation and management, exposure to competition, and the quality of the population's health and education.

Empirical studies show that growth in the labor force and an expansion in physical capital in the long term explain between 20% and 50% of growth in product. Therefore, between 50% and 80% of growth is determined by the overall productivity of the factors. On the whole, the classical recommendations for accelerating economic growth are the following.

- Accumulate human capital through formal education, on-the-job training and better health.

- Provide encouragement to added savings and investment.

- Promote development and proper operation of markets and competition, which includes having an appropriate framework of regulations and being part of the world economy.

- Have macroeconomic stability. This is understood as the existence of an average balance between spending and government taxes throughout the economic cycle and a credible and responsible monetary policy.

These features add up to companies and people with the ability and energy to participate in the advancement of knowledge. Companies emerge that are capable of translating innovation and ideas into successful businesses. They integrate into the world economy, become specialized and do not limit themselves to the local market. Governments help to keep interest rates low and encourage savings, change and an accumulation of human capital. Economies keep inflation down, thereby facilitating decisions on savings and investment. They also encourage productive investment, discourage speculation, and promote the development of broad, deep and diversified financial markets.

As to the classical conditions for encouraging long-term economic growth, Colombia in international terms occupies a mediocre position as far as most of them are concerned. Savings and investment rates are low, as is the quality and coverage of education, adaptation of new technology, the capacity to compete on international markets, and the effectiveness of State action. In the recent past, some of the determinants of growth in Colombia have deteriorated as well. The reduction in private savings is a case in point, as is the sharp increase in spending and the public debt, increased vulnerability, and the drop in profundization of the financial system.

All these factors are interrelated and come together to create less than favorable conditions for productive investment and the generation of employment. Government spending in Colombia has grown considerably since the early nineties. In the beginning, it was financed with tax revenue and proceeds from privatization, but the rate of savings declined all the same. As of late, it has been financed with a growing public debt. The results of increased spending have been poor in terms of access to public utilities. And, an increase in the public debt compromises the government's capacity to respond to negative shocks. It also pressures a rise in interest rates and obliges the country to pay a high risk premium for access to international credit markets. All this makes capital more expensive. Furthermore, with the drop in private savings, investment falls off or becomes heavily dependent on foreign savings, which are an unstable source of funds, one that generates volatility in the exchange rate and deals a blow to development in the sectors producing tradables. After several years of an increase in its profundization, the financial sector reversed that trend and now finds itself in a situation where it manages to offer and extend only a limited amount of credit. Under these conditions, its role in softening fluctuations in consumption when people's earnings are affected by negative shocks is less than effective and fails to support (to the full extent of its potential) financing for investment and growth.

According to the institutional theory of economic development, countries that grow the most are those with stable economic institutions; that is, countries with institutions and laws that favor production over revenue and those with companies that are open to international trade and competition on global markets. These characteristics favor investment in physical and human capital. They also attract foreign capital and technology transfer, reward entrepreneurial spirit, and stimulate the search for new ways to create, produce and transport goods and services.

Empirical studies done in recent years rely on a variety of indicators to evaluate the predictions of the institutional theory. Those used most often are indicators that measure the regulatory burden and the extent of deregulation in the economy, levels of corruption and political violence, confidence in the law, respect for property rights and observance of the rules of society, and the existence of civil liberties and political rights. For the most part, these indicators are closely correlated with the country's per capita income. This phenomenon is explained not only by the reasons already mentioned, but by the fact that countries with good institutional development facilitate and adapt themselves to technological innovation and change in general, which is a necessary condition for growth in productivity.[1] Because of its nature, the earnings generated by productivity come from producing goods and services in different and better ways, or the production of new goods and services.

In Colombia, lack of confidence in the justice system, impunity, legal insecurity and corruption are high compared to world standards, and some of these factors have increased in recent years. Likewise, the reigning violence, financed by the drug traffic and perpetrated by all groups who operate outside the law, is one of the most negative factors for economic growth. Not only does violence have an impact on investment and productivity, it also obliges the State and the private sector to invest in security as opposed to investing in other activities, such as ones to expand the economy's productive capacity. Due to insecurity and a less than adequate institutional framework, economic growth in Colombia has declined considerably in recent years.

The variety of factors that explain the setback in Colombia's economic growth in recent years implies the need to implement different public

[1] See, for example, Barro, F. (1997), *Determinants of Economic Growth*, Cambridge, MIT Press, Hall, R.; Jones, C. (1996), "The Productivity of Nations," *NBER*, Working Paper No. 5812, Cambridge. Sachs, J.; Warner, A. (1996), "Economic Reform and the Process of Global Integration," *Brookings Papers of Economic Activity*, No. 1. Kaufman, D.; Kraay, A.; Zodio-Lobaton. P. (1999), "Governance Matters," *World Bank*, *Policy Research*, Working Paper, No. 2196.

policies for the future, if the economy is to regain a more dynamic course. Doing so necessitates measures that affect what are referred to herein as the "classical" determinants of growth. These include promoting education, having macro-economic stability and generating incentives to savings, investment and the development of markets and competition. It is also important to act on "institutional" determinants by applying policies to improve the quality of public and private institutions, to reduce corruption, impunity and legal insecurity, and to restore investor confidence and that of the general public in terms of the force of law in Colombia. Any effort to make Colombia a nation that is safe and at peace will lead to more economic growth in the future.

III

Macroeconomic Policy

A. Monetary Policy

In the last four years, monetary policy in Colombia and other Latin American countries has responded to the slowdown in economic activity by trying to encourage more comfortable conditions on financial markets. A simultaneous effort is also underway to reduce inflation gradually to the level of the major developed countries (3% or less). In Colombia, once the Board of Directors had established an inflation target in agreement with the government, monetary policy was directed towards promoting economic growth and employment in keeping with this target.

As has been the case for the last few years, Colombia's monetary policy is based on the so-called target inflation strategy (TI), whereby monetary authorities alter their policy in response to deviations between inflation (projected) and inflation targets. In the absence of supply shocks, this policy implies a stabilization of product with respect to its potential level. For this strategy to be effective, the country must be free of critical fiscal situations and enjoy external and financial-sector stability.

1. Interest Rates

The stance of the country's monetary policy is reflected in the interest rates on open market operations conducted by Banco de la República. These are short-term operations (one-day repos) carried out through an auction system in which the Bank set quotas and respective minimum and maximum cut-off interest rates for expansion and contraction operations. There are also two windows to handle the liquidity surpluses or shortages of financial intermediaries at "punitive" rates (the so-called Lombard rate).

Accordingly, the structure of Banco de la República interest rates on repo operations guides the trend in interbank rates and curbs their fluctuation. During the course of 2002, the Board of Directors lowered the band for overnight interest on five occasions (Table 1). The total rate reduction for expansion and contraction auctions came to 325 basis points (bp), while the maxi-mum and minimum rates on expansion and contraction operations (Lombards) were reduced by 325 and 300 bp respectively. The biggest change was in April, when the Board of Directors lowered all the Bank's overnight rates by 100 bp.

Expansion auctions during the first half of the year were held at the minimum expansion rate, and quotas for one-day repos were broad and underused by more than 40% (Table 2). There were window transactions during the same period, although in highly marginal amounts (Col$7 b. on average for the semester).

On the other hand, contraction auctions were used in amounts below those offered and were carried out at maximum contraction rates. Contraction window transactions were conducted throughout the period, mostly with resources from excess liquidity in the National Treasury.

Table 1
Banco de la República Overnight Rates (*)
(Percentage)

Valid From	Valid To	Minimum Contraction Rate (Lombard)	Maximum for Contraction Auction	Minimum for Expansion Auction	Maximum Expansión Rate (Lombard)	IBR (End of)
17-Dec-01	18-Jan-02	6.25	7.50	8.50	12.25	8.21
21-Jan-02	15-Mar-02	6.00	7.00	8.00	11.75	7.78
18-Mar-02	12-Apr-02	5.25	6.25	7.25	11.00	7.14
15-Apr-02	17-May-02	4.25	5.25	6.25	10.00	5.97
20-May-02	14-Jun-02	3.75	4.75	5.75	9.50	5.65
17-Jun-02		3.25	4.25	5.25	9.00	5.13

(*) Figures up to 20 June 2002.
Source: Banco de la República.

Table 2
One-day Expansion and Contraction Operations (*)
(Billions of pesos)

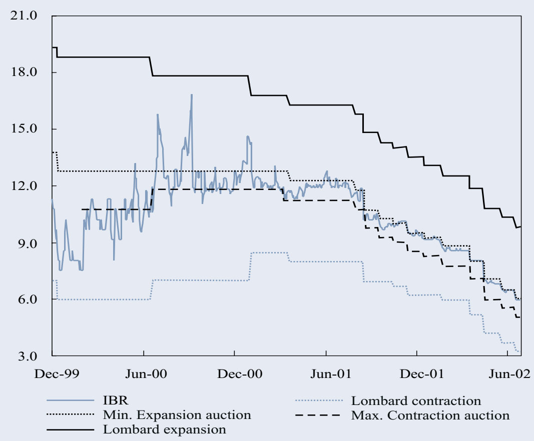
	Auction Transactions						Window Transactions	
	Expansion			Contraction			Expansion	Contraction
	Quota	Use	% Use	Quota	Use	% Use		
January	565.9	293.7	51.9	1,300.0	271.1	20.9	2.9	62.3
February	920.0	432.8	47.0	1,050.0	243.0	23.1	7.6	27.1
March	1,018.8	647.7	63.6	529.4	140.5	26.5	10.6	10.2
First Quarter Average	834.9	458.1	54.9	959.8	218.2	22.7	7.1	33.2
April	727.5	325.3	44.7	1,210.0	781.1	64.6	7.7	57.8
May	769.6	396.3	51.5	804.3	550.2	68.4	4.1	50.7
June	800.0	575.8	72.0	725.0	307.2	42.4	10.3	23.0
Second Quarter Average	765.7	432.5	56.5	913.1	546.2	59.8	7.3	43.9

(*) Figures updated to 28 June 2002, monetary month average.
Source: Banco de la República.

In recent years, the Bank has lowered the level and dispersion of the interest rate structure substantially, as shown in Figure 4. The outcome of this policy has been a downturn in the level and volatility of interbank interest rates in both nominal and real terms (Figures 4 and 5). For example, the minimum cut-off rate for the Bank's expansion auctions declined, in real terms, by 8.2 percentage points between January 1999 and June 2002, as did the real interbank rate. In fact, real short-term interest rates in Colombia are now among the lowest in Latin America (Figure 6).

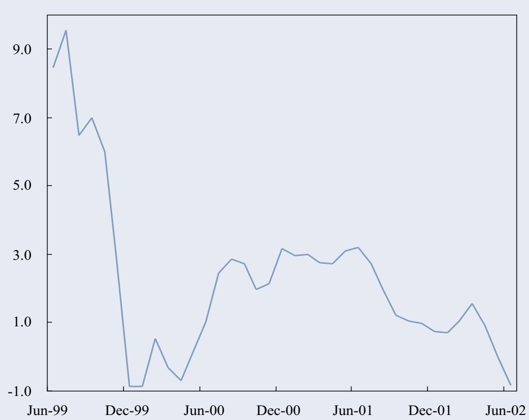
The decline in the level and volatility of the interbank rate was a determinant in the downturn in long-term nominal and real interest, and was

FIGURE 4
BANCO DE LA REPÚBLICA INTERBANK AND OVERNIGHT RATES
(PERCENTAGE)



Source: Banco de la República.

FIGURE 5
TREND IN REAL INTERBANK INTEREST RATES (*)
(PERCENTAGE)

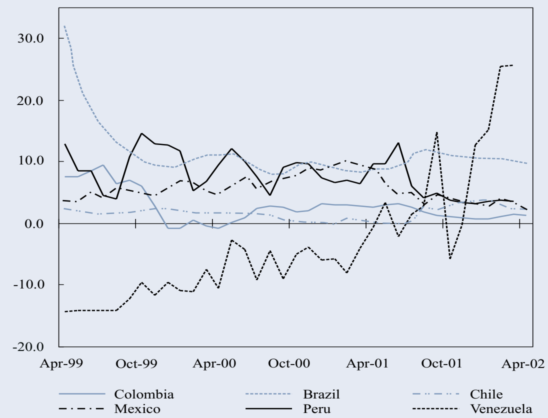


(*) CPI deflated.
Source: Banco de la República and the Superintendent of Banks.

possible in a favorable context of external financing and growing monetary policy credibility, as will be illustrated later.

Following somewhat belatedly on the heels of the trend in the interbank rate, deposit and lending rates in the financial system also declined in both nominal and real terms, as did the interest rate on TES (Figures 7 and 8). In fact,

FIGURE 6
REAL INTERBANK AND/OR INTERVENTION RATE IN SOME LATIN AMERICAN COUNTRIES (*)
(ANNUAL PERCENTAGE)



(*) Deflated with the CPI in each country.
Source: IFM.

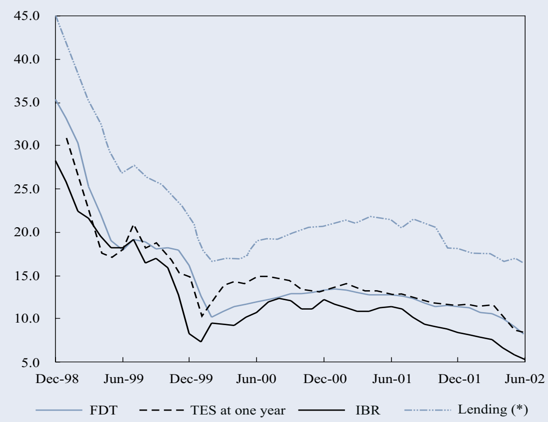
real deposit rates in the last two years were below their historic average (Figure 9).

This reduction brought relief to debtors in the economy (the national government, among others). It also aided the recovery in aggregate demand during 2000, and curbed the effects of negative shocks on available income in 2001. These shocks were due to the drop in terms of trade and a larger tax burden. The result was a positive impact on economic growth. Nonetheless, this expansionary policy had a limited effect on demand and product due to the weak financial position of various economic agents and the risk perception financial institutions have of certain sectors in the economy,. Under these circumstances, reductions in the cost of financing via intermediaries was not immediately reflected in lower rates for borrowing or in more credit (Figure 10).[2]

This is particularly important in a country like Colombia, where credit from the financial sys-

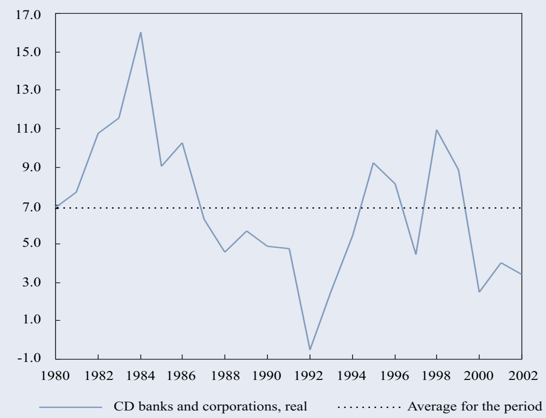
[2] Between 1999 and 2000, lending rates, particularly those for consumer credit, were affected by limits imposed on them through the usury rate.

FIGURE 7
NOMINAL INTEREST RATES: IBR, FTD, TES - ONE YEAR AND LENDING
(EFFECTIVE ANNUAL PERCENTAGE)



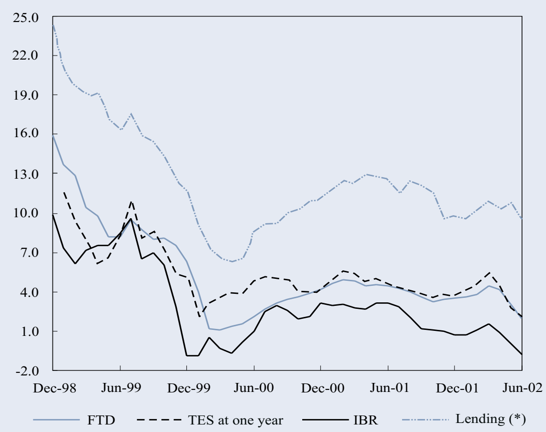
(*) According to the method used by Banco de la República.
Source: Banco de la República

FIGURE 9
REAL INTEREST RATE ON 90-DAY CERTIFICATES OF DEPOSIT (CD) FOR BANKS AND CORPORATIONS
(AVERAGE PERCENTAGE, EFFECTIVE ANNUALLY)



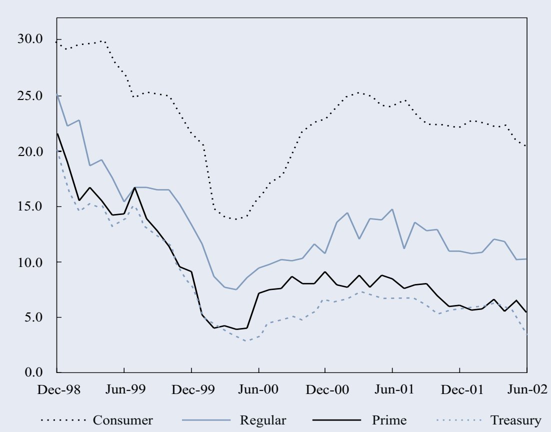
Source: Banco de la República and the Superintendent of Banks.

FIGURE 8
REAL INTEREST RATES: IBR, FTD, TES - ONE YEAR AND LENDING
(PERCENTAGE, EFFECTIVE ANNUALLY)



(*) According to the method used by Banco de la República.
Source: Banco de la República

FIGURE 10
REAL LENDING RATES, ACCORDING TO TYPE OF CREDIT
(PERCENTAGE)



Source: Banco de la República.

tem is a major source of financing for a number of agents and sectors in the economy. Therefore, the financial position of companies, households and the financial system itself will have to improve if monetary policy is to be more effective in terms of its impact on aggregate demand, product, employment and prices.

2. Monetary Aggregates

a. Monetary Base

The gradual reduction in short-term interest rates in the last few years is coherent with efforts to provide enough primary liquidity to satisfy increases in demand on the monetary base. These

TABLE 3
MONETARY AGGREGATES: 1999-2001

	Supply	Cash	M1	Quasi-money	M2	M3
			Annual average (billions of pesos)			
1999	7,068.2	4,202.9	9,303.1	40,088.2	49,391.3	57,482.8
2000	8,227.7	5,391.1	12,405.3	40,096.5	52,501.8	59,419.6
2001	9,500.6	6,529.9	13,927.7	42,700.0	56,627.6	63,761.4
			Nominal annual growth %			
2000-1999	16.4	28.3	33.3	0.0	6.3	3.4
2001-2000	15.5	21.1	12.3	6.5	7.9	7.3
			Real annual growth %			
2000-1999	7.0	17.9	22.6	(8.0)	(2.3)	(4.9)
2001-2000	7.3	12.5	4.3	(1.1)	0.2	(0.3)

Source: Banco de la República.

have been substantial for a number of reasons. One is the tax levied on financial transactions, which has undergone several modifications and has increased the demand for cash in the hands of the public.[3] Increases in demand on the monetary base were also unusually high because of the drop in nominal interest and inflation. This reduced the opportunity cost of non-earning liquid assets. As of 1999, the monetary base and M1 have exhibited growth rates above those for nominal GDP (Table 3).

Between 1998 and 1999, Banco de la República supplied primary liquidity through repos and liquidity quotas (Col$2,629 b.), net TES purchases on the secondary market (Col$ 1,476 b.), and distribution of profits to the government (Col$1,328 b.), all at the cost of less accumulation in international reserves (Table 4). Between 2000 and 2002, the monetary base was expanded through profits distributed to the government (Col$3,195 b.) and recomposition of the international reserve balance (Col$2,597 b.). Accordingly, as shown in Table 4, the country's monetary base increased by Col$2.1 trillion between 1998 and 2002, with Col$3.9 b. of this amount corresponding to an issue associated with sources that facilitate financing for the government.

During the course of 2002, the Board of Directors provided permanent liquidity through the purchase of international reserves and public debt securities (TES) in the amount of Col$699 b. With respect to this sum, Col$459 b. were extended through the exercise of options to accumulate international reserves (US$$202.5 million); the other Col$240 b., through the purchase of public debt securities (TES). The TES purchases helped, in part, to restructure the Bank's portfolio, which included Col$707 b. in maturities (TES A and B) during the course of the year (Col$522 b. in principal and Col$185 b. in coupons).

[3] The financial transaction tax was created in November 1998. The initial rate was 0.2% on deposit account withdrawals. In January 2000, the same levy was extended to transfers between accounts held by the same depositor in a financial institution. Later, in January 2001, the tax was increased to 0.3% and its application to transfers between accounts held by the same depositor in a financial institution was eliminated. Finally, in March 2001, an exemption was authorized for withdrawals from savings accounts used to finance mortgages.

Table 4
Monetary Base Sources: 1998- 2002
(Annual flow in billions of pesos)

	1998	1999	2000	2001	2002 1/
Government	644	2,480	832	914	(1,033)
Profit transfers	83	1,244	516	1,453	1,226
Net purchase of TES	384	1,092	400	(623)	(282)
Public current accounts	177	143	(84)	84	(1,976)
Repos and liquidity (limits)	899	1,730	(691)	(1,215)	(38)
Net purchase of reserves	(2,761)	(1,437)	692	1,445	459
Monetary base stock **2/**			(112)	(225)	(4)
Others	(148)	44	249 **3/**	18	(69)
Total	(1,365)	2,817	971	938	(548)
Saldo base	6.922	9,739	10,710	11,648	11,100

1/ Year to June 2002.

2/ Primarily Granahorrar.

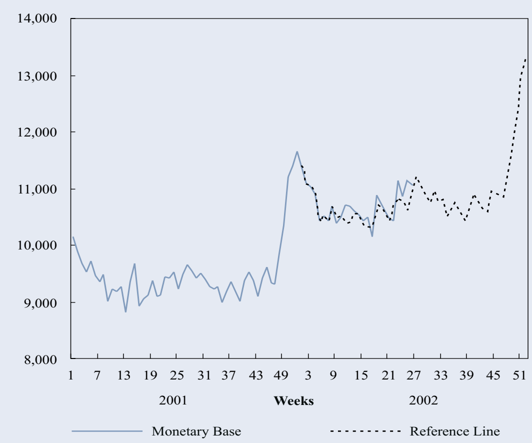
3/ Includes US$55 m. in foreign currency purchased from multilateral agencies, with an increased of Col$126 b.

Source: Banco de la República.

The reference line for the monetary base in 2002 was adopted by the Board of Directors on 14 December 2001.[4] However, growth in the demand for cash during the first two months of the year was far superior to what was implicit in the reference line. As a result, expansion in the monetary base exceeded the projection. This change in monetary aggregate growth prompted a revision of the 2002 reference line, a new version of which was adopted by the Board of Directors on 1 March. It is illustrated in Figure 11, which shows 14.4% average annual growth and 14.5% by year's end.

Annual growth in the monetary base was 17.1% at 28 June. This is slightly above the reference line and raised it to Col$11,100 b. As to the components of the monetary base, the demand for cash remained high between January and June, when it increased by 17.0% on average (Figure 12). During the same period the year before, cash grew by 27.5% on average. For its part, the banking reserve experienced an average increase of 8.8%.

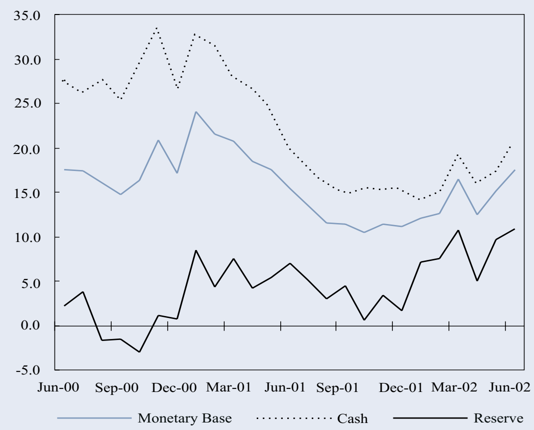
Figure 11
Monetary Base and Reference Line
(Billions of pesos)



Source: Banco de la República.

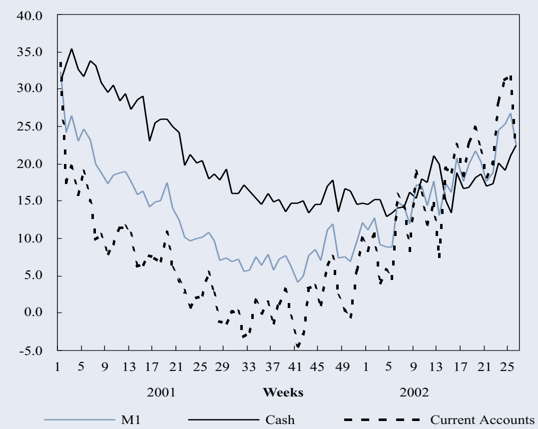
[4] It assumes 10.6% average annual growth in the monetary base during 2002 and 12.4% by year's end.

Figure 12
Monetary Base: Cash and Reserves
(Annual percentage change in the monthly average)



Source: Banco de la República, SGEE.

Figure 13
M1, Cash and Current Accounts
(Annual percentage change)



Source: Banco de la República, SGEE.

b. Money Supply (M1)

The year to date has seen a major acceleration in M1 growth, ending the downward trend that began in November 2000 (Figure 13). Money supply during this period increased by 16.9% on average, particularly in the second quarter of the year when M1 growth averaged 20.7%, which is well above the figure for the first quarter (13.2%). This rise is explained by an 18.1% increase in the demand for cash and 23.1% in current accounts. The surge in current accounts was particularly strong, with average annual growth above that observed in the same period the year before (5.4%).

The fast pace of M1 growth, particularly the growth in private current accounts, may be due, in part, to less inflation and to cuts in nominal interest rates, which lowered the opportunity cost of demand for liquid asset. This is in spite of the higher costs associated with the tax on financial transactions. On the other hand, current accounts in the public sector registered even more of an increase, thanks to larger treasury payments to the other institutions in the sector.

c. Broad Monetary Aggregate (M3)

As of 1999, the broad monetary aggregate, or M3 (cash balance + liabilities subject to reserve requirements + restricted deposits of entities in liquidation), has increased at rates below those for nominal GDP. This is due, in part, to less growth in income and, equally important, to the growing supply of public debt securities and the increased risk perception of liabilities in the financial system. The result has been a real location of household and company portfolios in favor of public securities. As illustrated in Table 5, growth in the M3 + TES aggregate was similar to that of real GDP, although M3 dropped in real terms. Private capital flight in the form of portfolio investment or external debt payments also caused a drain on growth of this aggregate.

The first quarter of 2002 saw a slowdown in M3, with a reversal of the upward trend observed since 2001. M3 growth was 9.5% that year and 7.8% between January and March 2002 (Figure 14). As of April, it has been even more dynamic, registering an average increase of 8.9% in the second quarter as opposed to 6.2% during the same period in 2001.

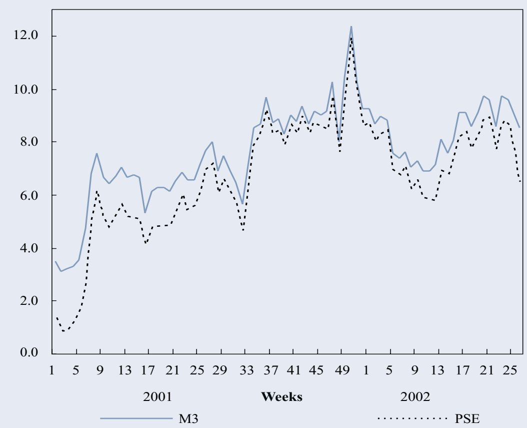
TABLE 5
MONETARY AGGREGATES: M3 AND TES

Annual Averages	M3	TES 1/	M3 + TES
	Billions of Pesos		
1999	57,482.8	12,566.2	70,049.0
2000	59,419.6	18,070.1	77,489.6
2001	63,761.4	21,891.5	85,653.0
2002 2/	67,674.0	24,343.0	92,016.0
	Nominal Growth - %		
2000-1999	3.4	43.8	10.6
2001-2000	7.3	21.1	10.5
2002-2001 3/	8.2	22.5	11.7
	Real Growth - % 4/		
2000-1999	(4.9)	32.2	1.7
2001-2000	(0.3)	12.5	2.7
2002-2001 3/	2.3	15.7	5.5

1/ Does not include TES in the financial system.
2/ Figures at May 2002.
3/ May 2002 versus May 2001
4/ CPI deflated.

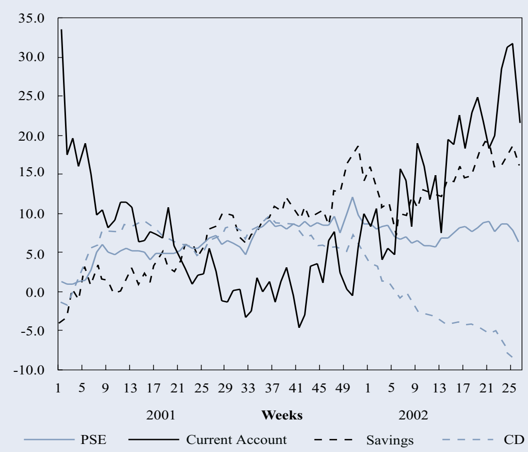
Source: Banco de la República.

FIGURE 14
M3 AND LIABILITIES SUBJECT TO RESERVE REQUIREMENTS (PSE)
(PERCENTAGE ANNUAL CHANGE)



Source: Banco de la República, SGEE.

FIGURE 15
PSE, CURRENT ACCOUNT, CD SAVINGS, TRUSTS
(PERCENTAGE ANNUAL CHANGE)



Source: Banco de la República SGEE.

Growth in time certificates of deposit (CD) slowed during this period (Figure 15), possibly due to less market demand for this type of instrument as a result of low nominal interest rates and the high cost of the transactions associated with their handling. This development would be associated with the increased preference for liquidity seen in the last few months, as mentioned earlier.

Given the foregoing, the conclusion is that monetary policy in recent years has been counter-cyclical and expansive, thanks to the presence of external factors such as recovery of the United States economy, the trend in international interest rates and sufficient external funding to cover the external and public deficit. Internal factors also exerted an influence, such as credibility of the anti- inflation policy, which prevented monetary growth from translating into inflation expectations and, hence, into pressure on interest rates.

It stands to reason that important changes in these conditions can threaten the possibility of managing a counter-cyclical monetary policy. Accordingly, it is essential to avoid action or announcements that might compromise the credibility of the country's monetary policy. It is also important to institute a program that affords the possibility of stabilizing external and public debt indicators by putting the State's finances in order. These indicators declined sharply in recent years.

The downturn in inflation and interest rates occasioned by the country's monetary policy also helped to lower the cost of the central government's domestic debt. As shown in Table 6, the implicit real rate on TES B declined from 13.7% in 1999 to 10.3% in 2000 and 7.6% in 2001.

Added to this is the change in the structure of TES B maturities towards longer terms, thanks to market expectations of lower and more stable inflation in the years ahead. During 1999, the maturity on 67.2% of TES B was less than five years. This proportion had declined to 53.3% by the end of 2001. On the other hand, the proportion of TES B with five to ten year maturities rose from 21.2% to 39.8% during the same two years. This change in profile, coupled with reduced financial costs, slightly softened financing needs and domestic interest paid by the national government. Between 2000 and 2001, despite an increase in the public debt, interest payments declined from 2.52% to 2.28% of GDP.

B. The Exchange Market and Exchange Policy

1. Nominal Exchange Rate

The market representative rate (TRM) appreciated at an annual rate of -3.04% up until April 2002. However, in May, the situation changed and the TRM devaluated by 2.08%, on average, compared with the month before. At the end of June, the exchange rate was Col$2,398.82 or Col$108 more than in December 2001 and Col$100 more than on the same date the year before. Accordingly, annual devaluation was

Table 6
Outstanding TES B by Maturity and Type of Yield

	1999		2000		2001	
	(Col$b.)	%	(Col$b.)	%	(Col$b.)	%
Maturity						
Between 0 and 5 years	13,500	67.2	17,314	64.7	17,777	53.3
Between 5 and 10 years	4,266	21.2	7,143	26.7	13,295	39.8
Between 10 and 15 years	2,335	11.6	2,315	8.6	2,295	6.9
Total outstanding per maturity	20,100	100.0	26,772	100.0	33,367	100.0
Yield						
Fixed rate	13,782	68.6	20,679	77.2	24,468	73.3
Variable rate	5,909	29.4	5,685	21.2	8,457	25.3
Mixed **1/**	409	2.0	409	1.5	442	1.3
Total outstanding per yield	20,100	100.0	26,772	100.0	33,367	100.0
Implicit real rate on TES 2/	-	13.7	-	10.3	-	7.6

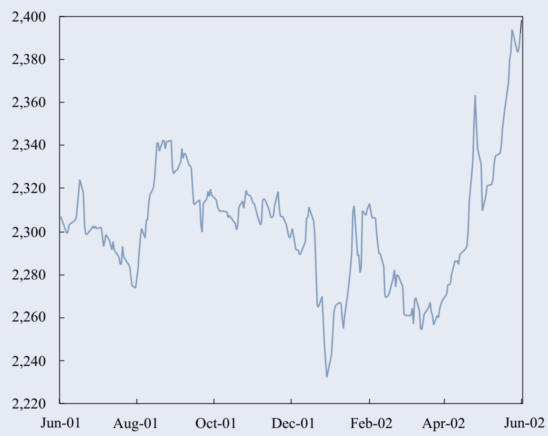
1/ This applies to ten-year TES issued by the government. The first two years are at a fixed rate; the other eight, at a flexible rate.
2/ Calculated as interest paid during the period (t) on the outstanding capital balance in (*t - 1*). Deflated with average inflation (CPI).

Source: Banco de la República.

4.35%, and 4.70% for the year to date (Figures 16 and 17).

The excess foreign currency in the market up until April was the result of a combination of factors. To begin with, some expected the government to monetize its foreign currency, given the excess that had accumulated since mid-2001. A second factor was the volume of remittances from Colombians abroad. Coupled with these factors was a chain of cyclical events that aggravated exchange rate behavior. The following are some important examples: i) the active involvement of exchange houses in the interbank market, meaning that foreign currency previously negotiated on the free market began to enter the interbank market; ii) hedging by mandatory pension funds to reduce the exchange risk to their portfolios in foreign currency, pursuant to regulations instituted by the Banking Superintendent[5]; iii) the decline in the financial system's own position, due to its own expectations of peso revaluation; iv) the policy of United States monetary authorities to reduce interest rates, which could also encourage the entry of short-term capital into the domestic exchange market.

FIGURE 16
TREND IN THE MARKET REPRESENTATIVE RATE
(PESOS PER DOLLAR)



Source: Banco de la República and the Superintendent of Banks.

FIGURE 17
ANNUAL NOMINAL DEVALUATION
(PERCENTAGE)

Source: Banco de la República and the Superintendent of Banks.

At the start of this year, the government conducted a US$ 600 million external debt-for-domestic debt swap. As a result, it was able to reduce its exchange exposure, defer maturities and improve the indicators of the Colombian debt denominated in foreign currency.[6] Additionally, with this operation, pension funds reduced their active exposure in foreign currently, thus eliminating one of the factors that had been exerting downward pressure on the representative market rate, and probably helped to reverse the trend observed in the exchange market up to that point. The increase in the exchange rate as of May might also be explained by the worsening environment in several Latin American countries, particularly Brazil and Venezuela.

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5 The Banking Superintendent issued a circular on 15 June 2001 limiting the uncovered portion of the total value of the investment portfolio of mandatory pension funds to 20%.

6 The nation exchanged US$428.3 m. in Yankee bonds and $174.7 m. in euro bonds, with maturities in 2003, 2004 and 2005, for TES B securities denominated in pesos, at a fixed rate with maturities at five and seven years, and other ten-year securities indexed to inflation.

2. Sale of Foreign Currency to Banco de la República: Exercise of Sale Options

By June 2002, the country had accumulated US$625.2 m. in net international reserves, of which US$201.5 m. originated with the exercise of options for the sale of foreign currency to Banco de la República.[7] The net yield on the investment portfolio of international reserves explains US$230.9 m. of the total increase in reserves during that period.

Banco de la República designed its intervention policy to place international reserves at levels in keeping with acceptable values for international liquidity indicators, such as the ratio of international reserves to external debt redemption at one year, the ratio of international reserves to M3, and the indicator of international reserves as months of total goods and services imported into the country. These indicators reflected adequate levels in recent years, as illustrated in Table 7.

Between January and June 2000, Banco de la República auctioned foreign currency sale options for an accumulation of US$449.9 m. in international reserves; US$201.5 m. of these options were exercised (Table 8). To raise international reserves to the desired level, the auction quota on foreign currency sale options was increased to US$100 m. per month as of April. Between January and April, the premium offered in auctions of sale options fluctuated around Col$8,700 per US$1,000, before declining to Col$3,566 in May. The premiums paid in June increased slightly (to Col$6,010).

3. Real Exchange Rate

The ITCR-IPP, which uses producer prices to measure variations in domestic/foreign purchasing power, was 112.89 in June 2002. This represents 4.2% real annual appreciation and 2.1% in the year to date[8]. Real revaluation in the first half of 2002 is explained primarily by the increase in nominal external devaluation (7.9%) against Colombian devaluation (2.5%), which contributed -5.0 percentages points to the ITCR-IPP decline. External nominal devaluation was led by trading partners such as Argentina (269.1%), Venezuela (62.1%) and Brazil (15.1%). Domestic and external prices contributed 3.1 percentage points to the change in the index, inasmuch as domestic inflation measured by the CPI (2.7%) was below the external rate (5.9%). The CPI increase in the United States, Canada, Argentina and Venezuela was an important factor. The index that uses consumer prices (ITCR-CPI) behaved similarly: 6.8% real annual appreciation and 6.3% for the year to date, reaching 110.10 at June of this year (Figure 18).

7 Banco de la República purchased US$201.5 m. in reserves during 2002.

8 The ITCR has been used traditionally in Colombia. It is based on the parity of buying power. Variations in this indicator reflect the difference between nominal devaluation of the peso against the 20 currencies of Colombia's major trading partners and the ratio of domestic to external inflation.

FIGURE 18
REAL EXCHANGE RATE INDEX IN COLOMBIA
NON-TRADITIONAL COMMERCE
(CPI AND PPI DEFLATED)

Source: Banco de la República and the Banking Superintendent.

Table 7
International Reserve Indicators: 1999-2001

	1999	2000	2001
Net international reserves (US$m.), according to IMF	8,113	8,800	9,982
Gross international reserves	8.103	9,006	10,245
Import indicators			
Imports (US$m.)			
Goods	10,262	11,089	12,267
Non-financial goods and services	13,405	14,403	15,808
Goods and services	15,793	17,791	19,482
Cash reserves as months import of:			
Goods year to date	9.5	9.5	9.8
Non-financial goods and services year to date	7.3	7.3	7.6
Goods and services year to date	6.2	5.9	6.1
Cash reserves as months import of:			
Goods next year	8.8	8.6	10.3
Non-financial goods and services following year	6.8	6.7	7.9
Goods and services following year	5.5	5.4	6.3
External debt indicator			
External debt outstanding (US$m.)			
Total	36,659	36,394	40,076
Long-term	33,648	33,497	36,282
Short-term	3,011	2,897	3,795
External debt outstanding/Gross reserves (%)			
Total	452.4	404.1	391.2
Long-term	415.2	371.9	354.1
Short-term	37.2	32.2	37.0
M3 indicator			
M3 balance (Col$b.)			
Total	60,574.0	62,761.4	68,572.5
M3 balance (US$m.)			
Total	32,327.3	28,154.5	29,928.9
M3/Cash reserves (%)			
Total	398.4	319.9	299.8
Indicator of external debt amortizations			
External debt amortizations (US$m.)	8,900.3	8,599.1	8,086.9
Gross reserves/External debt amortizations year to date (%)	91.0	104.7	126.7
Gross reserves/External debt amortizations following year (%)	94.2	111.4	107.6

Source: Banco de la República.

Table 8
Sales Option Auctions for Accumulation of International Reserves
(Millions of Dollars)

Auction Date (*)		Amount Presented	Amount Approved	Quota	Premium Minimum	Premium Maximum	Premium Closing	Amount Exercised
					(Peso/thousands of dollars)			
2000		4,818.8	1,014.9	1,060.0			32,230.0	318.6
2001		3,242.0	834.9	835.0			67,660.0	629.2
2002	Jan.	188.5	50.0	50.0	3.5	10,510.0	8,000.0	50.0
	Feb.	211.5	49.9	50.0	3,600.0	10,565.0	10,000.0	1.5
	Mar.	107.5	50.0	50.0	3,000.0	9,010.0	8,560.0	50.0
	Apr.	277.8	100.0	100.0	4,000.0	12,000.0	8,300.0	100.0
	May.	275.0	100.0	100.0	1,500.0	8,220.0	3,566.0	0.0
	Jun.	388.0	100.0	100.0	2,010.0	9,220.0	6,010.0	0.0
Accrued June 2002		1,448.3	449.9	450.0			44,436.0	201.5

(*) The options auction is held on the last working day of the previous month.
Source: Banco de la República.

C. Financial System

1. Credit in the Financial System

As of 1999, the total gross portfolio[9] in the financial system declined by a nominal 7.7% and 24.4% in real terms. The portfolio in domestic currency saw a 5.4% nominal and 22.5% real reduction. Part of this decline was related to withdrawals from the balance sheet accounts of financial intermediaries, favored by relief for mortgage holders, portfolio write-offs and mortgage securitization. Once these effects has been corrected with respect to the portfolio in domestic currency, the gross portfolio in domestic currency increased by a nominal 6.9% between December 1999 and December 2001. This is a reduction of 8.7% in real terms (Table 9). According to type of portfolio, the biggest drop was in the mortgage portfolio. This was to be expected in view of the profound crisis in that sector of the financial system (Table 10). In contrast, other types of portfolio showed some nominal recovery throughout the period. As mentioned earlier, this trend in portfolio aggregates reflects a credit crunch in the financial sector[10] and an adjustment (recapitalization) in household and company balances after the surge in credit and asset prices during the nineties.

More recent figure indicate that in May 2002, according to the latest consolidated monthly balances for the financial system, the total nominal gross portfolio grew at a rate of 0.3%, which is 0.7 percentage points below the rate observed at the end of 2001 (1.0%). (Figure 19). This poor performance in 2002 is associated primarily with the standstill in commercial and consumer portfolios and the decline in the mortgage portfolio during the year to date.

[9] Includes the portfolio in domestic currency and the portfolio in foreign currency.

[10] See, for example, Barajas, López and Oliveros (2001), "¿Por qué en Colombia el crédito al sector privado es tan reducido?" *Borradores de Economía*, No. 185, Banco de la República.

Table 9
Adjusted and Nonadjusted Gross and Net Portfolio in Domestic Currency (*)
(Annual % change)

Period		Real Growth Gross	Real Growth Net	Real Growth Gross Adjusted (pr)	Real Growth Net Adjusted (pr)	Nominal Growth Gross	Nominal Growth Net	Nominal Growth Gross Adjusted (pr)	Nominal Growth Net Adjusted (pr)
1999	Dec.	(8.3)	(9.4)	(2.9)	(3.6)	0.1	(1.1)	6.1	5.3
2000	Jan.	(9.8)	(10.4)	(4.3)	(4.6)	(2.3)	(3.0)	3.6	3.3
	Feb.	(11.6)	(12.5)	(5.8)	(6.5)	(3.7)	(4.8)	2.6	1.9
	Mar.	(13.7)	(15.0)	(6.6)	(7.4)	(5.3)	(6.8)	2.5	1.6
	Apr.	(12.9)	(14.8)	(5.3)	(6.6)	(4.2)	(6.3)	4.2	2.6
	May.	(14.6)	(15.3)	(5.6)	(5.8)	(6.0)	(6.9)	3.9	3.6
	Jun.	(16.0)	(17.1)	(7.3)	(7.8)	(7.9)	(9.1)	1.7	1.1
	Jul.	(13.2)	(14.8)	(5.4)	(6.5)	(5.2)	(6.9)	3.4	2.2
	Aug.	(13.0)	(15.2)	(5.4)	(6.9)	(5.1)	(7.4)	3.2	1.6
	Sep.	(14.0)	(15.9)	(5.9)	(7.3)	(6.0)	(8.2)	2.7	1.2
	Oct.	(14.2)	(14.8)	(3.6)	(3.7)	(6.5)	(7.2)	5.0	4.9
	Nov.	(15.5)	(16.1)	(5.1)	(5.1)	(8.1)	(8.7)	3.2	3.3
	Dec.	(14.2)	(15.4)	(5.1)	(5.7)	(6.6)	(8.0)	3.2	2.5
2001	Jan.	(12.6)	(13.7)	(4.2)	(4.7)	(5.2)	(6.4)	3.9	3.4
	Feb.	(10.7)	(11.6)	(2.8)	(3.2)	(3.5)	(4.5)	5.0	4.6
	Mar.	(8.9)	(8.7)	(2.6)	(2.1)	(1.7)	(1.6)	5.0	5.5
	Apr.	(9.8)	(9.2)	(3.3)	(2.5)	(2.6)	(1.9)	4.4	5.3
	May.	(7.4)	(8.0)	(2.7)	(3.0)	(0.1)	(0.8)	4.9	4.6
	Jun.	(6.8)	(7.3)	(2.6)	(2.8)	0.6	0.0	5.1	4.9
	Jul.	(7.2)	(7.3)	(3.1)	(3.0)	0.3	0.2	4.7	4.9
	Aug.	(5.8)	(6.1)	(1.8)	(1.9)	1.8	1.4	6.1	6.0
	Sep.	(6.7)	(7.4)	(2.9)	(3.3)	0.8	0.0	4.8	4.4
	Oct.	(5.1)	(7.0)	(4.1)	(5.5)	2.5	0.5	3.6	2.1
	Nov.	(4.5)	(5.8)	(3.4)	(4.3)	3.0	1.5	4.1	3.1
	Dec.	(5.0)	(6.1)	(3.8)	(4.6)	2.2	1.0	3.6	2.7
2002	Jan.	(4.7)	(6.6)	(3.3)	(4.8)	2.4	0.2	3.8	2.3
	Feb.	(4.1)	(6.1)	(2.6)	(4.2)	2.4	0.2	3.9	2.2
	Mar.	(3.1)	(5.3)	(2.5)	(4.2)	2.6	0.2	3.2	1.5
	Apr.	(2.4)	(4.8)	(1.5)	(3.3)	3.1	0.6	4.1	2.1
	May.	(4.4)	(6.9)	(1.0)	(2.8)	1.2	(1.5)	4.8	2.9
Variations									
Dec/99-Dec/01		(18.5)	(20.6)	(8.7)	(10.0)	(4.6)	(7.1)	6.9	5.3
Dec/99-May/02		(22.5)	(25.3)	(10.2)	(12.0)	(5.4)	(8.8)	9.6	7.5

(pr): Preliminary

(*) Includes entities being liquidated. Does not include special financial institutions.

Source: Banco de la República, based on the monthly balance for financial institutions.

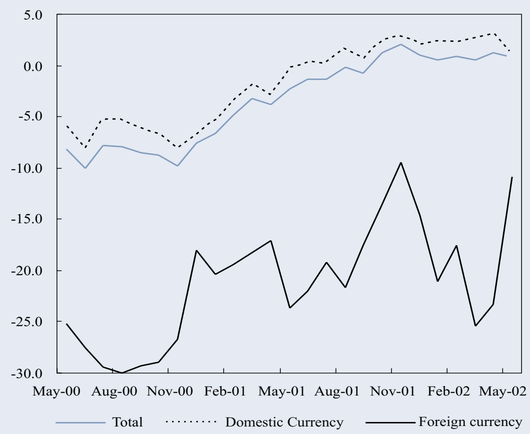
Table 10
Real Rate of Growth in the Gross Portfolio , by Type of Loan
(Annual % change)

	Period	Gross			Consumer			Commercial			Mortgage
		DC	FC/DC	Total	DC	FC/DC	Total	DC	FC/DC	Total	DC
1999	Dec.	(8.3)	(33.7)	(11.2)	(32.9)	(51.9)	(33.3)	(0.3)	(33.2)	(7.2)	(5.1)
2000	Jan.	(9.8)	(33.9)	(12.6)	(34.1)	(48.9)	(34.3)	0.0	(33.5)	(7.3)	(8.5)
	Feb.	(11.6)	(33.8)	(14.1)	(34.6)	(50.4)	(34.8)	(2.5)	(33.3)	(9.0)	(10.4)
	Mar.	(13.7)	(33.4)	(15.9)	(35.0)	(46.6)	(35.2)	(4.9)	(33.0)	(10.6)	(13.7)
	Apr.	(12.9)	(33.2)	(15.1)	(34.3)	(41.7)	(34.4)	(3.4)	(33.0)	(9.4)	(13.6)
	May.	(14.6)	(32.0)	(16.5)	(33.5)	(37.0)	(33.6)	(5.2)	(31.8)	(10.7)	(16.9)
	Jun.	(16.0)	(33.9)	(18.0)	(31.7)	(34.5)	(31.7)	(6.6)	(33.9)	(12.0)	(20.8)
	Jul.	(13.2)	(35.5)	(15.7)	(25.5)	(22.5)	(25.4)	(6.1)	(35.8)	(11.9)	(17.4)
	Aug.	(13.0)	(35.8)	(15.6)	(21.2)	(25.1)	(21.2)	(4.0)	(36.1)	(10.4)	(22.0)
	Sep.	(14.0)	(35.3)	(16.2)	(19.6)	(15.2)	(19.6)	(6.1)	(35.7)	(11.7)	(22.8)
	Oct.	(14.2)	(34.8)	(16.2)	(17.7)	(36.8)	(17.9)	(6.8)	(34.7)	(11.7)	(23.6)
	Nov.	(15.5)	(32.6)	(17.1)	(16.9)	(38.1)	(17.2)	(8.7)	(32.5)	(12.6)	(25.3)
	Dec.	(14.2)	(24.6)	(15.0)	(10.5)	(33.9)	(10.8)	(7.1)	(24.4)	(9.8)	(26.2)
2001	Jan.	(12.6)	(26.6)	(13.9)	(10.3)	(31.5)	(10.6)	(6.4)	(26.4)	(9.5)	(23.3)
	Feb.	(10.7)	(25.4)	(12.0)	(7.5)	(21.4)	(7.7)	(4.0)	(25.5)	(7.3)	(22.3)
	Mar.	(8.9)	(24.1)	(10.2)	(6.3)	(12.8)	(6.4)	(2.6)	(24.4)	(5.9)	(19.8)
	Apr.	(9.8)	(23.2)	(10.9)	(6.3)	(16.5)	(6.4)	(3.7)	(23.4)	(6.6)	(20.9)
	May.	(7.4)	(29.3)	(9.4)	(3.1)	(24.1)	(3.4)	(2.3)	(29.4)	(6.5)	(17.5)
	Jun.	(6.8)	(27.7)	(8.6)	(2.8)	(20.7)	(3.1)	(1.5)	(27.9)	(5.5)	(17.1)
	Jul.	(7.2)	(25.2)	(8.7)	(2.4)	(19.7)	(2.7)	(2.7)	(25.4)	(6.0)	(16.9)
	Aug.	(5.8)	(27.4)	(7.6)	(3.0)	(15.5)	(3.2)	(3.0)	(27.8)	(6.5)	(12.1)
	Sep.	(6.7)	(23.6)	(8.1)	(1.9)	(6.4)	(2.0)	(4.6)	(24.1)	(7.3)	(12.8)
	Oct.	(5.1)	(20.0)	(6.2)	0.8	38.4	1.2	(3.2)	(21.2)	(5.6)	(11.4)
	Nov.	(4.5)	(16.0)	(5.3)	2.5	35.5	2.8	(3.2)	(17.0)	(5.0)	(10.4)
	Dec.	(5.0)	(20.7)	(6.2)	3.7	27.8	3.9	(4.6)	(21.6)	(6.7)	(10.3)
2002	Jan.	(4.7)	(26.5)	(6.3)	3.3	8.7	3.4	(4.1)	(27.3)	(7.0)	(9.9)
	Feb.	(4.1)	(22.7)	(5.4)	4.7	3.5	4.7	(3.6)	(23.3)	(6.1)	(9.5)
	Mar.	(3.1)	(29.6)	(5.0)	(4.0)	(59.4)	(4.7)	1.1	(28.8)	(2.5)	(10.7)
	Apr.	(2.4)	(27.4)	(4.2)	(2.6)	(52.5)	(3.3)	1.8	(26.7)	(1.7)	(10.1)
	May.	(4.4)	(15.7)	(5.2)	(1.5)	(38.8)	(2.0)	(0.5)	(15.1)	(2.2)	(13.4)
Variation of:											
Dec/99-May/02		(22.5)	(44.9)	(24.4)	(15.1)	(48.1)	(15.6)	(13.2)	(44.8)	(17.9)	(39.8)

Observation: Circular 051 issued by the Superintendent of Banking on October 31, 2001 ordered a new portfolio structure (commercial, consumer, mortgage and microcredit). Financial intermediaries began to apply it on March 2002. For comparative purposes, as of that date, the consumer portfolio includes microcredit.

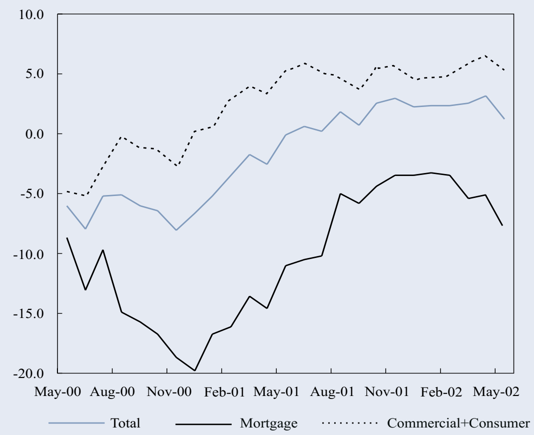
Source: Banco de la República, SGEE.

FIGURE 19
TOTAL NOMINAL GROSS PORTFOLIO, BY TYPE OF CURRENCY
(ANNUAL PERCENTAGE CHANGE)



Source: Banco de la República and the Banking Superintendent.

FIGURE 20
NOMINAL GROSS PORTFOLIO IN DOMESTIC CURRENCY, BY PORTFOLIO TYPE
(ANNUAL PERCENTAGE CHANGE)



Source: Banco de la República and the Banking Superintendent.

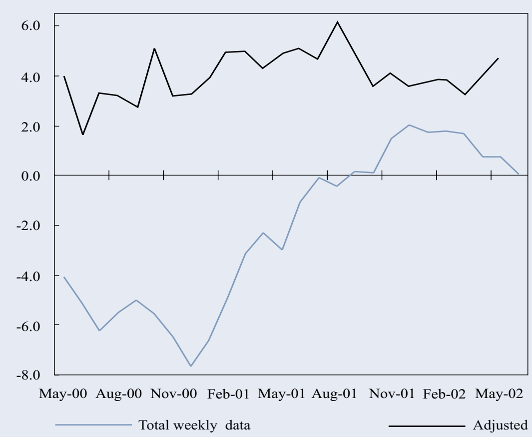
The mortgage portfolio reduction rate gained momentum, going from -5.1% in April to -8.3% in May (Figure 20).[11] Growth in the nominal gross portfolio is higher when corrected by portfolio withdrawals from the balance sheets of financial intermediaries. Annual growth in the adjusted portfolio at May was 4.8%. This rate has fluctuated considerably throughout 2002 (Figure 21).

2. Asset Quality

The traditional indicator of portfolio quality[12] has deteriorated during the course the year, from 9.8% in December 2001 to 10.6% in May 2002. This ended the positive trend exhibited by this indicator throughout 2001 (Figure 22). The coverage index[13] remained positive, increasing from 73.9% to 76.4% (Figure 23).

The standstill in portfolio growth throughout 2001 might have been associated with the drop

FIGURE 21
NOMINAL GROSS PORTFOLIO IN DOMESTIC CURRENCY
(ANNUAL PERCENTAGE CHANGE)



Fuente: Banco de la República and the Banking Superintendent.

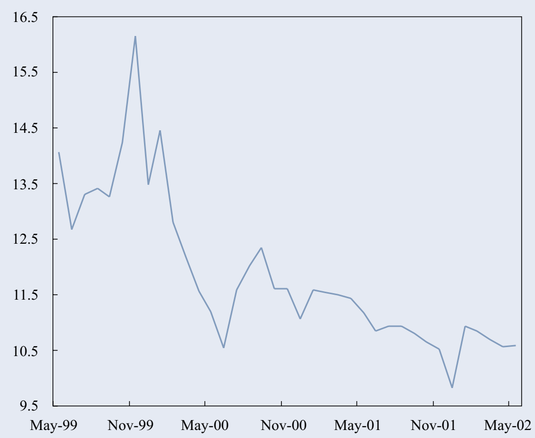
in the monetary multiplier, due to more preference on the part of the public for cash and current accounts, which largely offsets the supply of primary liquidity. However, as reiterated in previous reports, factors such as investor and consumer uncertainty over the future of the economy have slowed the demand for credit. Likewise, the high profitability and security of treasury paper issued by the central government

[11] Much of this trend can be explained by onset of the mortgage portfolio securitization scheme. At the beginning of May, there was an initial portfolio sale for this item of Col$478 b.

[12] Quality indicator = overdue portfolio/gross portfolio.

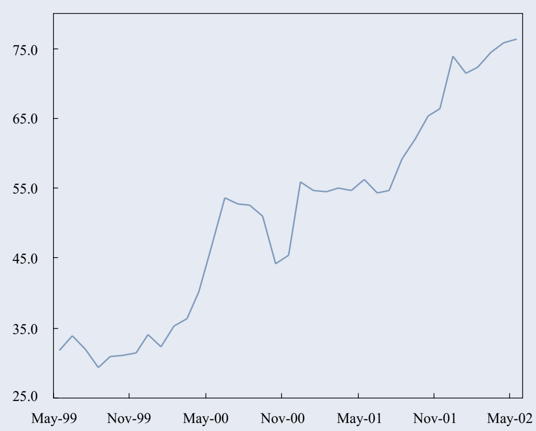
[13] Coverage indicator = Portfolio provisions/overdue portfolio.

Figure 22
Portfolio Quality Indicator
(Overdue Portfolio/Gross Portfolio)
(Percentage)



Source: Banco de la República and the Superintendent of Banking.

Figure 23
Coverage Indicator
(Portfolio Reserve/Overdue Portfolio)
(Percentage)



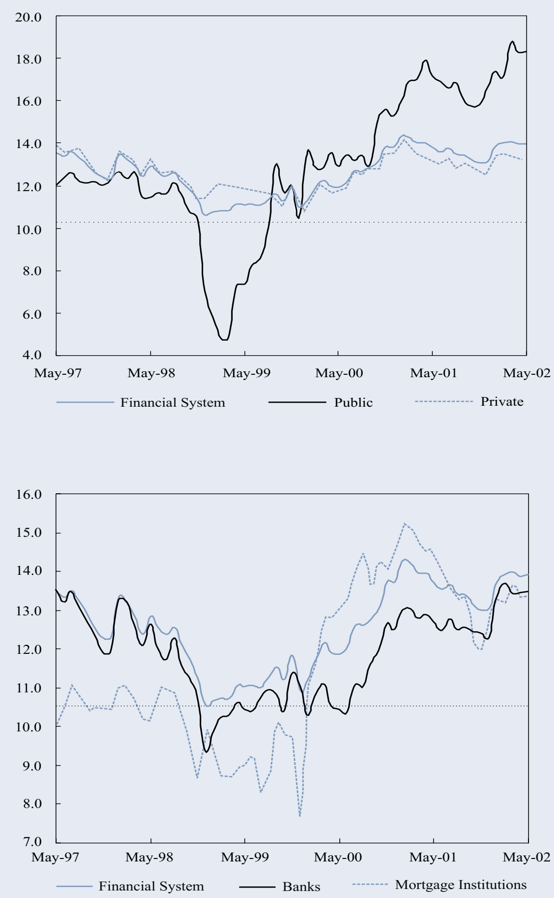
Source: Banco de la República and the Superintendent of Banking.

has made it less attractive for intermediaries to extend new loans.

3. Solvency [14]

Up to May 2002, the solvency indicator for the financial system as a whole improved in comparison with the close of 2001, by increasing from

Figure 24
Solvency Ratio - Credit Establishments
(Percentages)



Source: Banco de la República, Monetary Reserve Division (SGMR).

13.1% to 14.0%.[15] The various institutional categories in this indicator improved or stayed the same. A highlight in this respect is the public sector, were the solvency indicator rose from 16.7% to 18.3% (Figure 24).

4. Profitability

The profit rate for the financial system as a whole continued to recover. Twelve months accrued profits rose from Col$286 b. in December 2001 to Col$396 b. in April 2002 (Figure 25).

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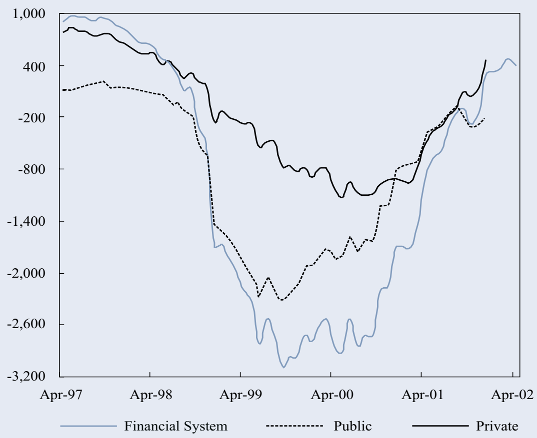
[14] Technical wealth/risk-weighted assets

[15] Includes market risk as of January 2002.

FIGURE 25
12-MONTH ACCRUED PROFITS IN THE FINANCIAL SYSTEM
(BILLIONS OF PESOS)



Source: Banco de la República, SGMR.

D. FISCAL POLICY

1. First Quarter 2002 Performance

At the close of the first quarter, the finances of the consolidated public sector showed a deficit of Col$821 b., which is 0.4% of annual GDP. This outcome is within the terms of the International Monetary Fund (IMF) agreement, which sets the quarterly deficit target at Col$950 b. As illustrated in Table 11, consolidated fiscal performance was determined by the balance for the non-financial public sector (SPNF), since costs to reorganize the financial sector, which came to 0.2% of GDP, were offset by cash profits of Banco de la República and Fogafin.

TABLE 11
CONSOLIDATE PUBLIC SECTOR DEFICIT (-) OR SURPLUS (+)
(FIRST QUARTER)

Item	Billions of Pesos		Percentage of GDP	
	2001	2002 (pr)	2001	2002 (pr)
Electricity	217.0	89.0	0.1	0.0
F.A.E.P.	240.0	(342.0)	0.1	(0.2)
Ecopetrol	703.0	768.0	0.4	0.4
Telecom	117.0	36.0	0.1	0.0
Other Entities **1/**	177.0	475.0	0.1	0.2
Social Security	218.0	344.0	0.1	0.2
Regional and Local Entities	(111.0)	(39.0)	(0.1)	(0.0)
National Coffee Fund	29.0	7.0	0.0	0.0
1. Sub-total: Decentralized Sector	1,590.0	1,338.0	0.8	0.7
2. National Government	(1,984.0)	(2,166.0)	(1.0)	(1.1)
A. Total non-financial public sector (SPNF) (1+2)	(394.0)	(828.0)	(0.2)	(0.4)
B. Cash losses and profits - Banco de la República	452.0	250.0	0.2	0.1
C. Cash losses and profits - Fogafin	77.0	111.0	0.0	0.1
D. Cost of reorganizing the financial sector	(482.0)	(482.0)	(0.3)	(0.2)
E. Adjustments(394.0)	128.0	(0.2)	0.1	
F. **Total Consolidated Public Sector (A + B + C + D + E)**	(741.0)	(821.0)	(0.4)	(0.4)

(pr) Preliminary
1/ Includes EPM and Emcali
Source: Confis.

Central government finances registered a deficit of Col$2,166 b. This is equivalent to 1.1% of annual GDP. Compared with the first quarter of 2001, revenue declined by 1.1% and spending by 12.4% (Table 12). The drop in revenue was highest for taxes on imports, gasoline and income. In the case of the former, revenue from external VAT and customs duties reflects the limited extent of devaluation in the period and the trend in imports, which fell by 13% in the first quarter of the year. The decline in gasoline and income tax revenue is due to lower tariffs and fewer domestic sales, particularly as a result of fuel theft and smuggling. The trend in income tax was determined by several adjustments in the tax calendar, coupled with limited economic activity the year before and increased use of the fiscal benefits provided for in the 2000 tax reform. Revenue from the financial transaction tax also declined, mainly because of new means of eluding this levy and the exemption on monthly savings account withdrawals under four million pesos.

As to spending, there was a 14.4% drop in operating expenses, 30.6% in investment and 28.8% in net loan. Spending for interest on the debt remained at the level observed in the first quarter the year before, with 23.0% growth in foreign payments and a reduction of 13.4% in domestic payments. As part of operating costs, expenses for personal services rose by 6.3%, while general expenses and transfers declined by 30.2% and 17.9%, respectively. Although the reduction in general spending originated with less expenditure for military equipment, the trend in transfer payments is associated primarily with enforcement of Law 715 of 2001, which changed the way transfer payments to the provinces are made. In fact, before this law was passed, three months worth of transfer payments to the provinces were paid in the first quarter, along with payments corresponding to the last two months of the municipal share for the previous year and the first two months of the municipal share for the current year. With the new law, only payments for two months of the territorial share are made in the first quarter. The government's net loan came to Col$121 b., including movement through the special external debt account (CEDE) in the amount of Col$68 b., secured debt operations in the amount of Col$84 b. and Col$31 b. in portfolio recovery.

The funds to finance the central government deficit came from domestic credit and profits transferred by Banco de la República, which added up to Col$1.226 b. Net external borrowing was negative by Col$651 b., thanks to Col$82 b. in outlays and Col$733 b. in amortizations. Net domestic borrowing came to Col$2.647 b., with Col$4,378 b. in outlays against Col$1,731 b. in amortizations. A total of Col$4,246 b. In TES were placed during the quarter, including Col$1,892 b. in agreed or forced investments and Col$2,353 b. at auction.

The decentralized public sector reported a surplus below 0.1% of GDP, compared with what was observed in the first quarter of 2001. This largely reflects use of savings in the Oil Stabilization Fund (FAEP) by Ecopetrol, the oil-producing regions and the National Royalties Fund. By the end of the quarter, Col$342 b. in funds of this type had been used, including Col$200 b. to prepay the regional debt. However, it is important to bear in mind that social security, together with the so-called "other institutions," reported an increase in fiscal surplus, particularly due to less of an increase in payments for effective operations.

Table 12
Effective Central Government Operations
First Quarter
(Billions of Pesos)

	2001 (pr.)	2002	Growth Annual
I. Total Revenue (A + B + C + D)	6,572.0	6,500.0	(1.1)
A. Tax revenue	6,058.0	5,808.0	(4.1)
Income tax	2,252.0	2,168.0	(3.7)
Internal VAT	1,967.0	1,930.0	(1.9)
External VAT	708.0	646.0	(8.8)
Customs	478.0	453.0	(5.2)
Gas tax	270.0	238.0	(11.9)
Tax on financial transactions	356.0	353.0	(0.8)
Others	27.0	20.0	(25.9)
B. Non-tax revenue	228.0	171.0	(25.0)
C. Special funds	43.0	51.0	18.6
D. Capital resources	243.0	470.0	93.4
Financial yields	112.0	146.0	30.4
Financial surpluses	61.0	66.0	8.2
Others	70.0	258.0	268.6
II. Total Expenses (A + B + C + D)	8,928.0	7,821.0	(12.4)
A. Interest	2,046.0	2,046.0	0.0
External	753.0	926.0	23.0
Internal	1,293.0	1,120.0	(13.4)
B. Operating Costs	6,134.0	5,253.0	(14.4)
Personal services	1,176.0	1,250.0	6.3
General expenses	556.0	388.0	(30.2)
Transfers	4,402.0	3,615.0	(17.9)
C. Investment	578.0	401.0	(30.6)
D. Net loan	170.0	121.0	(28.8)
III. Adjustments	372.0	(845.0)	(327.2)
IV. Cash Deficit (-) or Surplus (+) (I - II + III) 1/	(1,984.0)	(2,166.0)	9.2
V. Financing (A + B + C + D)	1,984.0	2,166.0	9.2
A. Net external credit	1,660.0	(651.0)	(139.2)
Outlays	1,911.0	82.0	(95.7)
Amortizations	251.0	733.0	192.0
B. Net internal credit	620.0	2,647.0	326.9
Outlays	3,956.0	4,378.0	10.7
Amortizations	3,336.0	1,731.0	(48.1)
C. Banco de la República profits	1,453.0	1,226.0	(15.6)
D. Others	(1,749.0)	(1,056.0)	(39.6)
VI. Deficit as a Percentage of GDP	(1.0)	(1.1)	1.9

(pr) Preliminary

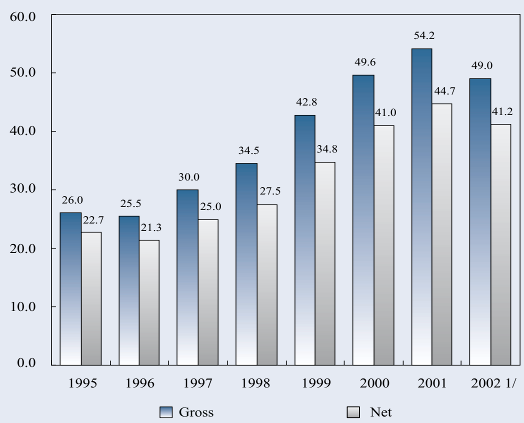
1/ Does not include the cost of restructuring the financial sector

Source: Confis.

2. Public Debt

Given the fiscal outcome of the first quarter, the gross outstanding debt in the non-financial public sector (SPNF) was 49.0% of GDP, which is four GDP points less than at the end of the previous year. This reduction is associated with external amortization payments, which more than surpassed outlays made during the period. Not counting liabilities within the non-financial public sector, the debt was 41.2% of GDP by the end of March.(Figure 26).

FIGURE 26
NON-FINANCIAL PUBLIC SECTOR DEBT



1/ Balance at March 2002
Source: Banco de la República

E. THE ADJUSTMENT PROGRAM WITH THE IMF

The macroeconomic adjustment program agreed on by the government and the IMF is based on reduction of the fiscal deficit and implementation of a funding policy compatible with this reduction. In 2001, these quarterly goals applied to: a) net international reserves; b) inflation through the accrued CPI in the last 12 months; c) overall balance of the combined public sector; and d) net disbursements on the short, inter-mediate and long-term external debt in the public sector. The program was last revised in January 2002, and the latest mandatory goals for com-pliance are those for March and June of this year, which include structural reform criteria. Table 13 contains the outcome for the quanti-tative variables at March 2002. By that date, all the goals had been met.

TABLE 13
FULFILLMENT OF THE PROGRAM WITH THE INTERNATIONAL MONETARY FUND (IMF)

	March 2002			June 2002
	IMF Goal (a)	Actual (b)	Difference (b) - (a)	IMF Goal
RIN Floor (US$m.)	9,580.0	10,169.3	589.3	9,660.0
Target Inflation	7.8	5.9	(1.9)	7.2
Ceiling on the overall consolidated public sector deficit as of January 1, 2002 (Col$ b.)	950.0	821.8	(128.2)	2,100.0
Ceiling on accrued net disbursements on the medium and long-term external debt in the public sector as of January 1, 2002 (US$m.) **(*)**	1,100.0	198.6	(901.4)	1,800.0
Ceiling on accrued net disbursements on the short-term external debt in the public sector as of January 1, 2001 (US$m.)	180.0	0.0	(180.0)	180.0

(*) Preliminary data at March 2002.
Source: Banco de la República and the Ministry of Finance and Public Credit.

Exchange policy in colombia

Banco de la República abandoned the exchange band system in September 1999 and adopted a floating regime. This floatation was successful in Colombia because it did not imply a leap in exchange and interest rates.[1] The Board of Directors decided the floating system had to be as clear and transparent as possible. Accordingly, in November 1999, it established rules for exchange market intervention on the part of Banco de la República. These rules concern two of the Board's foreign exchange objectives:

i. *Replenish Colombia's international reserves*. These were reduced by US$1,892 m. between January 1998 and September 1999 in response to adverse conditions in the external sector and in the context of the exchange band system. In more general terms, the Board of Directors wanted to maintain a level of international reserves that is "adequate" in light of the current and capital accounts in the balance of payments. This means Banco de la República must purchase foreign currency on the exchange market at some point, when considered necessary to increase the amount of external liquidity required to guarantee foreign payments and to minimize the probability of speculative attacks on the currency.

ii. *Curb exchange rate volatility*. To the extent that the secondary market offers no coverage against excessive fluctuations in the exchange rate, Banco de la República would intervene in the exchange market to mitigate these fluctuations, provided said intervention does not change the tendency in the exchange rate.

Based on these objectives, two mechanisms were instituted for Banco de la República to intervene in the exchange market:

i. *Auctions to "accumulate international reserves"*: These are monthly auctions of options for the sale of foreign currency to Banco de la República, provided the representative market rate is below its moving average for the last 20 days. The Board of Directors sets the quotas for the auction, and the options are valid for one month. The idea is to increase international reserves to desired levels, provided the market is free of pressure to depreciate the exchange rate.

ii. *"Volatility" auctions*: These are auctions of options to sell or buy foreign currency to or from Banco de la República, provided the market representative rate is 4% above or below its 20-day moving average. Obviously, the idea is to limit excessive volatility of the market, if such be the case. A present, Banco de la República would intervene by auctioning US$180 million in options valid for one month.[2] After having intervened, the Bank can act on the exchange market at its discretion.

Later, in December 2001, the Board of Directors approved an occasional mechanism to "deaccumulate" reserves. In this case, the aim is to help curb inflationary pressures brought on by excessive peso depreciation in the face of a strong, temporary external shock. The mechanism is, therefore, an additional tool for keeping inflation close to the target. As to the way it operates, options to purchase foreign currency from Banco de la República would be auctioned when the exchange rate exceeds its 20-day moving average.

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[1] Part of the reason why the floating regime has not had an adverse effect in Colombia is because of the real depreciation achieved with the band system and prior regard for the more critical problems of the crisis in the financial system, among others (See Additional Report to Congress by the Board of Directors, October 1999).

[2] Initially, a deviation of 5% in the representative market rate prompted an auction, and the amount of intervention was set at US$120 million. These parameters were established to make intervention as sporadic and effective as possible. Deviations of 4% or 5% imply sharp fluctuations in the exchange rate during a single day, while amounts of US$120 or US$180 m. corresponded, at the time, to slightly less than the size of the market on a "normal" day.

IV

Recent Economic Performance and the Outlook for 2002

A. Macroeconomic Performance And Employment

Like other Latin American countries, Colombia was obliged to deal with a rather unfavorable international environment during 2001 and the first half of 2002. The continued decline in terms of trade, the slow growth of developed economies and the Argentine crisis and its repercussions substantially reduced world demand for exports from the countries of the region. This was evident in a new decline in foreign capital flows and investment in Latin America. As was the case in 2001, almost all the countries have lowered their growth forecasts for this year. Several economies in the region, namely Brazil and Uruguay, have external account problems associated with the Argentine crisis of late 2001. Others, such as Venezuela, have been negatively affected by domestic political instability. ECLAC estimates that, because of these factors, the region will see almost no growth during 2002.

In this context, as mentioned in the last Report to Congress, performance of the Colombian economy during 2001 and in the first months of 2002 was below the official targets set by the government, having slowed in comparison with the situation in 2000. The National Bureau of Statistics (DANE) recently revised the growth figure for that first year, lowering the initial calculation from 1.57% to 1.4%. On the other hand, in the first quarter of this year, the economy grew by only 0.5%. The negative impact of the external factors mentioned earlier was amplified by the effect of internal factors. The most important of these are the increased tax burden, high unemployment and violence perpetrated by groups operating outside the law. The continued decline in the demand for exports was accen-tuated by slow recovery of the United States economy and by political events in Venezuela. Heightened uncertainty caused by the break-down in peace talks was also a factor that affected economic growth. Although unemployment declined somewhat –it was 17.5% in the 13 major cities– and the occupation rate continued to increase, this is still one of the country's most pressing economic problem.

The outlook for growth in the remainder of the year is not promising. Even if economic performance is expected to improve in comparison with the first quarter, the unfavorable environment for the economy has prompted the government to lower its projection for growth in 2002 from 2.5.% to 1.5%.

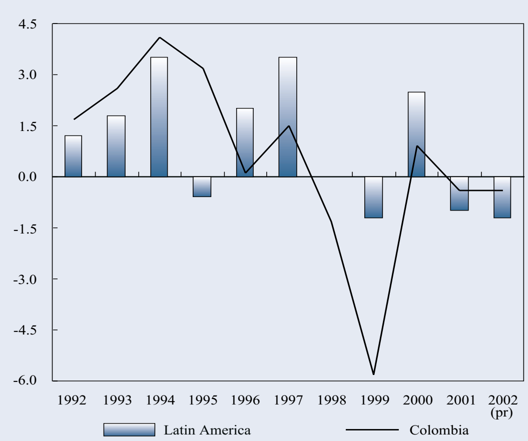
The downward trend in inflation continued throughout the early months of 2002. This was due to two factors. The first was a monetary policy that is coherent with the inflation targets set by the Board of Directors and with the goal of long-term price stability. Among other things, this substantially lowered inflation expectations among economic agents in recent months, as suggested by lower and less frequent adjustments in the price of highly indexed goods and services such as public utilities, transportation and professional health services, among others. The second factor was the availability of considerable unused productive capacity in most production sectors, coupled with slow growth in demand. As to the remainder of the year, inflation may increase somewhat in terms of food prices, but the Board of Directors is confident the target of 6% for 2002 will be met.

1. Economic Activity

Economic activity in Colombia during 2001 and the first two quarters of 2002 was influenced by an unfavorable international environment. In 2001, GDP per capita shrunk in Colombia and in the rest of Latin America, due to this environment and to other factors that will be analyzed later. (Figure 27). A further reduction in this variable is expected for 2002.

Terms of trade declined as well, more so in Colombia than in other countries, and there was a slowdown in foreign capital flows and investment (Figures 28 and 29). Evidence suggests that the poor economic performance of Latin American countries originates with external shocks that are common them all. Figure 28 shows the close relationship between terms of trade and GDP changes in Colombia, reflecting the economy's vulnerability to external shocks of this nature.

FIGURE 27
EVOLUTION IN GDP PER CAPITA
LATIN AMERICA AND COLOMBIA: 1992-2002
(REAL GROWTH RATES)

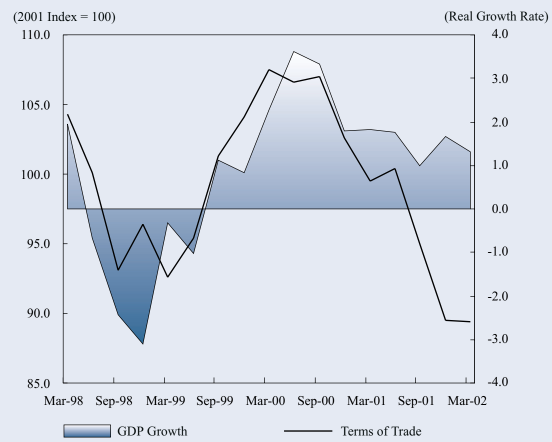


(pr) Preliminary
Source: ECLAC

a. Analysis of Demand

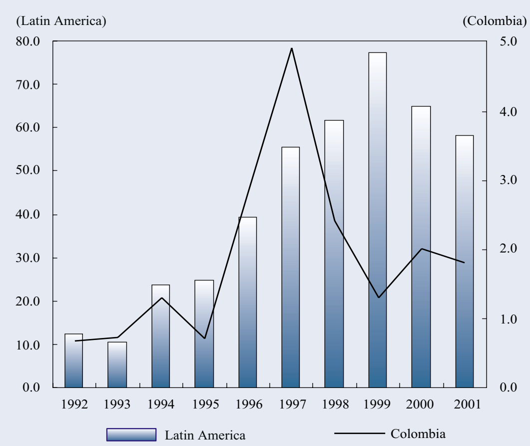
As stated in the March 2002 Report to Congress, the trend in aggregate demand during 2001, particularly with respect to private consumption, is explained by the drop in available national income throughout the year due to worsening terms of trade, the tax reform and larger foreign remittances to pay interest on the external debt (Figure 30).

FIGURE 28
TREND IN TERMS OF TRADE AND GDP
(MARCH 1998 - MARCH 2002)
(1995 INDEX = 100)



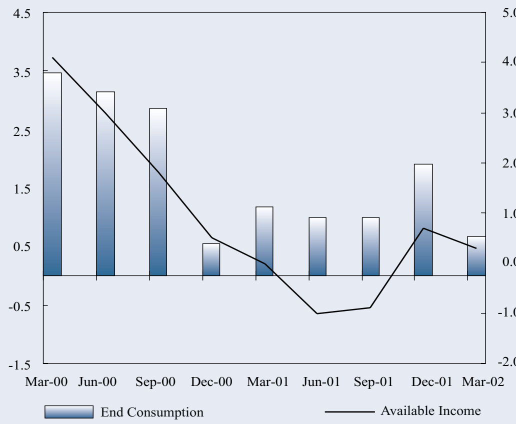
Source: Banco de la República and DANE.

FIGURE 29
EVOLUTION IN FOREIGN INVESTMENT FLOWS TO
LATIN AMERICA AND COLOMBIA: 1992-2001
(BILLIONS OF DOLLARS)



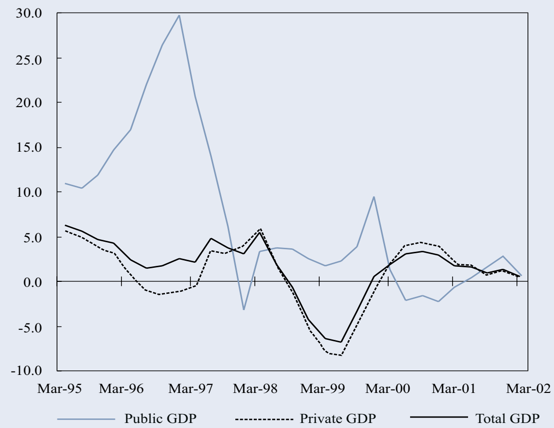
Source: ECLAC.

Figure 30
Rate of Growth in Available Income and End Consumption
January 2000 - January 2002
Real Growth Rate (%)



Source: Ministry of Finance and Public Credit and DANE.

Figure 31
Evolution in Public and Private GDP
(Percentage)



Source: DANE and the National Department of Planning (DNP).

Figure 30 shows a slight recovery in available income during the last quarter of 2001. This was due to a sizable increase (more than 25%) in remittances from Colombians living abroad, compared with the third quarter of the same year. This recovery coincided with a wage increase ordered by the Constitutional Court at the start of 2001 and with bonuses paid to public employees in December. The fourth quarter saw a decline of 150 bp in the Bank's intervention rates. Together with a similar reduction in the third quarter of the year, this lowered the cost of financial liabilities for households and provided an incentive for people to purchase articles usually acquired on credit, such as new cars. These factors allows for some recovery in available income and household consumption, as reflected in more consumption of durables and services. Consumption of non-durables ceased to decline as well (Figure 14).

Thanks to the increase in payments by the public sector, GDP growth in this sector also accelerated slightly at year's end, as shown in Figure 31. Nevertheless, it did nothing to influence the trend in private GDP or total product.

The recovery in end consumption was not maintained in the first quarter of 2002. According to the latest figures published by DANE, after having expanded at a rate of 1.90% in the last quarter of 2001, consumption rose by 0.66% in the first quarter of 2002 compared with the same period the year before. Household consumption went from an increase of 1.51% to 0.97% between the two quarters, reflecting the slowdown experienced by all items in general (Table 14). During the early months of the year, the trend in indicators such as credit card purchases and commercial activity, coupled with the positive impact of the expansive monetary policy being applied by the Board of Directors, which has placed interest rates at historic lows, contrasts with the foregoing. The trend in consumption during the first quarter of the year may be due, in part, to seasonal and methodologial events and to less consumer confidence and expectations, as suggested by the Fedesarrollo consumer confidence index (ICC) (Figure 34).

The expansion in merchandise trade mentioned earlier is evident in the DANE monthly retail trade sample (MMCP). In March, this indicator

Table 14
Annual GDP According to Demand
(Percentage change)

	2000 (pr)					2001 (pr)					2002 (pr)
	I	II	III	IV	Annual	I	II	III	IV	Annual	I
Gross domestic product	2.41	3.39	3.32	1.85	2.74	1.59	1.71	0.89	1.42	1.40	0.50
Total Imports	1.50	7.29	12.35	13.56	8.63	11.37	20.22	9.98	4.08	11.19	(4.26)
Total end supply	2.28	3.93	4.57	3.51	3.57	3.01	4.37	2.24	1.83	2.85	(0.25)
End Consumption	3.46	3.06	3.05	0.44	2.49	1.29	0.96	0.91	1.90	1.26	0.66
Household	2.58	3.30	4.93	3.79	3.65	1.94	1.15	0.33	1.51	1.23	0.97
Non-durables	6.04	4.62	4.49	0.29	3.82	0.62	(0.48)	(2.17)	0.32	(0.44)	(0.42)
Semi-durables	3.24	14.05	21.36	23.21	15.28	8.99	4.47	1.84	0.60	3.83	(0.35)
Utilities	(0.05)	0.80	2.39	3.25	1.60	2.21	2.24	2.45	2.99	2.48	2.41
Durables	5.14	2.34	8.56	7.50	5.90	4.10	4.73	3.51	6.30	4.67	4.14
Government	6.01	2.38	(2.09)	(8.30)	(0.74)	(0.54)	0.43	2.60	3.06	1.37	(0.23)
Gross Capital Formation	(6.47)	13.38	19.06	24.85	11.79	11.77	22.77	8.44	2.14	10.92	(6.12)
Gross fixed capital formation	(13.99)	(3.97)	4.19	13.36	(0.84)	7.37	13.56	12.44	12.04	11.37	0.81
Machinery and equipment	(9.60)	(3.29)	12.17	20.15	4.22	18.26	35.34	18.57	9.80	19.96	1.61
Transport equipment	0.08	12.87	7.16	15.42	8.65	31.82	34.46	45.95	37.81	37.46	(16.26)
Buildings	(28.58)	(17.23)	(0.21)	7.83	(11.10)	7.90	10.48	7.98	17.35	11.04	24.33
Civil works	(10.28)	0.77	(0.28)	13.34	0.22	(10.84)	(9.38)	1.03	4.83	(3.63)	(16.96)
Subtotal: End domestic demand	1.98	4.33	5.06	3.44	3.70	2.72	3.87	1.98	1.94	2.62	(0.35)
Total Exports	3.85	1.89	2.04	3.90	2.92	4.57	7.01	3.63	1.30	4.09	0.23
Total end demand	2.28	3.93	4.57	3.51	3.57	3.01	4.37	2.24	1.83	2.85	(0.25)

(pr) Preliminary.
Source: DANE.

showed positive growth rates for 13 of the 16 product groups, particularly an acceleration in sales of automobile, furniture and appliances and footwear (Table 15). The figures for April were less encouraging, but this is explained by Easter Week.[16] Additionally, in the first months of 2002, national sales of new vehicles (domestic and imported) showed an annual increase above 30%, maintaining the trend observed in the fourth quarter of 2001 (Figure 32).

Growth in credit card sales and advances (9%) accelerated in the early months of 2002 (Figure 33), and financial institutions reported highly

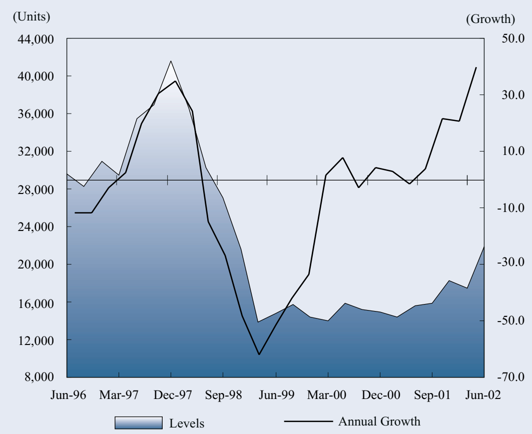
Table 15
Annual Growth in Retail Sales: 2002
(Percentage)

	January	February	March	April
Food	(1.34)	0.79	4.86	(2.12)
Liquor and cigarettes	(5.66)	2.84	7.77	(0.00)
Wearing apparel	1.73	(0.75)	20.75	(17.88)
Footwear	7.87	5.17	18.13	(11.16)
Medicine	(5.98)	(6.03)	(13.45)	(2.50)
Personal hygiene	6.33	3.52	17.80	(12.11)
Electrical appliances	2.69	8.79	21.37	10.31
Domestic use	9.20	18.26	47.28	(15.58)
Home cleaning	(3.48)	(4.81)	8.99	(4.85)
Office equipment	9.58	36.69	47.99	(12.63)
Books	6.36	(11.42)	(18.88)	(3.94)
Hardware	(6.03)	(12.34)	14.89	(17.13)
Spare parts	(0.86)	(4.12)	(13.90)	7.59
Vehicles	17.61	37.77	25.89	44.52
Lubricants	(11.37)	1.26	(24.32)	(5.12)
Others	15.65	9.56	10.28	6.04

Source: DANE.

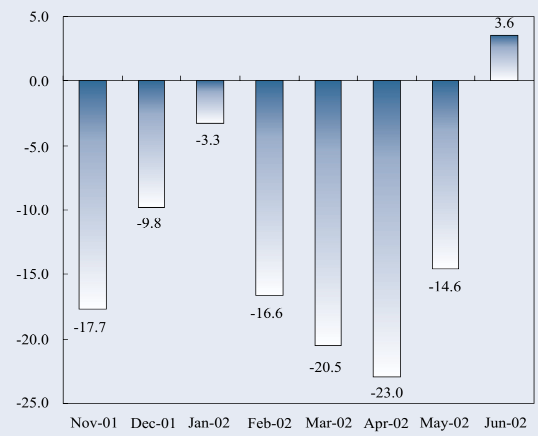
[16] Easter week was in April 201 and in March 2002.

Figure 32
Quarterly Vehicles Sales on the National Market
(Not including exports)



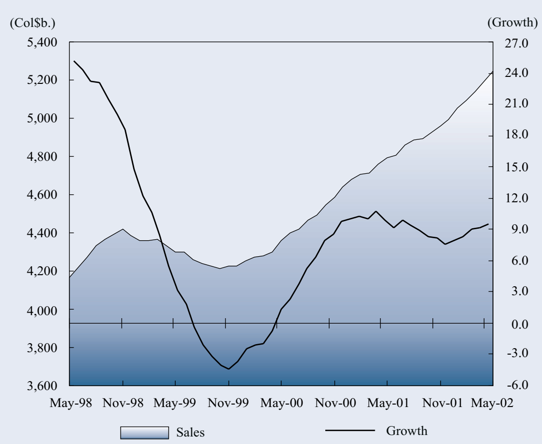
Source: Colmotores.

Figure 34
Consumer Confidence Index
(Balances)



Source: Fedesarrollo.

Figure 33
Credit Card Sales
(Last 12 months)



Source: Red Multicolor.

favorable outlays for consumer credit during the first half of the year.[17]

The situation with law an order at the start of 2002, particularly the breakdown in the peace process, had an apparently temporary effect on consumer confidence, as shown by recovery of the indicator in recent months (Figure 34). A slight recovery in household consumption is expected during the remainder of the year, following negative performance by this variable in the first quarter of 2002. As noted earlier, lower interest rates and less indebtedness on the part of families may contribute to this recovery. A projection developed by DNP and the Finance Ministry for the entire year points to 1.0% estimated growth in consumption.

Government consumption rose at a rate of 1.4% during 2001 (Table 14). The last three quarters of that year saw a positive change in this variable due to a retroactive wage increase ordered by the Constitutional Court in 2001 for public employees and a step up in government payments, which reduced the budget lag. Nevertheless, in first quarter of 2002, government consumption declined by 0.23% and is expected to continue to drop throughout the remainder of the year. The scheduled adjustment in the 2002 financial plan[18] contemplates a nominal rise of 4% in

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[17] For more about this topic, see the section on monetary aggregates in Chapter III.

[18] The 2002 Financial Plan, CONFIS Advisory Document No. 17/ 2001, December 21, 2001.

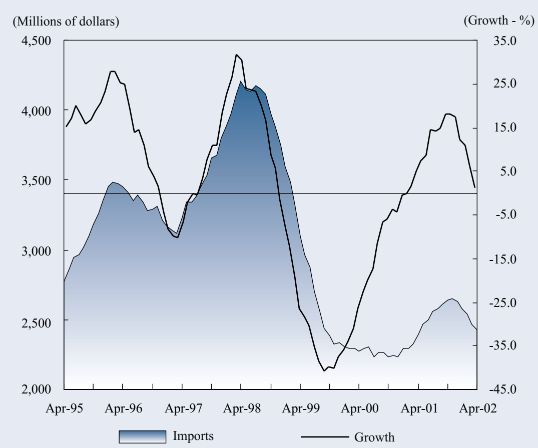
payments for personal services, a nominal increase of 10% in total transfers and a nominal decline of 3% in general expenses.

Gross capital formation continued to slow towards the end of 2001 (Table 14). This was mainly because of changes in stock on hand, since gross fixed capital formation continued to grow as observed in the second quarter of 2001 and expanded at a rate of 12.04% in the last quarter. Companies made an important investment in machinery and equipment in the second half of 2001, possibly in response to less exchange rate devaluation and better expectations about the future of the economy. Investments in transportation equipment also grew quickly, particularly those associated with Plan Colombia and Transmilenio. Investment in civil works expanded at a faster pace during the last quarter than in the first part of the year This was in response to a policy adopted by the Ministry of Finance and Public Credit to reduce the budget lag. Yet, in spite of everything, this variable declined by 3.6% for the year as a whole.

The positive trend in some investment components did not continue during the first quarter of 2002. According to figures published by DANE, gross capital formation declined and gross fixed capital formation grew very little (0.81%). This situation is attributed to a climate of growing uncertainty, not only because of reduced expectations for economic performance but due to increased insecurity and violence throughout the country, especially since February 2002. The only component of this variable to increase sharply was investment in buildings, which grew by 24.33% in the first months of 2002, thanks to recovery in the construction sector supported by tax exemptions and subsidies for low-cost housing. Investment in machinery and equipment was at a standstill, while investment in transportation equipment dropped by -16.26% and in civil works by -16.96%.

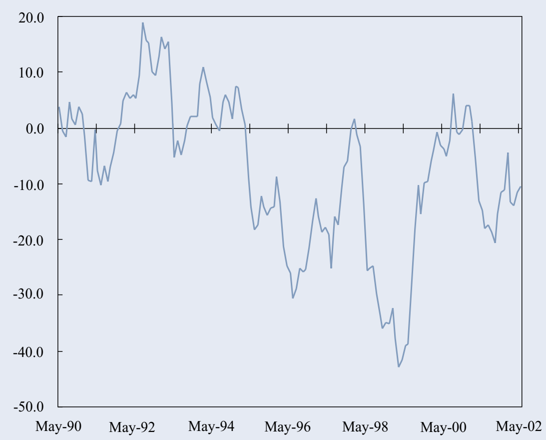
The less than favorable performance registered by investments in general also reflects changes in some of the principal indicators of this variable. During the first four months of the year, annual growth in imports of industrial capital goods declined substantially (Figure 35). Accordingly, it seems likely that companies will spend less on investment during the remainder of 2002 than in the second half of 2001, despite a recent improvement in the confidence indicator of the Fedesarrollo business opinion survey (Figure 36). After knowing the results for the first quarter, many businesses felt the demand for their products had not developed as expected. At any rate, investment in buildings is expected to be the most dynamic component of gross fixed capital formation. In contrast, investment in transportation equipment will not increase as much as last year, primarily because of fewer imports for Plan Colombia and bus imports for Transmilenio. It is also likely that investment in civil works will continue to decline.

FIGURE 35
IMPORTS OF CAPITAL-INDUSTRIAL GOODS
(LAST 12 MONTHS)



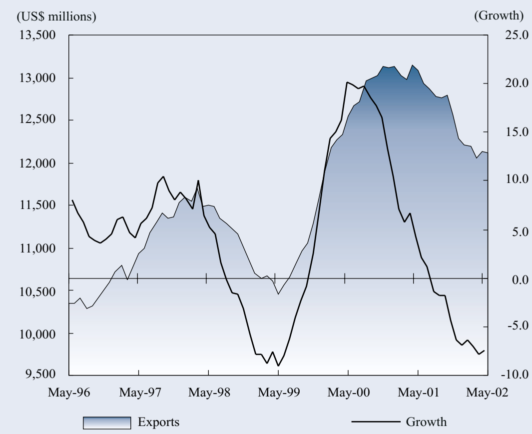
Source: DANE.

Figure 36
Confidence Indicator
(Balances)



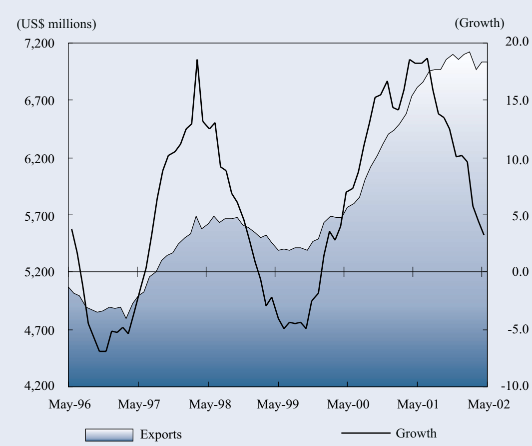
Source: Fedesarrollo.

Figure 37
Total Exports
Last 12 Months



Source: DANE.

Figure 38
Non-traditional Exports
Last 12 Months



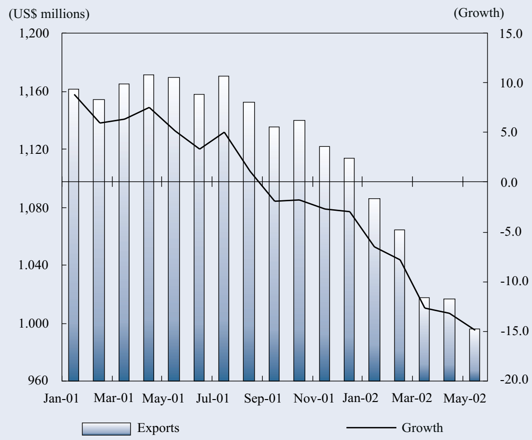
Source: DANE.

The downward trend in external demand as of the second half of 2001 continued (Table 14). Traditional exports such as coffee and oil continued to drop and non-traditional ones lost force due to less demand for exports to the United States market. Unlike the previous year, the decline in this component of external demand during the course of 2002 has not been offset by good performance with respect to non-traditional exports to Venezuela and Ecuador. As a result, April figures on total external sales show a drop of more than 5.0% (Figure 37) and non-traditional sales are below the levels reported in November 2001 (Figure 38).

The figures up to May also reflect a decline in non-traditional industrial exports to the United States during the past 12 months. This is due to the slow-down in the United States economy and the delay in approval of ATPA (Figure 39). As for Venezuela, industrial sales figures up to May show a decline (Figure 40), while industrial sales to Ecuador barely maintained their growth rates (Figure 41). Consequently, external demand in the first quarter of the year rose by only 0.23% (Table 14).

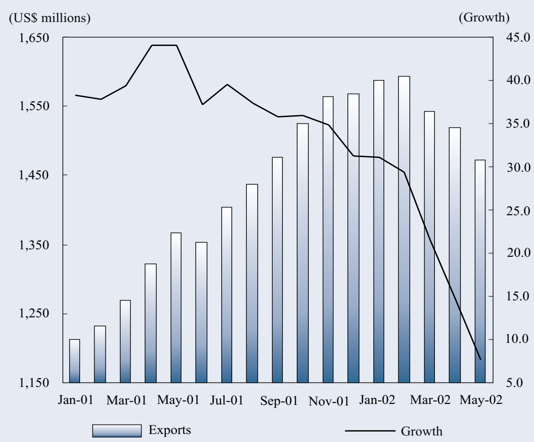
There is evidence to suggest a continued slowdown in external demand for Colombian products during the first months of the year. Although the United States economy has begun to recover, sales to that country are still on the decline, even sales of non-traditional goods. This is explained by the slow pace of economic recovery in the United States and by the negative effect delay in approval of the system of Andean preferences (ATPA) has had on certain sales. The trend in exports to the North American market could change somewhat in the months ahead, provided

Figure 39
Non-traditional Industrial Exports
to the United States
Last 12 Months



Source: DANE.

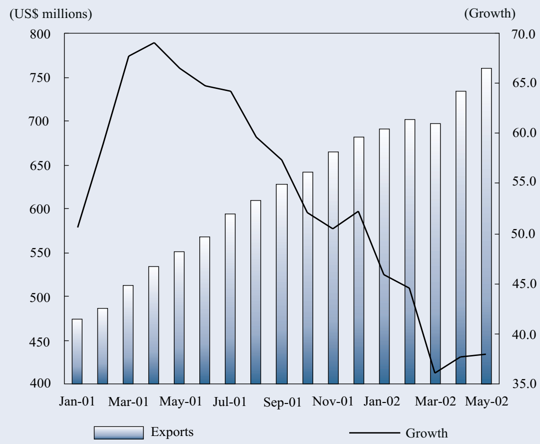
Figure 40
Non-traditional Industrial Exports
to Ecuador
Last 12 Months



Source: DANE.

ATPA becomes fully effective in the near future. Nonetheless, their momentum will be limited, since analysts say the major deter-minant; that is, GDP growth in the United States, will recover slowly.[19]

Figure 41
Non-traditional Industrial Exports
to Venezuela
Last 12 Months



Source: DANE.

An added complication is the slow growth expected in sales to Venezuela. The events of April 11 in that country accelerated the economic decline evident since late last year. At present, all forecasts point to a more than 5.0% drop in Venezuela's GDP during 2002. This, coupled with the effects of devaluation of the Bolívar, which had exceeded 75.4% in nominal terms by 30 June 2002 -and was nearly 87.3% the year before- plus measures announced to restrict imports of certain goods, will spell a reduction in Colombian exports. According to the Bank's projections, these could be somewhere between 20% and 30% of their 2001 dollar value. Whereas sales to Venezuela represent an important share of Colombia's total exports, this impact will not be offset by the momentum still evident in sales to Ecuador, which are expected to remain the same for the rest of 2002. Consequently, on the demand side of the GDP forecast, the new projection by the Ministry of Finance and Public Credit with respect to total exports estimates a decline of more than 2.0% in real terms.

b. Analysis of Supply

The sectors registering the most growth in 2001 were transportation, construction, commerce and

19 For information on determinants of Colombian sales to the United States, see Ramírez, M.T., Misas, M. and Silva, M.F. (2001), "Exportaciones no tradicionales en Colombia y sus determinantes," *Borradores de Economía*, No. 178, Banco de la República.

Table 16
Quarterly GDP by Branch of Activity - Deseasonalized Series
(Percentage of Real Growth)

	2000 (pr)					2001 (pr)					2002 (pr)
	I	II	III	IV	Annual	I	II	III	IV	Annual	I
Agriculture, forestry, hunting and fishing	1.42	6.95	4.09	7.78	5.03	2.63	(0.93)	(1.38)	0.15	0.10	0.54
Mining and quarrying	(4.69)	(11.57)	(12.71)	(11.26)	(10.04)	(7.56)	(1.35)	4.10	(3.58)	(2.23)	(4.70)
Electrical power, gas and water	2.77	0.73	(0.53)	(0.10)	0.70	0.81	2.71	2.70	1.23	1.86	3.08
Manufacturing industry	10.55	11.75	12.19	4.72	9.72	2.83	0.74	(3.30)	(3.17)	(0.76)	(3.72)
Construction	(13.35)	(4.65)	0.49	8.23	(2.85)	(2.52)	(0.41)	4.49	10.84	3.17	3.47
Commerce, repairs, restaurants and hotels	5.82	11.35	13.57	11.14	10.46	3.89	1.98	0.25	1.50	1.88	1.08
Transport, storage and communications	2.00	2.24	2.91	1.77	2.23	3.04	4.50	2.79	3.13	3.36	3.68
Financial institutions, insurance and real estate	0.78	0.95	2.42	0.44	1.15	0.32	(0.77)	0.31	1.10	0.24	(0.14)
Social, community and personal services	3.97	1.33	(1.73)	(6.73)	(0.92)	(0.15)	0.77	2.38	2.82	1.45	0.20
Gross domestic product	2.41	3.39	3.32	1.85	2.74	1.59	1.71	0.89	1.42	1.40	0.50

(pr) Preliminary.
Source: DANE.

electricity, gas and water (Table 16). In spite of shortcomings and delays in the information provided by DANE, this momentum does not appear to have been maintained in all sectors during the early months of 2002.

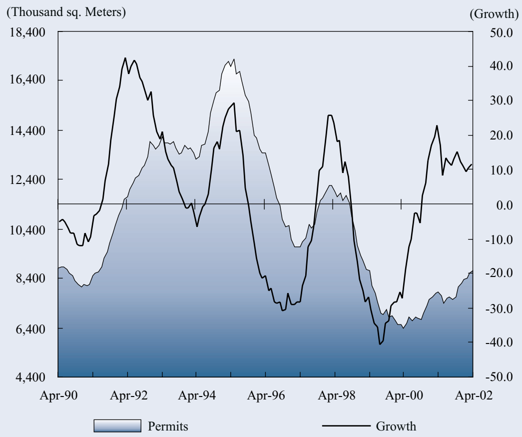
Construction was the only sector to continue to demonstrate sustained growth since last year, consistent with its recovery process, although its rate of increase in the first quarter of 2002 (3.47%) was below that of the fourth quarter the year before (10.84%). Other indicators of the sector also suggest recovery. For example, according to the Colombian Savings and Loan Institute (ICAV), by May 2002 loans to home builders had increased at a real annual rate of 126.6%. This is a dramatic rise compared with the fourth quarter of 2001, when the growth rate was 57.7%. Likewise, by April, building permits had increased by more than 10%, particularly those for non-low-cost dwellings (Figure 42).

Two other dynamic sectors in the first quarter of 2002 were transportation and electricity, gas and water, with respective increases of 3.68% and 3.08%. These sectors continued to grow despite the slowdown in commerce (1.08%), agriculture (0.54%) and industry (-3.72%) during this period.

According to the most recent figures released by DANE, industrial production in April 2002 was substantially less negative than the trend up to March. Industrial production during that month seems to have been affected by statistical factors associated with Easter Week,[20] although

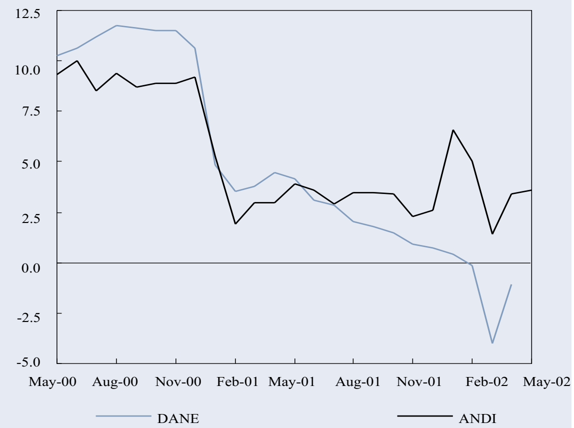
[20] Because of Easter Week, there were fewer working days in March than in the other months of the year.

FIGURE 42
BUILDING PERMITS IN THOUSAND OF SQUARE METERS
LAST 12 MONTHS



Source: DANE.

FIGURE 43
REAL INDUSTRIAL PRODUCTION INDEX
ANNUAL GROWTH YEAR TO DATE
(PERCENTAGE)



Source: DANE and ANDI.

growth remained negative compared with December 2001 (-0.8%). The DANE industrial production index has continued to drop, as illustrated in Figure 43. This trend in the sector is a cause for concern and underscores the difficulties in achieving sustained recovery. The drop in external demand and the slow recovery in internal demand were the most important factors in this trend.

Growth in mining remained negative, reflecting the trend in oil and coal production. In the case of oil, production continued to decline due to the depletion of wells developed in Colombia and to guerrilla attacks on oil facilities. The sharp drop in coal prices on international markets undermined the profitability of coal production. This is the reason for its decline in the first quarter of the year.

The same quarter of 2002 saw a continuation of slow growth in the agricultural sector (barely 0.54%). However, according to new estimates by DANE, this exceeds the rate in the last three quarters. The fourth quarter figure for 2001 was adjusted from 2.08% to 0.15% due to a new estimate that suggests a decline in illicit crops as a result of government policies on eradication. Accordingly, the figure for GDP growth in 2001 was also revised downward, as mentioned earlier. Agricultural performance in the first quarter of 2002 is explained not only by a standstill in the production of exportable goods -caused by the trend in external demand- but by the important effect of the cattle retention cycle and the impact of violence perpetrated by illegally armed groups. These two factors reduced livestock production.

According to DNP and Ministry of Finance projections on supply during the remainder of 2002, the construction sector will continue to be the most dynamic, as was the case last year, with 7.33% growth for the year as a whole (Table 17). Transportation, electricity and commerce are also likely to keep growing at positive rates (4.15%, 3.34% and 1.52%, respectively). Agriculture and mining will suffer respective reductions of -0.44% and -4.14%.

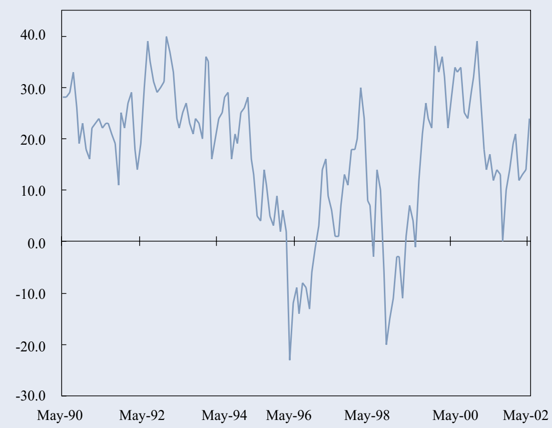
As yet, it is unclear how industrial production will behave during the remainder of 2002. Apparently, part of the decline in expectations among businessmen was temporary. In April, the business opinion poll conducted by Fede-

Table 17
Projected GDP for 2002 by Branch of Economic Activity
(% annual change)

Branch of Economic Activity	
Agriculture, forestry, hunting and fishing	(0.44)
Mining and quarrying	(4.14)
Electrical power, gas and water	3.34
Manufacturing industry	1.25
Construction	7.33
Commerce, repairs, restaurants and hotels	1.52
Transport, storage and communications	4.15
Financial institutions, insurance companies, real estate agencies and company services	0.67
Social, community and personal services	0.56
Financial brokerage services, indirectly measured	(8.80)
Subtotal: Value added	(1.54)
Taxes, except VAT	(0.83)
Subsidies	7.35
Non-deductible VAT	5.80
Import duties and fees	(5.47)
GDP	1.50

Source: Ministry of Finance and Public Credit, based on information from DANE and DIAN.

Figure 44
Expectations on the Economic Situation of Industry in the Next Six Months
(Balances)



Source: Fedesarrollo.

Figure 45
Actual Volume of Orders
(Balances)

Source: Fedesarrollo.

sarrollo seemed to indicate an improvement in expectations and orders (Figures 44 and 45). However, there is no way to know how this will influence production and investment decisions. On the other hand, there is considerable uncertainty about how the situation in Venezuela will play out and its effect on non-traditional exports. Hopefully, the approval of ATPA will constitute a positive shock for industrial production and the expectations of economic agents. Nevertheless, there is no definite approval date; nor is there any certainty as to which goods will benefit from the tariff exemptions. As a result, the new projection indicates that manufacturing activity will increase by only 1.25% in real terms during the current year.

2. Balance of Payments

a. Trend in the Balance of Payments during the First Quarter of 2002

According to preliminary figures developed by Banco de la República, the current account in the balance of payments showed a deficit of US$384 m. (1.8% of quarterly GDP) at the end of the first quarter of 2002. This is US$292 m.

less than the deficit reported for the same period in 2001 (Table 18). The capital and financial account showed US$223 m. in net entries; that is, US$617 m. less than those reported in the first quarter of 2001. The variation in gross international reserves came to US$103 m.[21] and the balance at the end of the quarter totaled US$10,233 m.

- **Current Account**

The reduction in the current account deficit during the first quarter of 2002 is explained primarily by an increase in the merchandise account surplus, which went from US$37 m. in the first quarter of 2001 to US$265 m. between January and March 2002. This decline was the result of fewer imports in terms of value (US$456 m.), which offset the lesser value of exports (US$228 m.). Tables 19 and 20 summarize the trend in exports and imports during the first quarter of the year, according to export product and type of import.[22]

Exports of oil and petroleum by-products added up to US$702 m. This implies an annual reduction of 20.2% and was due to a 21.4% drop in crude prices, which offset the 2.4% increase in volume. Coffee accounted for US$174 m. in foreign earnings, similar to those reported for the first quarter of 2001. This was in spite of an annual increase of 16.2% in exported volume. Non-traditional exports declined by 3.1% between January and March 2002 compared with the same period the year before. This was due to a drop of 7.0% in those of industrial origin.

On the other hand, a highlight between January and March 2002 was the annual reduction in the dollar value of total exports to the United States (-20.0%) and, to a lesser extent, exports to Venezuela (-1.2%). The growth in non-traditional exports to Ecuador (14.1%) was also an important feature (Table 20). The drop in imports during the first quarter of the year originated with fewer purchases of capital and intermediate goods; the dollar value of these acquisitions declined by 21.7% and 14.0% respectively. This was a reflection of less economic growth between January and March 2002 (0.5%) compared with the same period the year before (1.6%). On the other hand, imports of consumer goods, mostly non-durables, rose by 5.5% (Table 21).

As mentioned earlier, the period from January to March 2002 saw terms of trade drop at an annual rate of 10.1% compared with the same period in 2001 (Figure 28). This was due to the average reduction in the producer price index (PPI) for exported goods (8.6%) and, to a lesser extent, to the increase in the PPI for imported goods (1.7%).

With respect to other current account components, non-factor and factor services registered respective deficits of US$341 m. and US$771 m., which were similar to those of the January-March 2001 period. Net current transfers came to US$463 m.

- **Capital Account**

In the first quarter of 2002, the capital and financial account registered US$223 m. in net income, or US$617 m. less than in the same period the year before. Essentially, this was the result of reductions in long-term external flows, which went from US$1,093 m. in recorded entries between January and March 2001 to US$ 574 m. in outflows during the first quarter of 2002. This situation was offset in part by US$798 m. in short-term inflows.

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21 This accrual includes US$264 m. in errors and omissions.

22 In these tables, export and import growth differs somewhat from the figures presented in the balance of payments table. In the latter, import and export items include special commercial transactions.

Table 18
Colombia's Balance of Payments - Summary
(Millions of Dollars)

	2001					2002	2002 - 2001
	I Qtr.	II Qtr.	III Qtr.	IV Qtr.	Total	I Qtr. (e)	Difference I Qtr.
I. CURRENT ACCOUNT	(677)	(488)	(215)	(409)	(1,789)	(384)	292
Income	4,255	4,625	4,692	4,495	18,066	3,972	(282)
Outlays	4,931	5,114	4,907	4,904	19,856	4,357	(574)
A, Nonfactor goods and services	(293)	(324)	(32)	(259)	(908)	(76)	217
1. Goods	37	37	321	113	508	265	228
Exports	3,091	3,252	3,360	3,073	12,775	2,863	(228)
Imports	3,054	3,215	3,038	2,960	12,267	2,598	(456)
2. Nonfactor Services	(330)	(361)	(353)	(372)	(1,416)	(341)	(11)
Exports	489	516	554	597	2,157	429	(59)
Imports	819	877	907	969	3,573	771	(48)
B. Factor Income	(793)	(767)	(714)	(700)	(2,975)	(771)	22
Income	205	190	170	174	739	151	(54)
Outlays	999	957	884	875	3,714	922	(77)
C. Current Transfers	410	603	531	551	2,094	463	53
Income	470	668	608	650	2,396	529	59
Outlays	60	65	78	99	301	66	6
II, CAPITAL AND FINANCIAL ACCOUNT	840	582	339	710	2,470	223	(617)
A. Financial Account	840	582	339	710	2,470	223	(617)
1. Long-term Financial Flows	1,093	2,036	575	1,292	4,997	(574)	(1,668)
a. Assets	48	68	(225)	148	39	15	(33)
i. Colombian direct investment abroad	48	69	(225)	150	41	16	(31)
ii. Loans **1/**	0	(1)	0	(1)	(2)	(1)	(1)
iii. Leasing	0	0	0	0	0	0	0
iv. Other assets	0	0	0	0	(1)	0	0
b. Liabilities	1,146	2,104	376	1,445	5,071	(559)	(1,705)
i. Foreign direct investment in Colombia	519	914	221	675	2,328	773	254
ii. Loans **1/**	624	1,252	209	827	2,912	(1,282)	(1,906)
Public sector	554	1,294	139	963	2,949	(467)	(1,021)
Private sector	70	(42)	71	(136)	(37)	(815)	(886)
iii. Leasing	3	(62)	(54)	(56)	(169)	(50)	(53)
Public sector	(7)	(10)	(6)	(9)	(31)	(3)	3
Private sector	10	(52)	(48)	(48)	(138)	(47)	(57)
iv. Other liabilities	0	0	0	0	0	0	0
c. Other long-term financial movement	(5)	0	(25)	(5)	(35)	0	5
2. Short-term Financial Flows	(253)	(1,454)	(236)	(583)	(2,526)	798	1,051
a. Assets	277	1,706	406	938	3,326	(197)	(474)
i. Portfolio investments	440	1,480	554	1,007	3,481	(199)	(639)
Public sector	122	913	248	321	1,604	(659)	(781)
Private sector	318	566	306	686	1,876	460	142
ii. Loans **1/**	(164)	226	(148)	(69)	(154)	2	166
Public sector	17	97	(115)	(2)	(4)	(10)	(27)
Private sector	(180)	130	(33)	(67)	(151)	12	192
b. Liabilities	23	252	170	355	800	600	577
i. Portfolio investments	5	(27)	8	(26)	(41)	57	52
Public sector	6	0	9	(13)	2	24	19
Private sector	(1)	(27)	(1)	(14)	(42)	33	34
ii. Loans **1/**	19	279	162	381	840	543	525
Public sector	(16)	91	(17)	64	121	(164)	(148)
Private sector	34	188	179	318	719	707	673
B. Special Capital Flows	0	0	0	0	0	0	0
III. NET ERRORS AND OMISSIONS	153	(22)	74	331	536	264	112
IV. CHANGE IN GROSS INTERNATIONAL RESERVES 2/	316	72	198	632	1,217	103	(213)
V. GROSS INTERNATIONAL RESERVES	9,285	9,276	9,768	10,245	10,245	10,233	948
VI. NET INTERNATIONAL RESERVES	9,283	9,270	9,765	10,192	10,192	10,229	946
VII. CHANGE IN NET INTERNATIONAL RESERVES	316	68	201	581	1,166	152	(163)

(e) Estimated

1/ Includes portfolio investment, direct loans and commercial credit

2/ According to the balance-of-payments methodology.

Source: Banco de la República.

Table 19
Exports, According to Principal Products and Economic Sectors (PR)
(Millions of Dollars, FOB)

	January-March		Variation	
	2001	2002	Absolute	%
Total Exports	2,978	2,748	(230.3)	(7.7)
Traditional Exports	1,427	1,246	(181.6)	(12.7)
Coffee	176	174	(1.5)	(0.9)
Coal	274	285	11.6	4.2
Ferronickel	73	58	(15.7)	(21.4)
Oil and petroleum by-products	880	702	(177.6)	(20.2)
Gold	0	6	5.4	-
Emeralds	24	21	(3.8)	(15.6)
Non-traditional Exports	1,551	1,502	(48.7)	(3.1)
Agricultural sector	318	350	32.6	10.3
Industrial sector	1,224	1,139	(85.6)	(7.0)
Mining sector	9	14	4.3	45.7

(pr) Preliminary.

Source: DANE and Banco de la República.

Table 20
Annual Percentage Growth in the Dollar Value of Colombian Exports
(January-March 2001)

	United States	Venezuela	Ecuador	Japan	Germany	Mexico	Others	Total
Totals	(20.0)	(1.2)	14.1	36.0	(7.0)	11.7	2.3	(7.7)
Non-traditional Exports	(17.7)	(1.2)	14.2	(1.0)	(12.8)	13.0	2.6	(3.1)
Agricultural Sector	8.9	73.3	65.2	(20.1)	2.0	321.6	1.4	10.3
Industrial Sector	(33.1)	(6.5)	11.3	13.9	(36.8)	12.5	2.7	(7.0)
Food. beverages and tobacco	21.4	(23.2)	15.7	(13.8)	(48.4)	11.4	(6.8)	(6.8)
Yarn and fabric	(50.5)	(20.7)	(26.3)	(100.0)	(9.7)	4.2	(16.4)	(20.8)
Clothing	(30.1)	9.4	14.1	(78.0)	(15.3)	48.9	(1.4)	(15.3)
Plastic and rubber products	(62.7)	(32.3)	(20.7)	n. a.	(97.1)	351.3	(36.5)	(28.3)
Leather and leather goods	(22.8)	(60.7)	(42.7)	180.9	(32.4)	51.0	(24.4)	(26.3)
Wood and wood products	(6.2)	(21.4)	(40.0)	n. a.	258.0	(45.1)	(23.4)	(15.8)
Graphic arts and publishing	(30.3)	(12.2)	17.6	187.3	(70.0)	(16.4)	(15.1)	(11.5)
Chemical industry	(64.7)	5.7	0.7	7.998.3	(61.0)	26.1	26.4	(1.8)
Non-metallic minerals	14.0	32.4	30.7	516.0	112.1	(6.7)	(11.0)	8.0
Common metals	(10.9)	(44.9)	(13.8)	19.2	(85.0)	(32.7)	(4.8)	(19.9)
Machinery and equipment	(50.2)	(32.0)	11.9	4.160.1	(8.2)	(15.8)	(6.2)	(24.1)
Transport material	(61.1)	30.6	71.4	n. a.	n. a.	68.1	123.5	44.1
Optical. cinema and other apparatus	37.4	(11.2)	(8.2)	n. a.	(38.8)	92.1	29.9	22.4
Other industries	(9.5)	(15.7)	(41.6)	(90.4)	(10.9)	23.5	(18.0)	(18.5)
Mining sector **1/**	(12.8)	109.2	1.332.6	328.9	(9.4)	(60.0)	37.6	46.6

n.a. Not applicable

1/ Does not include emeralds.

Source: DANE and Banco de la República

TABLE 21
IMPORTS, ACCORDING TO USE OR ECONOMIC DESTINATION (PR)
(MILLIONS OF DOLLARS, FOB)

	January-March		Variation	
	2001	2002	Absolute	%
Total Imports	2,977	2,579	(398.2)	(13.4)
Consumer Goods	531	560	29.2	5.5
Durables	192	221	28.7	15.0
Non-durables	339	340	0.5	0.1
Intermediate Goods	1,337	1,151	(186.8)	(14.0)
Fuel and lubricants	43	3	(39.8)	(92.2)
For agriculture	117	108	(8.2)	(7.0)
For industry	1,178	1,039	(138.8)	(11.8)
Capital Goods	1,108	868	(240.6)	(21.7)
Construction materials	43	46	3.0	7.1
For agriculture	6	13	6.7	109.0
For industry	637	485	(151.7)	(23.8)
Transport equipment	423	324	(98.6)	(23.3)

(pr) Preliminary.
Source: DANE and DIAN.

As to long-term flows, net external borrowing in the public and private sectors declined with respect to the year before. In particular, the public sector paid US$470 m. in net debt and the private sector, US$862 m. Nevertheless, net foreign direct investment flows rose by US$286 m. in the first quarter of 2002, compared with the same period in 2001, particularly invest-ments in the communication sector. Short-term capital inflows originated with more external borrowing for commercial credit and loans, and less foreign portfolio investments by Colombians. From the standpoint of short-term credit, the first quarter of the year showed US$543 m. in net borrowing, which is US$525 m. more than between January and March the year before.[23] For its part, the public sector liquidated US$659 m. in financial investments abroad. This reflects a change in sources of external funding for the public sector, which came from the liquidation of external investments as opposed to credit.

- **Change in International Reserves**

The movement of capital and goods and services in the first quarter of 2002 resulted in an accumulation of US$103 m. in gross international reserves.[24] This placed the balance at US$10,233 m. or the equivalent of 11.8 months of merchandise imports, 7.2 months of merchandise and service imports, and 1.03 times the value of public and private debt amortizations in one year.

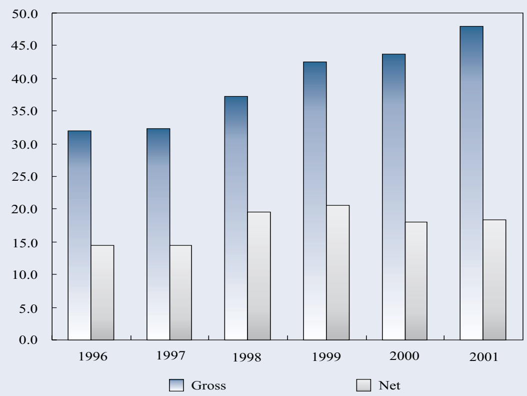
- **External debt indicators**

Figure 46 shows the external debt, as a per cent of GDP, was 48.3% at the end of 2001. External debt service, as a proportion of merchandise exports in that same year, was 84.0%. This percentage is expected to increase to 101.6% in 2002 (Figure 47).

[23] These figures deal only with the liability portion; that is, loans Colombians receive from abroad.

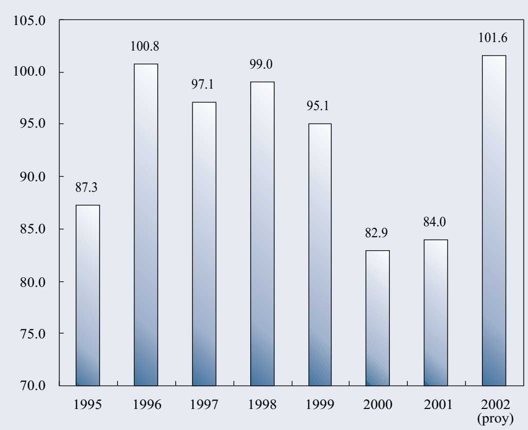
[24] As mentioned earlier, this accrual includes US$264 m. in errors and omissions.

FIGURE 46
EXTERNAL DEBT AS A PERCENTAGE OF GDP 1/



1/ The net external debt was calculated by deducting the balance of external assets held by Colombians, including the balance of international reserves reported by Banco de la República.
Source: Banco de la República.

FIGURE 47
COLOMBIAN EXTERNAL DEBT SERVICE AS A PERCENTAGE OF GOODS EXPORTS



(proj): Projected
Source: Banco de la República

b. Outlook for the Balance of Payments in 2002

According to the projected balance of payments (Table 22), the current account deficit would add up to US$1,939 m. (2.3% of GDP). Financing for this deficit would be met with US$2,496 m. in anticipated capital income (2.9% of GDP) from new long-term and short-term capital inflows of US$1,109 m. and US$ 1,387 m. respectively.

As to current account estimates, an annual decline of 3.6% in merchandise exports[25] is forecast as a result of less revenue from oil and petroleum by-products, coal and coffee (which would suffer respective declines of 14.7%, 2.1% and 2.5% in comparison with 2001). The expected drop in merchandise imports comes to 2.0%.[26] It is important to bear in mind that the current account balance is sensitive, among other things, to the trend in merchandise imports. In fact, with each additional one-point decline in imports, the current account deficit is reduced by 0.14 points of GDP.

The projection for the capital and financial account includes US$1,109 m. in long-term flows and US$1,387 m. short-term inflows. The outcome for the first item is based on US$2,266 m. in net foreign direct investment and US$389 m. net external borrowing by the public sector.[27] This projection also contemplates US$1,547 m. in net payments on the debt in the private sector. The performance of short-term capital flows would be explained largely by the public sector, which would liquidate nearly US$1,869 m. in investments abroad, primarily government and FAEP investments.

Finally, as a result of the foregoing, the accumulation in gross international reserves would add up to US$557 m. in 2002, with a balance of US$10,965 m. at the close of December. This is equivalent to 10.9 months of merchandise imports in the following year and 6.9 months of merchandise imports and services in the same year.

3. Employment

The unemployment rate declined in May of this year to 17.5%, which is 0.6% less than the rate in May 2001 (Figure 48). Even so, unemployment is still the major problem in the Colombian economy. The underemployment rate also dropped nationwide to 15.3%.

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25 Including special trade operations.

26 *Ibid.*

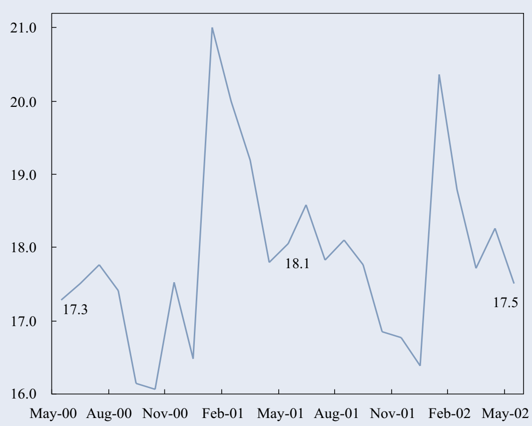
27 Leasing included.

Table 22
Colombia's Balance of Payments - Summary

	Millions of Dollars			As a % of GDP		
	2000 (pr)	2001 (pr)	2002 (proj.)	2000 (pr)	2001 (pr)	2002 (proj.)
I. CURRENT ACCOUNT	357	(1,789)	(1,939)	0.43	(2.17)	(2.29)
Income	18,382	18,066	17,485	22.09	21.92	20.62
Outlays	18,026	19,856	19,424	21.66	24.09	22.91
A. Nonfactor goods and services	1,225	(908)	(1,096)	1.47	(1.10)	(1.29)
1. Goods	2,531	508	289	3.04	0.62	0.34
Exports	13,621	12,775	12,309	16.37	15.50	14.52
Imports	11,089	12,267	12,020	13.32	14.89	14.17
2. Nonfactor Services	(1,307)	(1,416)	(1,386)	(1.57)	(1.72)	(1.63)
Exports	2,004	2,157	2,155	2.41	2.62	2.54
Imports	3,311	3,573	3,541	3.98	4.34	4.18
B. Factor Income	(2,530)	(2,975)	(2,907)	(3.04)	(3.61)	(3.43)
Income	858	739	648	1.03	0.90	0.76
Outlays	3,388	3,714	3,555	4.07	4.51	4.19
C. Current Transfers	1,662	2,094	2,064	2.00	2.54	2.43
Income	1,900	2,396	2,372	2.28	2.91	2.80
Outlays	238	301	308	0.29	0.37	0.36
II. CAPITAL AND FINANCIAL ACCOUNT	497	2,470	2,496	0.60	3.00	2.94
A. Financial Account:	497	2,470	2,496	0.60	3.00	2.94
1. Long-term Financial Flows	2,064	4,997	1,109	2.48	6.06	1.31
a. Assets	248	39	400	0.30	0.05	0.47
i. Colombian direct investment abroad	250	41	400	0.30	0.05	0.47
ii. Loans **1/**	(1)	(2)	0	(0.00)	(0.00)	0.00
iii. Leasing	0	0	0	0.00	0.00	0.00
iv. Other assets	(1)	(1)	0	(0.00)	(0.00)	0.00
b. Liabilities	2,352	5,071	1,509	2.83	6.15	1.78
i. Foreign direct investment in Colombia	2,281	2,328	2,666	2.74	2.83	3.14
ii. Loans **1/**	273	2,912	(1,040)	0.33	3.53	(1.23)
Public sector	1,139	2,949	394	1.37	3.58	0.46
Private sector	(866)	(37)	(1,434)	(1.04)	(0.05)	(1.69)
iii. Leasing	(202)	(169)	(117)	(0.24)	(0.21)	(0.14)
Public sector	(32)	(31)	(5)	(0.04)	(0.04)	(0.01)
Private sector	(169)	(138)	(113)	(0.20)	(0.17)	(0.13)
iv. Other liabilities	0	0	0	0.00	0.00	0.00
Public sector	0	0	0	0.00	0.00	0.00
Private sector	0	0	0	0.00	0.00	0.00
c. Other long-term financial movement	(40)	(35)	0	(0.05)	(0.04)	0.00
2. Short-term Financial Flows	(1,567)	(2,526)	1,387	(1.88)	(3.07)	1.64
a. Assets	1,518	3,326	(626)	1.82	4.04	(0.74)
i. Portfolio investments	1,014	3,481	(642)	1.22	4.22	(0.76)
Public sector	100	1,604	(1,869)	0.12	1.95	(2.20)
Private sector	913	1,876	1,227	1.10	2.28	1.45
ii. Loans **1/**	504	(154)	16	0.61	(0.19)	0.02
Public sector	(75)	(4)	(10)	(0.09)	(0.00)	(0.01)
Private sector	579	(151)	27	0.70	(0.18)	0.03
b. Liabilities	(50)	800	762	(0.06)	0.97	0.90
i. Portfolio investments	17	(41)	0	0.02	(0.05)	0.00
Public sector	0	2	0	0.00	0.00	0.00
Private sector	17	(42)	0	0.02	(0.05)	0.00
ii. Loans **1/**	(67)	840	762	(0.08)	1.02	0.90
Public sector	(473)	121	(80)	(0.57)	0.15	(0.09)
Private sector	406	719	842	0.49	0.87	0.99
B. Special Capital Flows	0	0	0	0.00	0.00	0.00
III. NET ERRORS AND OMISSIONS	16	536	0	0.02	0.65	0.00
IV. CHANGE IN GROS INTERNATIONAL RESERVES 2/	870	1,217	557	1.04	1.48	0.66
V. GROSS INTERNATIONAL RESERVES	9,006	10,245	10,965	10.82	12.43	12.93
VI. NET INTERNATIONAL RESERVES	9,004	10,192	10,961	10.82	12.37	12.92
Months of merchandise imports	9.7	10.0	10.9			
Months of imports of merchandise and services	6.1	6.3	6.9			
Nominal GDP in millions of dollars	83,227	82,411	84,803			
VII. CHANGE IN NET INTERNATIONAL RESERVES	869	1,166	606	1.04	1.42	0.71

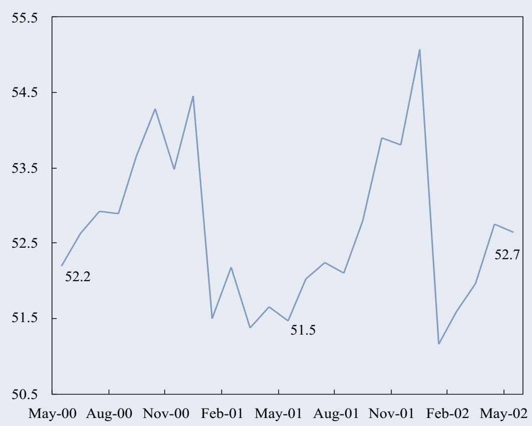
(pr.) Preliminary
(proj.) Projection
1/ Includes portfolio investment, direct loans and commercial credit.
2/ According to the balance-of-payments methodology.
Source: Banco de la República.

FIGURE 48
UNEMPLOYMENT IN 13 CITIES
NEW METHOD
(PERCENTAGE)



Source: DANE, Continuing Home Survey (ECH).

FIGURE 49
OCCUPATION IN 13 CITIES
NEW METHOD
(PERCENTAGE)

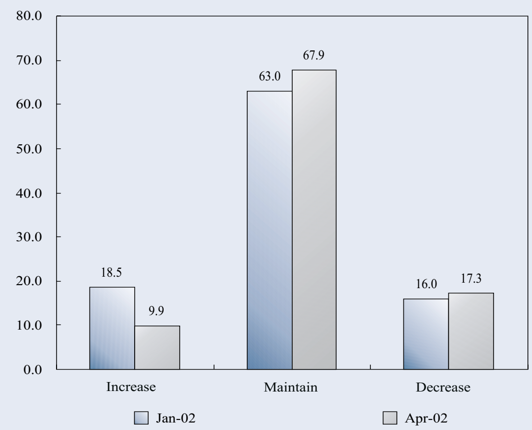


Source: DANE, ECH.

However, there was also an important rise in the occupation rate and a decline in participation (Figure 49). In fact, the latest figures for April show the occupation rate increased by 1.2 percentage points, while the supply of jobs increased by 1.0 percentage points in comparison with May the year before.

Creation of employment continued to accelerate, thanks to good performance in sectors such as construction and commerce. The first quarter of the year saw an 11% increase in the group working in construction and 16% in those involved in commerce. Growth in labor-intensive sectors such as construction and commerce is expected to have a favorable impact on occupation in 2002, as was the case last year. This was ratified by the results of the Expectation Survey conducted by Banco de la República in April, when 67.9% of those surveyed said they would maintain their staff for the next three months and 70.4% for the next six months (Figures 50 and 51).

FIGURE 50
TREND IN COMPANY PERSONNEL IN THE NEXT THREE MONTHS
(PERCENTAGE)

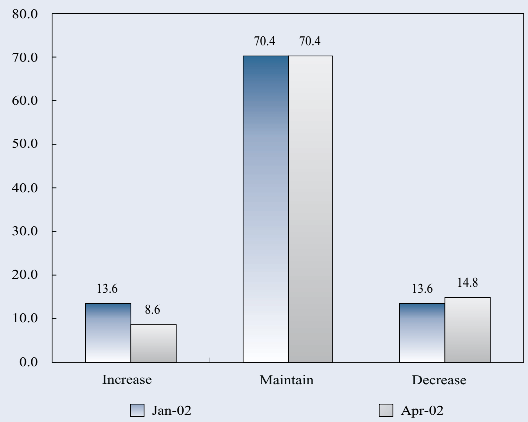


Source: Banco de la República, Expectation Survey, April 2002.

B. INFLATION OUTCOME AND BASIC TRENDS

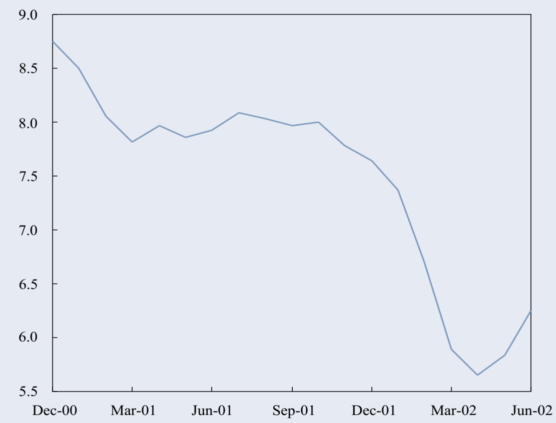
The decline in inflation during the first four months of 2002 was essentially the result of three factors. The first is a monetary policy consistent with the inflation targets set by the Board of Directors and with the goal of long-term price stability. This prompted an important reduction in agent expectations of inflation during recent months, as evident in smaller and less frequent

Figure 51
Trend in Company Personnel in the Next Six Months
(Percentage)



Source: Banco de la República, Expectation Survey, April 2002.

Figure 52
Annual Consumer Inflation in Each Month Between 2000:12 and 2002:06
(Percentage)



Source: National Bureau of Statistics (DANE). Calculations by Banco de la República.

adjustments in the price of highly indexed goods, such as public utilities, transportation and professional health care. The second factor concerns the existence of considerable available capacity for production in most manufacturing sectors, coupled with slow growth in demand. Finally, less devaluation between the end of last year and April 2002 made it possible to reduce adjustments in the price of tradable goods. May and June, particularly the latter, saw food prices rise sharply, beyond expectations. This can be attributed to factors associated with the weather. The other indicators of basic inflation continued to evolve as predicted, which means the inflation target set by the Board of Directors in coordination with the government is likely to be met by the end of the year.

1. Consumer Price Index (CPI)

Annual consumer inflation was 6.2% in June 2002. This is 1.7 percentage points lower than the rate reported in June 2001, but 0.4 percentage points above the rate the month before (Figure 52). The outcome for May and June is contrary to the downward trend in inflation that began in November 2001, prompted fundamentally by the surge in food prices (Table 23).

The increase in food prices had an impact on total inflation, even though basic inflation declined with respect to the month before. Specifically, inflation excluding food went from 5.1% to 5.0% in the last month, while the average of the three indicators used by Banco de la República stayed at 5.3%. In June, all indicators of basic inflation were below the inflation target set for 2002. On that date, core inflation rates, excluding food and public utilities, came to 5.1%, 5.9% and 5.9%, res.pectively (Figure 53).[28]

The decline in inflation during the first four months of the year was accompanied by additional reductions in agent expectations of inflation, as demonstrated by the expectation surveys conducted quarterly by Banco de la República. The latest survey, done in April, shows that although inflation expected for December 2002 (6.4%) exceeds the target, it is less than what was anticipated by those surveyed last January, when the expectation of inflation by year's end was 6.9% (Figure 54).

[28] Twenty percent of the items showing the most price volatility between January 1990 and April 1999 are excluded when weighting the CPI.

TABLE 23
CONSUMER PRICE INDEX - 2002

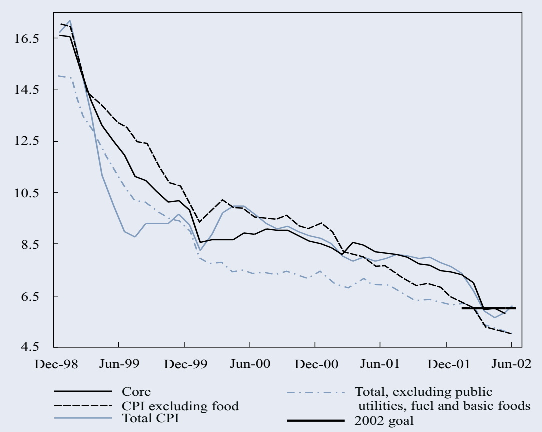
	Percentage of Change								
	Full Year			Year to date			Monthly		
	April	May	June	April	May	June	April	May	June
Total	5.6	5.8	6.2	3.7	4.3	4.8	0.9	0.6	0.4
Food	6.6	7.7	9.2	5.2	6.8	7.7	1.3	1.5	0.8
Housing	3.8	3.7	4.2	1.7	1.9	2.5	0.6	0.2	0.6
Clothing	1.8	1.3	1.1	0.2	0.2	0.4	(0.1)	(0.1)	0.2
Health	9.1	9.4	9.7	4.8	5.6	6.4	1.3	0.8	0.8
Education	6.7	6.7	6.7	5.5	5.5	5.5	0.0	0.0	0.0
Entertainment, culture and recreation	7.2	6.8	5.9	4.6	4.4	4.5	0.5	(0.2)	0.1
Transport and communications	6.3	5.9	5.0	3.9	4.0	3.7	1.2	0.1	(0.2)
Other expenses	6.4	6.6	6.8	5.4	5.9	6.2	1.4	0.5	0.4

	Contribution to the Change								
	Full Year			Year to date			Monthly		
	April	May	June	April	May	June	April	May	June
Total	5.6	5.8	6.2	3.7	4.3	4.8	0.9	0.6	0.4
Food	2.0	2.3	2.7	1.5	2.0	2.3	0.4	0.5	0.2
Housing	1.0	1.0	1.1	0.4	0.5	0.7	0.1	0.1	0.1
Clothing	0.1	0.1	0.1	0.0	0.0	0.0	(0.0)	(0.0)	0.0
Health	0.4	0.4	0.4	0.2	0.2	0.3	0.1	0.0	0.0
Education	0.3	0.3	0.3	0.3	0.3	0.3	0.0	0.0	0.0
Entertainment. culture and recreation	0.2	0.2	0.2	0.2	0.2	0.2	0.0	(0.0)	0.0
Transport and communications	1.0	0.9	0.8	0.6	0.6	0.6	0.2	0.0	(0.0)
Other expenses	0.6	0.6	0.6	0.5	0.5	0.6	0.1	0.0	0.0

	Share in the Change								
	Full Year			Year to date			Monthly		
	April	May	June	April	May	June	April	May	June
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Food	34.8	39.0	43.3	41.1	46.2	47.1	43.1	77.0	55.3
Housing	18.0	16.8	17.7	11.8	11.5	13.6	15.8	9.5	34.5
Clothing	2.0	1.4	1.2	0.4	0.2	0.5	(0.4)	(0.7)	3.2
Health	6.9	6.9	6.7	5.6	5.6	5.8	6.1	5.9	7.8
Education	6.1	5.8	5.4	7.5	6.5	5.9	0.0	0.2	0.2
Entertainment. culture and recreation	4.4	4.0	3.3	4.2	3.5	3.2	1.9	(1.0)	0.6
Transport and communications	17.6	15.9	12.7	16.5	14.5	12.3	20.0	2.0	(9.1)
Other expenses	10.2	10.2	9.7	12.8	12.0	11.6	13.4	7.1	7.6

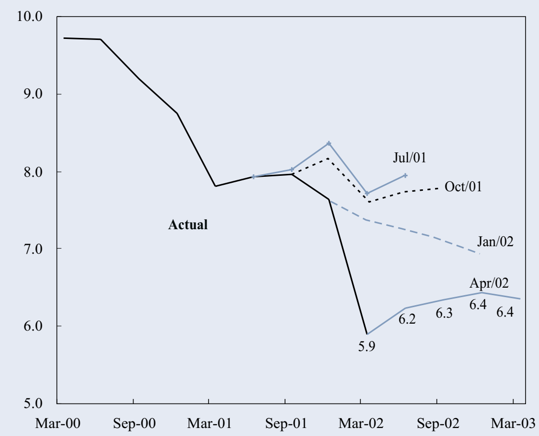
Source: DANE and Banco de la República.

Figure 53
Trend in Total and Basic Inflation
(Annual percentage change)



Source: DANE and Banco de la República.

Figure 54
Actual Inflation and the Trend in Inflation Expectations
(Annual Inflation)



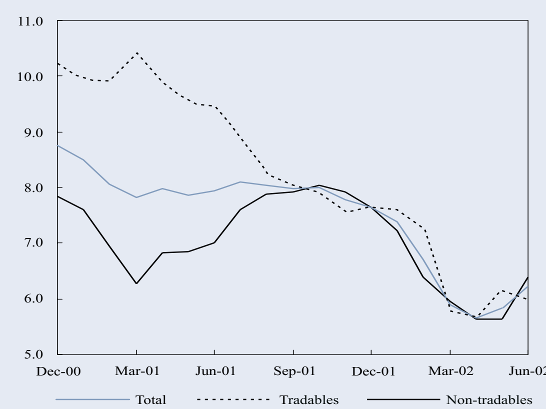
Source: Banco de la República, Expectation Survey, April 2002.

As noted earlier, the acceleration in inflation during May and June was due fundamentally to the behavior of food prices, which registered annual increases of 7.7% and 9.2%. This was due, among other factors, to a rise in potato prices, which increased by 10.7% and 8.0% compared with the month before (Table 23).

Other items in addition to food that explain the upswing in inflation were housing (4.2%) and transport (5.0%). "Miscellaneous expenses" were affected by the annual adjustment in the price of telephone service (10%).

An alternate CPI classification shows the acceleration in inflation during the last month was also due to the price of tradables. By last June, annual inflation in this group was 6.2%, as opposed to 5.7% in May, and was associated with the surge in devaluation that month. Growth in non-tradables stayed at 5.3%, in spite of a rise in the sub-group comprised of flexibles, particularly tubers (Figure 55).

Figure 55
CPI for Tradable and Non-tradable Goods
(Annual percentage change)



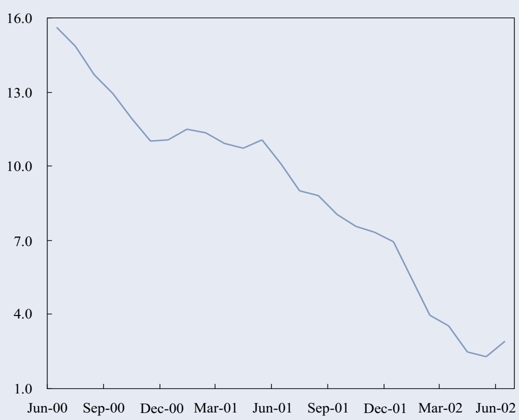
Source: DANE. Banco de la República calculations.

2. Producer price index (PPI)

Annual PPI inflation was 2.9% in June as opposed to 2.3% in May (Figure 56). According to merchandise origin, prices for imported goods increased during June due to the rise in devaluation as of mid-May. Inflation in manufactured and consumed goods came to 3.4% in June, which is 0.1 points above the rate in May (Table 24).

Classified by economic activity, every sector, except building materials, saw an annual price variation above that of the previous month, even though all experienced annual inflation below the rate observed in June the year before (Table 24). Price increases for imported, mining and agricultural products were the sharpest.

FIGURE 56
PRODUCER PRICE INDEX (PPI)
(ANNUAL PERCENTAGE CHANGE)



Source: Banco de la República.

According to classification by economic activity or use, the PPI for end consumption saw 4.6% annual inflation, which is 0.1% above that registered for the month before (Table 24). This item bears the most similarity to the CPI basket, and its behavior is consistent with the acceleration in consumer inflation observed since May.

In conclusion, the prospect of higher food prices is likely to continue for the rest of the year, and there is every indication these prices will exert inflationary pressure on this front as of the second half of the year. Low commodity prices at the start of the year could discourage planting in the months ahead. This would elevate prices in the second half of the year, pushing up consumer inflation as a result. Moreover, the trend in the exchange rate as of mid-May could translate into price increases for some of these goods.

The risk is even greater when considering the likelihood of El Niño in the second half of 2002, with its upward effect on prices. Besides

TABLE 24
PRODUCER PRICE INDEX
(PERCENTAGE CHANGE)

	2000				2001			
	March	**April**	**May**	**June**	**March**	**April**	**May**	**June**
PPI	10.9	10.7	11.1	10.1	3.6	2.5	2.3	2.9
By origin								
Produced and consumed	10.4	5.2	9.3	9.8	4.4	(0.0)	0.8	2.1
Imported	12.5	32.6	30.8	17.3	0.8	(0.7)	(3.3)	2.1
Exported	2.8	11.7	11.0	10.0	(7.1)	3.2	2.9	3.2
By industrial origin (CIIU)								
Agriculture. forestry and fishing	4.2	10.3	11.2	10.9	2.4	3.5	3.3	3.4
Mining	27.0	12.1	10.7	7.6	1.7	(0.8)	(0.6)	1.6
Manufacturing industry	12.4	8.1	4.8	(1.7)	3.9	(8.1)	(8.1)	(2.4)
By economic use or destination								
Intermediate consumption	12.4	13.2	13.3	11.6	2.9	1.4	0.2	1.2
Final consumption	8.8	7.7	8.8	9.0	4.3	3.5	4.5	4.6
Capital goods	10.2	9.9	9.0	6.5	2.4	1.1	1.1	2.8
Building materials	14.4	13.9	12.8	12.0	5.0	5.0	5.1	5.0

Source: Banco de la República.

reducing the supply of products because of its effect on crops,[29] this phenomenon obliges farmers to reduce the amount of land under cultivation in order to cut their losses. The price of meat will continue to exert inflationary pressure in food prices, because of prolongation of the cattle retention cycles during the remainder of the year.

No increases in basic inflation are anticipated for the rest of 2002, and the downward trend is likely to continue. Accordingly, the Board of Directors is confident the target of 6% total inflation will be met.

[29] Ideam estimates El Niño tends to reduce the yield on major crops by 4% to 5% (Ideam (2002). "Efectos naturales y socioeconomicos del fenomeno El Niño en Colombia," No. 190.

C. The Fiscal Outlook For 2002

As indicated in the March Report to Congress, the fiscal deficit in the consolidated public sector could add up to 2.6% of GDP by the end of 2002. This would imply a reduction equivalent to 0.7% of GDP compared with what was observed in 2001. Reducing the fiscal deficit in 2002 will depend on the efforts of the non-financial public sector and, more specifically, on the performance of the central government, which will have to reduce its deficit by more than one point of GDP if this fiscal target is to be met (Table 25).

According to official estimates, central government finances will yield a deficit equivalent to

Table 25
Effective Deficit Operations (Proj) 1/
Consolidated Public Sector

Item	Billions of Pesos		Percentage of GDP	
	2001	2002	2001	2002
Electricity	256.0	386.0	0.1	0.2
Emcali	141.0	80.0	0.1	0.0
EPM	293.0	460.0	0.2	0.2
FAEP	451.0	(814.0)	0.2	(0.4)
Ecopetrol	779.0	984.0	0.4	0.5
Telecom	355.0	124.0	0.2	0.1
Other Entities	308.0	762.0	0.2	0.4
Social Security	1,100.0	899.0	0.6	0.4
Regional and Local Entities	26.0	1,243.0	0.0	0.6
National Coffee Fund	(77.0)	(64.0)	(0.0)	(0.0)
1. Sub-total: Decentralized sector	3,632.0	4,060.0	1.9	2.0
2. National Government	(10,774.0)	(9,687.0)	(5.8)	(4.7)
A. Total non-financial public sector (SPNF) (1+2)	(7,142.0)	(5,627.0)	(3.8)	(2.7)
B. Cash losses and profits - Banco de la República	1,393.0	879.0	0.7	0.4
C. Cash losses and profits - Fogafin	327.0	256.0	0.2	0.1
D. Cost of reorganizing the financial sector	(1,268.0)	(969.0)	(0.7)	(0.5)
E. Adjustments	593.0	0.0	(0.3)	0.0
F. Total Consolidated Public Sector (A + B + C + D + E)	(6,097.0)	(5,461.0)	(3.3)	(2.6)

(Proj) Projections
1/ Deficit (-) or surplus (+)
Source: Confis.

Table 26
Effective Central Government Operations
(Billions of pesos)

	2001 (pr)	2002 (proj)	Annual Growth 2002/2001
I. Total Revenue (A + B + C + D)	27,489.0	29,892.0	8.7
A. Tax revenue	24,802.2	27,161.0	9.5
Income tax	10,022.0	11,421.0	14.0
Internal VAT	6,931.5	7,552.0	9.0
External VAT	3,079.4	3,182.0	3.3
Customs	2,150.1	2,286.0	6.3
Gas tax	1,106.4	1,104.0	(0.2)
Tax on financial transactions	1,421.4	1,519.0	6.9
Others	91.4	97.0	6.1
B. Non-tax revenue	374.9	293.0	(21.8)
C. Special funds	240.5	331.0	37.6
D. Capital resources	2,071.4	2,107.0	1.7
Financial yields	571.3	902.0	57.9
Financial surpluses	1,320.0	1,076.0	(18.5)
Others	180.1	118.0	(34.5)
II. Total Expenses (A + B + C + D)	39,043.6	40,438.0	3.6
A. Interest	7,497.1	8,870.0	18.3
External	3,114.4	3,838.0	23.2
Internal	4,382.7	5,032.0	14.8
B. Operating Costs	27,171.9	29,074.0	7.0
Personal services	5,279.6	5,299.0	0.4
General expenses	1,774.3	1,804.0	1.7
Transfers	20,118.0	21,971.0	9.2
C. Investment	2,904.0	1,005.0	(65.4)
D. Net loan	1,470.6	1,489.0	1.3
Cash deficit or surplus	(11,554.6)	(10,546.0)	(8.7)
III. Adjustments	780.6	859.0	10.0
IV. Deficit (-) or Surplus (+) (I - II + III) 1/	(10,774.0)	(9,687.0)	(10.1)
Cost of restructuring the financial sector	1,267.7	969.0	(23.6)
V. Financing (A + B + C + D)	(12,041.7)	(10,656.0)	(11.5)
A. Net external credit	8,746.4	877.0	(90.0)
Outlays	12,589.8	5,978.0	(52.5)
Amortizations	3,843.4	5,101.0	32.7
B. Net internal credit	5,945.9	3,253.0	(45.3)
Outlays	13,879.9	11,298.0	(18.5)
Amortizations	7,925.0	8,045.0	1.5
C. Banco de la República earnings	1,452.8	1,022.0	(29.7)
D. Others	(4,103.4)	5,504.0	(234.1)
VI. Deficit as a Percentage of GDP	(5.8)	(4.7)	-

(pr) Preliminary
(proj) Projections
1/ Does not include the cost of restructuring the financial sector.
Source: Confis.

4.7% of GDP, thanks to an 8.7% rise in income and 3.6% in spending (Table 26). Income tax revenue is expected to increase by 14.0%, domestic VAT revenue by 9.0%, customs revenue by 6.3%, tax collections on financial transactions by 6.9% and external VAT by 3.3%. Capital income, which is comprised primarily of financial yield and surpluses of national companies and institutions in the public sector, will increase by barely 1.7% because of the reduction in profits transferred by Ecopetrol.

Organized by spending items, the projected growth in interest is 18.3%, operations 7.0% and net loan 1.3%. Investment payments will decline by approximately 66.0% to around Col$1 trillion. As to growth in spending on operations, a 0.4% increase is anticipated for personal services, 1.7% for general expenses and 9.2% for transfers. The net loan is projected at Col$1,489 b., with Col$500 b. earmarked for the Social Security Institute, Col$417 b. for Corelca and Col$250 b. for the Medellín Metro Company.

As highlighted in the last report, the central government deficit will be financed mostly with domestic credit, use of the Treasury portfolio, and profits transferred by Banco de la República. Net external borrowing will amount to Col$877 b. Because of Col$5,978 b. in outlays and Col$5,101 b. in amortizations. Net internal borrowing will come to Col$3,253 b. due to Col$11,298 b. in outlays and Col$8,045 b. In amortizations. TES placements are estimated at Col$10,898 b., with Col$6,330 b. of this amount from agreed and forced investments and Col$4,568 b. From auctions.

V

International Reserves and the Financial Position of Banco de la República

A. International Reserves

1. The International Reserve Balance

Colombia had US$10,817 m. in net international reserves at June 2002. This represents an increase of US$625.2 m. compared with the balance at December 2001.[30] The investment portfolio accounts for the bulk of these reserves (91% of the total or US$9,841.5 m.). The others are distributed as follows: i) US$669.4 m. in the country's reserve position with the International Monetary Fund and the Latin American Reserve Fund, ii) US$148.6 m. in special drawing rights (SDR), iii) US$125.4 m. in gold, Andean pesos and positive balances from international agreements, and iv) US$35.9 m. in demand deposits and cash. At June 2002, short-term external liabilities came to US$3.8 m. (Table 27).

2. Criteria for Managing International Reserves

The three criteria defined by Banco de la República for managing international reserves are, in order of importance, security, liquidity and profitability. Accordingly, and to make sure the country is able to honor its external liabilities, reserves are invested in financial assets on a broad secondary market. A portion are kept as working capital to guarantee immediate availability.

Pursuant to these guidelines, external financial institutions are appointed to manage part of the portfolio in which the country's international reserves are invested. These institutions are scrutinized carefully and selected according to their experience in the business, the size of the funds they manage, and the extent of their capacity for management and risk control. As mentioned in previous reports, they have improved the profitability of international reserves through specialized management.[31]

In terms of the overall investment portfolio, Banco de la República directly managed US$6,621.8 m. (67.3% of the total), including US$459.6 m. in working capital. The other 32.7% (US$3,219.7 m.) was managed by Barclays Global Investors, Morgan Investment Management and Goldman Sachs Asset Management.

During the first half of 2002, the reference index used to evaluate management of the portion of Colombia's international reserves managed by institutions other than Banco de la República was 4%, as opposed to 4.55% on the portion managed by Barclays Global Investors, 4.39% on the portion managed by JP Morgan Investment

30 Net reserves are equal to total international reserves, or gross reserves, minus the external short-term liabilities of Banco de la República. The latter are comprised of sight liabilities in foreign currency with non-resident agents.

31 A number of central banks, such as those of Argentina, Brazil and Chile, use similar delegation schemes to allow first-rate institutions to manage a portion of their external assets. This enables them to benefit from the specialized expertise these firms have to offer.

Table 27
Principal Components of International Reserves
(Millions of Dollars)

Description	June 2001	Share %	December 2001	Share %	June 2002	Share %
Cash	278.7	3.0	30.3	0.3	35.9	0.3
Vault	21.1	0.2	29.9	0.3	35.3	0.3
Demand deposits	257.6	2.8	0.5	0.0	0.6	0.0
Investments	8,124.3	87.6	9,317.0	91.4	9,841.5	91.0
Managed directly	5,172.8	55.8	6,236.3	61.2	6,621.8	61.2
Delegated management	2,951.5	31.8	3,080.7	30.2	3,219.7	29.8
Gold	88.6	1.0	90.6	0.9	104.4	1.0
Vault	0.0	0.0	0.0	0.0	0.0	0.0
Custody	88.6	1.0	90.6	0.9	104.4	1.0
International Monetary Fund	490.3	5.3	495.9	4.9	528.9	4.9
Special drawing rights	134.3	1.4	137.1	1.3	148.6	1.4
Reserve position	356.0	3.8	358.9	3.5	380.3	3.5
Latin American Reserve Fund	285.8	3.1	309.1	3.0	309.1	2.9
Contributions	265.8	2.9	289.1	2.8	289.1	2.7
Andean pesos	20.0	0.2	20.0	0.2	20.0	0.2
International Agreements	7.9	0.1	2.2	0.0	1.0	0.0
Total Gross Reserves	9,275.5	100.1	10,245.1	100.5	10,820.8	100.0
Short-term Liabilities	5.2	0.1	53.3	0.5	3.8	0.0
International agreements	0.0	0.0	0.0	0.0	0.0	0.0
Foreign banks	0.0	0.0	50.0	0.5	0.0	0.0
Latin American Reserve Fund-LARF	0.0	0.0	0.0	0.0	0.0	0.0
Amounts payable for investment purchase	0.0	0.0	0.0	0.0	0.0	0.0
Liability accrual and valuation	5.2	0.1	3.3	0.0	3.8	0.0
Total Net Reserves	9,270.4	100.0	10,191.8	100.0	10,817.0	100.0

Source: Banco de la República.

Management and 4.69% on the portion delegated to Goldman Sachs Asset Management.[32, 33] The portion managed directly by Banco de la República -not including working capital- yielded 3.49%, as opposed to 3.48% for the reference index used to evaluate management of this portion.[34] The yield on working capital was 0.86%.

The investment portfolio, including the portions managed directly and externally, is mostly in securities issued by sovereign governments (61.3%), which ensures broad liquidity, even

[32] The reference portfolio , which is used to measure the performance of external managers, is comprised of assets denominated in US dollars (84%), euros (12%) and yen (4%). These assets are invested in a combination of money market instruments at three months (25%) and in one-to-five-year government bonds (75%), with two years average duration for the portfolio as a whole.

[33] International asset managers are able to obtain higher yields than those on the reference portfolio, because portions of their portfolios are invested in specialized management assets different from those of the index used as a reference by Banco de la República.

[34] The reference portfolio , which is used to measure the performance of the portion managed directly by Banco de la República, is comprised of assets denominated in US dollars (84%), euros (12%) and yen (4%). These assets are invested in a combination of money market instruments at three months (47%) and in one-to-five-year government bonds (53%), with 1.46 years average duration for the portfolio as a whole.

with a crisis in emerging markets, and a lesser portion (38.7%) in banks. The way credit risk is distributed reflects the security with which international reserves are managed. At June 2002, risk distribution was as follows, according to the rating by specialized agencies: 77.5% AAA, 4.2% AA+, 5.4% AA, 12.5% AA- and 0.4% A+.[35]

Banco de la República and the external managers obtained a total of US$399.1 m. in net yield on the investment portfolio of international reserves, including US$230.9 m. in cash revenue and US$168.2 m. in earnings derived from adjustment and valuation of international reserves at market prices. Most of the valuation earnings were the result of a stronger euro and yen against the dollar (US$155.6 m.); a lesser portion (US$29.6 m.) came from appreciation of the portfolio in SDR.[36] On the other hand, US$17.3 m. in losses were reported due to the drop in the price of US treasury bonds during this period, while an increase in the price of gold appreciated international reserves by US$12.1 m.[37]

B. Financial Position

1. Results in 2002

Banco de la República reported Col$33,463.4 b. in assets on June 30 of this year; that is, Col$1,588.9 b. more than in December 2001 (Table 28). This increase is explained by (a) the added value of international reserves (Col $1,948.6 b.) due to an accumulation of reserves (US$575.7 m.) and peso devaluation against the dollar; (b) increased contributions in international organizations (Col$74.2 b.) because of the adjustment in the peso-dollar exchange rate; and c) a positive change in other assets (Col$47.1 b.), primarily because of appreciation in the portfolio representative of funds for retirement pensions (Col$40.4 b.). These increases were offset, in part, by a) the decline in investments (Col$311.8 b.) resulting from TES B redemption for monetary control and TES A representative of the government's consolidated debt; b) less demand for repos and temporary liquidity support on the part of the financial system (Col$156.3 b.); and c) a decline of Col$13.4 b. in the credit portfolio balance.

The bank reported Col$16,574.1 b. in liabilities on the same date and Col$16,889.3 b. in equity, with positive changes during the semester of Col$1,285.5 b. and Col$404.4 b. respectively. The trend in liabilities was determined by a) added deposits from the national government (Col$2,078.8 b.); b) appreciation in the value of liabilities with international organizations (Col$49.3 b.), thanks to devaluation of the peso against the dollar; c) a reduction in the monetary base (Col$549.7 b.); d) a decline in investments in repos by the financial system (Col$117.8 b.); and e) a reduction in other deposits (Col$127.4 b.).[38]

At the close of the first semester, Banco de la República reported Col$917.1 b. in profits, thanks to Col$1,197.3 b. in total income and Col$280.2 b. in outlays. This surpassed profits reported for the same period the year before, which came to Col$358.6 b. (Table 29). Compared with that period, income rose by Col$510.2 b. (74.2%) and outlays declined by Col$48.3 b. (14.7%). The most notable components of the foregoing were Col$905 b. (US$399.1 m.) in yield on international reserves, including US$167.9 m. in unrealized valuations derived

35 Standard & Poors, Moody's and IBCA.

36 In effect, between December 31, 2001 and June 28, 2002, the euro in terms of dollars went from ∉1.12 to ∉1.01. This generated 9.65% appreciation in the first half of 2002.

37 The international market price of standard quality goal (99.5% pure) rose from US$278.12 per ounce in December 2001 to US$319.69 per ounce on June 28, 2002.

38 Current account deposits other than the bank reserve.

Table 28
General Balance Sheet - Banco de la República
2000-2002
(Billions of Pesos)

	December, 2000		December, 2001		June, 2001		June, 2002 (*)	
	Balance	Share %	Balance	Share %	Balance	Share %	Balance	Share %
Assets	29,149.2	100.0	31,874.5	100.0	29,590.5	100.0	33,463.4	100.0
Gross international reserves	19,689.9	67.5	23,634.5	74.1	21,386.2	72.3	25,583.1	76.5
Contributions in international organizations	2,268.6	7.8	2,482.3	7.8	2,479.0	8.4	2,556.5	7.6
Investments	3,248.7	11.1	2,056.0	6.5	2,576.1	8.7	1,744.1	5.2
Consolidated public debt	308.8	1.1	240.3	0.8	223.0	0.8	156.1	0.5
Public securities - monetary control	2,398.0	8.2	1,730.2	5.4	1,970.7	6.7	1,502.3	4.5
Public bank bonds - Fogafin and others	541.8	1.9	85.4	0.3	382.4	1.3	85.7	0.3
Loan portfolio	323.9	1.1	141.7	0.4	221.7	0.7	128.4	0.4
National government-public sector	3.7	0.0	3.4	0.0	3.6	0.0	3.3	0.0
Banks	6.0	0.0	3.5	0.0	4.1	0.0	3.6	0.0
Financial corporations	154.1	0.5	132.9	0.4	146.9	0.5	121.3	0.4
Other loans **1/**	235.9	0.8	14.5	0.0	102.6	0.3	3.9	0.0
Less provisions	75.8	0.3	12.6	0.0	35.6	0.1	3.7	0.0
Repurchase Agreements - Temporary liquidity support	1,729.0	5.9	1,111.4	3.5	963.7	3.3	955.1	2.9
Accounts receivable	64.3	0.2	94.3	0.3	78.9	0.3	94.8	0.3
Other net assets	1,824.9	6.3	2,354.3	7.4	1,884.9	6.4	2,401.4	7.2
Liabilities and Net Worth	29,149.2	100.0	31,874.5	100.0	29,590.5	100.0	33,463.4	100.0
Liabilities	13,821.5	47.4	15,288.6	48.0	14,294.7	48.3	16,574.1	49.5
Foreign currency liabilities affecting international reserves	4.3	0.0	4.3	0.0	11.9	0.0	9.0	0.0
Money supply	10,710.4	36.7	11,647.9	36.5	9,477.0	32.0	11,098.2	33.2
Notes in circulation	8,698.6	29.8	9,990.8	31.3	7,777.6	26.3	9,341.0	27.9
Treasury coins	344.2	1.2	357.7	1.1	338.0	1.1	351.8	1.1
Bank reserve requirement deposits	1,362.8	4.7	1,118.5	3.5	1,119.1	3.8	1,262.1	3.8
Current account deposits from rest of financial sector	304.9	1.0	180.9	0.6	242.4	0.8	143.3	0.4
Other deposits	77.5	0.3	244.5	0.8	51.9	0.2	117.1	0.3
National government - National Treasury	253.7	0.9	97.9	0.3	1,812.9	6.1	2,176.7	6.5
International agency liabilities	1,853.8	6.4	1,980.2	6.2	1,970.5	6.7	2,029.6	6.1
External credit liabilities	207.6	0.7	183.9	0.6	198.0	0.7	177.1	0.5
Securities for monetary and exchange control	28.7	0.1	162.7	0.5	30.9	0.1	44.6	0.1
Reverse REPOs and Central Bank bonds	20.9	0.1	161.8	0.5	24.6	0.1	44.0	0.1
Foreign currency funding certificates & Dep. Res. 5/97	6.9	0.0	0.8	0.0	5.4	0.0	0.6	0.0
Others	0.9	0.0	0.1	0.0	0.9	0.0	0.1	0.0
Accounts payable	31.4	0.1	40.9	0.1	51.2	0.2	37.1	0.1
Other liabilities	654.1	2.2	926.3	2.9	690.3	2.3	884.6	2.6
Total Net Worth	15,327.7	52.6	16,585.9	52.0	15,295.9	51.7	16,889.3	50.5
Capital	12.7	0.0	12.7	0.0	12.7	0.0	12.7	0.0
Reserves	345.9	1.2	321.2	1.0	321.2	1.1	311.6	0.9
Capital surplus	13,254.2	45.5	14,172.1	44.5	14,324.3	48.4	14,791.8	44.2
Special exchange account liquidation	453.5	1.6	453.5	1.4	453.5	1.5	453.5	1.4
Exchange adjustment: 1993 and thereafter & surplus	12,619.7	43.3	13,689.3	42.9	13,681.9	46.2	14,301.6	42.7
Others	181.0	0.6	29.3	0.1	188.9	0.6	36.7	0.1
Appreciation	279.1	1.0	856.1	2.7	279.1	0.9	856.1	2.6
Profits (Losses)	1,435.9	4.9	1,223.8	3.8	358.6	1.2	917.1	2.7
Previous year profits/losses	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Current year profits/losses	1,435.9	4.9	1,223.8	3.8	358.6	1.2	917.1	2.7

(*) Figures subject to revision.
1/ Includes the portfolio corresponding to the seizure of charged assets for default on liquidity quota credit.
Source: Banco de la República

TABLE 29
INCOME STATEMENT - BANCO DE LA REPÚBLICA: 2000-2002
(BILLIONS OF PESOS)

	Performance Jan-Jun 2001 1/		Performance Jan-Jun 2002 1/		Change Jan-Jun 2002-2001	
	Flows %	Share	Flows %	Share	Absolute	%
I. Total Income	687.2	100.0	1.197.3	100.0	510.2	74.2
1. Operating Income	679.5	98.9	1.192.6	99.6	513.1	75.5
Interest and yield	527.9	76.8	1.096.4	91.6	568.6	107.7
Net international reserves	242.3	35.3	905.1	75.6	662.8	273.6
External credit lines	7.5	1.1	4.1	0.3	(3.3)	(44.7)
TES "A" appreciation at market prices	19.7	2.9	13.8	1.2	(6.0)	(30.2)
TES appreciation through monetary expansion transactions	168.3	24.5	142.4	11.9	(25.8)	(15.4)
Appreciation public bank capitalization bonds	28.4	4.1		0.0	(28.4)	(100.0)
Temporary purchase of securities and quotas	29.2	4.2	20.7	1.7	(8.5)	(29.0)
Others	32.5	4.7	10.3	0.9	(22.2)	(68.4)
Commissions	43.1	6.3	55.9	4.7	12.8	29.7
Banking services and trusts	39.1	5.7	46.2	3.9	7.1	18.2
Foreign currency management	4.0	0.6	6.5	0.5	2.6	65.0
Others	0.0	0.0	3.1	0.3	3.1	-
Exchange difference	58.0	8.4	36.4	3.0	(21.6)	(37.2)
Issue of coins and precious metals	0.4	0.1	1.2	0.1	0.8	191.4
Securities redeemed in advance	0.5	0.1		0.0	(0.5)	(100.0)
Others	49.6	7.2	2.5	0.2	(47.1)	(94.9)
2. Non-operational Income	7.7	1.1	4.8	0.4	(2.9)	(38.0)
II. Total Disbursements	328.5	100.0	280.2	100.0	(48.3)	(14.7)
1. Operational outlays	308.8	94.0	278.1	99.3	(30.7)	(9.9)
Interest and yield	103.5	31.5	82.0	29.3	(21.5)	(20.8)
Float in deposit accounts	92.6	28.2	65.5	23.4	(27.1)	(29.3)
Temporary sale of securities	5.8	1.8	11.8	4.2	6.0	102.1
External credit lines and exchangeable securities	5.1	1.5	4.7	1.7	(0.3)	(6.8)
Commissions and fees	8.6	2.6	4.2	1.5	(4.4)	(51.4)
Exchange difference	33.2	10.1	27.7	9.9	(5.5)	(16.7)
International organizations	5.7	1.7	5.8	2.1	0.1	1.8
External credit lines	12.0	3.6	9.6	3.4	(2.4)	(20.2)
Others	15.5	4.7	12.3	4.4	(3.2)	(20.7)
Cost of currency issue	8.6	2.6	21.3	7.6	12.7	148.0
Personnel expenses	76.2	23.2	80.3	28.6	4.1	5.3
Retirement pensions	30.6	9.3	17.1	6.1	(13.5)	(44.1)
General expenses	23.1	7.0	25.0	8.9	1.9	8.1
Taxes	1.5	0.5	1.5	0.5	0.0	2.3
Insurance	2.6	0.8	3.0	1.1	0.4	16.5
Cultural expenses	2.1	0.6	1.8	0.7	(0.2)	(11.8)
Provisions. depreciation and amortization	15.8	4.8	12.2	4.3	(3.6)	(22.8)
Other operating expenses	3.0	0.9	2.0	0.7	(1.0)	(34.1)
2. Non-operational disbursements	19.7	6.0	2.1	0.7	(17.6)	(89.4)
III. Fiscal year profit/loss including depreciation	358.6	109.2	917.1	327.3	558.5	155.7

1/ Figures subject to revision
2/ Projections
Source: Banco de la República

	Performance Jan-Dec, 2001		Projection Jan-Dec, 2002		Performance Jan-Dec 2002-2001 2/	
	Flows	Share %	Flows	Share %	Absolute	%
I. Total Income	1,857.4	100.0	1,355.3	100.0	(502.1)	(27.0)
1. Operating Income	1,839.6	99.0	1,349.8	99.6	(489.8)	(26.6)
Interest and yield	1,602.4	86.3	1,099.1	81.1	(503.3)	(31.4)
Net international reserves	1,104.0	59.4	792.1	58.4	(311.9)	(28.3)
External credit lines	12.3	0.7	9.6	0.7	(2.7)	(22.1)
TES "A" appreciation at market prices	37.0	2.0	27.3	2.0	(9.7)	(26.3)
TES appreciation through monetary expansion transactions	297.8	16.0	237.1	17.5	(60.7)	(20.4)
Appreciation public bank capitalization bonds	39.6	2.1	0.3	0.0	(39.3)	(99.2)
Temporary purchase of securities and quotas	66.0	3.6	27.8	2.1	(38.2)	(57.9)
Others	45.6	2.5	4.9	0.4	(40.7)	(89.3)
Commissions	96.2	5.2	95.6	7.1	(0.6)	(0.6)
Banking services and trusts	85.8	4.6	86.8	6.4	1.0	1.1
Foreign currency management	10.3	0.6	8.8	0.6	(1.5)	(14.4)
Others	0.1	0.0	0.0	0.0	(0.1)	(100.0)
Exchange difference	56.8	3.1	112.2	8.3	55.4	97.7
Issue of coins and precious metals	0.8	0.0	40.4	3.0	39.6	4,958.3
Securities redeemed in advance	0.7	0.0		0.0	(0.7)	(100.0)
Others	82.8	4.5	2.5	0.2	(80.3)	(97.0)
2. Non-operational Income	17.8	1.0	5.5	0.4	(12.3)	(69.1)
II. Total Disbursements	633.6	100.0	693.6	100.0	60.0	9.5
1. Operational outlays	610.1	96.3	690.8	99.6	80.7	13.2
Interest and yield	208.7	32.9	181.0	26.1	(27.7)	(13.3)
Float in deposit accounts	180.4	28.5	135.8	19.6	(44.6)	(24.7)
Temporary sale of securities	18.3	2.9	35.1	5.1	16.8	91.3
External credit lines and exchangeable securities	9.9	1.6	10.1	1.5	0.2	1.6
Commissions and fees	16.6	2.6	10.5		(6.1)	(36.8)
Exchange difference	31.4	5.0	57.6	8.3	26.2	83.3
International organizations	5.0	0.8	16.5	2.4	11.5	230.0
External credit lines	12.8	2.0	22.4	3.2	9.6	74.7
Others	13.6	2.1	18.7	2.7	5.1	37.4
Cost of currency issue	27.2	4.3	59.4	8.6	32.2	118.5
Personnel expenses	152.8	24.1	164.2	23.7	11.4	7.4
Retirement pensions	62.9	9.9	95.8	13.8	32.9	52.4
General expenses	52.6	8.3	58.6	8.4	6.0	11.3
Taxes	2.9	0.5	4.7	0.7	1.8	61.2
Insurance	5.3	0.8	7.9	1.1	2.6	48.1
Cultural expenses	5.7	0.9	6.2	0.9	0.5	9.6
Provisions. depreciation and amortization	34.5	5.4	36.1	5.2	1.6	4.7
Other operating expenses	9.5	1.5	8.8	1.3	(0.7)	(7.1)
2. Non-operational disbursements	23.5	3.7	2.8	0.4	(20.7)	(88.1)
III. Fiscal year profit/loss including depreciation	1.223.8	193.2	661.7	95.4	(562.1)	(45.9)

from appreciation of the euro and the yen against the dollar and a lower international interest rate. Other items of importance to income were Col$142.4 b. in appreciation on TES B for monetary control, Col$55.9 b. in commissions and Col $36.4 b. corresponding to the exchange difference.

In terms of outlays, the major items were Col$82.0 b. for payments on interest and yield, Col$80.3 b. for personnel expenses, Col $25.0 b. for general expenses,[39] Col $27.7 b. for the exchange difference on liabilities in foreign currency, Col$21.3 b. for the cost of monetary issue, Col$17.1 b. for pension expenses and Col$12.2 b. for provisions, depreciation and amortization.

2. Projected Income and Expenditure for 2002

The projection for the entire year contemplates Col$1,353.3 b. in income and Col$693.3 b. in outlays. This implies Col$661.7 b. in profits, which will exceed the estimate in the March Report (Col$200.9 b.) by Col$460.8 b. This adjustment is explained essentially by two factors: a) an increase of Col$386.8 b. in the yield on international reserves and b) Col$66.6 b. in added appreciation on TES B, which will increase from Col$170.5 b. to Col $237.1 b. The increased yield on reserves obeys the fact that valuations realized in the first semester were included. These originated primarily with appreciation of the euro and the yen against the dollar and, to a lesser degree, with appreciation of the portfolio because of the reduction in foreign interest rates.[40] However, the end result will depend on how these features evolve. The increase in TES valuation is related to the decline in domestic interest rates.

The amount estimated for outlays (Col $693.6 b.) represents an increase of 9.5% compared with outlays in 2001. The major items in this respect are Col$181.0 b. for payments on interest and yield, Col$164.2 b. for personnel expenses, with 7.4% nominal growth, Col$95.8 b. in net expenses for retirement pensions,[41] Col $58.6 b. to cover general expenses, Col$59.4 b. for monetary issue, Col$57.6 b. for the exchange difference attributed to an increase in the peso value of liabilities in foreign currency, and Col$36.1 b. for provisions and depreciation.

39 This item includes public utilities, janitorial service, surveillance, maintenance and repairs, transportation, currency, stationary, information activities, etc.

40 The annual projection does not include unrealized valuations, which came to US$167.9 million at June. Given the volatility of international markets, this income may be reversed due to depreciation of the euro and the yen and/or to increases in the external interest rate during the second half of the year.

41 Projected pension expenditure is based on the assumption that what the Bank spends on retirement pensions and to update the allowance for the actuary's valuation increases at a nominal rate of 6.3% a year; that is, in a proportion almost equal to the target for inflation. However, in view of the way interest rates are expected to behave, yield on the actuarial liabilities investment portfolio is expected to decline by 13.3%. These two projections combined explain expected growth of 52.4% in the Bank's net pension expenditure.

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