Inflation Report

December 2000

Banco de la República

Presentation, summary and conclusions

✠ Consumer inflation, measured as annual change in the Consumer Price Index (CPI), stood at 8.7% in December 2000, down by 0.1 percentage points on November and by 0.5 points on a year earlier. This made it 20 months in a row with inflation not exceeding 10.0%, and two years running with single-digit inflation (for the first time in thirty years). Inflation continued to fall in the fourth quarter, a trend practically unbroken since midyear, and by December it was 0.5 percentage points lower than in September.

✠ The half-percentage-point drop in inflation between December 1999 and December 2000 resulted from decreasing price rises in health-care (15.1% to 10.3%), housing (5.8% to 4.9%), transport (18.7% to 16.2%), education (10.2% to 9.9%), and food (7.5% to 7.4%). The only CPI group displaying faster price growth was clothing (3.1% to 3.6%). Upward pressure on prices came chiefly from rising world fuel prices, the dismantling of public-services subsidies, and devaluation.

✠ The CPI items most responsible for inflation in 2000 were fuel (with a 30.3% annual price rise), residential telephone charges (27.5%), banking services (22.3%), and bus fares (17.2%). These services, together, accounted for 22.4% of inflation in 2000, while another 5.9% came from a 17.2% rise in vehicle prices.

✠ The breakdown of consumer inflation by the alternate classification shows tradables registering a lower annual price rise in December 2000 (10.2%) than in September (10.7%) and a year earlier (12.2%). For nontradables the annual price rise was also lower in December (7.8%) than in September (8.3%) but slightly higher than a year earlier (7.5%). The tradables' price rise was higher than headline inflation all through 2000, partly because of devaluation, as evidenced by the large pick-up in the prices of import-intensive goods such as drugs (14.6%).

✠ To judge by the behavior of the core-inflation indicators, no great inflationary pressures came from demand during 2000. Core inflation, measured as the average of four indicators, stood at 8.0% in December, 1.1 percentage points lower than in December 1999 (9.1%) and 0.4 points lower than in September 2000. A similar trend was shown by inflation measured as the average of three of the indicators, leaving out the most volatile one (the asymmetric mean). None of the indicators overshot the inflation target, and only the CPI excluding food (9.3%) exceeded actual inflation.

✠ Producer inflation, measured as annual change in the Producer Price Index (PPI), was 11.0% in December, down by 1.9 percentage points on three months earlier and by 1.7 points on December 1999. The breakdown by origin shows imports as the main cause of lower PPI inflation in 2000, import price growth having decreased by 3.6 percentage points between December 1999 (16.1%) and December 2000 (12.5%). In the breakdown by industrial activity, the fall in producer inflation resulted from slower growth in agricultural prices: 11.7% a year in December 19990 to 6.0% twelve months later.

✠ Core inflation as the average of four indicators is currently projected to be 7.0% by December 2001. Leaving out the asymmetric mean, which was volatile all through 2000, the projected average would be 7.9% by the end of 2001.

✠ Various indicators of economic activity point to a fourth-quarter growth not much different from the annual rate registered for 2000 up to then. Thus, Colombia's economic expansion over 2000 should be close to the 3.0% rate forecast by the government. No big changes are expected in growth trends in early 2001, given the still satisfactory behavior of such variables as industrial orders and stocks, short- and medium-term business expectations about the economy, and present interest rates. Economic expansion in 2000 brought a recovery in capacity utilization, raising it in the fourth quarter to levels slightly above historical averages, for the first time since early 1998. But the country's high rate of unemployment and the low level of production in some industries should work against any strong inflationary pressures in the first months of 2001. It is important to point out that low investment levels have characterized the Colombian economy since 1996, resulting in limited expansion of production capacity for the future.

✠ At the end of the fourth quarter the monetary base's 20-month average stood 0.5% above the reference line's moving average, whereas the base's 45-month average stood on this line. The financial system's loan portfolio shrank somewhat faster in the fourth quarter than in the third, in both real and nominal terms. As in the previous quarters, however, private non-mortgage financial institutions saw the nominal net value of their loan portfolio expanding by 5.9% in December, compared with 3.3% in September. Likewise, on the latest information available in November, the entire financial system's gross loan portfolio, excluding the loans removed from balance sheets by intermediaries in the previous 18 months, grew at an annual rate of 2.5%.

✠ The nominal deposit rate averaged 13.3% in December, down by 0.3 percentage points on September, while the nominal lending rate averaged 29.4%, some 0.5 points higher than in September. In real terms the deposit rate was 4.2% and the lending rate 19.0% in December, having risen by 0.7 and 0.5 percentage points respectively since September. In December the interbank rate averaged 12.2% in nominal terms, and 3.2% in real terms.

✠ The Board of Directors of the Banco de la República kept the fundamental aspects of monetary policy unchanged in the final quarter of 2000, which ensured attainment of the 10% inflation target, in an environment of economic recovery. In December the Board decided to narrow the range of the intervention band, from January 2001, so as to reduce volatility in the interest rate. Thus, the Lombard expansion rate was lowered from 17% to 16% and the contraction rate raised from 7% to 8.5%, while the auction rates of contraction and expansion were left unchanged at 11% and 12% respectively.

✠ Attainment of the 2000 inflation target places the Colombian economy solidly among the group of countries with single-digit inflation. The lowering of inflation in 2000 was particularly noteworthy in that it was achieved in a context of economic upturn. Last year's results have created a suitable environment for obtaining a rate of inflation no higher than 8.0% in 2001 and consolidating the economy's recovery. As the analysis and forecasts presented in this Report suggest that meeting an 8.0% inflation target is feasible in the present circumstances, the Board of Directors does not consider it necessary to make any further changes to the intervention interest rates currently governing monetary policy.

The Board of Directors,

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Minister of Finance and Public Credit

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Luis Bernardo Flórez Enciso
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INFLATION REPORT

DECEMBER 2000

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I

Price Indexes

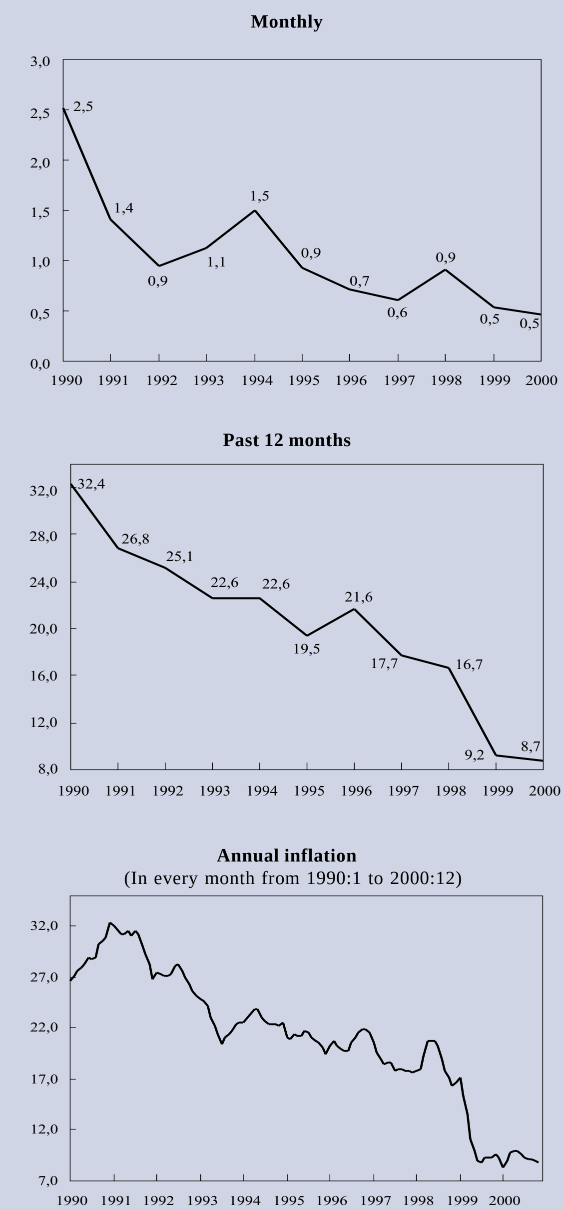
A. Consumer price index

1. Overall Performance

Inflation measured as annual change in the Consumer Price Index (CPI) was 8.7% by December 2000, running 1.3 percentage points below the target for 2000, and 0.5 points below the 9.2% rate recorded both a year earlier and in September (Figure 1 and Table 1). This result made it 20 months in a row with inflation not exceeding 10.0%, and two years running with single-digit inflation for the first time since 1969-1970 (8.6%, 6.6%). Inflation over the fourth quarter of 2000 (0.9%) was a little higher than in the third (0.7%) but lower than in the final quarter of 1999 (1.4%). Monthly inflation in December (0.47%) was much the same as a year earlier (0.52%).

Inflation rose sharply in the first quarter of 2000, from 8.2% in January to 9.7% in March. As stated in previous Reports, the rise was caused mainly by strong growth in farm prices, and partly by increases in domestic fuel prices in February and March, by the updating of charges and dismantling of subsidies for public services, and by higher charges for financial services. During the second quarter, however, annual inflation levelled out at around 10.0%, and from the beginning of the third quarter it followed a declining trend, down to 8.7% in December. This continuous decline in inflation over the second half of the year was led by food and transport prices,

Figure 1
Consumer price index
(percentage change to December)



Sources: National Statistics Agency (DANE). Calculations by Banco de la República.

Table 1
Inflation indicators
(% change to December 2000)

	Monthly			Annual		
	1998	1999	2000	1998	1999	2000
I. CPI	0,9	0,5	0,5	16,7	9,2	8,7
Food	0,5	1,0	0,4	15,7	7,5	7,4
Housing	1,6	0,3	0,2	16,6	5,8	4,9
Clothing	0,5	0,2	0,5	7,8	3,1	3,6
Health care	0,6	0,2	0,4	20,6	15,1	10,3
Education **1/**	(0,9)	0,0	0,6	17,3	10,2	9,9
Transport	1,2	0,9	0,4	20,2	18,7	16,2
Diverse expenditures	1,0	0,3	1,0	20,2	16,1	15,2
II. Core Inflation2/	1,1	0,3	0,5	16,9	9,1	8,0
Non-food CPI **3/**	1,1	0,3	0,5	17,1	10,0	9,3
Nucleus **4/**				16,6	9,8	8,5
Trimmed mean **5/**				17,2	8,8	7,8
Asymmetric mean **6/**				16,5	7,9	6,3
III. PPI	0,2	0,6	0,6	13,5	12,7	11,0
By economic use or destination						
Intermediate consumption	(0,1)	0,9	0,8	12,2	12,4	10,9
Final consumption	0,4	0,9	0,4	15,2	12,4	10,8
Capital goods	0,2	(1,0)	0,5	14,5	15,8	10,8
Building materials	0,7	0,1	1,1	12,4	14,3	12,9
By origin						
Domestically produced and consumed	0,2	1,1	0,5	13,6	11,6	10,6
Imported	(0,3)	(0,9)	1,0	12,6	16,1	12,5
Exported **7/**	(0,7)	0,9	(1,8)	4,3	26,7	6,4
By industrial activity (ISIC)						
Farming, forestry & fishing	(0,4)	2,6	0,0	10,0	11,7	6,0
Mining	(2,4)	0,5	(0,5)	(8,2)	31,1	27,3
Manufacturing	0,4	0,1	0,8	15,5	12,7	11,9

1/ Starting from January 1999 a new CPI methodology divided this group into education, and culture and recreation. For purposes of price monitoring, it was decided to leave them together as a single group.
2/ The average of the four core-inflation indicators calculated by the Banco de la República.
3/ CPI excluding all items of the food group.
4/ CPI excluding 20% of the weight of the items showing the greatest price volatility between January 1990 and April 1999.
5/ The weighted mean trimmed by 5% in each tail, calculated by the CPI-60 methodology. See Luis Fernando Melo et al. Un análisis de las medidas de inflación básica para Colombia, mimeo 1997, Banco de la República.
6/ The asymmetric mean trimmed by 15% in the left tail and 13% in the right tail, calculated by the CPI-60 methodology.
7/ The total PPI does not include exported goods . It is calculated from the weighted sum of domestically produced and consumed goods and imported goods.
Sources: Economic Studies Division (SGEE) of the Banco de la República, PPI and CPI Lists and DANE.

which weakened in annual growth by 2.5 and 2.2 percentage points respectively between June and December. Slower growth in food prices began in July and resulted from good crop harvests arriving on the market in the third quarter. Growth in transport prices was weakened by a freeze on domestic gasoline prices for two months during the second half of the year.

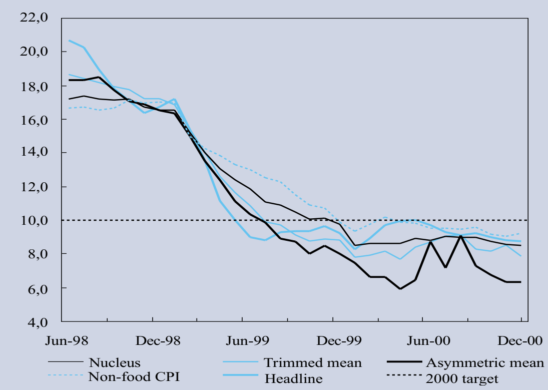
The four indicators of core inflation calculated by the Banco de la República clearly reveal two patterns of behavior over the year 2000: relative stability in the nucleus and non-food CPI; and volatility in the trimmed and asymmetric means (Figure 2).[1] As mentioned in previous Reports, the asymmetric mean varied sharply during the year, because the methodology used in calculating it takes housing rents into account in some months and leaves them out in others.

Core inflation measured as the average of the four indicators referred to above was 8%, down from 8.5% in the third quarter and from 9.1% in December 1999. Measured as the average of the three indicators not showing high volatility (non-food CPI, nucleus and trimmed mean), core inflation was 8.6% in 2000, some 0.4 percentage points lower than in September (9.0%) and 0.9 points lower than in December 1999 (9.5%). By the end of 2000 none of the core-inflation indicators exceeded the inflation target, and only the non-food CPI stood higher than observed inflation.

The cities of Cúcuta and Pasto, both with a 10.5% inflation, had the highest price growth in 2000. They were followed by Montería (9.8%) and Bucaramanga (9.6%).

[1] The criteria for selecting these core-inflation indicators are described in detail in "Evaluación de indicadores de inflación básica en Colombia: 1989-1998" by the Economic Studies Division, in Ensayos sobre política económica, No. 34, December 1998, Banco de la República.

FIGURE 2
CONSUMER INFLATION: HEADLINE AND CORE INDICATORS. 1998:6 - 2000:12
(ANNUAL PERCENTAGE CHANGE)



Source: DANE. Calculations by Banco de la República.

The lowest inflation was registered by Villavicencio (7.8%), Cali (8.1%) and Barranquilla (8.1%) (Table 2).

2. Performance of main CPI components

In the long term inflation is a reflection of sustained excess aggregate demand, which may be induced by rapid growth of the money supply in the economy. Price stability therefore calls for the curbing of excess liquidity in the economy by the monetary authority. In the short term, however, relative-price adjustments tend to alter the dynamics of long-term inflation temporarily. A description follows of the main relative-price adjustments in the CPI.

Accumulated inflation in the fourth quarter of 2000 was moderate (0.9%), reflecting slower price growth in housing (0.2%) and education (0.3%) and a moderate price expansion in farm produce (0.7%). The prices of entertainment and recreation, water supply, certain vegetables and legumes, vehicles, and soft and malt drinks accounted together for about 42% of fourth-quarter inflation (Table 3).

Table 2
Consumer price index, total and by city
(Percentage change to December)

	Monthly			Year to December			Annual		
	1998	1999	2000	1998	1999	2000	1998	1999	2000
Total	0,9	0,5	0,5	16,7	9,2	8,8	16,7	9,2	8,7
Bogotá	1,2	0,4	0,5	16,9	9,2	8,9	16,9	9,2	8,9
Medellín	0,6	0,9	0,5	17,2	10,0	8,2	17,2	10,0	8,7
Cali	0,7	0,3	0,3	14,4	7,5	8,1	14,4	7,5	8,1
Barranquilla	1,0	0,7	0,4	17,0	9,7	8,1	17,0	9,7	8,1
Bucaramanga	0,4	0,5	0,4	15,0	10,1	9,6	15,0	10,1	9,6
Manizales	0,3	0,8	0,3	15,7	10,3	8,3	15,7	10,3	8,3
Pasto	1,1	0,1	0,5	18,0	10,9	10,5	18,0	10,9	10,5
Pereira	0,4	0,5	0,5	16,1	10,4	8,9	16,1	10,4	8,9
Cúcuta	0,9	0,9	0,3	20,4	10,0	10,5	20,4	10,0	10,5
Montería	0,6	0,6	(0,0)	18,9	8,6	9,8	18,9	8,6	9,8
Neiva	0,3	0,4	0,5	13,7	8,9	8,5	13,7	8,9	8,5
Cartagena	0,8	0,8	0,4	18,1	7,9	8,6	18,1	7,9	8,6
Villavicencio	0,1	0,5	0,1	15,8	8,0	7,8	15,8	8,0	7,8

Source: DANE's Lists. Calculations by Banco de la República, SGEE.

Analysis of price behavior by large CPI components reveals three different patterns. First is a pattern of moderate price growth at annual rates well below observed inflation, shown by clothing (3.6%) and housing (4.9%). In the second pattern, inflation was driven throughout the year by annual growth far above observed inflation, in transport prices (16.2%) and diverse expenditures (15.2%) (Table 1).

This growth in transport prices was caused by constantly rising domestic gasoline prices and by devaluation, while expansion in diverse expenditures stemmed from a 20% surge in financial-service charges during the year. The third pattern was one of price growth at annual rates not much different from observed inflation, exhibited by the remaining CPI groups: food (7.4%), health care (10.3%), and education (9.9%).

The greatest contribution to CPI inflation in 2000 came from services rather than goods. Four of the five items most responsible for last year's inflation were service items: banking (with a 22.3% annual price growth), residential telephone services (27.5%), fuels (30.3%), and bus fares (17.2). These services together accounted for 22.4% of inflation in 2000, while vehicles contributed a further 5.9% by registering an annual price increase of 17.2% (Table 4).

3. Alternate classification: inflation speeding or slowing groups

Figure 3 presents a breakdown of consumer inflation by an alternate classification that divides

TABLE 3
GREATEST CONTRIBUTORS TO FOURTH-QUARTER
(CONSUMER INFLATION, 2000)

Description	Weight	Variation	Contribution	
			Points	Percentage
Total	100,0	0,9	0,9	100,0
Entertainment-related services	1,4	8,3	0,1	11,2
Water supply, sewerage & waste collection	1,3	5,3	0,1	8,8
Certain vegetables & fresh legumes	0,4	14,6	0,1	7,6
Vehicles	3,0	2,2	0,1	7,4
Soft and malt drinks	1,0	6,6	0,1	7,1
Other	92,9	0,6	0,5	57,9

Source: DANE's Lists. Calculations by Banco de la República, SGEE.

TABLE 4
GREATEST CONTRIBUTORS TO CONSUMER INFLATION IN 2000

Description	Weight	Variation	Contribution	
			Points	Percentage
Total	100,0	8,7	8,7	100,0
Banking services	3,0	22,3	0,7	8,2
Vehicles	3,0	17,2	0,5	5,9
Residential telephone service	1,4	27,5	0,5	5,3
Fuel	1,1	30,3	0,4	4,6
Bus fares	1,9	17,2	0,4	4,3
Other	89,7	7,1	6,3	71,7

Source: DANE's Lists. Calculations by Banco de la República, SGEE.

the CPI basket into tradables[2] and nontradables, the latter comprising indexed,[3] flexible[4] and cyclical[5] items. The breakdown reveals, notably, that the tradables' price variations invariably exceeded headline inflation throughout the year, this behavior being associated with the pesos's devaluation in 2000. In the second half of the year, however, the tradables' inflation tended to converge with headline inflation, and by December it was down to 10.2%, some 0.5 percentage points lower than in September and 2.0 points lower than in December 1999.

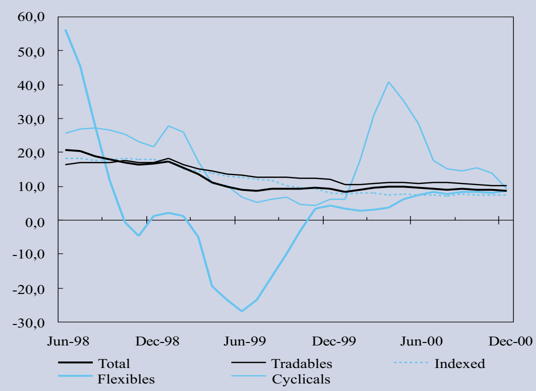
[2] Tradables: textiles, footwear, tobacco, beverages, cereals, dairy produce, cooking fats, drugs, vehicles, electrical appliances, etc.

[3] Indexed items: rent, fuel, utilities, education, transport, and other items.

[4] Flexible items: root crops, plantains, vegetables, legumes, and fruit.

[5] Cyclical items: meat, and meat products.

Figure 3
Inflation in tradables and nontradables
1998:6 - 2000:12
(Annual percentage change)



Source: DANE. Calculations by Banco de la República.

Among nontradables, the flexibles (root crops, fruit and vegetables) displayed annual price rises that were significant in early 2000 but later became moderate, ending the year at 7.8% (Table 5).

The prices of cyclicals (meat products), having grown slowly over the first quarter, at about 3%, picked up sharply in the second, and by the end of the year their 8.7% growth was similar to observed inflation. The indexed items' price growth remained below observed inflation all year long, thanks to a minimal rise in housing rents (2.6%), which offset considerable expansion in utilities charges (25.0%).

The breakdown of inflation by the alternate CPI classification further shows that tradable goods and services were essentially responsible for the 0.5-percentage-point drop in inflation over 2000. The tradables' price growth slowed from 12.2% in 1999 to 10.2% in 2000, resulting in a negative contribution (-0.6 percentage points) to inflation change between 1999 and 2000.

In contrast, the nontradables, with a price growth of barely 0.3 percentage points between 1999 (7.5%) and 2000 (7.8%), helped to speed up inflation by 0.1 percentage points in the past 12 months. Among nontradables, cyclicals made the greatest contribution (0.4 percentage points) to speeding up inflation, their impact being counteracted by the indexed items' deflationary effect of -3.0 percentage points.

Table 5
Consumer price index, 1999-2000
(To december)

Items	12-month change		Contribution to change		Contribution to infln. reducn 1/
	1999 2/	2000	1999	2000	2000-1999 Points
Total	9,2	8,7	9,2	8,7	(0,5)
Tradables	12,2	10,2	4,5	3,9	(0,6)
Nontradables	7,5	7,8	4,7	4,9	0,1
Indexed	8,2	7,6	4,1	3,7	(0,3)
Flexibles	6,3	9,3	0,3	0,4	0,1
Cyclicals	4,4	8,7	0,4	0,8	0,4

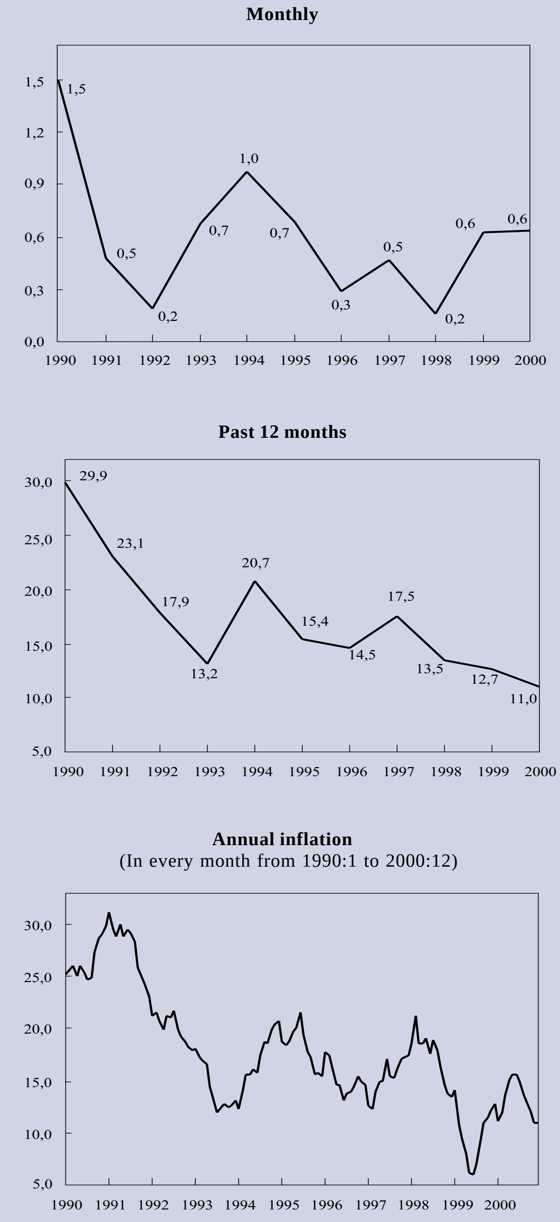
1/ Each item's contribution to inflation reduction is the difference between its contributions to inflation in 1999 and 2000. The apparent lack of consistency between figures is caused by rounding.
2/ This table's figures were calculated entirely from DANE's new CPI basket, unlike those presented in previous Reports.
Sources: DANE's Lists. Calculations by Banco de la República, SGEE.

B. Producer price index

Producer inflation, measured as annual variation in the Producer Price Index (PPI), was 11.0% for the year, down by 1.9 percentage points on September 2000 (12.9%) and by 1.7 points on December 1999 (12.7%) (Figure 4). Two distinct trends are discernible in producer-price growth during 2000: a rise of 2.9 percentage points in the first half of the year, to 15.6% in June; then a big fall in the second half, to 11.0% in December. Import-price growth was responsible for both trends, having jumped from 16.1% in December 1999 to 21.4% in June 2000, then plunged by 9 percentage points in the second half of the year to 12.5% in December (Table 1).

The breakdown of producer inflation by origin of goods shows, notably, declining inflation in domestically produced and consumed goods, from an annual rate of 13.1% in September to 10.6% in December. In contrast, annual growth in import prices was much the same in December (12.5%) as in September (12.4%). The breakdown of producer inflation by ISIC industrial activity reveals that all groups registered lower rates of price increase at the end of the fourth quarter than at the end of the third. The biggest drop was in farming, forestry, hunting and fishing: from an annual rate of 12.6% in September to 6.0% in December, making this the only group ending the year with a price growth below producer inflation. Mining prices rose by 27.0% over the year, while price expansion in manufacturing (11.9%) was close to average producer inflation.

Figure 4
Producer price index
(Percentage change to december)



Sources: Banco de la República, SGEE.

II

Determinants of inflation

A. Monetary aggregates, interest rates, and exchange rate

1. Monetary aggregates

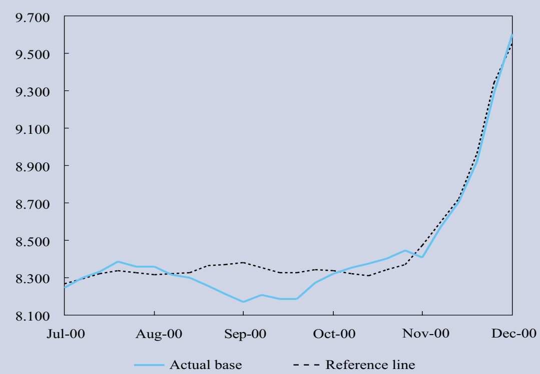
The behavior of the monetary aggregates is analyzed by examining the evolution of the monetary base, M1 money supply, broad money M3, and the financial system's loan balance.

Monetary base

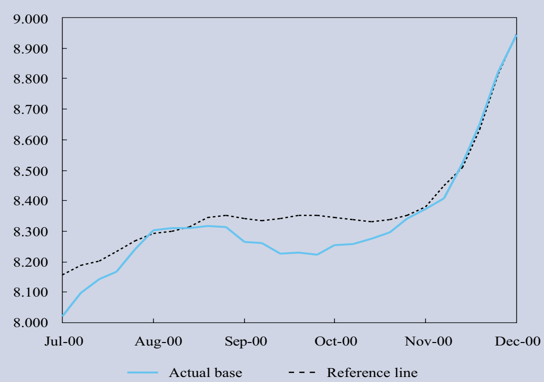
On December 29th the monetary base amounted to 10,710 billion pesos, with a 12-month growth rate of 10.0%. The base's 20-month moving average ended up 0.5% higher than the reference line's moving average, while the base's 45-month moving average coincided with the reference line's (Figure 5).

FIGURE 5
MONETARY BASE AND REFERENCE LINE
(BILLIONS OF PESOS)

20-MONTH DAILY MOVING AVERAGE



45-MONTH DAILY MOVING AVERAGE



Source: Banco de la República, SGEE.

In December the monetary base's average balance showed an annual growth rate of 17.1%, up by 2.5 percentage points on September. A breakdown of the monetary base into its uses, shows this rise to have come from a pick-up, between September and December, in both reserves (from -1.9% to 0.7%) and cash (from 25.4% to 26.7%) (Figure 6).

M1 money supply

The M1 balance on December 29th stood at 16,769 billion pesos, with a 12-month expansion rate of 30.4%. Annual growth in M1's average balance was lower in December (32.0%) than in September (34.7%). This decline was caused exclusively by slower growth in checking accounts (36.5% in December, down from 43.1% in September) and occurred despite the expansion in cash holdings referred to above (Figure 7).

Broad money (M3)[6]

The broader measure of money supply, M3, showed a balance of 61,762 billion pesos on December 29th, with a 2.7% annual growth rate (Figure 8). Annual growth in M3's average monthly balance was higher in December (3.0%) than in September (2.7%), as a result of faster expansion in cash holdings. This rise stemmed from faster expansion in cash holdings, which made up for slower growth in liabilities subject to reserve (0.6% in December, down from 0.8% in September). These liabilities' slower growth was in turn caused by greater contraction in savings accounts (¾6.7% in December, compared with -0.4% in September), and also by a weaker rise in checking accounts, as described above. In contrast, CDs showed a smaller contraction in December (-1.7%) than in September (-3.1%). (Figures 9 and 10).

The average M3 multiplier fell from 7.105 to 6.121 between September and December. This fall was connected with an increase in both the cash ratio (from 0.103 to 0.126) and the reserve ratio (from 0.052 to 0.058 (Figure 11).

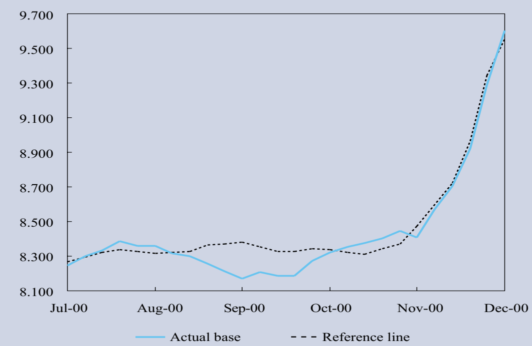
Credit

The financial system's overall net balance of local- and foreign- currency loans amounted to 46.161 billion pesos on December 29th, with an annual contraction of -8.4%. Annual contraction in domestic currency loans was -7.4%; in foreign-currency loans, calculated in pesos, -19.1%; and in the dollar equivalent of foreign-currency loans -32.0%.

The average gross nominal balance of local-currency loans held by all financial

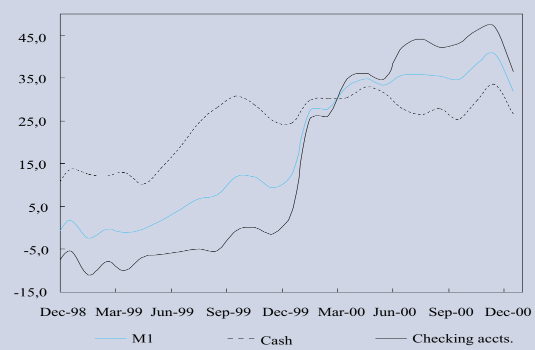
6 Starting from the fourth quarter of 2000, the financial system's bonds will be shifted to the group of liabilities subject to reserve (LSR). Consequently, the aggregate referred to in previous Reports as M3-plus-bonds will henceforth be called M3.

FIGURE 6
MONETARY BASE AND ITS USES
(ANNUAL % CHANGE IN MONTHLY AVERAGE)



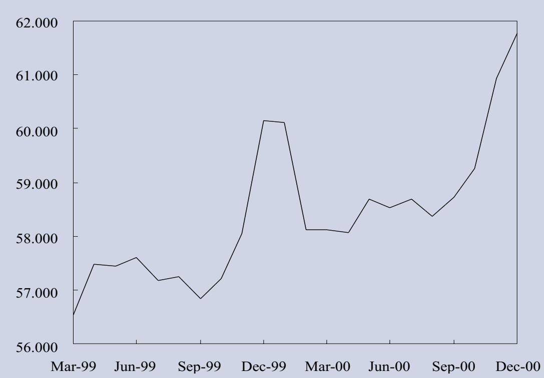
Source: Banco de la República, SGEE.

FIGURE 7
M1 AND ITS COMPONENTS
(ANNUAL % CHANGE IN MONTHLY AVERAGE)



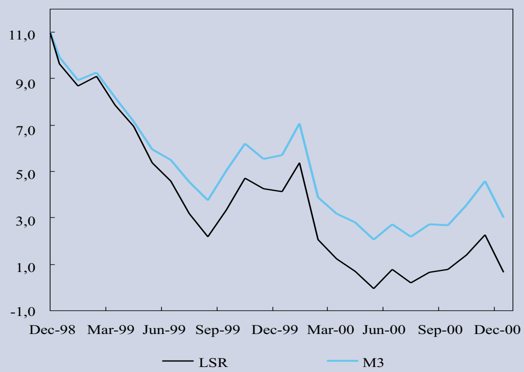
Source: Banco de la República, SGEE.

FIGURE 8
BROAD MONEY - M3
(MONTHLY BALANCE, BILLIONS OF PESOS)



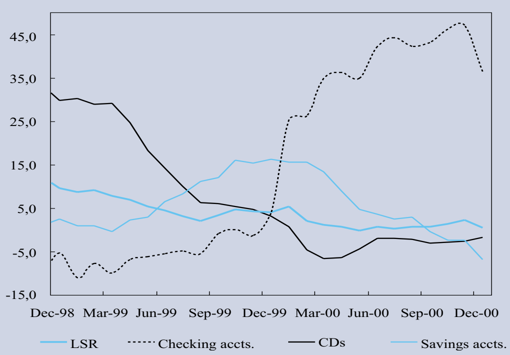
Source: Banco de la República, SGEE.

FIGURE 9
M3 AND LIABILITIES SUBJECT TO RESERVE (LSR)
(ANNUAL % CHANGE IN MONTHLY AVERAGE)



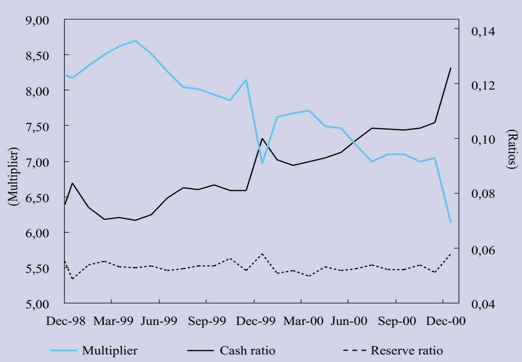
Source: Banco de la República, SGEE.

FIGURE 10
LIABILITIES SUBJECT TO RESERVE (LSR)
AND THEIR COMPONENTS
(ANNUAL % CHANGE IN MONTHLY AVERAGE)



Source: Banco de la República, SGEE.

FIGURE 11
M3 MULTIPLIER



Sources: Banco de la República and Banking Superintendency.

intermediaries contracted at a higher annual rate in December (-7.0%) than in September (-4.3%). Leaving out the mortgage banks shows that the balance held by the rest of the system grew faster: 6.8%, up from 5.2%. The balance held by mortgage banks contracted more strongly: -23.4%, up from -15.7% (Figure 12).

In real terms, there was a deeper contraction in December than in September in the gross local-currency loan balance of both the financial system (-14.5%, up from -12.4%) and the mortgage banks[7] (-29.6%, up from -22.8%) (Figure 13).

A breakdown by groups of financial intermediaries reveals that annual growth in the net nominal loan balance of non-mortgage private institutions rose from 3.3% to 5.9% between September and December. In contrast, growth in the loan balance of non-mortgage state banks slowed from 3.8% to 1.2% over the same period. Lastly, the loan balance of mortgage banks, state-owned and private alike, continued to shrink more rapidly, as in the past several quarters. (Figure 14)

It is important to point out that the portfolio behavior described above can be partly explained by the statistical effect of loan removals from the financial intermediaries' balance sheets. These removals were brought about by the liquidation of a number of financial entities, the writing-down of unproductive assets, reductions by reason of property received in payment, portfolio securitizations and sales to institutions outside the system, and recalculations of mortgage loans. The loan portfolio, cleaned up in this way, gives a better idea of the performance of new loans extended by the financial system.

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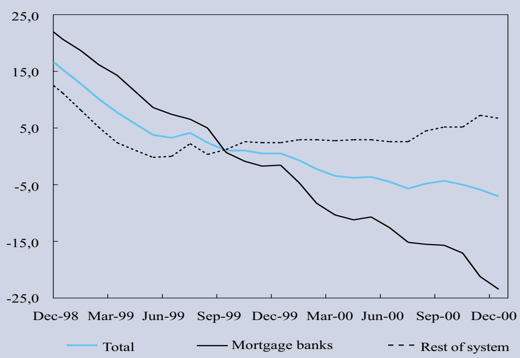
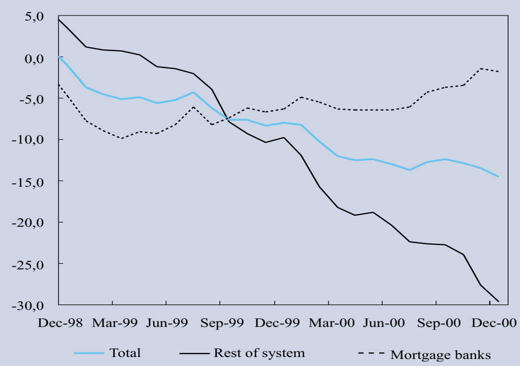
[7] Starting from this Report discussion of loan-portfolio performance will consider mortgage banks in replacement of savings and loan associations (CAVs).

Figure 12
Gross nominal local-currency loan balance
Financial system excluding FEN
(Annual % change in monthly average)



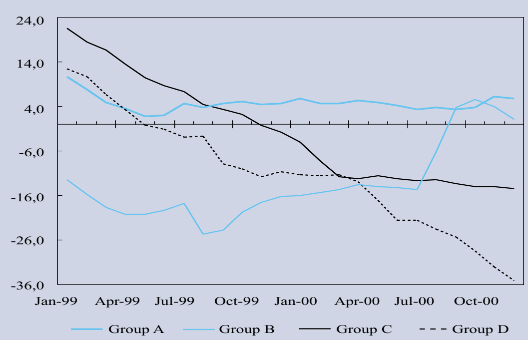
Sources: Banco de la República and Banking Superintendency.

Figure 13
Gross real local-currency loan balance
Financial system excluding FEN
(Annual % change in monthly average)



Sources: Banco de la República and Banking Superintendency.

Figure 14
Nominal net local-currency loan balance
By type of intermediary
(Annual % change in monthly average)



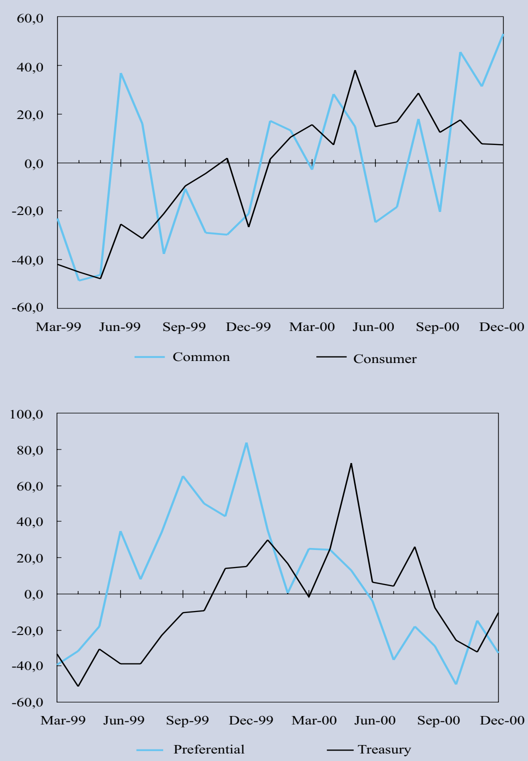
A: Private-sector non-mortgage banks. **B:** Public-sector non-mortgage banks. **C:** Private-sector mortgage banks. **D:** Public-sector mortgage banks.
Sources: Banco de la República and Banking Superintendency.

Table 6 presents an estimation of the portfolio's behavior if such removals had not taken place. In contrast to the gross portfolio, the corrected portfolio expanded in nominal terms throughout the year, at annual rates ranging between 2.5% and 7.0%. According to these figures, the gross local-currency portfolio would have shown a 2.5% annual growth in November.

Lastly, Figure 15 shows annual variations in monthly disbursements by the entire financial system, by type of loan. Interestingly, the figures reveal that over the second half of 2000 disbursements for consumer and common loans[8] behaved in the opposite way to disbursements

[8] Consumer loans are for an amount less than 300 times the Minimum Wage. [In 2000 the Minimum Wage was... pesos, equivalent in December to $260.100]

Figure 15
Monthly loan disbursements, by type of loan
Entire financial system
(Annual percentage change)



Sources: Banco de la República and Banking Superintendency.

Table 6
Financial system's gross adjusted loan portfolio 1/
(Millions of pesos)

Period		Gross portfolio 2/ (a)	change %	Loans removed 3/ (b)	change %	Law 546 Treasury paper (c)	Gross corrected portfolio (d)	change %
1998	Dec.	46.734.905		4.169.482			50.904.387	
1999	Jan.	46.739.081		4.573.703			51.312.784	
	Feb.	46.710.313		4.734.359			51.444.672	
	Mar.	46.931.283		5.024.443			51.955.725	
	Apr.	46.511.564		5.028.112			51.539.676	
	May.	46.625.671		5.243.263			51.868.934	
	Jun.	47.106.731		5.454.880			52.561.611	
	Jul.	46.496.683		6.055.746			52.552.429	
	Aug.	45.900.959		6.220.077			52.121.036	
	Sep.	46.814.400		6.358.948			53.173.348	
	Oct.	46.343.487		6.453.982			52.797.468	
	Nov.	47.190.023		6.491.439			53.681.462	
	Dec.	47.230.673	1,1	7.231.853	73,4		54.462.526	7,0
2000	Jan.	46.107.279	(1,4)	7.324.666	60,1		53.431.945	4,1
	Feb.	45.444.189	(2,7)	7.402.887	56,4	188.984	53.036.060	3,1
	Mar.	44.908.963	(4,3)	7.750.279	54,3	1.009.811	53.669.053	3,3
	Apr.	45.045.524	(3,2)	7.645.202	52,0	1.424.182	54.116.547	5,0
	May.	44.330.299	(4,9)	8.471.145	61,6	1.554.655	54.356.099	4,8
	Jun.	44.405.167	(5,7)	8.560.088	56,9	1.606.548	54.571.803	3,8
	Jul.	44.396.256	(4,5)	8.152.700	34,6	1.888.354	54.437.309	3,6
	Aug.	43.866.250	(4,4)	8.206.494	31,9	1.875.198	53.947.942	3,5
	Sep.	44.313.825	(5,3)	8.595.603	35,2	1.865.097	54.774.525	3,0
	Oct.**4/**	43.720.934	(5,7)	10.068.227	56,0	1.859.460	55.648.621	5,4
	Nov.	43.725.868	(7,3)	9.397.440	44,8	1.888.094	55.011.401	2,5

(d) = (a) + (b) + (c).

1/ This information is provisional because some items are calculated on estimates, and financial intermediaries continually update their financial statements.

2/ Starting from March 2000 the gross portfolio includes the liquidation balances of the Banco Central Hipotecario (state mortgage bank) provided by the Banking Superintendency.

3/ Portfolio adjustments were made on the following criteria:

- Mortgage-debt relief does not include the financial system's accounts receivable from the government.
- The 1999 loan administration portfolio held by Fogafin (state financial guarantee fund) is not included, because account 821905 was opened by the Banking Superintendency at the end of 1999 and has not been reprocessed backward in time.
- The loans of entities under liquidation figuring in the gross portfolio calculated by SGEE are included.
- Write-downs in respect of property received in payment are not included.

4/ Fogafin has been authorized by government Decree 1814 dated September 18, 2000 to provide capital for public-law corporations principally engaged in acquiring, administering and disposing of unproductive assets owned by establishments of this nature. Fogafin has therefore created an entity for this purpose, called Central de Inversiones (CISA), which carried out the following operation in October:
Bancafé sold loans for 1,153,000 million pesos, receiving payment for them in Fogafin bonds, but will continue to administer the loans itself. In October Bancafé also sold loans for 33,600 million pesos to the National Coffee Fund, receiving payment for them in cash, and in November it sold loans for 34,000 million to Finagro.

Source: Calculations by Banco de la República, SGEE, on the basis of balances provided by the Banking Superintendency and obtained through telephone surveys.

for preferential and treasury loans[9]: the former expanded relative to the same period the year before, whereas the latter declined.

This seemingly contradictory behavior may be normal when an economic upturn begins to show signs of greater strength, as was the case with the Colombian economy in the second half of 2000. An increase in Treasury and preferential loans is usually connected with liquidity and risk problems, characteristic of the initial stage of economic recovery. But when recovery is well on the way, liquidity and risk levels tend to return to normal, and so the financial system's lending begins to be channelled through normal lines of credit such as consumer and common loans.

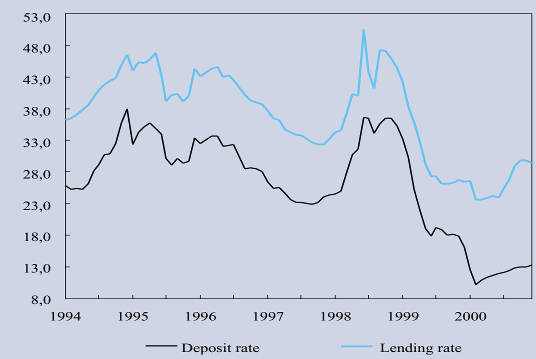
2. Interest rates

At the end of December the average deposit rate, as measured by the DTF, stood at 13.3% and the average lending rate at 29.4%. The difference between the two was 16.1 percentage points, one of the biggest differences since 1986, and bigger than the previous quarter's by 0.1 points (Figures 16 and 17). The interbank rate averaged 12.2% during December (Figure 18). It is to be noted that in December 2000 the Banco de la República's Board of Directors decided to lower the Lombard expansion rate from 17.0% to 16.0% and raise the contraction rate from 7.0% to 8.5%, effective from January 2001, with the aim of reducing interest-rate volatility.

In real (ex-post) terms, the deposit rate rose from 3.4% at the end of the third quarter to 4.2% at the end of December, and the lending rate from to 18.1% to 19.0% (Figure 19). December's real interbank rate averaged 3.2%.

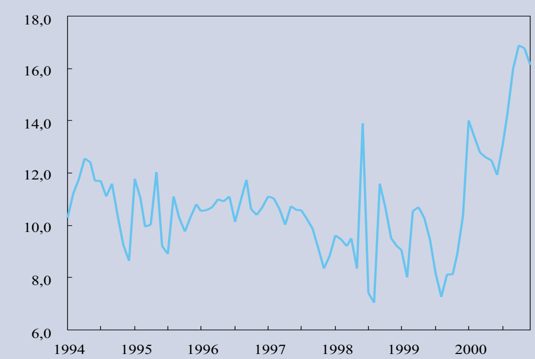
9 Both Treasury and preferential loans are for corporate customers. The maturity of Treasury loans is under 30 days, while preferential loans are made for longer periods.

Figure 16
Lending and deposit rates
(Annual effective rate)



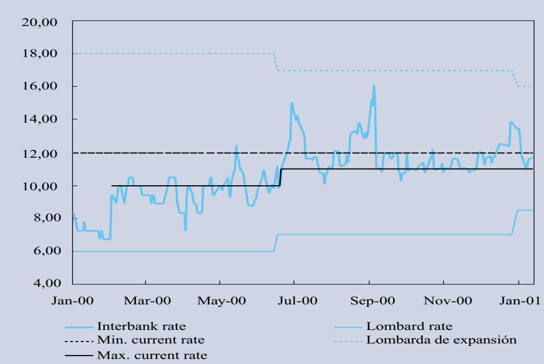
Sources: Banco de la República and Banking Superintendency.

Figure 17
Lending and deposit rate differential
Financial system
(Percentage)



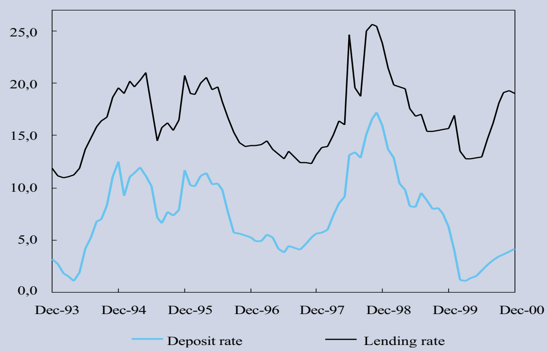
Sources: Banco de la República and Banking Superintendency.

Figure 18
Interbank rate and intervention band
(Percentage)



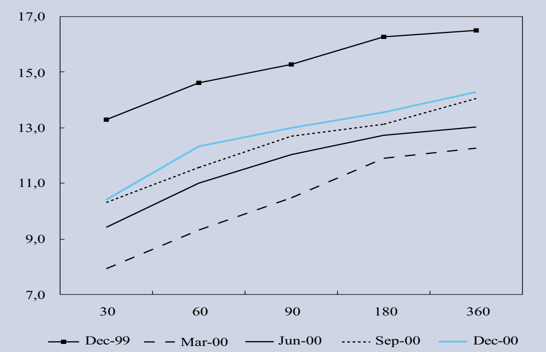
(*) The auction of contraction to this rate become to a term of 14 days.
Sources: Banco de la República and Banking Superintendency.

FIGURE 19
REAL DEPOSIT AND LENDING RATES, FINANCIAL SYSTEM
(PERCENTAGE)



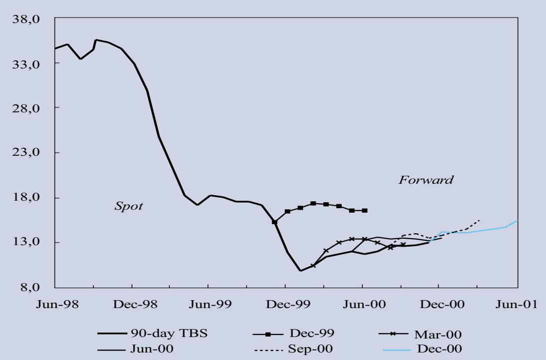
Sources: Banco de la República and Banking Superintendency.

FIGURE 20
BASIC DEPOSIT RATE (TBS) FOR DIFFERENT MATURITIES, AS DETERMINED BY BANKING SUPERINTENDENCY
(PERCENTAGE)



Sources: Banking Superintendency. Calculations by Banco de la República.

FIGURE 21
90-DAY TBS PROJECTIONS
(PERCENTAGE)



Source: Banking Superintendency. Calculations by Banco de la República.

Figure 20 shows how the yield curve of the Banking Superintendency's basic rate (TBS) for different maturities evolved over the past 12 months. The TBS rate, having dropped to historically low levels in March (8.0% for the shortest maturities and 12.0% for the longest), then rose continuously over the year, for all maturities. In December it stood at 10.4% for the shortest maturities and 14.3% for the longest, its highest levels in 2000, though only slightly higher than in September.

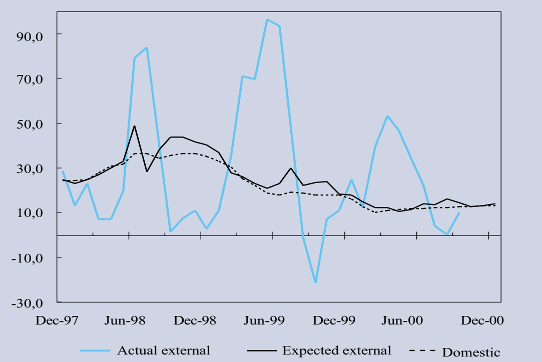
Figure 21 displays the TBS rate's spot and forward curves for the past 12 months. The 90-day spot curve (thick line) shows how this rate rose by about three percentage points over the year, as predicted by the forward rates presented in previous Reports.

The points on the forward curves (thin lines) represent agents' expectations about the 90-day rate at the present time (the first point), in 30 days (second point), and so on up to 360 days. The forward curves suggest that the market continues to expect further rises in the 90-day rate, which might take it up to about 15.0% by the middle of 2001.

3. Yield differentials

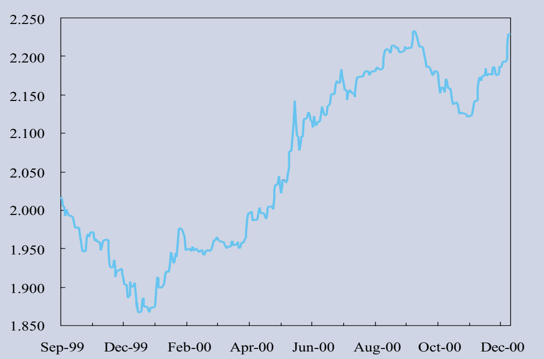
This section deals with the differential between external and domestic yields. External yield is defined as the yield that local investors expect to obtain on dollar-denominated investments. It is calculated on the basis of an external interest rate of reference, and devaluation expectations. The devaluation expectations used for this purpose are those implicitly contained in the financial system's forward (80 to 100 days) dollar sales contracts. The 90-day Libor rate is used as the external rate of reference, and the DTF rate as the domestic one.

Figure 22
External and domestic annual yields: Actual v. Expected
(Percentage)



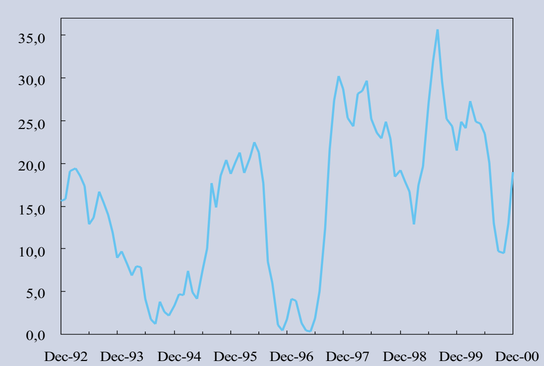
Source: Banco de la República.

Figure 23
Market exchange rate
1999:9 - 2000:12
(Pesos to the dollar)



Sources: Banco de la República, SGEE.

Figure 24
Nominal devaluation
(Percentage)



Sources: Banco de la República, SGEE.

Figure 22 compares the expected external yield, return on domestic investments (as measured by the DTF rate), and actual external yield (with a three-month lag). Over the fourth quarter the expected external yield and domestic yield remained at very similar levels. The domestic rate went up a little at the end of the year, but its rise was offset by increments in the devaluation expectations implicit in forward contracts.

4. Nominal exchange rate

The nominal exchange rate stood at 2,230 pesos to the dollar at the end of December, compared with 2,212 pesos at the end of the third quarter, registering a 19.0% devaluation for the year. The exchange rate started the fourth quarter on a downward trend that lasted to the end of November but then reversed sharply in December, partly as a result of the Treasury's decision not to release foreign currency, as expected by market operators. (Figures 23 and 24).

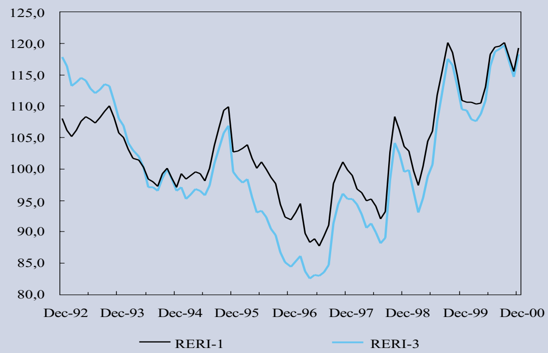
5. Real exchange rate

The real exchange rate, as measured by the RERI-1 index (1994 = 100), which is based on Colombia's producer price index and those of its 20 trading partners, averaged 119.3 in December, giving a real devaluation of 7.5% for the year. But using the RERI-3 index (1994 = 100), which is based on consumer price indices, gives a real devaluation of 7.9% for the year. (Figures 25 and 26).

6. Asset prices

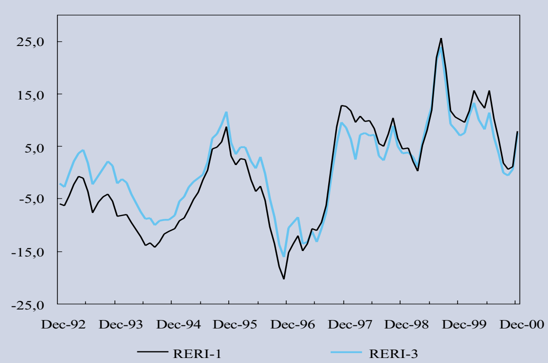
A description follows of a number of variables that indicate the price behavior of certain assets in Colombia. The first is the Bogotá Stock Exchange Index (IBB), a weighted index of the prices of the 20 shares of Colombian companies having registered the largest trading by volume and value on the Bogotá Stock Exchange in the

Figure 25
Real exchange rate indices
RERI-1 and RERI-3 (1994 = 100)
1992:12 - 2000:12



Source: Banco de la República, SGEE.

Figure 26
Real devaluation
RERI-1 and RERI-3 (1994 = 100)
1992:12 - 2000:12
(Percentage)

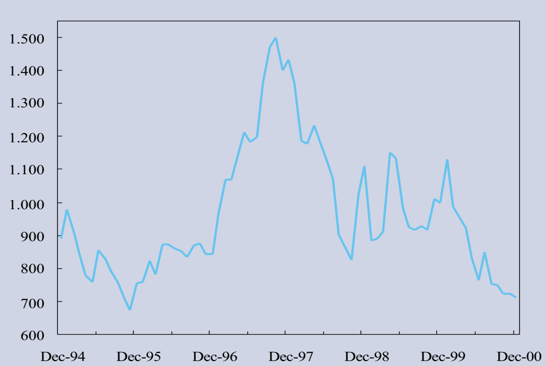


Source: Banco de la República-SGEE.

preceding 48 fortnights. The weight of each of the 20 shares making up the Index depends on the volume and value of its trading and is recalculated every fortnight. The Index varied greatly in 1999 but dropped steadily during most of 2000, ending the year at 713 (Figure 27). The price of shares, as measured by the IBB, fell by 28.6% between December 1999 and December 2000, its value last December remaining at levels similar to those registered in September.

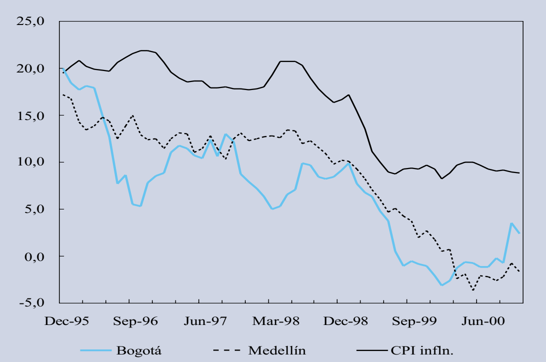
Another variable that provides information on asset-price behavior is the National Planning Department's housing-price index for Bogotá and Medellín, calculated on a monthly basis, since 1994. Figure 28 shows annual variations in housing prices for Bogotá and Medellín, together with consumer-price inflation. Since the second half of 1995 housing prices in the two cities have varied at rates below CPI inflation. This implies that in that period the real value of housing in Colombia began to fall steadily, the fall being greater in Bogotá than in Medellín. In the second half of 2000 both cities' housing-price variations reversed the downward trend they had been on since January 1999, and in Bogotá's case even became positive again in October and November.

Figure 27
Bogota stock exchange index
(January 1991 = 100)
1994:12 - 2000:12
(Percentage)



Source: Bogotá Stock Exchanges.

Figure 28
Housing-price inflation in Bogota and Medellin
And CPI inflation
(Percentage)



Source: National Planning Department.

Although this does not mean that housing prices have recovered, it does show a clear break in their trend.

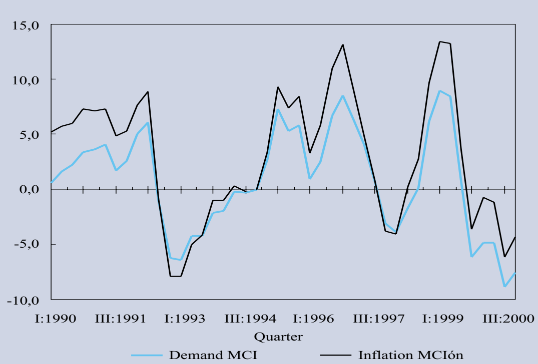
7. Monetary Conditions Indicator

The Monetary Conditions Indicator (MCI), presented here for the first time, is a new variable designed to guide the current stance of monetary policy. It is built on a univariate measure of the effects produced by the real interest rate and the real exchange on economic activity or inflation. By taking into account the effects of both these rates, monetary policy can be better shaped as a determinant of the general level of prices.

The fourth quarter of 1994 was taken as the base in calculating the MCI, for it was a period in which monetary policy was tightened after almost two years of very low, and at times negative, interest rates. An MCI above this base level indicates contractionary monetary conditions affecting aggregate demand or inflation, relative to the chosen base period. An MCI below the base level indicates an expansionary effect (Figure 29).

From mid-1999 through to December 2000 the MCI for aggregate demand ran below the 1994 fourth-quarter level, suggesting that monetary policy throughout that period was relatively loose. In the third quarter, in particular, this was because of both low real interest rates and real devaluation. The MCI for inflation leads to a similar conclusion: throughout 2000 it ran below the 1994 fourth-quarter level, indicating that monetary policy was loose. (See Box).

TABLE 29
MONETARY CONDITIONS INDICATOR (MCI)
FOR AGGREGATE DEMAND AND INFLATION
(PERCENTAGE)



Source: National Planning Department.

B. SUPPLY AND DEMAND

1. General considerations

The Colombian economy's growth trends did not change overmuch in the second half of 2000 relative to the first. GPD growth in the third quarter, and indicators of economic activity in various sectors over the fourth quarter point to a rate of growth for 2000 close to the government's 3.0% target. Likewise, rising expectations among manufacturers and other businessmen about the medium-term state of the economy, and the present levels of orders and stocks offer an optimistic outlook for economic performance in early 2001. Nevertheless, various economic and security situations make it presently unlikely that growth, at least over the first half of 2001, will be much stronger than in 2000. The government's 3.8% growth target for 2001 seems therefore reasonable.

Third-quarter GDP growth was up by 3.1% on a year earlier and by 1.2% on the second quarter (Table 7). As in the first half of the year, it was driven by recovery in manufacturing and commerce, although there was also expansion in the other sectors of production, except in mining and quarrying and in social, community and personal services. A notable development in the third quarter was positive growth in the financial and construction sectors, for the first

Table 7
Gross domestic product, by sector
(Annual percentage change)

	1999	2000		
		I	II	III
GDP	(4,3)	2,4	3,4	3,1
Farming, forestry, hunting & fishing	(0,2)	2,2	7,0	3,6
Mining and quarrying	4,9	0,2	(8,4)	(12,7)
Electricity, gas and & water	(3,5)	4,2	2,5	1,2
Manufacturing	(12,4)	8,8	11,8	13,2
Construction	(24,3)	(10,0)	(2,4)	2,8
Commerce, repairs, restaurants & hotels	(8,9)	3,9	7,3	6,4
Transport, warehousing & communications	(2,9)	3,3	3,8	4,1
Financial, insurance, real-estate & bus.-serv. entities	(6,1)	(1,7)	(0,4)	1,4
Social, community & personal services	4,0	1,1	(1,2)	(1,8)
Subtotal added value	(3,6)	2,6	3,5	2,9

Source: DANE.

time since early 1988. Non-coffee farm production also performed well, registering a 6.0% annual growth, according to preliminary estimates.

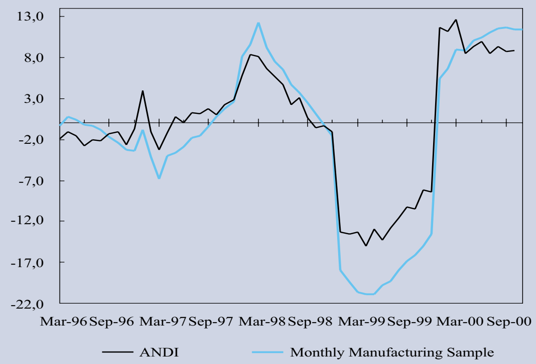
GDP growth to September would have been stronger but for a sharp third-quarter contraction in both coffee (12.6%) and oil (17.0%) production, relative to the same period in 1999. Oil production fell because of normal depletion in the biggest fields.

Growth trends do not appear to have changed substantially over the fourth quarter, judging by the evolution of various indicators of sectoral output. Manufacturing continued to be the most dynamic sector, growing by 11.1% from January to November, according to data from DANE's Monthly Manufacturing Sample (Figure 30). Industrial expansion remained particularly strong in such sectors as iron and steel, transport equipment, textiles and clothing, paper, furniture, and metal products, and continued to be largely associated with a good performance of external demand. In contrast, sectors more dependent on domestic demand, such as food and beverages, grew more slowly.

Total exports were still expanding apace in November though not as fast as in the preceding months, owing to a slowdown in oil exports. From January to November total exports grew at an annual rate of 15.6%, compared with 21.5% over the first half of the year. Nontraditional exports, led by industrials, maintained high rates of annual growth: 16.3% for the total accumulated to November and 22.4% for industrials (Figure 31). This pace of expansion in nontraditionals was much the same as at the end of the third quarter, but a little higher than in June, thanks to improvements in some nontraditional farm exports.

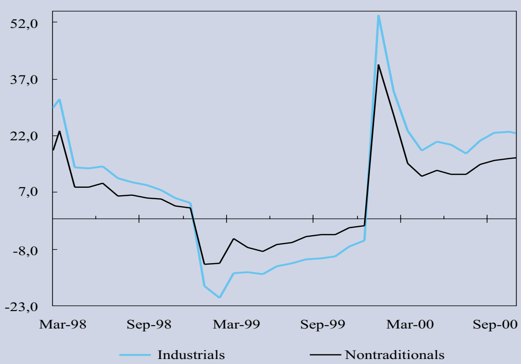
Lastly, power consumption, which tends to move in line with urban economic activity, rose at an average annual rate of 2.7% in the last three months of the year, a higher rate than

Figure 30
Real industrial production index, To November 2000
(Annual % change, year to date)



Sources: ANDI and DANE.

Figure 31
Exports
1998:3 - 2000:11
(Annual % change, year to date)

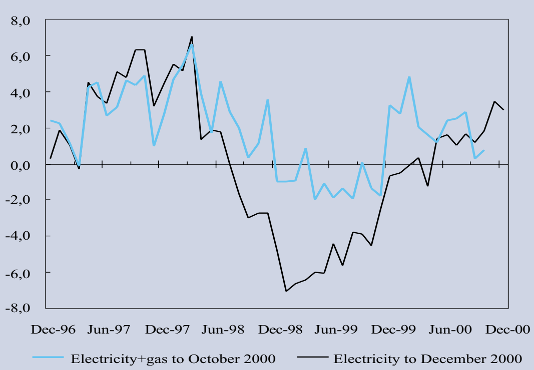


Source: DANE.

that registered between January and September (Figure 32). Expansion in agricultural production is implied by low food prices in the last months of 2000. Similarly, indicators such as retail sales, credit-card sales, and overtime in the industrial sector continued to exhibit satisfactory behavior at the beginning of the fourth quarter. It should be explained that, although annual growth in overtime (Figure 33) slowed in September and October-the last two months for which information is available-, this does not necessarily foreshadow a trend break in industrial growth, for the slowdown was accompanied by recovery in temporary employment, as indicated below.

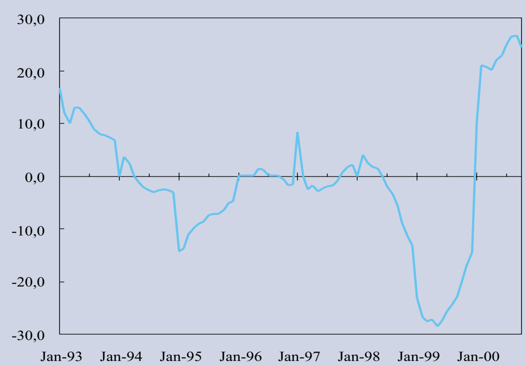
The latest findings of Fedesarrollo's Business Opinion Poll of industry and commerce, conducted in November, suggest that the economy's current rate of expansion can be expected to continue over the first months of 2001. In effect, stocks remain at historically low levels in industry, while orders are at high levels in both industry and commerce (Figures 34 and 35). Besides, industry's expectations regarding the current and medium-term status of the economy are

Figure 32
Electricity and electricity+gas consumption
(Annual % change in monthly consumption)



Sources: ISA and Ecopetrol.

Figure 33
Monthly overtime in manufacturing, To october 2000
(% Change, year to date)



Source: DANE, Monthly Manufacturing Sample.

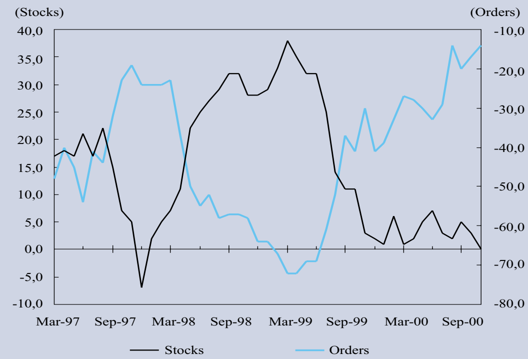
still relatively optimistic, as evidenced by the high level of the business-climate indicator (Figure 36).

For economic and other reasons, it appears unlikely today that growth in 2001 will be significantly higher than in 2000 or above the government's expected rate of 3.8%. Positive factors do continue to exist, such as low interest rates, and good growth prospects for several of our main trading partners including Venezuela and Ecuador. Yet, the persistence of other factors, such as high levels of consumer and corporate indebtedness and a high rate of unemployment, prevents greater buoyancy in consumption and investment. Moreover, for various reasons the exchange rate displays a certain degree of instability that discourages to some extent the inflow of foreign capital to finance spending. Besides, it has become evident in recent months that the economy of the United States has declined and will be growing at a slower pace in 2001 than it did in 2000; this will affect expansion of Colombia's exports, since the United States accounts for about 50.0% of the country's foreign sales. In this connection, lower oil prices will weaken public-spending capacity by reducing public-sector income, while coffee growers' spending capacity will be affected by falling coffee prices, which show no clear signs of recovering in the next few months. Lastly, uncertainty remains about the future of the peace process, curbing growth in investment spending by Colombian and foreign investors.

2. Consumption

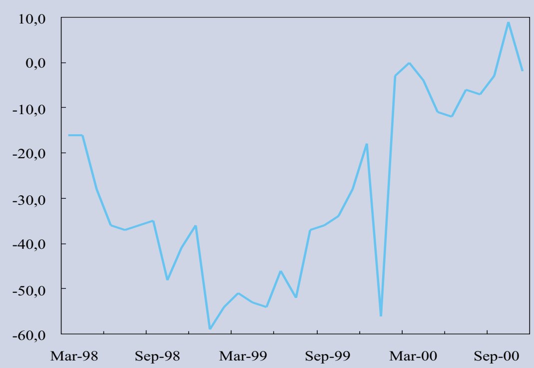
Everything seems to point to a consumption growth of about 2.5% by the end of 2000. This prediction gains support from low growth in the food and beverages industries, which is usually associated with lower consumer spending. The consumption aggregate's poor performance was

FIGURE 34
BUSINESS OPINION SURVEY
(BALANCES - TO NOVEMBER 2000)



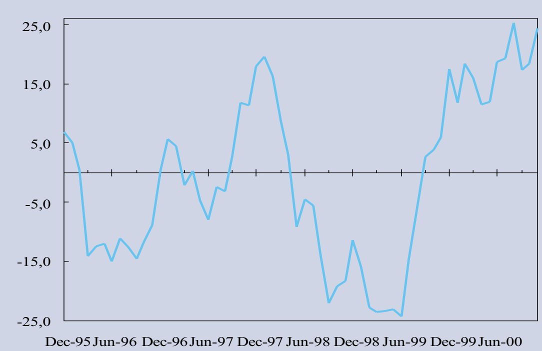
Sources: Fedesarrollo's, Business Opinion Surveys.

FIGURE 35
COMMERCIAL ORDERS
(BALANCES - TO NOVEMBER 2000)



Sources: DANE's Monthly Manufacturing Sample, and Fedesarrollo.

FIGURE 36
BUSINESS CLIMATE
(TO NOVEMBER 2000)



Sources: Banco de la República-SGEE, on figures from Fedesarrollo's Business Opinion Surveys.

caused by still high household indebtedness, high unemployment, and lower household incomes compared with previous years' income levels. As improvement in these factors tends to take time, consumption growth in 2001 is unlikely to be much stronger than in 2000.

DANE's latest figures show that consumption rose at an annual rate of 2.0% in the third quarter, more slowly than in either of the two preceding quarters (Table 8). But to judge by some leading consumption indicators, no further slowdown should have occurred in the fourth quarter. Such indicators include credit-card sales, which expanded at a nominal annual rate of 16.5% in the fourth quarter, compared with a third-quarter average of 9.0% (Figure 37). And, as mentioned in section A of this chapter, fresh consumer credit extended by financial entities continued to climb during the fourth quarter.

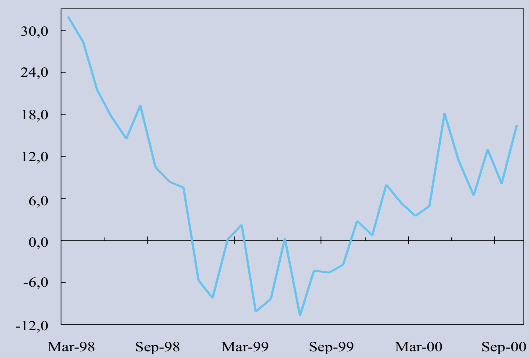
In addition to credit figures, those for consumer-goods imports to October do not point to any substantial change in the growth trends of consumer spending for December. In effect, consumer-goods imports increased in dollar value at an annual rate of 8.4% in the year to October, much as they had in the year to September (8.3%) and over the first half of the year (9.5%) (Figure 38). Nor did their growth rates vary substantially by volume (Figure 39).

3. Investment

According to DANE, investment spending surged at an annual rate of 17.1% over the third quarter, similar to the growth rate in the second quarter but higher than in the first (Table 8). Thus, this type of demand continued to recover, though remaining still at levels far below the 1995 and 1996 peaks.

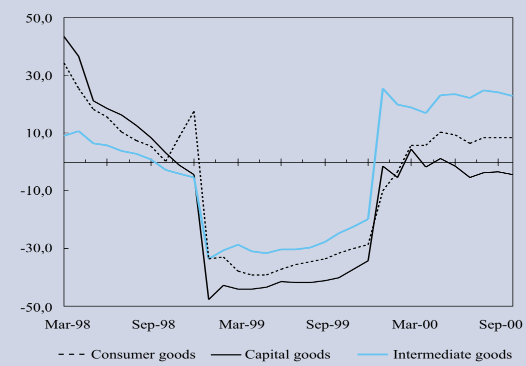
Investment is expected to have maintained its pace of growth over the fourth quarter, since

Figure 37
Credit-card sales, entire system
To October 2000
(Annual nominal % change)



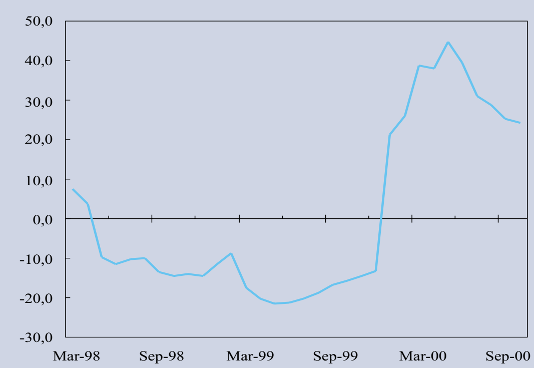
Source: Red Multicolor.

Figure 38
Imports
To October 2000
(% Change, year to date)



Source: DIAN Manifests.

Figure 39
Consumer-goods imports, by volume
To October 2000
(% Change year to date, thousands of tons)



Source: DANE, Monthly Manufacturing Sample.

Table 8
Gross domestic product
Spending distribution
(Annual percentage change)

Items	1999	2000 (p)		
		I	II	III
GDP	(4,3)	2,4	3,4	3,1
Total imports	(16,6)	7,1	7,6	9,9
Total final supply	(6,5)	3,1	4,1	4,2
Final consumption	(3,0)	2,6	2,6	2,0
Gross capital formation	(32,1)	7,6	18,5	17,1
Subtotal final domestic demand	(8,4)	3,3	4,7	4,1
Total exports	5,6	2,4	0,6	4,6
Total final demand	(6,5)	3,1	4,1	4,2

Source: DANE.

industrial output of capital goods or related items (transport equipment, electrical machinery and metallic products), accumulated in the year to October, continued to increase at rates of 15.0% or more. Similarly, the volume of capital-goods imports grew considerably faster in the second half of 2000 than in the first: at an annual rate of 20.2% in the year to October, compared with 16.3% to June (Figure 40). Lastly, imports of intermediate goods were still expanding rapidly by both volume and value in October (Figures 38 and 40).

C. Wages and employment

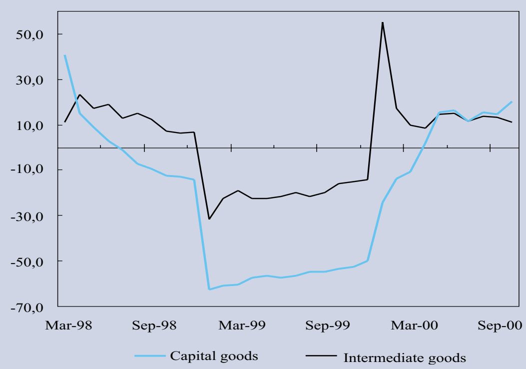
1. Industrial pay

In the 12 months to October average industrial pay for employees and wage earners rose at an annual rate of 14.1%, somewhat more slowly than in June (15.4%). Thus, nominal pay for all types of workers continued on a downward trend, consistent with lower inflation and higher unemployment rates prevailing at the time (Figure 41).

As in 1999, lower nominal pay rises in industry translated into lower real increases. In October, industry's 12-month average real pay index for wage earners and employees rose by 4.5% relative to the same month in 1999, down from 5.2% in June (Figure 42).

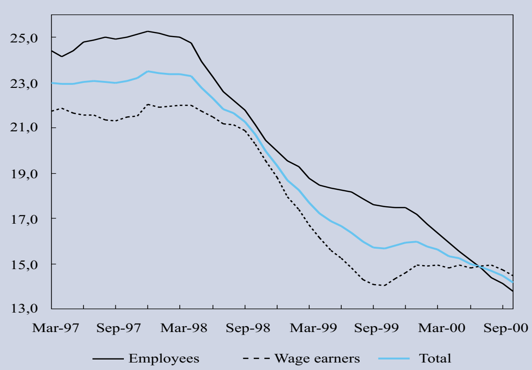
Such real pay increases may still appear high, considering current unemployment. But, on data to October, they are explained by implicit productivity gains per worker over the previous 18 months, of about 10.0% a year, on average. Thanks to rising productivity, unit labor costs fell substantially over this period, preventing any need for real pay increase to be passed on to prices. In October the unit labor cost index was at much the same level as in June (Figure 43). If real pay adjustments remain at current levels, industry is unlikely to continue maintaining low labor costs in 2001, for productivity gains have already been substantial and investment in technological renovation has been very low for several years.

Figure 40
Capital & intermediate goods imports, by volume to October 2000
(Annual % change year to date, thousands of tons)



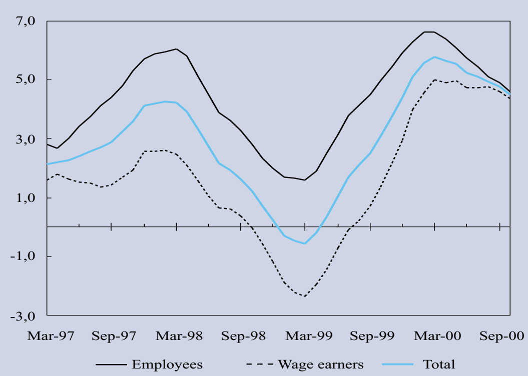
Source: DANE, Monthly Manufacturing Sample.

Figure 41
Nominal manufacturing pay To october 2000
(Annual % change, latest 12-month average)



SOURCE: DANE, Monthly Manufacturing Sample.

Figure 42
Real manufacturing pay
(Annual % change, latest 12-months average)



SOURCE: DANE, Monthly Manufacturing Sample.

2. Investment

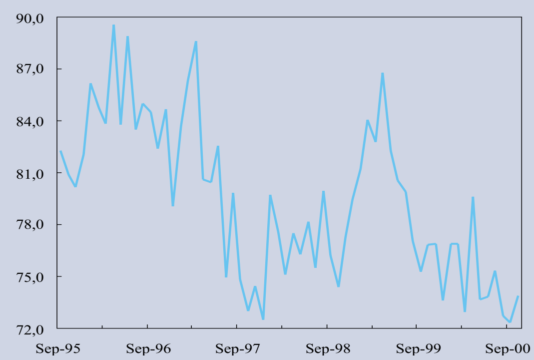
In December the unemployment rate for the country's seven major urban centers stood at 19.7%, up by 1.7 percentage points on a year earlier, but down by 0.8 points on September (Figure 44). The first three quarters of the year also saw large increases in unemployment, caused more by a sharp rise in the economically active population than by a fall in employment.

Labor supply has been expanding steadily for several years. This development is associated with a considerable decrease in family incomes that has forced traditionally inactive segments of the population (students and housewives) to look for jobs. Consequently, though employment rose over much of the year, it did not bring down the jobless rate.

It should be noted, however, that annual growth in employment was relatively low in the fourth quarter, compared with levels in the other three, and brought down the employment rate (number of people with jobs / the working-age population) for the first time in 2000. This development, combined with continual expansion of the labor supply, caused the jobless rate to be higher in the fourth quarter than in the same period the year before (Figures 45 and 46).

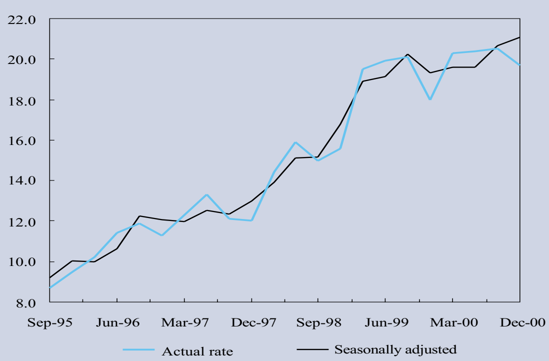
Industrial employment continued to rise exclusively in the form of temporary work. To October, the monthly temporary employment index grew at a rate of 18.8%, faster than in the first half of the year (Figure 47). Recovery in temporary employment began, in July, to raise industry's overall employment index, for the first time in several years, and did so despite continual shrinkage in permanent employment.

Figure 43
Real unit labor cost index, industrial wage earners
(To october 2000)



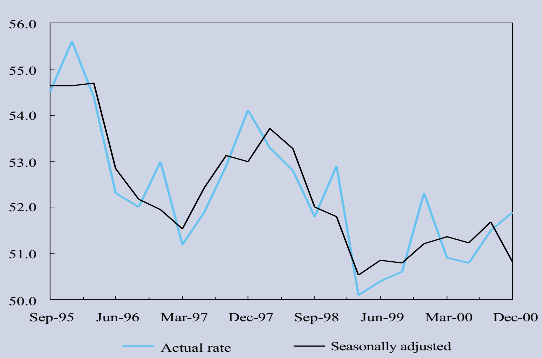
SOURCE: DANE, Monthly Manufacturing Sample.

Figure 44
Unemployment rate, seven cities
To december 2000
(Percentage)



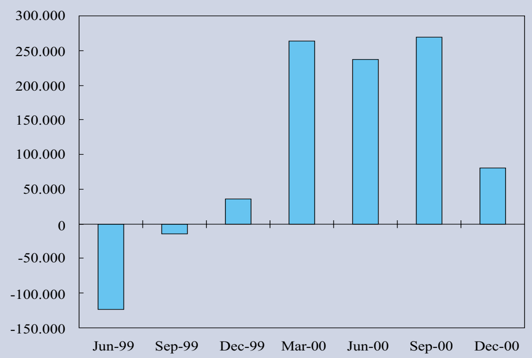
Source: DANE, National Household Surveys.

Figure 45
Employment rate, seven cities
To december 2000
(Percentage)



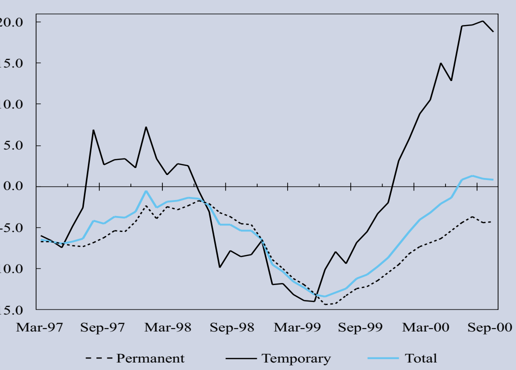
Source: DANE, National Household Surveys.

Figure 46
Annual change in employment, seven major cities



Source: DANE, National Household Surveys.

Figure 47
Monthly industrial employment index
To october 2000
(Annual percentage change)



Source: DANE, National Household Surveys.

3. Pay settlements

Tables 9 and 10 present figures on one-year and two-year pay rises established in collective bargaining agreements reported to the Ministry of Labor and Social Security. Table 9 shows the percentages of agreements negotiated in the public and private sectors, by range of pay rise. Most public-sector pay settlements (67.2%) were in the range of 8.0% to 11.0%, with another 22.4% in the range of 11.0% to 14.0%. In contrast, negotiated pay agreements in the private sector were more equally divided between these

TABLE 9
COLLECTIVE BARGAINING AGREEMENTS,
BY PAY RISE AND BY SECTOR
(PERCENTAGE)

Sector	Pay increase					Total
	Up to 5.0%	5,01-8,0	8,01-11,0	11,01-14,0	Over 14.0	
Públic	6,0	3,0	67,2	22,4	1,5	100,0
Private	2,6	3,3	49,9	42,2	2,1	100,0
Total	2,9	3,2	51,7	40,1	2,0	100,0

Source: Ministry of Labor and Social Security.

TABLE 10
COLLECTIVE BARGAINING AGREEMENTS
BY PAY RISE AND BY TYPE OF NEGOTIATION
(PERCENTAGE)

Negotiaion Type	Pay increase					Total
	Up to 5.0%	5,01-8,0	8,01-11,0	11,01-14,0	Over 14.0%	
Non-union	5,2	2,6	75,8	13,7	2,6	100,0
Union						
Company	5,4	4,6	70,8	17,7	1,5	100,0
Industry	1,1	3,1	33,6	60,2	2,0	100,0
Professional, craft	0,0	0,0	87,5	12,5	0,0	100,0
Total	2,9	3,2	51,7	40,1	2,0	100,0

Source: Ministry of Labor and Social Security.

two ranges, with 49.9% in the 8- 11% range and 42.2% in the 11-14% range. Table 10 shows the percentages of pay increases by type of union membership. Where no unions were involved, 75.8% of the agreements established 8-11% pay rises. Where company unions were involved, 70.8% of pay settlements were in the 8-11% range, with another 17.7% in the 11-14% range. Collective bargaining with industrial unions, however, established 11-14% pay rises in most agreements (60.2%), and 8-11% rises in 33% of the agreements. In contrast to the latter, the great majority of pay settlements reached with professional and craft unions were in the 8-11% range.

D. CAPACITY UTILIZATION

Fedesarrollo's capacity-utilization indicator maintained its slow recovery over the second half of 2000. In November it was 71.5%, higher than a year earlier and higher than in September. It was also slightly above its historical average (71.5%) for the first time since the end of 1997. In October, ANDI's indicator was higher than a year earlier but showed little change relative to the third quarter. At 76.1%--the latest figure available-, it too was running above the historical average (74.8%) of the series (Figure 48).

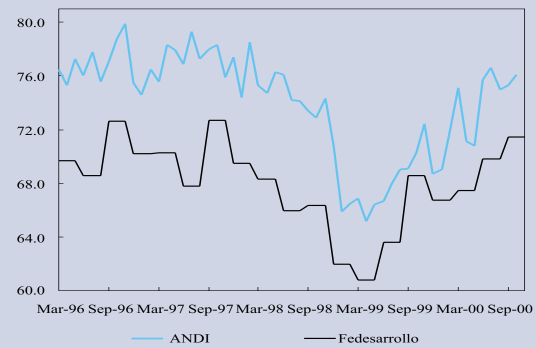
On figures to October, output in such sectors as manufacturing was still very low relative to record peaks reached in 1998. Hence, the economy still has a considerable production potential before growth translates into strong inflationary pressure (Figure 49). It should not be ignored however that sharply falling investment over several years must have depressed installed capacity. This is perhaps borne out by the fact that utilization capacity had risen above historical averages by the end of 2000.

E. The fiscal situation

The country's Financial Plan for 2000, last revised on data to September, forecasts a yearend consolidated public-sector deficit of 6,268 billion pesos, equivalent to 3.6% of GDP. As shown in Table 11, this resulted from the combined effect of the fiscal balances of the nonfinancial public sector and Fogafín and the Banco de la República's quasifiscal balance, plus financial restructuring costs. The consolidated public-sector deficit is lower than in 1999 by about 1.8% of GDP, thanks to improvement in the central government's and the decentralized sector's finances, resulting from rising world oil prices throughout the year. Relative to the deficit target OF 6,480 billion pesos set with the IMF, over-fulfillment is estimated at more than 200 billion pesos.

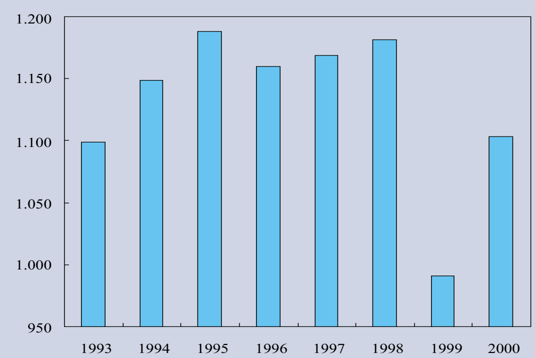
The overall deficit in the central government's finances is reckoned by the Fiscal Policy Council (CONFIS) to have been 10,297 billion pesos in 2000, representing 6.0% of annual GDP (Table 12). This is less than the deficit for 1999 by 1.8% of GDP, largely because of an increase of about 20.0% in income during the year. Among income items, tax revenues are the most dynamic, thanks to reactivation of the economy and efforts by the Tax and Customs Administration (DIAN) to curb tax evasion and elusion. Revenues from income tax and domestic VAT will have increased by 17.8% and import-tax receipts by 25.5%. Similarly, income from the gasoline tax and the

Figure 48
Capacity utilization
(To november 2000)



Sources: ANDI and Fedesarrollo.

Figure 49
Real manufacturing production index, accumulated first 10 months of year



Source: DANE, Monthly Manufacturing Sample.

financial-transaction levy will have risen by 17.8% and 13.5% respectively. In contrast, non-tax revenues will have expanded by only 9.8%, particularly because of smaller transfers of financial surpluses from public-sector companies and entities.

As regards expenditures, interest payments on debt will have grown by 34.7%, operating costs by 9.6%, and investment outlays by 21.9%. The slow growth in operating costs is associated with an increase of only 6% in transfer payments relative to 1999, this low increase resulting from a 6.0% drop in constitutionally mandated transfers to departments and districts (situado fiscal) and a rise of barely 2.6% in such transfers to municipalities.

The expansion in investment outlays is largely connected with funds allocated to reconstruction of the earthquake-ravaged coffee-growing region, which amounted to 325 billion pesos in 1999 and 467 billion in 2000. Net loans will have climbed to 884 billion pesos, including notably 285 billion pesos to Carbocol, 179 billion to Metro de Medellín, and 164 billion to the Urrá power project.

Funding for the government's deficit came mostly from foreign and domestic loans, net drawdowns amounting to 4,462 and 5,758 billion pesos respectively. Gross foreign borrowing rose to 6,152 billion pesos, of which 3.782 billion came from bond issues and 2,370 billion from disbursements by multilateral banks and other sources. Gross domestic borrowing totalled 11,609 billion pesos, of which 10,964 billion came from sales of Treasury paper and 645 billion from other sources, including subscriptions of Debt Reducing Certificates and Peace Bonds. Lastly, it should be noted that the transfer of profits from operations of the Banco de la República amounted to 516 billion pesos and the proceeds from the sale of Carbocol to 749 billion.

TABLE 11
CONSOLIDATED PUBLIC-SECTOR FISCAL BALANCE (*)

	Billions of pesos			Percentage of GDP		
	1999	2000	Difference	1999	2000	Difference
I. Nonfinancial public sector	(9.345)	(6.225)	(3.120)	(6,14)	(3,60)	(2,55)
II. Banco de la República's quasifiscal balance	608	660	(52)	0,40	0,38	0,02
III. Fogafin balance	828	(9)	837	0,54	(0,01)	0,55
IV. Financial restructuring costs	(10)	(694)	684	(0,01)	(0,40)	0,39
V. Adjustments	(352)	0	(352)	(0,23)	0,00	(0,23)
VI. Consolidated public-sector deficit or surplus (I+II+III+IV+V)	(8.271)	(6.268)	(2.003)	(5,44)	(3,62)	(1,81)

(*) For 2000, actual figures up to September, projections for the fourth quarter
Source: Fiscal Policy Council (CONFIS).

Table 12
Central government 1/
(Billions of peso)

	January-June		% Change
	1999	2000	2000 / 1999
I. Total income (A+B)	18.760,0	22.416,0	19,5
A. Tax revenues	16.067,0	19.459,0	21,1
Income tax & internal VAT	10.856,0	12.790,0	17,8
Customs & external VAT	3.229,0	4.051,0	25,5
Financial-transactions levy	881,0	1.000,0	13,5
Gasoline	707,0	833,0	17,8
Other	394,0	785,0	99,2
B. Nontax and other revenues	2.693,0	2.957,0	9,8
II. Total expenditures (A+B+C+D) 2/	29.488,0	33.696,0	14,3
A. Interest payments	5.026,0	6.770,0	34,7
B. Operating costs	21.255,0	23.294,0	9,6
C. Investment outlays	2.255,0	2.748,0	21,9
D. Net loans	952,0	884,0	(7,1)
III. Cash deficit or surplus (I-II)	(10.728,0)	(11.280,0)	5,1
IV. Adjustments	(1.094,0)	983,0	(189,9)
V. Total deficit or surplus (III+IV)	(11.822,0)	(10.297,0)	(12,9)
VI. Financing (A+B+C)	11.822,0	10.297,0	(12,9)
A. Net external credit	3.245,0	4.462,0	37,5
B. Net domestic credit	5.713,0	5.758,0	0,8
C. Privatizations and other	2.864,0	77,0	(97,3)
VII. Deficit as percentage of GDP	(7,8)	(6,0)	

1/ For 2000, actual figures up to September, projections for the fourth quarter.
2/ Does not include financial restructuring costs.
Source: CONFIS.

Colombia's monetary conditions index

In recent years a number of central banks interested in obtaining a better understanding of the transmission mechanism of monetary policy have proposed a univariate measure of the effects of the real interest rate and the real exchange rate on economic activity and inflation. In economic literature this measure is known as the Monetary Conditions Index (MCI). A similar measure constructed for Colombia[1] gives an idea of how loose or tight monetary policy is relative to a base period. A brief description follows of the construction, interpretation and weaknesses of this index, one of a broad range of economic and financial indicators taken into consideration by the Board of Directors of the Banco de la República.

Colombia's MCI in real terms is built on the estimation of a standard economic model made up of two basic equations. The first equation is a Phillips curve of the following form:

(1) $$\pi_t = \alpha_\pi^1 \pi_{t-1} + \alpha_\pi^2 \pi_{t-3} + \alpha_\pi^3 \pi_{t-6} + \alpha_z z_t + \alpha_q q_{t-2} + e_t$$

where π_t is quarterly inflation in period t; q_t is the variation of the logaritm of the real exchange rate, defined as the price of imports over the price of nontradables[2], and the variable e_t corresponds to the perturbance term and represents supply shocks on inflation in period t. The coefficients α_π^1, α_π^2, α_π^3, α_z and α_q are positive, and the sum of the lagged inflation coefficients is restricted to one $\left(\alpha_\pi^1 + \alpha_\pi^2 + \alpha_\pi^3 = 1\right)$ to ensure that the Phillips Curve is vertical in the long term. This means that changes in monetary policy do not affect the level of real variables in the long term and that, in the absence of shocks, inflation tends to perpetuate itself at the same level[3].

The second equation corresponds to the aggregate demand, measured in terms of real output gap. The function that is estimated is as follows:

(2) $$z_t = \beta_z^1 z_{t-1} + \beta_z^2 z_{t-3} + \beta_r r_{t-2} + \beta_q q_t + v_t$$

where z_t represents the output gap, measured in percentage points and defined as the deviation between the real-output log and the potential-output log; r_t is the real interest rate in the economy, measured as the difference between the short-term nominal interest rate (90-day deposit rate) and the expected inflation rate; and v_t is the perturbance term that captures demand shocks in period t The coefficients β_z^1, β_z^2 y β_q are positive, and the coefficient β_r is negative, in accordance with economic theory.

From the coefficients estimated for equations (1) and (2), weights are obtained for building two Monetary Conditions Indices, one for aggregate demand $\left(ICM_t^z\right)$ and the other for inflation $\left(ICM_t^\pi\right)$.

$\left(ICM_t^z\right)$ has been defined as:

$$ICM_t^z = \hat{\beta}_r(r_{t-2} - r_{0-2}) + \hat{\beta}_q(q_t - q_0)$$

where β_q and β_r are the weights of the exchange rate and interest rate respectively. The Index combines the effect of change in the interest rate with a lag of two periods, and the relative effect of change in the real exchange rate with respect to a base period, given the resulting specification of the estimation of aggregate demand for Colombia. Normalizing $\left(ICM_t^z\right)$ in terms of changes in the real interest rate, we can determine the relative size of the effects of each channel on the output gap. Formally

$$ICM_t^z = (r_{t-2} - r_{0-2}) + \frac{\hat{\beta}_q}{\hat{\beta}_r}(q_t - q_0)$$

According to the estimated coefficients, interest-rate effects and exchange-rate effects on aggregate demand are in a ratio of 1 to 4. More specifically, in a semi-open economy like Colombia's, a one-percentage-point change in the real interest rate would have the same effect on real aggregate demand as a four-percentage-point change in the real devaluation rate. The measure thus establishes the relative importance of the two channels of monetary-policy transmission (interest rate and exchange rate) in economic activity.

In the same way, with the coefficients obtained from estimation of the Phillips Curve, α_q and α_z, of the exchange rate and output gap respectively, we can construct the MCI of inflation $\left(ICM_t^\pi\right)$. This is defined as the weighted sum of variation in the exchange rate relative to a base year, plus a measure of the impact of monetary policy on aggregate demand:

$$ICM_t^\pi = \hat{\alpha}_q(q_{t-2} - q_{0-2}) + \hat{\alpha}_z\left((r_{t-2} - r_{0-2}) + \frac{\hat{\beta}_q}{\hat{\beta}_r}(q_t - q_0)\right)$$

Given the specification of the Phillips Curve equation for Colombia, $\left(ICM_t^\pi\right)$ combines the direct effect, on price formation, of variation in the exchange rate with a lag of two periods relative to a base year, (α_q) and the effect of the output gap, (α_z), grouping the indirect effect, on inflation, of change in the real interest rate with a lag of two periods and of variation in the real exchange rate relative to a base year, obtained from the aggregate-demand curve. From the inflation MCI, it is established that a six-percentage-point revaluation has the same effect on inflation reduction as a one-percentage-point rise in the real interest rate, and vice versa.

The base period chosen for constructing both indicators is the fourth quarter of 1994, when monetary policy was tightened after almost two year of very low, and at times negative, real interest rates. If either of the Monetary Policy Indicators stands above the base period, monetary conditions are considered to be contractionary for inflation or aggregate demand, relative to the base period. Below the base period, they indicate easier monetary conditions than at the end of 1994.

As a measure of the impact of monetary policy on aggregate demand and inflation, the MCI is a useful tool for understanding the transmission mechanism of monetary policy in Colombia. By considering interest-rate and exchange-rate effects, the MCI makes it possible to assess how monetary policy should be conducted to meet the inflation target, in accordance with the MCI's capacity to compare existing monetary conditions with a base period. Nevertheless, like any measurement of the magnitude of monetary-policy impact on inflation, the MCI should be interpreted cautiously, given the uncertainty of measures used to evaluate the economy, and the uncertainty of the relationship between changes in the MCI and those produced in aggregate demand or inflation. It is also important to bear in mind that choosing the fourth quarter of 1994 as the base period was to some extent arbitrary.

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[1] In this connection, see Rocío Mora "El índice de condiciones monetarias en Colombia", *Borradores de Economía*, No. 158, Banco de la República, 2000.

[2] Lars Svensson, *Open Economy Inflation Targeting*, National Bureau of Economic Research, Working Paper Series 6545, Cambridge, May 1998, p. 17.

[3] Javier Gómez and Juan M. Julio, *Output Gap Estimation, Uncertainty Estimation and Their Effect on Policy Rules*, Working Paper, SGEE, Banco de la República, November 1999, p. 24.

III

Measures of expectations

The main findings of the Expectations Survey carried out in October are presented below. Respondents were provided with information on the exchange rate, inflation, interest rates, monetary situation and GDP growth available to the third quarter of 2000.

A. Main findings

1. Inflation

The survey's first question concerned the credibility of the 10.0% inflation target for 2000. In the April survey 33.3% of respondents believed that the target would be met; the figure went up to 44.0% in July, and by October it had soared to 80.3% (Figure 50). So, the target became more credible over 2000, most probably particulary in the last months of the year thanks to good inflation behavior.

Figure 50
Credibility of inflation target for 2000

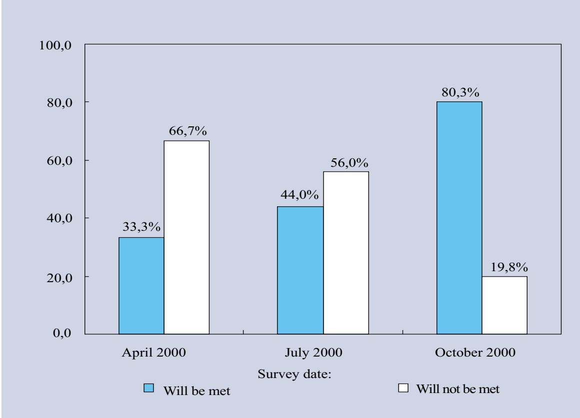
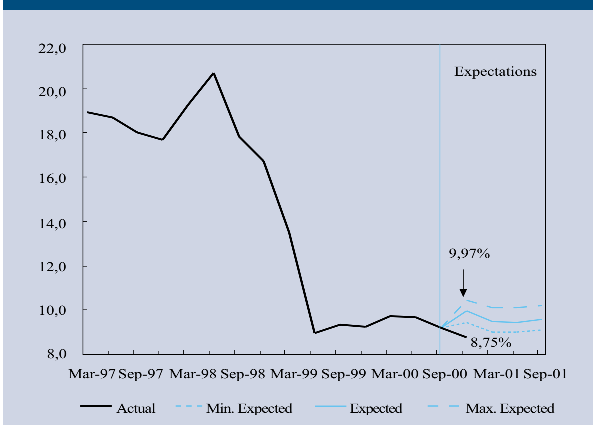


Figure 51
Actual inflation and Oct/2000 expectations
(For 3, 6, 9 and 12 months later)
(Annual rate)



Respondents in the October survey expected, on average, a 10.0% annual inflation by December, the maximum expected rate being 10.4% and the minimum 9.4%. In fact, at 8.75%, actual inflation in December 2000 was even below the minimum expected (Figure 51). For the first quarter of 2001, respondents saw inflation running between 9.5% and 9.6%. As can be observed from Figure 52, inflation expectations for December 2000 were revised down in October, as they had been since early 2000, the April survey's 11.3% expected rate having been reduced to 10.7% in July. Figure 52 also shows downward revisions in inflation rates expected for 6 and 12 months later. The explanation once again lies in satisfactory inflation results obtained over the year.

October's inflation expectations are broken down in Figure 53 between those who believed the 2000 target would be reached and those who did not. Unbelievers expected a 10.5% inflation, while believers thought the rate would be 9.8%. These expectations are respectively 0.5 and 0.2 percentage points lower than in the July survey. It is pertinent to point out again that at the end of 2000 actual inflation was running below even the most optimistic expectations.

FIGURE 52
ACTUAL INFLATION AND
APR. JUL. OCT.2000 EXPECTATIONS
(FOR 3, 6, 9 AND 12 MONTHS LATER)
(ANNUAL RATE)

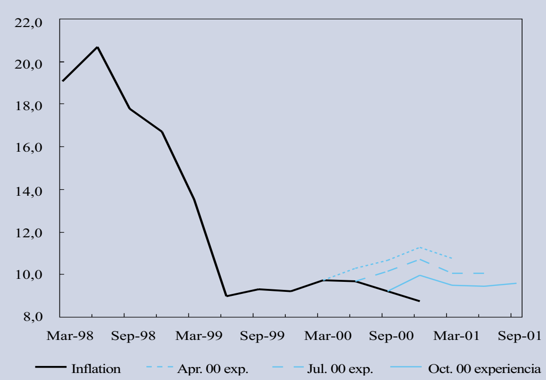
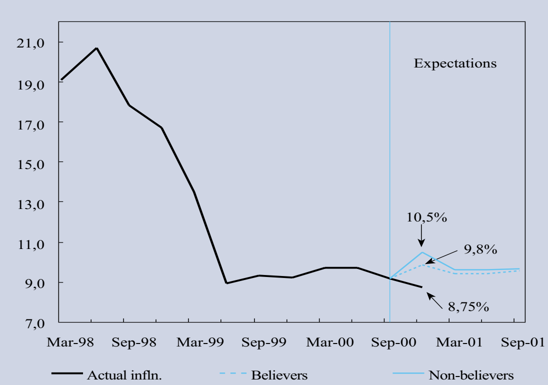


FIGURE 53
BREAKDOWN OF INFLATIONARY EXPECTATIONS BY BELIEVERS
AND NON-BELIEVERS IN TARGET'S ATTAINMENT



2. Wage rises

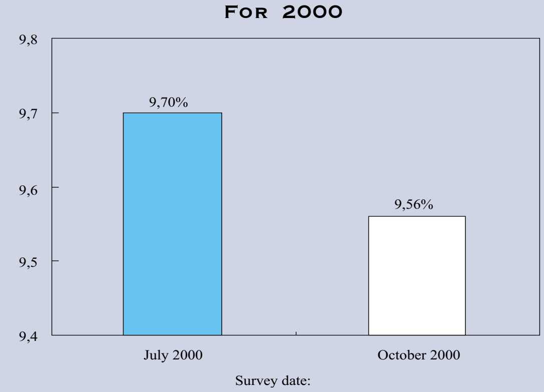
Figures 54 A and B present expected pay rises for 2000 and 2001, as reported in the last two expectations surveys. In October the wage rise for 2000 was expected to be 9.6%, or 0.4 percentage points below the year's inflation target. In contrast, the 9.6% average wage increase expected for 2001 would be 1.4 percentage points higher than the 8.0% inflation target for 2001 set by the Banco de la República.

3. Perceptions of liquidity and credit availability

In October the level of liquidity in the economy was considered high by 50.6% of respondents, and low by 35.8%. As can be appreciated from

FIGURE 54
EXPECTED WAGE INCREASES
(PERCENTAGE)

(A)
FOR 2000



(B)
FOR 2001

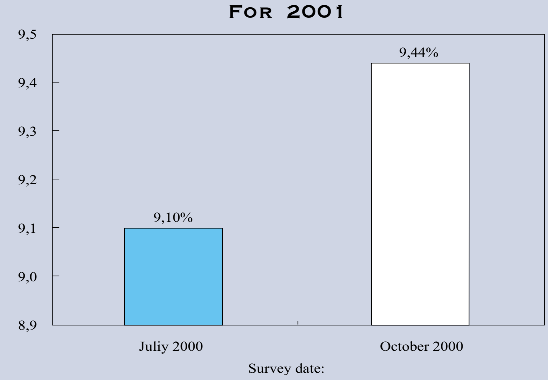


Figure 55 A, these proportions did not differ much from those of the first- and second-quarter surveys. As regards liquidity in six months' time, 50.0% of those polled expected it to remain unchanged from its October level, while 23.0% thought it would fall, and 27.0% saw it as rising (Figure 55 B).

With regard to credit availability, the percentage of respondents considering it low increased over the year, from 48.0% in April to 62.0% in July and to 65.4% in October (Figure 56 A).
Credit availability in six months' time was expected by 50.0% of respondents to remain as it was in October, while 27.0% saw it as rising and 23.0% thought it would fall (Figure 56 B).

4. Interest and exchange rates

In October respondents continued to expect interest rates to rise only very little during the following 12 months. They predicted an average DTF (deposit) rate of 13.4% for December 2000, very similar to the averages predicted in April and July, and much the same as the actual yearend rate of 13.3% (Figure 57). The DTF was expected to stand at 14.0% in 12 month's time.

In October the exchange rate expected by the end of the year was, on average, 2,204 pesos to the dollar, involving an annual nominal devaluation of about 17.6%. The actual rate in December was 2,229 pesos, not very different from October's expected rate (Figure 58). Exchange-rate expectations in October did not

FIGURE 55

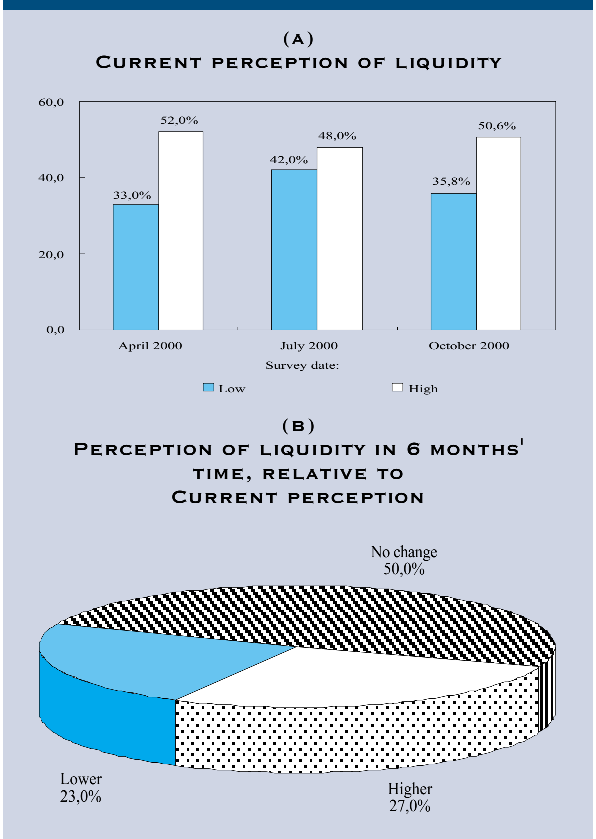


FIGURE 56

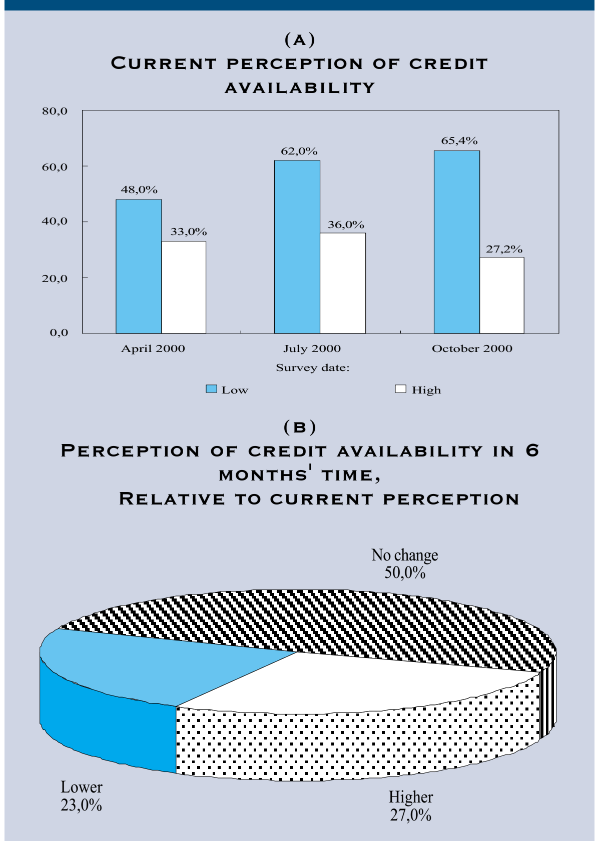


Figure 57
Actual deposit rate (DTF), and Oct/2000 expectations
(For 3, 6, 9 and 12 months later)
(Annual effective rate)

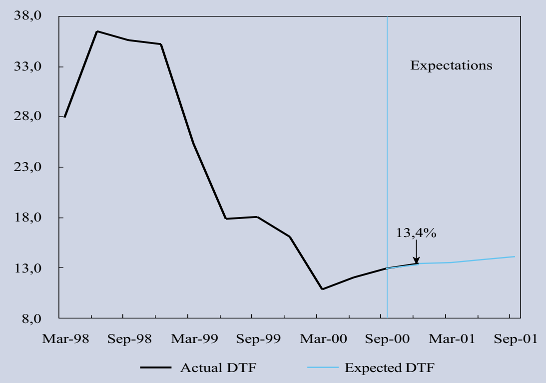


Figure 58
Nominal exchange rate, actual and Oct/2000 expectations
(For 3 , 6, 9 and 12 months later)
(Pesos to the dollar)

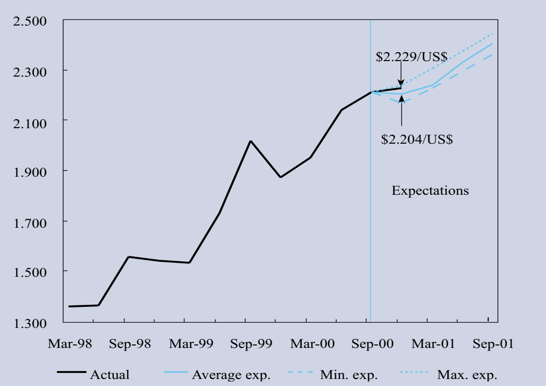
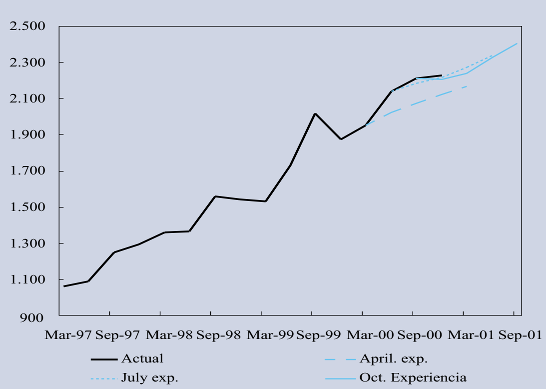


Figure 59
Nominal exchange rate, actual and Apr. Jul. Oct.2000 expectations
(Pesos to the dollar)



differ significantly from predictions in July, at least for the long term. They did differ however about the dollar's trend to December 2000, for whereas the July survey expected a pick-up in this variable, the October survey saw the rate as remaining at around 2,200 pesos to the dollar (Figure 59).

5. Growth and employment

Expectations of economic growth, too, continued to become more optimistic over the year. Thus, whereas expected growth for 2000 averaged 1.3% in April and 2.4% in July, the average expected rate in October was 2.6%, with a minimum of 2.1% and a maximum of 3.0%. In October, growth expectations for 2001 averaged 3.2% (in a range of 2.7% to 3.7%), unchanged from average expectations in July but higher than the rate expected in April (Figures 60 A and B).

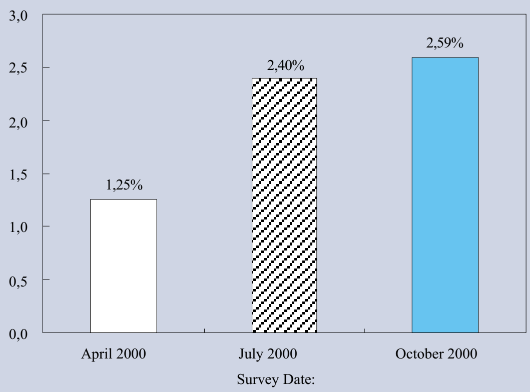
There continued to be little optimism about future workforce expansions, as reported in the October survey. Some 54.3% of the sample responded that the number of employees in their companies would remain unchanged in the first half of 2001, while 25.9% thought it would drop, and only 14.8% said it would increase. Nor were the figures for a somewhat longer horizon (June-September 2001) any more optimistic, with 64.2% answering that the workforce would remain unchanged, 17.2% that it would decrease, and 13.6% that it would expand (Figure 61).

B. Forecasts by investment banks and risk-rating firms

At the end of 2000 and beginning of 2001 a number of local economic analysts and foreign investment banks published their forecasts of Colombia's main macroeconomic variables for

Figure 60
Expected GDP growth rate

(A)
For 2000



(B)
For 2001

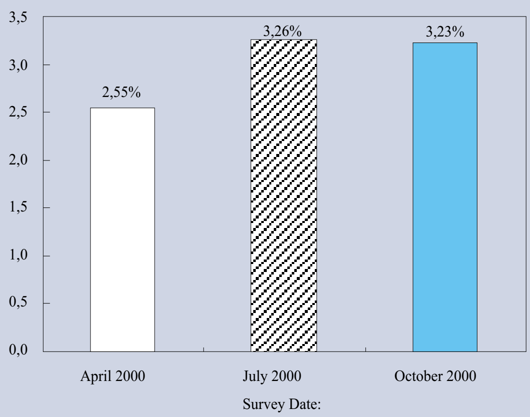
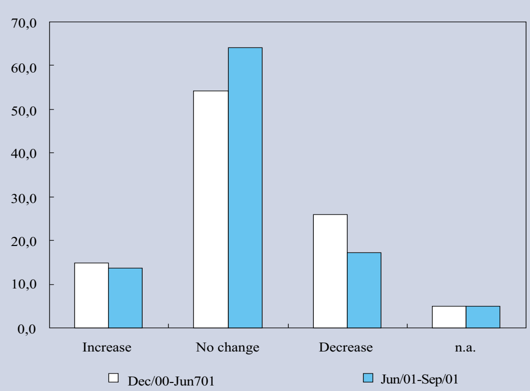


Figure 61
Corporate workforce plans for different time horizons
(Percentage)



2001. These forecasts are presented in Table 13 and summarized in the following paragraphs.

Growth rates expected by local analysts average 2.9%, less than the government's 3.8% target set in the macroeconomic plan, and less than the 3.7% growth expected, on average, by foreign analysts.

Inflation forecasts for 2001 by local and predictions by foreign analysts average to much the same rate, the local average being 9.8% and the foreign one 9.9%. Both rates are almost two percentage points higher than the Banco de la República's inflation target of 8.0% for 2001.

Local analysts expect an exchange rate of 2,381 pesos to the dollar by the end of 2001, compared with 2,358 pesos predicted by foreign analysts. It is important to point out that some exchange-rate forecasts were made in early December and assumed a lower exchange rate for the end of the month than turned out to be case. For hardly any of the analysts foresaw the pick-up that occurred in the exchange rate towards the end of 2000.

Local and foreign observers alike expect further rises in the DTF deposit rate during 2001, up to around 15.5%.

On average, the fiscal deficit for 2001 is forecast to be 3.1% of GDP by local analysts, and 2.9% by foreigners. Both forecasts are higher than the 2.5% fiscal deficit envisaged in the adjustment program drawn up with the IMF.

Foreign analysts reckon that the current-account deficit this year will be 2.1% of GDP, whereas local observers predict that it will be only 1.5%. Both forecasts are lower than 3.1% current-account deficit envisaged in the macroeconomic program.

Though very few analysts have made projections about unemployment, those who did so think it is very unlikely to be lower than 18.0% in 2001.

Table 13
Forecasts of main macroeconomic variables for 2001

	Forecast date	Real GDP growth %	CPI inflation %	Nominal exchange (yearend)	Nominal deposit rate %	Déficit (% of GDP): Fiscal	Curr. acct.	Unemploy-ment %
Colombian analysts								
Revista Dinero **1/**	7-dic-00	2,5	10,0	2.500	16,5	3,5		18,5
Javier Fernández Riva **2/**	22-nov-00	2,8	9,7	2.334	14,5		1,0 **3/**	19,1
Suvalor-Corfinsura **4/**	nov-00	3,6	9,4	2.370	15,8	2,5		
ANIF **5/**	27-oct-00	2,5	9,0	2.359	16,0	3,4	1,9	19,0
Fedesarrollo **6/**	ene-01	3,0	11,0	2.345	16,0			> 17,0
Average		**2,9**	**9,8**	**2.381**	**0,0**	**3,1**	**1,5**	**18,9**
Foreign analysts								
Latinwatch BBVA **7/**	nov-00	3,8	9,8	2.350	15,9	2,5	3,4	
WEFA **8/**	dic-00	4,0	8,3			4,0	1,6	18,0
Goldman Sachs **9/**	15-dic-01	4,0	8,0	2.300 **10/**	16,5	3,0	0,9	
IDEA global **9/**	15-dic-01	3,8	8,7	2.300		2,3	1,4	
ABN Amro Bank **11/**	29-nov-00	3,5	10,0	2.475		3,0	2,1	
Salomón Smith Barney **12/**	11-dic-01	3,5	10,0	2.430		3,0	1,0	
Deutsche Bank **13/**	12-ene-01	2,6	8,2	2.383		2,8	3,0	
Morgan Stanley **14/**	17-nov-00	4,8	15,0	2.268	14,0			
Merrill Lynch **9/**	15-dic-01	3,5	11,0			2,5	3,0	
Average		**3,7**	**9,9**	**2.358**	**15,5**	**2,9**	**2,1**	

1/ Revista Dinero, Dec.7, 2000, No. 123.
2/ Seminar on Economic and Financial Outlook.
3/ Obtained from level figures.
4/ Document dated November 2000.
5/ ANIF-Fedesarrollo Seminar on October 27, 2000.
6/ "Outlook for 2001".
7/ Document dated November 2000.
8/ *Latin America Monthly Monitor*, November 2000.
9/ *¿Cómo nos ven afuera?* Report by the Banco de la República's Monetary and Reserve Department (SMR), December 15, 2000.
10/ Projection to December 15, 2001.
11/ *¿Cómo nos ven afuera?* Report, SMR, November 29, 2000.
12/ *Ibid*., December 11, 2000.
13/ Ibid., January 12, 2001.
14/ *Ibid*., November 17, 2000.

IV

International context

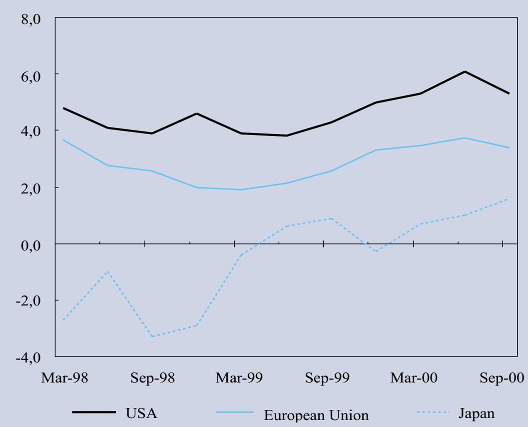
A. General aspects

Though the outlook for global economic activity continued to be good over the fourth quarter of 2000, clear signs began to appear of slower growth. The world economy is presently expected to grow less rapidly in 2001, mainly because of slowing growth of industrialized economies, but the likelihood of a strong recession is still minimal.

Global economic activity grew by about 4.7% in 2000, its biggest expansion in four years (Figure 62). Although overall inflation increased in most regions of the world because of rising oil prices, core inflation barely reflected the oil rise. Monetary policy was tight in 2000. The United States Federal Reserve Board raised its interest rate three times in the first half of the year, seeking to prevent mounting inflationary pressure from higher costs and wages.

The European Union, in an effort to avoid an upturn in inflation and greater depreciation of the euro, raised its interest rate (by six increments, from 3.0% in January to 4.75% in October) and intervened several times in the foreign-currency market. And, in August, Japan did away with its famous zero-interest policy, by raising the rate to 0.25%.

Figure 62
Annual growth rates of
Japan, USA and European Union
1998:3 - 2000:9



Source: Bloomberg.

1. United States

The US economy appears to have gone into a stage of slower growth in recent months. Although it is expected to have ended 2000 with an annual growth of around 5.0%, its expansion in 2001 is projected at no higher than 2.9%. Clear signs of a slowdown began to be discerned in the third quarter. By then the US economy's annualized quarterly growth rate was barely 2.2%, the lowest in four years. Moreover the Fed[10], in its December 6th report, laid stress

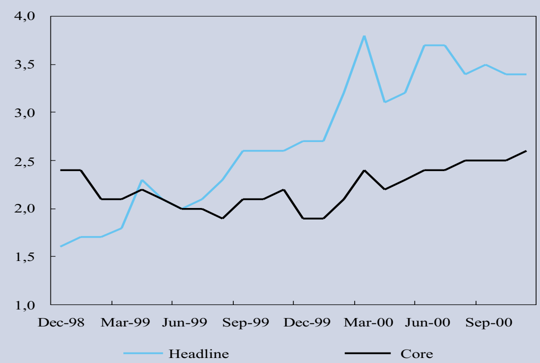
[10] Contained in the Beige Book, a Fed publication summarizing the US economy's behavior on the basis of economic information from its 12 districts: Boston, New York, Philadelphia, Cleveland, Richmond, Atlanta, Chicago, St. Louis, Minneapolis, Kansas City, Dallas and San Francisco.

on symptoms of cooling in economic activity: weakening car sales; slower economic growth in eight Fed districts, and moderate expansion in the other four; a slowdown in manufacturing in most districts, with orders decreasing more rapidly than expected in October (from 1.1% in September to -3.3% in October); and, last, a decline in investment spending. Moreover, although with unemployment at 4.0% the labor market continues to be tight in most parts of the country, the latest employment report brings signs of a loosening. In effect, unemployment claims have increased and job creation has declined, which too suggests that the economy has started to slow down.

The consumer price index went up by 0.2% in November, the same rate as in October but less than in September (0.5%). At the same time, November's core inflation rate (overall inflation excluding the more volatile foodstuffs and the price of energy) was 0.3%, marginally up on October's 0.2% but the same as in September (Figure 63). The evidence suggests that inflation is under control, yet there is a persisting fear that it might rebound as a result of oil-price behavior, rising wages, and the mounting costs of other factors of production.

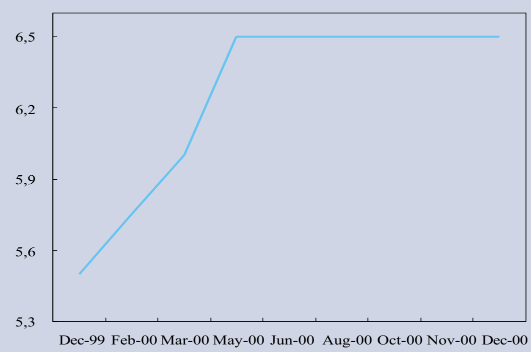
Though many analysts and a large part of the market anticipated an interest-rate cut by the Fed before the end of the year, no cut was made and the Fed decided at its last meeting of the year, on December 19th, to leave the rate unchanged at 6.5% (Figure 64). But the Federal Reserve did display at the time a change of stance on inflation and growth, by placing greater emphasis on recessionary trends in the economy than on a possible pick-up in inflation. Partly on the basis of this smaller inflationary bias shown by the Fed, economic analysts expect a rate cut of

FIGURE 63
UNITED STATES
HEADLINE AND CORE INFLATION RATES
1998:12 - 2000:11



Source: Bloomberg.

FIGURE 64
US FEDERAL-FUNDS INTEREST RATE



Source: Bloomberg.

some 50 basis points for the first quarter of 2001, which would set off a joint and coordinated softening of world monetary policy.

2. European Union

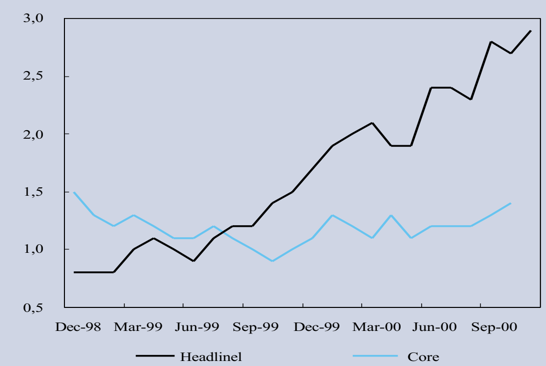
The eleven countries of the European Union registered an annual GDP growths of 3.7% in the second quarter of 2000 and 3.4% in the third. The third-quarter decline in GDP growth resulted largely from a fall in household spending, such spending having been a major factor of expansion in the region since early

1998. In contrast, investment spending remained strong in past months. In Europe, as in the US, the economy has already begun to show signs of cooling. Both consumer and business confidence declined in November, from a perception among households and companies of worsening economic conditions, although consumer confidence still remained at historically high levels. These lower expectations of economic growth were confirmed by slower expansion in industrial output, the annual rate falling from 6.5% in August to 5.6% in September. Similarly, household credit has started to grow more slowly, while car sales have dropped far below their historical average level.

Moreover, economic growth in the Union is being affected by a series of factors and risks that may make it difficult to manage the region's macroeconomic situation. As stated earlier, the European Central Bank (ECB) strongly tightened monetary policy during 2000, and the repercussions of this tightening on the real sector of the economy are beginning to show. Climbing oil prices have reduced the real income of households, with a consequent decline in household consumption. Lastly, inflation presents a latent risk, its recent rise largely reflecting the euro's depreciation against the US dollar and the surge in oil prices on international markets. Inflation in September, October and November stood at 2.8%, 2.7% and 2.9% respectively, far above the 2.0% target set by the ECB at the beginning of the year (Figure 65).

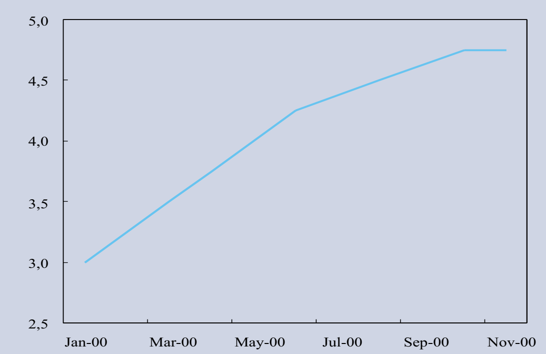
It is clear from the foregoing that the ECB faces a dilemma between economic growth and price stability. But the expected slowdown in economic growth, in a context of predicted lower oil prices in 2001 and greater stability in the euro, would be of greater importance than the emergence of price pressures. Many international analysts therefore expect to see a softening of monetary policy through an interest-rate cut in the first half of 2001 (Figure 66).

Figure 65
European Union
Headline and core inflation rates
1998:12 - 2000:11



Source: Bloomberg.

Figure 66
European central bank's repo rate



Source: Bloomberg.

3. Japan

The Japanese economy has begun to recover, largely under the impetus of rising corporate profits and fixed private-sector investment. Yet, despite considerable improvement in employment and incomes, private consumption continues to be very weak. Public investment has remained stagnant at levels registered in the second quarter of 2000. And net exports (real exports less real imports) are expected to fall, in view of slower world growth predicted for 2001.

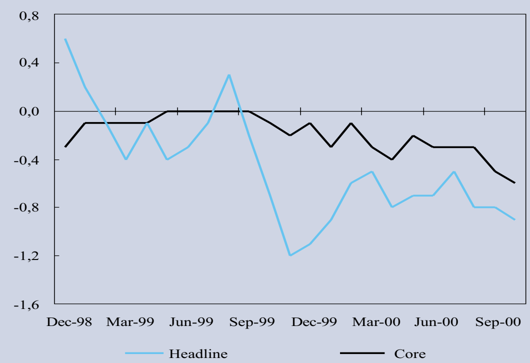
Japan's consumer price index continued on the declining trend exhibited in previous months (0.0% in July, -0.2% in August, and -0.2% in September) (Figure 67), despite higher import prices resulting from better international commodity prices.

Lastly, the central bank of Japan has expressed concern over the economy's still frail recovery, because there is a high risk that recent developments in external and financial markets might impair households' and businessmen's perception of the economy. This notwithstanding, a return to a zero-interest policy is unlikely, given that the raising of the interest rate in August has had an insignificant impact on economic reactivation. Besides, various economic analysts consider that lowering the interest rate would make no sense unless there were evident signs of a new economic recession with its corresponding deflationary spiral, or unless the financial sector's stability were at risk.

4. Latin America

Growth in the region has been satisfactory in recent months, with most countries expanding more rapidly in the third quarter than was expected. The upturn is expected to continue, though at a more moderate pace in some economies, because of persisting political and other problems, and also because of less favorable global conditions, liable to weaken exports, commodity prices and capital flows. Nevertheless, international analysts consider that, though Latin America continues to be vulnerable to external forces, it is much less so than in previous quarters, thanks partly to implementation of sound macroeconomic policies. In addition, the expected easing of monetary policy in the United States and the European Union improves the financial outlook for Latin America in 2001. The region should thus register a growth of 4.0% in 2000 and 3.5% in 2001 (Table 14).

FIGURE 67
JAPAN
HEADLINE AND CORE INFLATION RATES
1998:12 - 2000:10



Source: Bloomberg.

TABLE 14
ACTUAL AND FORECAST GROWTH
FOR COLOMBIA'S MAIN TRADING PARTNERS

	1999	2000(*)	2001(*)
United States	4,1	5,1	2,9
Japan	(0,3)	2,0	1,6
European Union	2,3	3,3	2,7
Argentina	(3,4)	0,0	2,0
Brazil	0,9	4,0	4,0
Chile	(1,1)	5,0	5,0
Ecuador	(7,3)	2,0	3,6
México	3,7	7,0	3,8
Perú	1,4	4,0	0,3
Venezuela	(6,1)	3,5	5,0

(*) Forecasts to December.
Sources: ECLA and J.P. Morgan.

A breakdown of the region's economic performance by country, however, continues to reveal mixed results. Mexico, being more closely integrated with the Unites States, should be more strongly affected by a cooling US economy, so its growth in 2001 is expected to be lower than in 2000. The Brazilian economy is likely to expand further, despite its failure to show strong signs of vigorous growth in previous quarters. Argentina's economy is expected to remain stagnant in the first half of 2001, but the likely lowering of interest rates in the United States will help to revive it.

The Andean countries are expected to show stronger growth, although political problems continue to be the main cause of uncertainty in the region. Ecuador is moving ahead successfully in the process of dollarization. Its economy is much more stable now than a year ago and expected to have grown by 2.0% in 2000, quickening the pace to 3.6% in 2001. In Venezuela, higher revenues from the surge in oil prices are amply financing public spending, and strongly stimulating private demand, which has been expanding rapidly. Thus, Venezuela's real growth by the end of last year should have been around 3.5%, rising to some 5.0% in 2001.

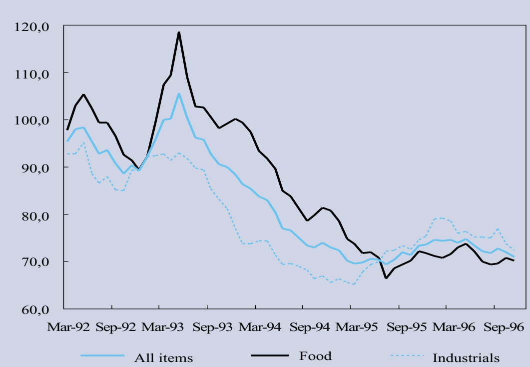
B. Commodity prices

World commodity prices affect Colombian consumer prices directly when the imported commodities are for consumption (for example, grains), and indirectly when they are inputs (for example, oil) for the production of final goods. Moreover, world prices for some Colombian commodity exports, such as oil and coffee, have a significant effect on the country's external and fiscal balances. To the extent that world commodity prices affect Colombia's consumer prices and macroeconomic balances, their behavior is a major determinant of inflation, exchange stability, and economic growth in the short term.

The prices of commodities other than oil fell sharply from mid-1997 to mid-1999 (Figure 68), helping to reduce inflationary pressures in Colombia and other countries. Although world commodity prices rose a little (6.2%) in the second half of 1999, the rise was not sustained, and a declining trend prevailed during 2000. In effect, The Economist's commodity price index fell by 5.1% between May and November 2000, the November level being 3.2% lower than a year earlier.

The decline in world commodity prices since May 2000 occurred mostly in products for industrial use. The Economist's index shows industrials falling by 5.2% between May and November, the level in November being 2.8% lower than a year earlier. The food-price subindex rose by about 4.0% between February and May, only to decline again from then on, to below its level at the beginning of the year.

FIGURE 68
COLOMBIA
MONTHLY MAIN COMMODITY EXPORT INDEX
(1995 = 100)



Source: The Economist.

1. Oil

In early September the price of oil stood at $37 a barrel, the highest since the Gulf War. Under international pressure to reduce the risk of inflationary and recessionary effects on the world economy, the Organization of Oil Exporting Countries (OPEC) agreed to increase daily production to 800,000 barrels a day from October 1st., 300,000 more than envisaged in the band scheme.[11] Likewise, the United States decided on September 22nd to release 30 million barrels from its strategic reserves over a period of 30 days.

These moves were expected to raise heating-fuel stocks and assuage fears of a possible shortage of crude over the winter. The price of oil was thus expected to fall to $30 a barrel in the fourth quarter. But, as predicted in the previous Inflation Report, oil prices responded slowly to OPEC's measure, mainly because of the time it takes for Middle East crude to be transported to major markets, particularly the United States. And fears of a possible shortage of crude persisted during the fourth quarter, in view of Iraq's threats to suspend its oil exports[12] and intensification of the Palestinian-Israeli conflict. With the result that upward pressure continued on crude prices, keeping them at around $36 in October and November.

OPEC responded to this situation by deciding on October 31st to raise the production level under the band scheme by a further 500,000 barrels a day. Thanks to this decision and assurances by the United States and the International Energy Agency of being fully able to make good any shortages on the market, uncertainty about the availability of crude during the winter was reduced, and prices dropped to $28 a barrel in early December (Figure 69).

The stocks of crude and heating oil in the United States now show signs of rising in response to the measures taken by OPEC since September to increase supply. Consequently, mounting stocks, and a weakening of gasoline demand that should result from a coolingof the US economy, point to lower oil prices for 2001, which are expected by some experts to average $25 a barrel.

The rise in oil prices during the first two months of the fourth quarter and their sharp fall in December were reflected in the price behavior of forward sales contracts on the New York Stock Exchange (Figure 70). Forward sales prices rose significantly up until November, reflecting great uncertainty among economic agents about the availability of crude. Subsequently, this uncertainty diminished, as indicated by the prices of one-, six- and twelve-month forward contracts: on December 12th they were $26.8, $24.9 ad $23.8 respectively,

FIGURE 69
WTI OIL PRICES NEW YORK STOCK EXCHANGE
1999:6 - 2000:12
(DOLLARS/BARREL)

Source: Bloomberg.

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[11] Under this scheme, OPEC undertook to increase daily production by 500,000 barrels if the average crude price remained above $28 a barrel for over 20 days, and to reduce it by the same volume if the price remained below $22.

[12] Iraq's production capacity is estimated at 2.8 million barrels a day, or about 4.0% of world oil production.

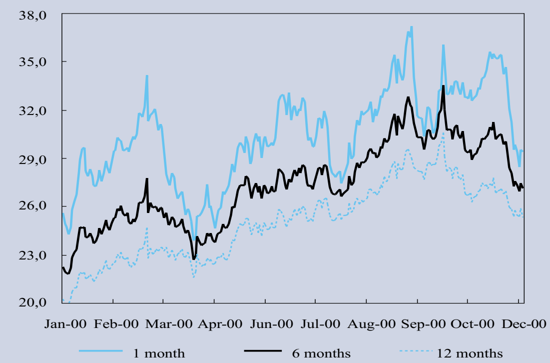
well below prices a month earlier ($34.6, $30.0 and $26.9). Thus, six- and twelve-month contracts suggest that the market expects oil prices to be lower this year than they were for a good part of 2000.

2. Coffee

The international price of coffee plummeted in 2000, compared with the 1999 average. Despite the introduction of a "Coffee Retention Plan" in July, the price of Colombian coffee in the last week of December was 72.2 cents a pound, the lowest in recent years (Figure 71). The same trend was displayed by forward sales prices (Figure 72). The price drop in the fourth quarter is largely attributable to mounting coffee stocks in consumer countries, particularly the United States.

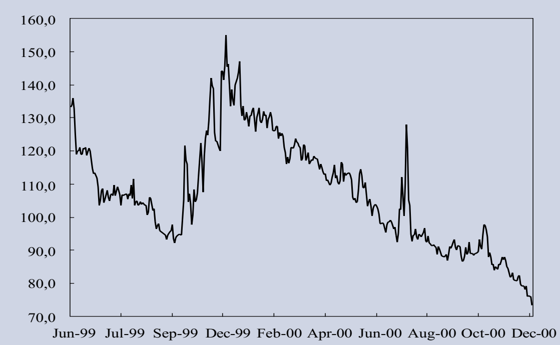
The Coffee Retention Plan[13] adopted by the Association of Coffee Producing Countries[14] was originally intended to reduce stocks in consumer countries and so raise world coffee prices to over 95 cents a pound. Under the Plan, Brazil decided to retain six million bags between July 2000 and July 2001 (three million more than initially planned), while Colombia undertook to withhold a million bags by the end of 2000.[15] Despite this stabilization scheme, no effect is as yet discernible on world supply, and coffee stocks are still high in consumer countries. Nevertheless, coffee prices are expected to pick up by March or April, when the

FIGURE 70
WTI OIL FORWARD SALES PRICES
NEW YORK STOCK EXCHANGE
(DOLLARS/BARREL)



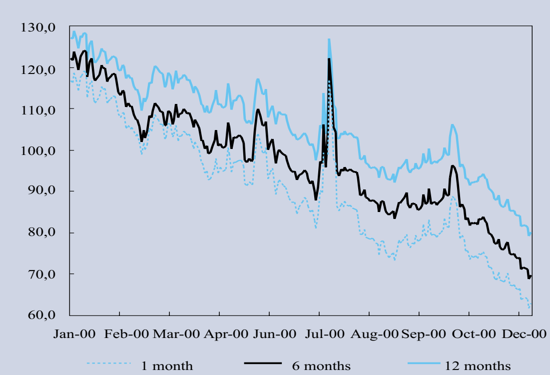
Source: Bloomberg.

FIGURE 71
COLOMBIAN ARABICA COFFEE PRICE
NEW YORK STOCK EXCHANGE
(CENTS/POUND)



Source: Bloomberg.

FIGURE 72
ARABICA COFFEE FORWARD SALES PRICES
NEW YORK STOCK EXCHANGE
(CENTS/POUND)



Source: Bloomberg.

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13 Under the Plan, coffee exports are to be reduced by 20% if the price drops below 95 cents a pound.

14 The ratified members of the Association are Brazil, Colombia, Costa Rica, El Salvador, India, Indonesia, Venezuela, Angola, Ivory Coast, Kenya, Tanzania, Togo, Uganda and the Democratic Republic of Congo.

15 Colombia exported 3.1 million bags of coffee in the fourth quarter of 2000.

Association's measures should begin to reduce excess supply in the market.

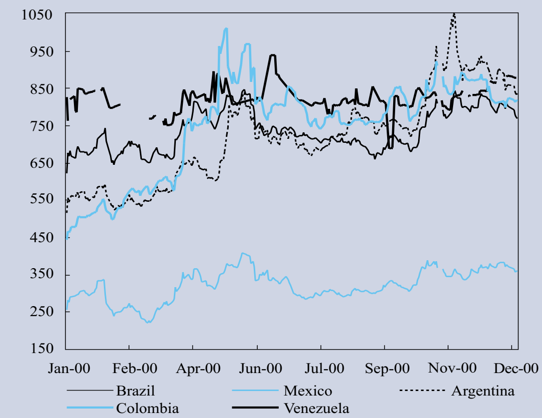
C. Financial outlook

Financial developments in Latin America and all emerging economies continue to be strongly influenced by the behavior of the US economy and its signs of cooling. The numerous indications of a slowdown in the US economy point to the likelihood of an interest-rate cut by the Fed in the first half of 2001. Such a cut, it is believed, would help to stabilize or even reduce spreads on 10- and 30-year sovereign debt in 2001 (Figures 73 and 74).

Yet, an expected reduction in US interest rates is not a wholly promising prospect, for it would be prompted by a decision to avert a recession. A US recession would effect Latin America by impairing the region's exports and terms of trade, creating greater uncertainty, lowering a number of commodity prices, and hence increasing the likelihood of capital flight from the region.

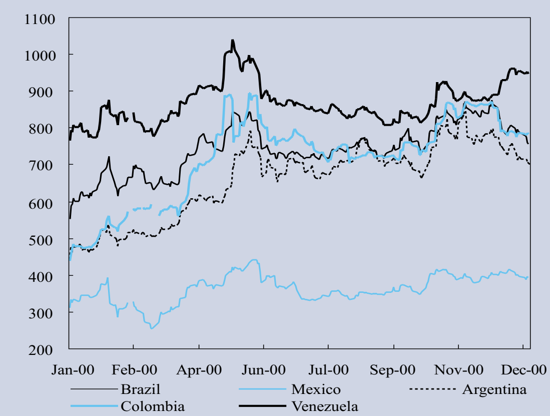
Apart from economic developments in the US, another factor liable to affect Latin America's financial situation in the coming months is the behavior of Argentina's economy, on account of the contagion effect that a massive capital flight from this country would have on emerging markets. The spread on Argentina's 10-year debt jumped from 762.1 basis points on September 1st to 901.8 points by mid-December, having peaked at 1,053.7 points in November. Argentina's feeble macroeconomic results and its climate of political uncertainty were largely responsible for the soaring spread. Although Argentina has sought help from the IMF to deal with these and other fiscal and credibility problems, it is not certain that implementation of the IMF's macroeconomic and financial programs will in the short run eliminate certain dangers that could affect the whole region in 2001. The fact is that foreign investors are constantly monitoring Argentina's economic results, and this in itself may increase the degree of uncertainty and vulnerability in the region.

Figure 73
Spreads on 10-year Latin American debt
(Basis points over 10-year US treasury bonds)



Source: Bloomberg.

Figure 74
Spreads on 30-year Latin American debt
(Basis points over 30-year US treasury bonds)



Source: Bloomberg.

V

Inflation forecasts

A. Forecasting for 2001 and 2002 using various models

The inflation forecasts for 2000 and 2001 presented in this chapter are based on price information available up to December. Forecasting was based on the assumption that the monetary base would show the same growth as the reference line for 2001 established by the Board of Directors.[16] It was further assumed that growth in the other monetary aggregates would be consistent with this reference line, though the effect that the three-per-thousand levy on financial transactions would have demand of different financial assets is still uncertain. For 2001, growth in the monetary base and the other money aggregates was assumed to be consistent with the 6.0% inflation target.

Forecasting for this Report envisaged no substantial changes in the other principal assumptions, relative to the September Report. Hence, as regards devaluation for 2001, the exchange rate is assumed to stay relatively stable, because the balance of payments is expected to show satisfactory behavior, making it possible to reach the accumulated-reserves targets set in the macroeconomic program. Devaluation for 2002 is expected to be consistent with stability in the real exchange rate. The government's 3.8% growth target for 2001 is considered to be feasible, and a stronger expansion, of 4.5%, is expected for 2002. Growth in import prices is assumed to be consistent with consistent with devaluation assumptions and with a 3.0% external inflation. Lastly, food prices are not expected to fluctuate greatly this year or next, so that by the end of both years their relative prices should not differ significantly from what they were at the end of 2000.

On the foregoing assumptions, the time-series and structural models show that the 8.0% inflation target for 2001 is feasible. In particular, by combining projections from the different models, a proven method of predicting inflation over horizons of a year or more, a 7.6% inflation is forecast for December 2001, slightly lower than the 8.1% inflation forecast last September. For 2002, most models predict that inflation will keep on declining relative to levels forecast for 2001.

The same method of combining forecasts gives a 6.9% inflation for next year, assuming that monetary policy is kept neutral. It should be pointed out, however, that the econometric methods employed here tend to overestimate inflation over long horizons, especially in times of deflation like the present in Colombia, for they fail to give much weight to the inertial components of the series used.

[16] For further details see *Reportes del Emisor* dated December 19, 2000. According to actual monetary-base figures for the end of 2000, the reference line's average growth for 2001 will be 12.7%, equivalent to a 4.3% growth at the end of the year.

B. Risks in 2001

The inflation risks identified by the September Report continue to exist. First, the risk of a new surge in world oil prices, caused by new cuts in OPEC's production quotas, cannot yet be disregarded, though it now appears to be less likely because world demand for crude oil is expected to grow more slowly.

Likewise, there is still a risk of food prices rising at higher rates than forecast. Unforeseen weather conditions, such as intense frosts, may affect the supply of some staples like milk or potatoes that have a big weight in the consumer basket. Since such conditions tend to occur at the beginning of the year, when a good number of prices are readjusted, the public's inflation expectations may be adversely affected.

Tariff rises and the increase in VAT, contemplated in the new tax reform, may produce a negative impact on prices in the short run, although their net effect in the long run will help to reduce the fiscal deficit. Lastly, despite the existence of economic conditions ensuring exchange-rate stability all through 2001, the risk of a devaluation higher than forecast cannot be disregarded, for the Colombian exchange market is highly sensitive to news about external developments and internal security.

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