

Colombia: Arrangement Under the Flexible Credit Line and Cancellation of the Current Arrangement—Staff Report; Staff Supplement; Press Release on the Executive Board Discussion; and Statement by the Alternate Executive Director for Colombia

In the context on the arrangement for Colombia under the Flexible Credit Line and cancellation of the current arrangement, the following documents have been released and are included in this package:

- The staff report for the Colombia: Arrangement Under the Flexible Credit Line and Cancellation of the Current Arrangement, prepared by a staff team of the IMF. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- A staff supplement of April 22, 2011 on the Assessment of the Impact of the Proposed Flexible Credit Line Arrangement on the Fund’s Finances and Liquidity Position.
- A Press Release summarizing the views of the Executive Board as expressed during its May 6, 2011 discussion of the staff report that completed the request.
- A statement by the Alternate Executive Director for Colombia.

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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**International Monetary Fund
Washington, D.C.**

INTERNATIONAL MONETARY FUND

COLOMBIA

**Arrangement Under the Flexible Credit Line and
Cancellation of the Current Arrangement**

Prepared by the Western Hemisphere Department
(In consultation with other departments)

Approved by Miguel A. Savastano and Tamim Bayoumi

April 22, 2011

Executive Summary

- **Background.** Colombia's very sound policies, underpinned by strong fiscal and monetary policy frameworks, have contributed to a solid macroeconomic performance and a reduction in vulnerabilities in recent years. Colombia was not impacted severely by the global crisis, largely owing to the implementation of prudent countercyclical policies and secured protection against extended downside risks through FCL arrangements approved in 2009 and 2010. An economic recovery is underway, inflation pressures are contained, and the financial system remains on sound footing. International reserves are strong, and the sovereign debt rating was recently raised to investment grade by one of the rating agencies.
- **Outlook.** The 2011 outlook is generally positive, with real GDP growth projected at about 4½ percent and end-year inflation within the 2–4 percent official target range. Macroeconomic policies are moving toward a more neutral position as the output gap is closing. Medium-term fiscal consolidation is a key objective of the new government, and efforts in this regard should be bolstered by a fiscal rule, presently being discussed in Congress, that would limit the structural deficit of the central government to 2 percent of GDP by 2015.
- **Risks.** Despite its very strong fundamentals, Colombia's near-term outlook could be adversely affected if commodity prices fall, the global recovery falters, or external financing conditions deteriorate.
- **FCL arrangement.** A new 2-year FCL arrangement for 500 percent of quota—which the authorities intend to treat as precautionary—would provide Colombia with reasonable cover in an adverse external scenario. Staff assesses that Colombia meets the qualification criteria for access to Fund resources under the Flexible Credit Line arrangement specified under Board decisions on such arrangements, and recommends its approval by the Board.
- **Fund liquidity.** The impact of the proposed commitment of SDR 3.87 billion on the Fund's finances and liquidity position would be manageable.
- **Process.** An informal meeting was held on April 7, 2011 to consult with the Executive Board on a possible FCL arrangement for Colombia.
- **Team.** This report was prepared by a staff team led by A. Wolfe, and comprising C. Faircloth, M. Garcia-Escribano (all WHD), and T. Miyoshi (SPR).

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I. BACKGROUND

Very strong economic fundamentals and institutional policy framework

1. **Colombia's strong institutional frameworks and sound policy management have underpinned a strong macroeconomic performance and contributed to reduce vulnerabilities.** Strong fiscal and monetary policy frameworks and adherence to sound policies have fostered private-sector led growth, increased foreign direct investment, and reduced balance sheet vulnerabilities. During 2004–09, real GDP growth averaged 4.1 percent, boosted by buoyant private investment and exports (especially of petroleum products). The inflation targeting regime (adopted in the late 1990s) was successful in anchoring expectations and bringing inflation down to single digits, while a flexible exchange rate helped mitigate external shocks. In addition, a rolling 5-year fiscal framework, which would be strengthened by the structural fiscal rule presently under discussion in the congress, has guided fiscal consolidation and enabled a decline in the public debt-to-GDP ratio of almost 7 percentage points from 2004 to 2009. At the same time effective financial sector supervision and regulation protected the integrity of the financial system and maintained financial soundness indicators at solid levels.

2. **Colombia's institutional framework and policies have been assessed very positively by the Executive Board.** During the Board discussion of the last Article IV consultation in March 2010 (IMF Country Report No. 10/105), Executive Directors praised the Colombian authorities for their sound policy response to the global crisis and the strong institutional framework, and considered that the country was well-placed to confront the challenges posed by the still uncertain global outlook. They welcomed the authorities' continued commitment to the flexible exchange rate and inflation targeting regimes, and to preserving medium-term fiscal sustainability guided by their medium-term framework and the fiscal rule that was being considered. Directors were encouraged by the resilience of Colombia's financial system and the ongoing efforts to build additional buffers (Box 1). Directors expressed similar views about Colombia's fundamentals during the May 2010 Board discussion of the request for a one-year FCL arrangement (IMF Country Report No. 10/156).

Performance since the global crisis

3. **The Colombian economy exhibited great resilience during the global crisis, and the output recovery is well entrenched** (Table 1, Figures 1 and 2). Following a short-lived contraction, economic activity started to recover in the second half of 2009, supported by a large fiscal stimulus. Activity gained further momentum in 2010 and real GDP grew by 4.3 percent (despite output disruptions late in the year caused by severe flooding). Growth continued to be led by domestic demand, and the external current account deficit widened to 3.1 percent of GDP, reflecting a sharp pick up in imports. Strong private capital inflows (mainly foreign direct investment) more than offset a decline in official borrowing, resulting in an overall balance of payments surplus of more than US\$3 billion (Tables 2 and 3).

Box 1. 2010 Article IV Consultation—Update on Key Staff Recommendations and Assessments

- *With expectations still inside the target range, the monetary stance should remain accommodative until there is clear evidence of a sustained recovery.* Forward-looking indicators of activity and inflation supported maintaining the monetary policy stance unchanged during 2010. A gradual tightening was initiated in early 2011 as price and activity indicators gained strength.
- *The deterioration of the fiscal position in 2009, including through a modest fiscal stimulus, did not jeopardize medium-term sustainability.* The fiscal stance remained supportive of economic recovery during 2010, and the overall fiscal deficit was similar to the previous year. The fiscal position envisaged for 2011 is also appropriate (considering expenses related to weather-related damages in late 2010) and is consistent with the authorities' fiscal consolidation plan.
- *The authorities' strategy of relying on the exchange rate as the first line of defense to private capital inflows is appropriate, but other instruments may have to be considered if inflows are too large.* Capital inflows increased significantly in 2010, and the authorities responded by letting the exchange rate appreciate, reintroducing a well-defined intervention rule, and reducing the drawdown of government foreign-currency assets to finance the fiscal deficit.
- *It would be advisable to develop a strategy to minimize medium-term fiscal risks, including those resulting from investment tax incentives and special tax regimes, and pension spending.* In late 2010, the new government adopted a fiscal reform package that eliminated many of the tax incentives, and work on pension and healthcare reform is underway.
- *Higher oil-related revenues over the medium term would provide the opportunity to build up gradually reserves and continue lowering external vulnerabilities.* The authorities are looking into mechanisms to build external assets of the government in a transparent manner without affecting exchange rate flexibility.

Financial soundness indicators remained solid, with capital adequacy and profitability at strong levels and NPLs broadly stable.

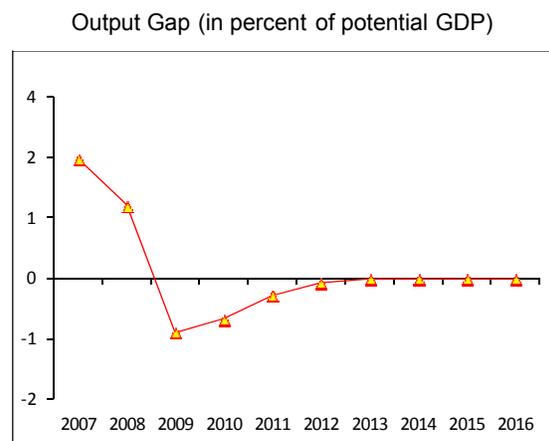
4. **In 2010 macroeconomic policies continued to support the economic recovery and responded appropriately to increased private capital inflows.** The fiscal deficit reached 3 percent of GDP by year end (Tables 4 and 5). On the monetary front, the central bank lowered the policy rate in April to an historic low of 3 percent and maintained it at this level until February 2011 (Table 6 and Figure 2). In response to growing private capital inflows, the government delayed the repatriation of dividends from the oil company in which it holds a majority stake, while the central bank adopted a rules-based intervention program (pre-announced purchases of US\$20 million per day). Notwithstanding these measures, the peso appreciated by 14.5 percent in nominal terms against the U.S. dollar from January to October

(although the trend reversed in the last quarter of the year). Close monitoring of the financial system continued (Table 7 and Figure 3). The Central Bank signed an agreement with the Financial Superintendency of Banks to improve the exchange of information and also tailored dynamic provisioning to bank-specifics to better monitor and address the build-up of vulnerabilities.

5. **The presidential elections had little effect on macroeconomic policies or investors' risk perceptions.** Elections took place in May and June, and a new administration (of President Juan Manuel Santos) took office in early August. The central bank governor remained in his position (as stipulated by the central bank law), and the new Minister of Finance launched initiatives that supported his predecessor's efforts to strengthen the fiscal policy framework (e.g., by adopting a fiscal reform package that included rationalizing tax incentives and submitting to congress important structural fiscal reforms, see paragraph 10 below). In addition, the new government completed the negotiation of a free-trade agreement with the United States that had been initiated in 2006.¹

Near-term economic outlook

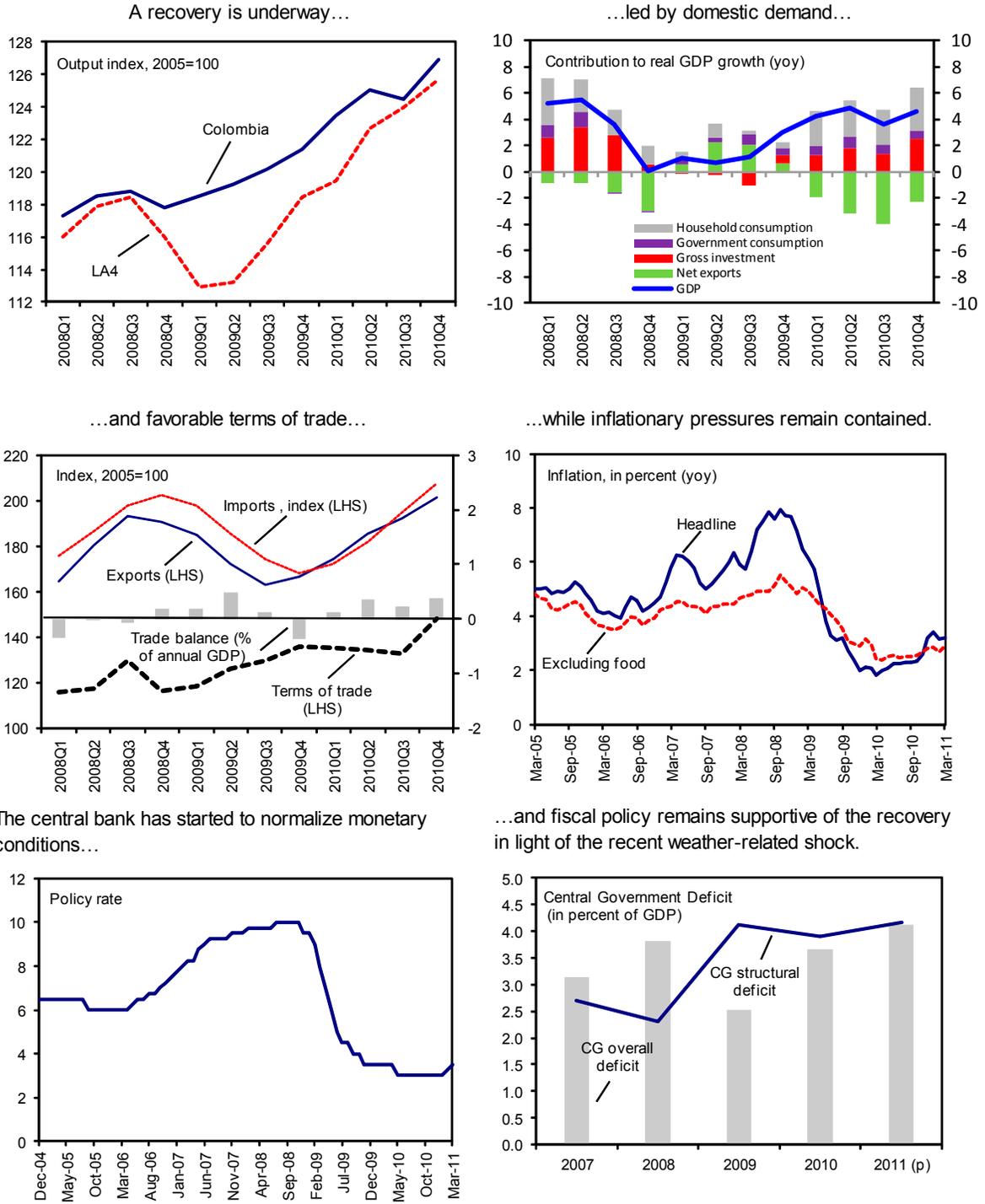
6. **The outlook for 2011 is generally positive.** Real GDP growth is expected to exceed 4½ percent, driven by still strong domestic demand; this growth outturn would leave a very small output gap by year end that would be fully closed in 2012. Inflation in 2011 is expected to remain within the 2–4 percent official target range, despite the higher world prices for fuel and food, as the central bank would continue to adjust the policy rate in a measured manner to its neutral level. The external current account deficit is projected to decline to 2.1 percent of GDP, as a result of higher oil prices, while net capital inflows are expected to remain strong, reflecting both solid domestic fundamentals and abundant global liquidity.



Source: Staff estimates.

¹ To enter into effect, the agreement needs to be approved by the United States Congress.

Figure 1. Colombia: Recent Economic Developments

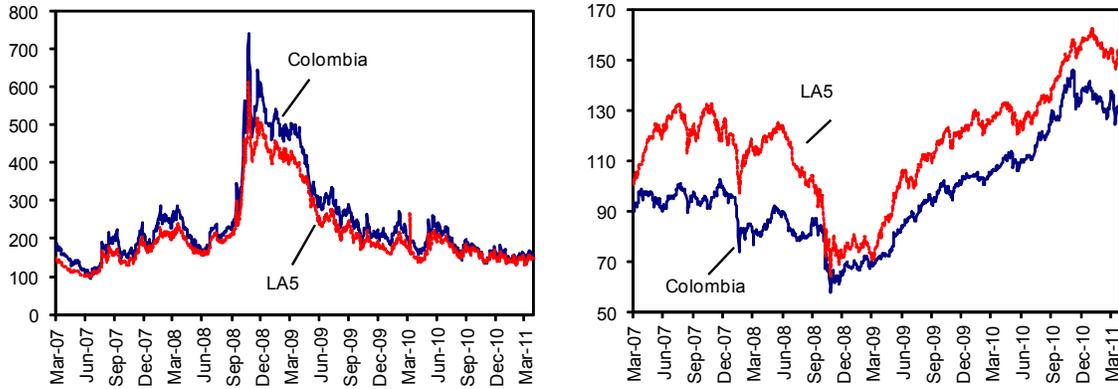


Sources: Haver, Datastream, and Fund staff estimates.

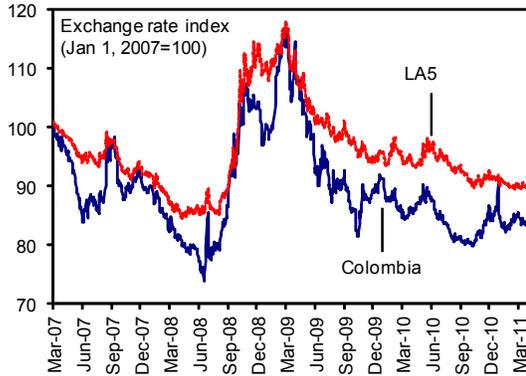
Note: LA4 represents the average of Chile, Brazil, Mexico, and Peru. LA5 includes also Colombia.

Figure 2. Colombia: Financial Developments

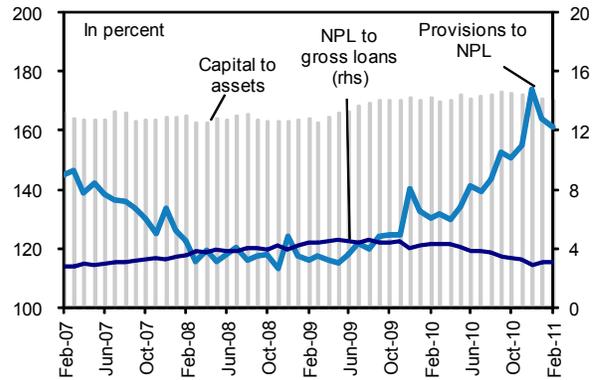
Sovereign spreads stabilized, in tandem with the region.... ..while equity prices pressures have recently receded...



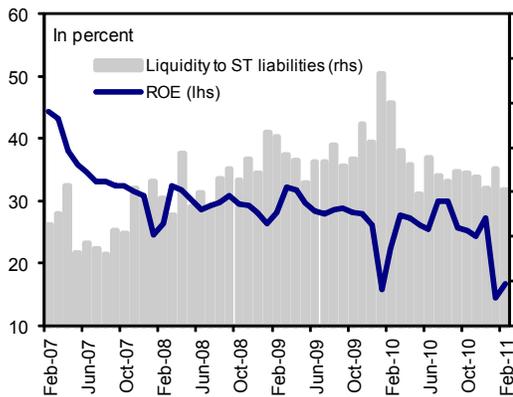
...and the peso has returned near its pre-Lehman level.



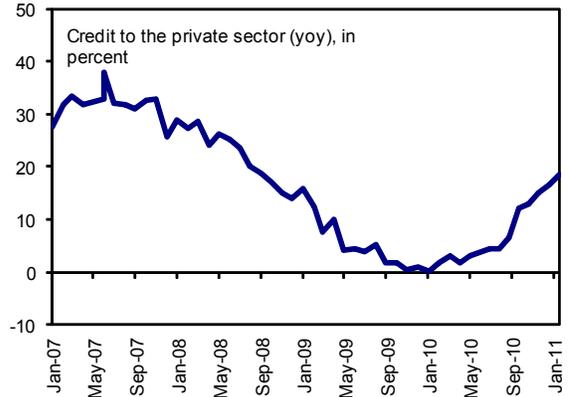
Financial soundness indicators remain solid...



...with comfortable liquidity and profitability ratios...



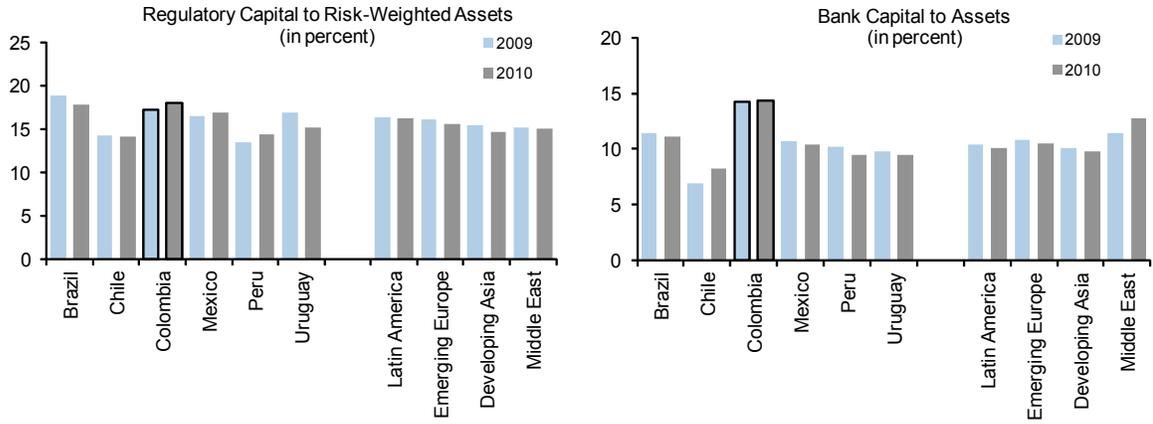
...while credit growth is picking up.



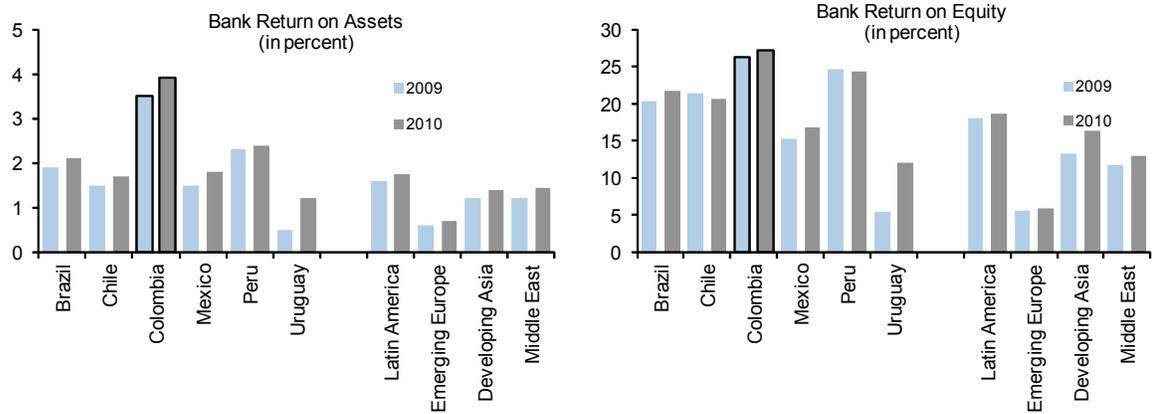
Sources: IFS, Haver, Datastream, and Fund staff estimates.
 Note: LA5 represents the average of Chile, Colombia, Brazil, Mexico, and Peru.

Figure 3. Financial Soundness Indicators: Colombia and Other Emerging Markets

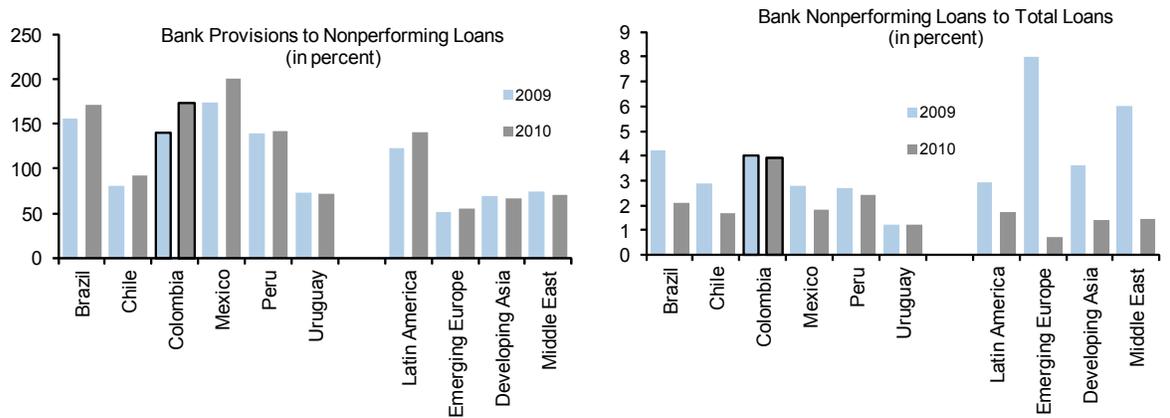
Colombian banks weathered the crisis with strengthened capitalization...



and robust and growing profitability.



Nonperforming loans have remained moderate and are well covered by provisions.

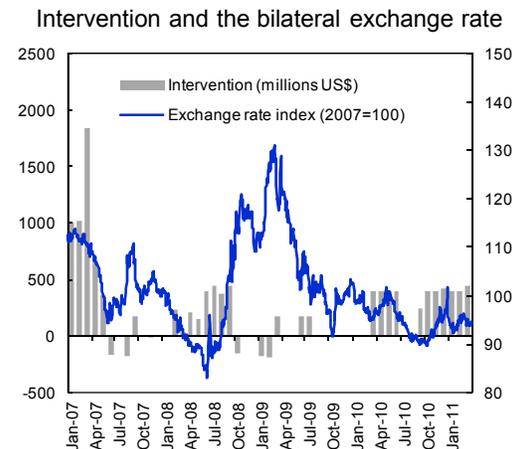
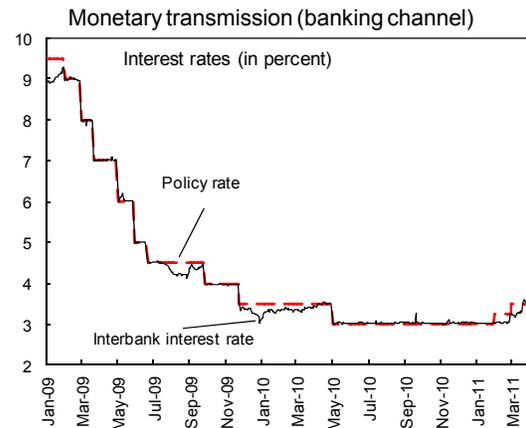


Source: April 2011 GFSR Statistical Appendix.

7. **Fiscal policy in 2011 will approach a more neutral position but remain supportive of economic activity, with consolidation to take hold beginning in 2012.** The budget for 2011 (approved in October 2010) contemplates an increase in infrastructure spending of about $\frac{3}{4}$ percent of GDP and an additional spending (transfers) for $\frac{1}{2}$ percent of GDP to mitigate the effects of the floods. This planned pick up in government expenditure is expected to be largely offset by higher revenue, stemming from the broadening of the tax base produced by the reform of late 2010 (see paragraph 9) and higher oil-related revenues. In all, the deficit of the combined public sector (central government) in 2011 is expected to reach 3.5 (4.2) percent of GDP, somewhat higher than last year's.

8. **Pressures for further peso appreciation are likely to continue.**

Global liquidity conditions and the favorable prospects for the Colombian economy (boosted by the recent sovereign upgrade) will maintain the upward pressure on the peso and may moderate the pace of monetary tightening. Given the planned fiscal policy, which includes emergency spending for last year's floods, mitigation of the effects of sizeable capital inflows would fall to the central bank—which would consider supplementing the flexible exchange rate regime and its discretionary foreign exchange purchases program of at least US\$20 million per day (until at least June 17) with additional macroprudential measures (see paragraph 12).² During 2011, the peso has appreciated by about 5 percent against the U.S. dollar, but preliminary estimates suggest that the real effective exchange rate has depreciated by some 10 percent since the last CGER assessment in the fall of 2010, bringing the estimates of overvaluation of the peso to the 0–10 percent range.



² Colombia's intervention, in percentage of GDP, is limited relative to other countries in the Latin America region.

Medium-term policies

Fiscal strategy

9. **The new government's fiscal strategy aims at strengthening the fiscal position, although with higher levels of revenue and expenditure.** The tax reform passed in December last year, further tax policy and tax administration reforms in the coming years (FAD is providing technical assistance in these areas), royalty reform (see paragraph 10), and tight control over current expenditure are expected to provide the basis for fiscal consolidation over 2012–15, while creating fiscal space for needed infrastructure expenditure.³ The authorities' intention is to shift the fiscal stance to a neutral position in 2012 once the output gap is closed.

10. **The authorities are also pursuing an ambitious set of structural reforms that would rationalize expenditure growth and safeguard fiscal dynamics.** These reforms will strengthen Colombia's fiscal framework further, and their key pillars include:⁴

- *Fiscal rule:* The rule presented to Congress will bolster credibility in fiscal management and ensure debt sustainability by establishing a limit on the structural deficit of the central government of 2 percent of GDP from 2015 onwards.
- *Royalty reform:* The reform of the system of royalties aims at achieving a more equitable distribution of royalties among regions and over time by establishing criteria and parameters for allocating and saving royalty flows through time.
- *Codifying fiscal sustainability:* The government aims at securing a constitutional mandate on fiscal sustainability. In practice, for example, this will require judicial rulings to explicitly consider their fiscal implications; thus, helping to underpin the fiscal consolidation sought by the government.

11. **The government's fiscal reform agenda would yield important dividends in transparency and fiscal consolidation, but risks remain.** Under conservative assumptions about the yield of revenue-enhancing measures, staff projects that the central government deficit would decline below 2 percent of GDP (the ceiling under the fiscal rule) by 2016, while the overall public sector balance would be nearer to zero. A key downside risk, however, are the costs of healthcare reform. The Constitutional Court decided in 2009 that

³ The tax reform package (adopted in December 2010) broadened the taxable base by eliminating the fixed asset tax credit, closing loopholes in the financial transactions tax, and increasing the rate and lowering the threshold of the net wealth tax.

⁴ These reforms involve constitutional amendments and, therefore, require a series of debates in Congress, about half of which have taken place. The remaining debates are scheduled in this March–June session of Congress.

the government needs to revise its proposed healthcare reforms and, as a result, projected health care costs have not been factored into expenditure projections. When the revised proposal is presented to Congress later this year, the government would need to incorporate its costs in its expenditure projection and identify offsetting revenue and expenditure measures to safeguard fiscal consolidation.

Financial sector

12. **Close monitoring of the financial sector remains a key objective.** Amidst low lending rates and easy global financial conditions, credit to the private sector, which has recovered strongly since mid-2010 (and grew by about 18.5 percent (y/y) in January 2011), may gain further steam. Financial soundness indicators and supervisory practices remain strong and generally above those in other countries in the region, and the authorities are determined to keep monitoring closely developments to mitigate the inherent procyclicality of financial systems and avoid the emergence of asset price bubbles. If inflows of private capital were to intensify in the environment of an on-going fiscal consolidation and normalized monetary policy, the authorities would be inclined to tighten the macroprudential (MaP) instruments currently in place (e.g., limits on open foreign exchange positions) and perhaps redeploy other MaP instruments used in 2007–08 (e.g., marginal reserve requirements).⁵ An FSAP update is planned for FY 2012.⁶

Financial Soundness Indicators, 2010 (in percent)

Capital to RWA 1/	NPLs to Total Loans	Provisions to NPL	Return on Assets	Return on Equity
Colombia 18.0	Uruguay 1.0	Mexico 200.7	Colombia 3.9	Colombia 27.2
Brazil 17.8	Mexico 2.0	Colombia 2/ 174.0	Peru 2.4	Peru 24.3
Mexico 16.9	Peru 2.6	Brazil 171.1	Brazil 2.1	Brazil 21.7
Uruguay 15.2	Chile 2.7	Peru 141.9	Mexico 1.8	Chile 20.7
Peru 14.4	Colombia 2/ 2.9	Chile 92.7	Chile 1.7	Mexico 16.8
Chile 14.1	Brazil 3.1	Uruguay 72.2	Uruguay 1.2	Uruguay 12.1

Source: GFSR Statistical Appendix. December 2010 data.

1/ Bank regulatory capital to risk-weighted assets

2/ NPL definition for Colombia is 30 days delinquent.

Downside risks

13. **While global conditions have improved since the last Article IV consultation, downside risks remain.** While the risk of a “double-dip” in global growth has diminished, the resilience and strength of the global recovery remains unclear and other global events

⁵ MaP instruments deployed in mid-2007 resulted in a decline in foreign borrowing, but other inflows, including FDI, remained strong. In May 2008, the authorities imposed a minimum stay for FDI inflows and an increase in the unremunerated reserve requirement on portfolio inflows from 40 to 50 percent; however, the impact of these measures is difficult to assess as they were abandoned a few months later.

⁶ The last FSAP update was carried out in September–October 2004 and the FSSA was discussed in April, 2005 (IMF Country Report No. 05/287). A key monitoring priority going forward is on the corporate and household balance sheets.

have added to the overall degree of uncertainty in commodity and financial markets. An adverse shock that lowers global growth would impact the outlook for Colombia's commodity exports, remittances, and foreign direct investment. At the same time, concerns about fiscal sustainability in several advanced economies and the unprecedented scale of government financing needs worldwide could affect the availability and access to external financing.

II. ROLE OF THE FLEXIBLE CREDIT LINE ARRANGEMENT

14. **The Colombian authorities are of the view that the uncertainties surrounding the external environment remain elevated and that a successor FCL arrangement with a duration of two years would provide useful protection against continuing external tail risks.** They consider that the current FCL arrangement, which expires in May 2011, has allowed Colombia to maintain policy flexibility despite global and regional uncertainties (including from neighboring Venezuela). They also are of the view that global uncertainties have not abated significantly since they requested the current FCL; on this basis, they believe that a two-year FCL arrangement, which they intend to treat as precautionary, will continue providing space for policy flexibility while bolstering prospects for Colombia's access to international markets if tail risks were to materialize (see letter attached).

15. **Colombia is particularly vulnerable to commodity price shocks.** Commodity exports accounted for about 65 percent of export revenue in 2010 (up from 50 percent in 2007) and the bulk of FDI inflows are in commodity-related projects (mainly oil). As a result, an adverse shock to oil and other primary exports (e.g., coffee) could result in a significant increase in Colombia's financing needs.

16. **A sudden deterioration of external financing conditions also would affect Colombia.** Tighter global financial conditions would lower the inflows of private capital envisaged in the baseline balance of payments scenario (Table 2), and public external financing conditions also could be affected, even if the government were to maintain access to international markets at favorable rates, possibly creating roll-over difficulties.

17. **In the staff's view, access under a two-year FCL arrangement in the order of US\$6.1 billion (SDR 3.87 billion or 500 percent of quota) would provide reasonable coverage against the risks noted above.** To secure broadly the same degree of protection under a new FCL arrangement as garnered under the current one, and as a result of the baseline scenario relying more heavily on increased export revenues and capital inflows related to commodities, precisely those flows most subject to tail risks, a higher level of access than under the present FCL would be necessary. In fact, the adverse external scenario prepared by staff applies broadly the same set of shocks to Colombia's projected external financing requirements as those applied at the time of the request of the current FCL arrangement (see Box 2). The only difference is the addition of a shock to remittances (which declined by almost one quarter during the global financial crisis). The exercise shows that in order to have a similar level of protection against the same set of shocks, Colombia would need to have access to more Fund resources than under the current FCL.

18. **As was the case in the requests for previous FCL arrangements with Colombia, it is expected that a worsening of the external environment would impact both the current and capital accounts.** As noted, a slower global recovery would reduce remittances while lower prices for oil and other commodities would impact exports as well as oil-and-mineral-related FDI inflows. In addition, renewed pressures on international capital markets would reduce Colombia's access to external funding.⁷ If all these shocks were to materialize over the same 12-month period, their combined effect would be to lower Colombia's projected balance of payments inflows by close to US\$7.6 billion, on average, during 2011–12. About one quarter of the external financing shortfall could be absorbed by foregoing the increase in international reserves projected in staff's baseline scenario; however, this would still result in (net) external financing needs of about US\$5.6 billion on average (Table 3 and Box 2).

Box 2. Illustrative Adverse Scenario

An adverse illustrative scenario developed by staff suggests that Colombia could experience an external financing shortfall in 2011 or 2012 on the order of US\$5.6 billion (equivalent to about 465 percent of quota) from a set of shocks that hit the country in either of these years. As in the staff report for the FCL arrangement expiring in May 2011, the scenario assumes concurrent shocks within a year to both the current and capital accounts of Colombia's balance of payments resulting from a worsening of global financial conditions and lower global growth. The shocks are assumed to lower commodity prices (which remain a key source of vulnerability for Colombia), remittances, and access to international capital markets.

Compared with a baseline balance of payments scenario where international reserves increase by just under US\$2 billion on average during 2011–12, the concurrent shocks could create a shortfall of about US\$5.6 billion on average during 2011–12, if Colombia were to forego the increase in international reserves assumed in the baseline projection (Table 3).

The main assumptions underlying this illustrative adverse scenario mirror those in the current FCL (except for the addition of a shock to remittances) and are as follows:

- A decline of 15 percent in world oil prices and 7.5 percent in the prices of other commodities relative to the 2011–12 baseline.
- A decline of 7.5 percent in remittances relative to the 2011–12 baseline.
- A fall in FDI inflows of 10 percent relative to the 2011–12 baseline.
- A ceiling on rollover rates on short term debt equal to 100 percent.
- Declines of 15 percent in medium-term inflows to the non-financial private sector and of 25 percent in inflows to the financial private sector, relative to the 2011–12 baseline.
- A decline of 10 percent in medium-term inflows to the public sector relative to the 2011–12 baseline.

These adverse shocks are smaller in scale than those experienced by Colombia during the financial crisis; on that occasion, world oil prices declined by more than 35 percent and non-fuel commodity prices fell by 16 percent; net FDI and remittance flows to Colombia contracted by 50 percent and 14½ percent, respectively; and short-term public and private debt inflows fell short of repayments by around 38 and 28 percentage points, respectively.

⁷Unlike Mexico, in Colombia, there are no large non-resident exposures to domestic equity and debt markets.

19. **Staff assesses that Colombia continues to meet the qualification criteria identified in paragraph 2 of the FCL Decision on access to Fund resources under a new FCL arrangement** (Figures 4 and 5 and Table 8).⁸ As noted earlier, Colombia has very strong economic fundamentals and institutional policy framework and a sustained track record of implementation of very strong policies, and the new government is firmly committed to maintaining such policies in the future. Staff's assessment of Colombia's qualification is based, in particular, on the following criteria:

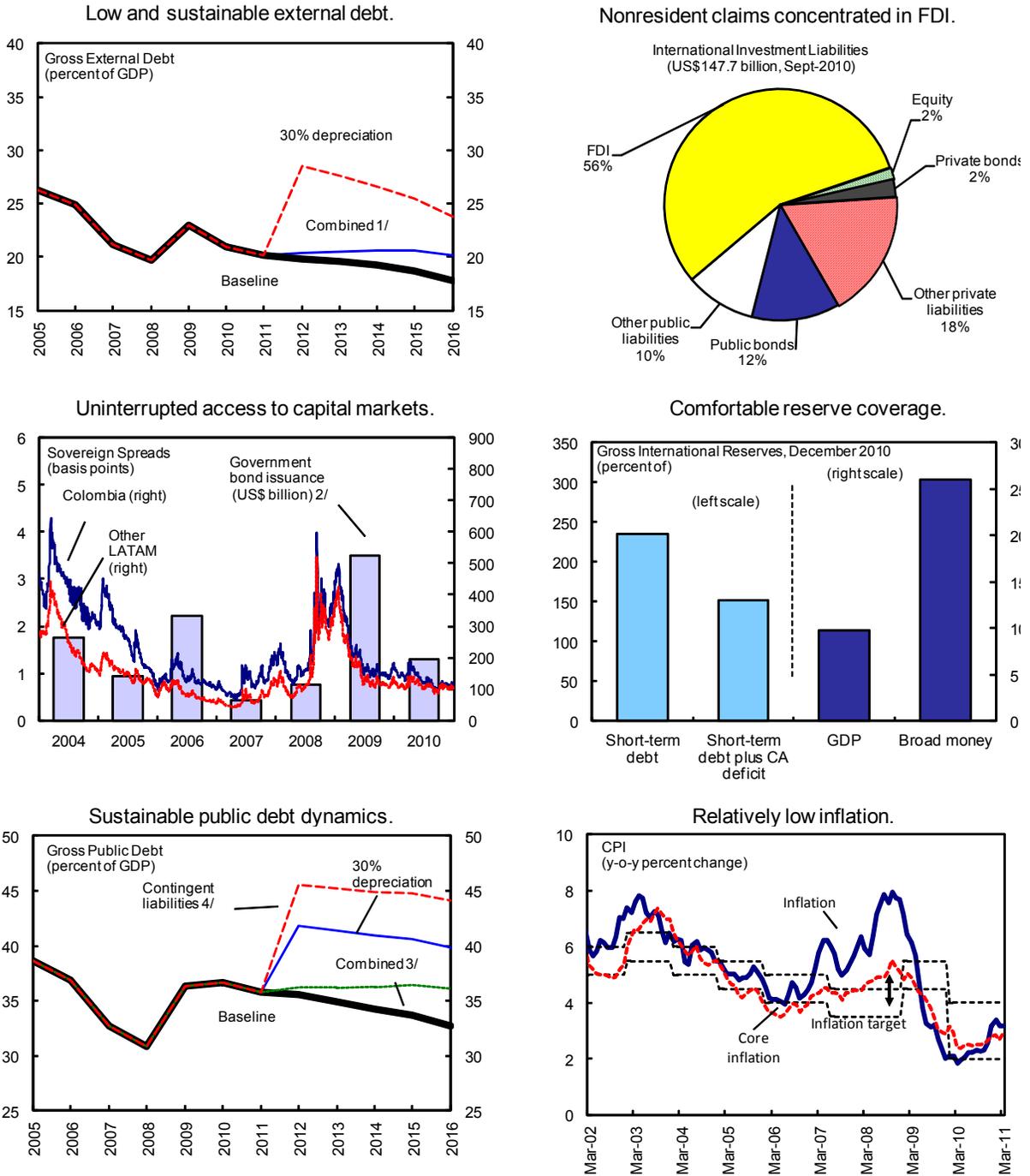
- **Sustainable external position.** Preliminary data suggest that the external debt-to-GDP ratio fell to 20.9 percent at end-2010 (22.9 percent in 2009), with public external debt remaining at moderate levels. Staff's updated external debt sustainability analysis (Figure 6 and Table 9) suggests that external debt ratios are expected to decline over the medium term and would remain manageable even under large negative shocks. Based on the latest WEO projections for oil prices, the external current account deficit is projected to stabilize at about 2 percent of GDP over the medium term.
- **Capital account position dominated by private flows.** Capital account flows in Colombia are predominantly private—mostly in the form of FDI (US\$9 billion in 2010, 3.2 percent of GDP).
- **Track record of steady sovereign access to international capital markets at favorable terms.** The Colombian government has had continued access to international capital markets at favorable terms, and Standard & Poors recently upgraded the sovereign to investment grade (the other credit rating agencies rate the sovereign at one notch below). During 2009 Colombia issued external bonds for US\$3.5 billion, and in 2010 it placed peso-denominated bonds for the equivalent of US\$1.3 billion in international capital markets. Sovereign CDS spreads are presently 40 basis points above Chile's, broadly the same as in Brazil and Mexico, and somewhat lower than Peru's.
- **Reserve position.** Colombia's gross international reserves stood at US\$28 billion at end-2010 (about 10 percent above the level at the time of the approval of the current FCL arrangement). The current level of reserves is comfortable, with coverage equivalent to about 6.5 months of imports of goods and services and exceeding 150 percent of the sum of external debt falling due and the external current account deficit projected for 2011 (Figure 5).

⁸ The Executive Board last assessed Colombia's adherence to the FCL qualification criteria on May 7, 2010, during the approval of a new FCL arrangement for 300 percent of quota (IMF Country Report No. 10/156).

- **Sound public finances, including a sustainable public debt position.** The Colombian authorities remain committed to fiscal sustainability. The new government's medium-term fiscal strategy will be guided by the Fiscal Responsibility Law submitted to Congress, which would limit the structural deficit of the central government to 2 percent of GDP starting in 2015. Staff's updated debt sustainability analysis (Figure 7 and Table 10) suggests that public debt would remain manageable and on a downward trajectory under alternative adverse scenarios.
- **Low and stable inflation, in the context of a sound monetary and exchange rate policy framework.** Notwithstanding the adverse effects of heavy rains on food prices at end-2010, inflation and inflation expectations continue to be well anchored within the inflation target range of 2–4 percent. The authorities remain committed to the inflation targeting framework and a flexible exchange rate regime.
- **Absence of bank solvency problems that pose an imminent threat of a systemic banking crisis.** As noted, Colombia's financial soundness indicators remain strong. As of December 2010, capital adequacy ratios stood at 18 percent; the ratio of NPLs to gross loans was low; provisions represented 174 percent of nonperforming loans; and banking system liquidity was adequate.
- **Effective financial sector supervision.** Colombia's regulatory and supervisory frameworks are sound and supported by a well established safety net. A recently finalized agreement between the Central Bank and the Financial Superintendent has improved the exchange of financial information.
- **Data transparency and integrity.** The overall quality of Colombian macroeconomic data is good and continues to meet the high standards found during the 2006 data ROSC. Colombia remains in observance of the Special Data Dissemination Standard (SDDS), and the authorities provide all relevant of data to the public on a timely basis.

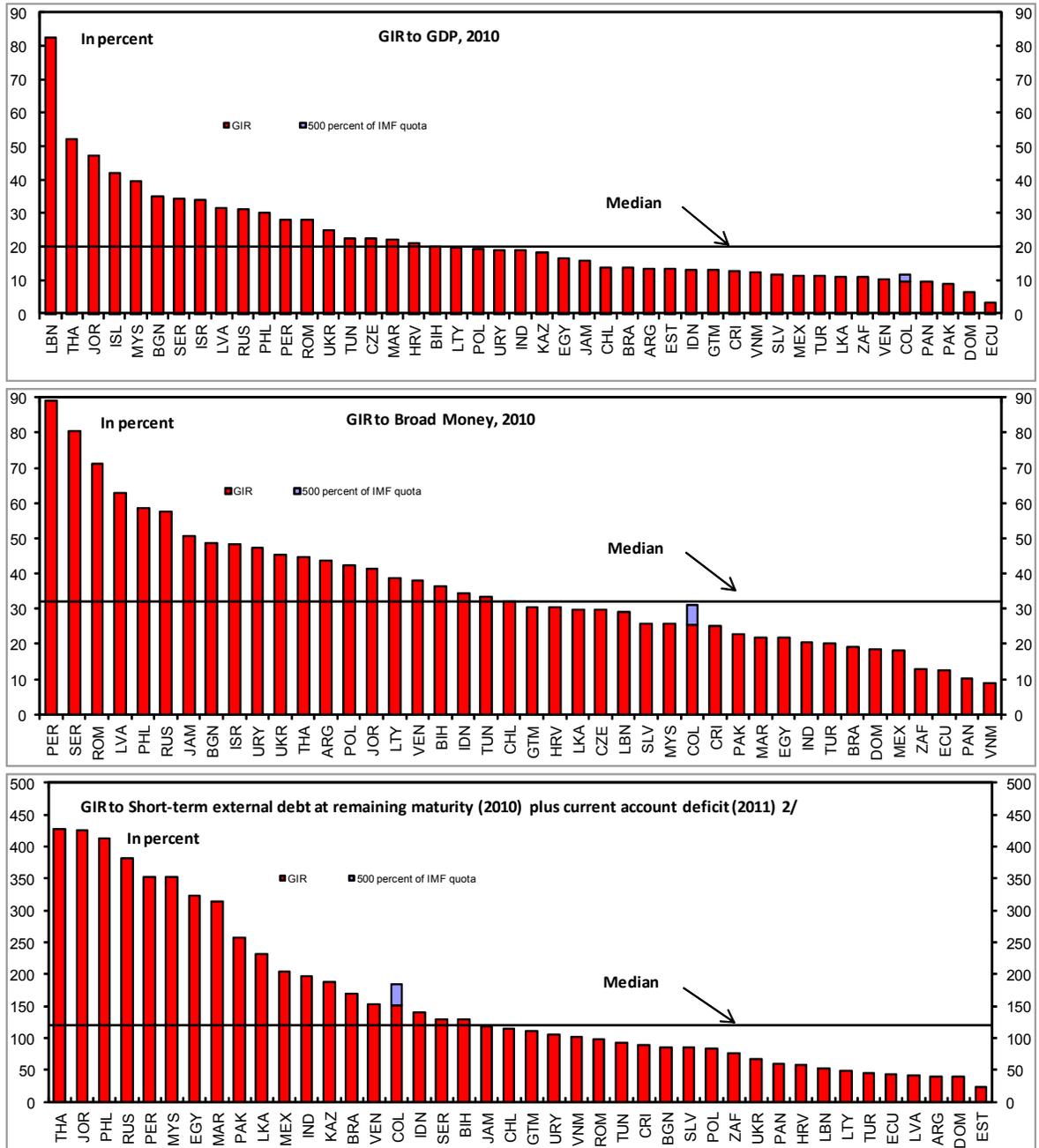
20. **The authorities' written communication (attachment) confirms their continued commitment to maintaining strong policy and institutional frameworks.** The authorities' priorities are to support the ongoing recovery while maintaining macroeconomic and financial stability. They are committed to continue strengthening their strong policy framework, anchored on a medium-term fiscal framework, inflation targeting, a flexible exchange rate, and strong financial sector supervision and regulation.

Figure 4. Colombia: FCL Qualification Criteria



Sources: Banco de la Republica; Ministerio de Hacienda y Crédito Público; Datastream; Haver; and IMF staff calculations.
 1/ Combined permanent 1/4 standard deviation shocks applied to interest rate, growth, and non-interest current account balance.
 2/ Includes data through end 2010.
 3/ Combined permanent 1/4 standard deviation shocks applied to real interest rate, growth, and primary balance.
 4/ One-time 10 percent of GDP increase in debt-creating liabilities.

Figure 5. Colombia: Reserve Coverage in International Perspective 1/



Sources: World Economic Outlook and IMF staff estimates.

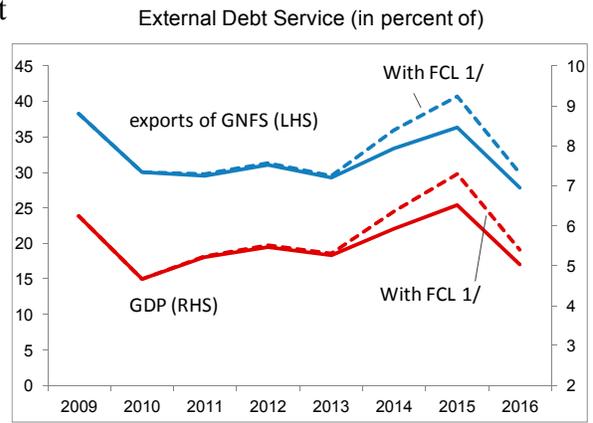
1/ Estimates for 2010. Figures for Mexico and Poland do not include resources available under their FCL arrangements.

2/ GIR at the end of 2010 in percent of ST debt at remaining maturity and current account deficit in 2011. The current account is set to zero if it is in surplus.

III. IMPACT ON FUND FINANCES, RISKS, AND SAFEGUARDS

21. **Access under the proposed two-year FCL arrangement for Colombia (SDR 3.87 billion or 500 percent of quota) would be manageable for Fund finances.** The Fund's liquidity is expected to remain adequate after the approval of the proposed FCL arrangement for Colombia (see supplement assessing the impact on the Fund's finances and liquidity position).

22. **Colombia's strong repayment capacity will help mitigate the risks to the Fund.** The authorities have indicated that they intend to continue to treat the FCL arrangement as precautionary. Nevertheless, even if Colombia were to draw all the resources available under the new FCL arrangement, its capacity to meet its financial obligations to the Fund would remain strong. Colombia has an excellent track record of meeting its financial obligations, the government has a deep commitment to macroeconomic stability and prudent policies, and the economy's medium-term growth prospects are excellent. Even if the adverse scenario were to materialize, Colombia's external debt would remain on a sustainable medium-term path, with debt service remaining very manageable.



1/ Assumes full drawing of the FCL in 2011, and projected exports and GDP in the baseline scenario.

23. **Staff is in the process of completing the necessary safeguards procedures for an FCL arrangement.** The central bank has provided PricewaterhouseCoopers (PwC) with a new authorization to communicate with staff. On February 7, 2011, PwC issued an unqualified audit opinion on the central bank's 2010 financial statements, which states that the audit was conducted in accordance with International Standards on Auditing. A complete set of audited statements and PwC's opinion have been published on the central bank's external website. Staff has contacted PwC to schedule a discussion of the audit and obtain copies of any related control recommendations.

IV. STAFF APPRAISAL

24. **A successor FCL arrangement for Colombia would provide an appropriate buffer in support of the government's economic strategy.** Notwithstanding Colombia's very strong underlying fundamentals and medium-term prospects, uncertainties about the global recovery and the availability and access to external financing constitute key risks to the near-term outlook. A successor FCL arrangement for 500 percent of quota—which the authorities intend to treat as precautionary—would provide Colombia with an appropriate level of protection against a possible deterioration of global conditions (including lower

commodity prices), and help maintain confidence in the authorities' capacity to withstand external shocks while preserving their commitment to macroeconomic stability.

25. **Staff assesses that Colombia continues to meet the qualification criteria for access to FCL resources and recommends approval of a two-year FCL arrangement for SDR 3.87 billion (500 percent of quota).** As discussed above, Colombia has very strong policy frameworks and economic fundamentals and has demonstrated an excellent track record of policy implementation. The authorities' policy response to the global crisis has been sound, and their policy stance remains anchored in tested institutional policy frameworks that the authorities are seeking to strengthen further. In their letter the authorities reaffirm their commitment to maintain sound policies in the future and to react appropriately if shocks were to materialize. All of the above are assessed by staff to contain the risks to the Fund arising from a potential drawing under the proposed FCL arrangement. Risks to the Fund are further contained by the authorities' intention to treat the FCL arrangement as precautionary, and Colombia's very strong debt servicing record and manageable external debt service profile.

Table 1. Colombia: Selected Economic and Financial Indicators

I. Social and Demographic Indicators							
Population (millions), 2009	45.0			Physicians (per 100,000 people), 2008			143.0
GDP, 2010				Adult illiteracy rate (percent ages 15 and older), 2008			6.9
per capita (US\$)	5,153			Gross primary school enrollment rate, 2008			119.9
in billions of Col\$	543,117			Sustainable access to safe water, 2006			
in billions of US\$	287.4			(percent of population)			93.0
Unemployment rate, february 2011 (percent)	12.8			Gini index, 2009			57.8
Life expectancy at birth (years), 2008	73.0			Poverty rate, 2009			45.5
Under 5 mortality rate (per 1,000 live births), 2008	20.6			Extreme poverty rate, 2009			16.4
II. Economic Indicators							
	2007	2008	2009	Prelim. 2010	Projections		
					2011	2012	2013
(Percentage changes, unless otherwise indicated)							
National income and prices							
Real GDP	6.9	3.5	1.5	4.3	4.6	4.5	4.5
GDP deflator	5.0	7.8	4.2	2.4	6.9	2.9	2.7
Consumer prices (average)	5.5	7.0	4.2	2.3	3.3	2.9	3.0
Consumer prices (end of period)	5.7	7.7	2.0	3.2	3.1	3.1	3.0
External sector (on the basis of US\$)							
Exports (f.o.b.)	21.4	26.0	-11.7	16.8	25.6	5.8	8.3
Imports (f.o.b.)	25.4	20.5	-16.2	22.3	12.6	6.2	7.0
Terms of trade (deterioration -)	3.9	11.2	-12.0	9.9	16.3	-1.7	-2.4
Real effective exchange rate (depreciation -)	7.7	0.4	5.2	5.5	...	...	...
Central government							
Revenue	14.8	16.0	2.8	-2.9	15.9	11.4	8.1
Expenditure	9.9	12.9	13.6	-2.0	16.9	3.4	6.3
Money and credit							
Broad money	17.4	18.5	8.1	11.5	18.2	10.9	10.5
Credit to the private sector	25.6	14.0	0.9	16.8	16.8	10.5	10.3
Interest rate (90-day time deposits; percent per year)							
Nominal	9.0	10.1	4.1	3.5	...	...	...
Real	3.3	2.4	2.1	0.3	...	...	...
(In percent of GDP)							
Central government balance	-2.7	-2.3	-4.1	-3.9	-4.2	-2.9	-2.7
Combined public sector balance 1/	-0.7	-0.1	-2.7	-3.0	-3.5	-1.7	-1.5
Public debt 2/	32.7	30.8	36.3	36.7	35.8	35.6	34.9
Public debt, excluding Ecopetrol	32.7	30.8	35.3	35.5	34.7	34.5	34.0
Gross domestic investment	23.0	23.4	22.7	22.6	23.9	24.6	24.8
Gross national savings	20.2	20.5	20.5	19.5	21.9	22.5	22.9
Current account (deficit -)	-2.9	-2.9	-2.1	-3.1	-2.1	-2.1	-1.9
External debt	21.2	19.7	22.9	20.9	20.2	19.9	19.5
Of which: public sector	13.7	12.5	15.9	13.7	13.4	13.3	13.1
GIR in percent of short-term debt	198.7	207.3	251.3	234.9	218.7	229.8	197.9
(In percent of exports of goods and services)							
External debt service	40.0	32.5	38.3	30.0	29.5	31.1	29.2
Of which: public sector	15.8	12.8	11.7	11.7	10.1	11.0	10.2
Of which: Interest payments	10.1	8.2	8.4	7.7	7.9	7.5	7.2
Of which: public sector	6.6	5.5	5.8	5.4	5.2	5.0	4.8
(In millions of U.S. dollars)							
Changes in GIR	5,498	3,065	1,321	3,086	1,985	1,918	1,965
Exports (f.o.b.)	30,577	38,534	34,026	39,741	49,909	52,814	57,223
Of which: Petroleum products	7,318	12,204	10,254	15,829	23,523	25,953	28,885
Coffee	1,714	1,883	1,543	2,034	2,919	2,791	2,739
Gross official reserves (US millions)	20,607	23,672	24,992	28,078	30,063	31,981	33,946
Share of ST debt at remaining maturity + CA deficit	119	144	133	153	144	156	134
In months of imports of goods and services	5.5	7.4	6.5	6.5	6.6	6.6	6.6

Sources: Colombian authorities; UNDP Human Development Report; World Development Indicators; and Fund staff estimates and projections.

1/ Includes the quasi-fiscal balance of Banco de la República, Fogafin balance, net cost of financial system restructuring, and statistical discrepancy.

2/ Includes Ecopetrol and Banco de la República's outstanding external debt.

Table 2. Colombia: Summary Balance of Payments

	2007	2008	2009	Prelim. 2010	Projections					
					2011	2012	2013	2014	2015	2016
(In millions of U.S. dollars)										
Current account balance	-6,018	-6,923	-5,001	-8,866	-6,440	-7,064	-6,636	-8,237	-7,659	-7,182
Trade balance	-584	971	2,546	1,230	6,550	6,751	7,919	6,956	7,744	8,844
Exports, f.o.b.	30,577	38,534	34,026	39,741	49,909	52,814	57,223	59,456	63,555	68,295
Coffee	1,714	1,883	1,543	2,034	2,919	2,791	2,739	2,317	1,975	1,751
Petroleum products	7,318	12,204	10,254	15,829	23,523	25,953	28,885	29,918	32,691	35,661
Non-traditional	15,174	17,101	14,624	13,851	14,512	15,506	16,890	18,285	19,825	21,574
Other	6,370	7,346	7,605	8,026	8,954	8,564	8,710	8,936	9,064	9,309
Imports, f.o.b.	31,161	37,563	31,479	38,511	43,359	46,064	49,304	52,500	55,811	59,451
Services (net)	-2,647	-3,072	-2,728	-2,821	-3,157	-3,357	-3,558	-3,813	-4,062	-4,303
Income (net)	-8,002	-10,333	-9,432	-11,667	-13,820	-14,730	-15,592	-16,320	-16,649	-17,422
Interest (net)	-1,737	-2,067	-2,515	-2,816	-3,519	-3,310	-3,075	-2,723	-2,221	-1,690
Of which: public sector	-1,284	-1,502	-1,779	-2,183	-2,478	-2,366	-2,248	-2,083	-1,817	-1,567
Other Income (net)	-6,265	-8,266	-6,918	-8,851	-10,301	-11,421	-12,517	-13,597	-14,428	-15,733
Current transfers (net)	5,216	5,512	4,614	4,391	3,987	4,273	4,594	4,940	5,307	5,698
Financial account balance	10,347	9,492	6,324	11,931	8,424	8,982	8,602	10,247	9,601	9,134
Public sector (net)	2,198	-309	6,310	4,965	2,512	2,320	1,857	1,875	1,383	386
Nonfinancial public sector	1,928	-95	6,176	5,190	2,120	2,156	1,773	1,755	1,398	463
Medium- and long-term (net)	1,298	998	6,383	2,643	2,129	2,164	1,782	1,763	1,406	471
Disbursements	4,096	3,246	7,942	4,767	4,016	4,860	4,409	5,556	5,434	2,481
Amortization	2,798	2,248	1,559	2,124	1,887	2,695	2,628	3,793	4,027	2,010
Other long-term flows	-19	0	1	-8	-8	-8	-8	-8	-8	-8
Short term 1/	649	-1,093	-208	2,555	0	0	0	0	0	0
Financial public sector	270	-215	135	-224	392	164	83	120	-15	-76
Private sector (net)	8,149	9,801	14	6,966	5,912	6,662	6,745	8,372	8,218	8,748
Nonfinancial private sector (net)	7,918	8,806	1,248	7,062	5,986	6,677	6,740	8,354	8,193	8,718
Direct investment	8,136	8,342	4,118	2,535	6,540	7,431	7,116	7,841	8,265	8,449
Direct investment abroad	913	2,254	3,088	6,522	3,184	2,422	2,956	2,497	2,538	2,783
Direct investment in Colombia	9,049	10,596	7,207	9,057	9,723	9,853	10,072	10,339	10,803	11,233
Leasing finance	116	277	733	-210	101	190	310	246	174	129
Disbursements	656	1,004	1,797	736	822	841	906	967	1,021	1,085
Amortization	540	726	1,064	946	721	651	596	721	847	956
Long-term loans	951	408	574	3,600	0	0	0	0	0	0
Disbursements	3,031	2,263	3,298	5,849	3,803	4,309	4,373	5,920	8,747	5,925
Amortization	2,080	1,854	2,724	2,250	3,803	4,309	4,373	5,920	8,747	5,925
Short term 2/	-1,286	-222	-4,177	1,137	-655	-944	-687	266	-246	140
Financial private sector (net)	231	996	-1,234	-96	-74	-15	5	19	25	30
Valuation changes/Contribution to FLAR 3/	800	442	-27	-46	0	0	0	0	0	0
Net errors and omissions	368	53	24	67	0	0	0	0	0	0
Changes in GIR 4/ 5/	5,498	3,065	1,321	3,086	1,985	1,918	1,965	2,010	1,942	1,952
<i>Memorandum Items:</i>										
Current account balance (in percent of GDP)	-2.9	-2.9	-2.1	-3.1	-2.1	-2.1	-1.9	-2.2	-2.0	-1.7
Oil Price (Colombian mix)	66.2	90.2	56.6	73.3	99.3	100.1	97.8	96.9	97.3	98.3
Gross international reserves (in US\$ billion)	20.6	23.7	25.0	28.1	30.1	32.0	33.9	36.0	37.9	39.8
Gross international reserves / (st debt at remaining maturity + ca deficit)	119.2	144.2	132.9	152.7	144.5	155.6	133.7	126.8	160.8	173.0
Gross international reserves (months of imports of G&S)	5.5	7.4	6.5	6.5	6.6	6.6	6.6	6.6	6.5	6.5
Nominal GDP (US\$ billion)	210.6	235.7	234.2	287.4	313.3	332.1	350.6	369.9	390.1	416.2

Sources: Banco de la República; and Fund staff estimates and projections.

1/ Mainly deposit flows of public sector entities abroad.

2/ Includes net portfolio investment.

3/ FLAR is Fondo Latinoamericano de Reservas.

4/ IMF definition.

5/ Figures for 2009 include SDR allocation to Colombia amounting to US\$972 million.

Table 3. Colombia: External Financing Requirements and Sources
(In millions of U.S. dollars)

	2008	2009	2010	Staff Projections			
				2011		2012	
				Prelim.	Baseline	Adverse Scenario	Baseline	Adverse Scenario
Gross financing requirements	20,357	17,740	21,896	20,376	23,072	22,730	25,839
External current account deficit	6,923	5,001	8,866	6,440	11,120	7,064	12,091
Debt amortization	10,369	11,419	9,944	11,952	11,952	13,748	13,748
Medium and long term debt	5,225	5,802	5,931	6,696	6,696	7,927	7,927
Public sector 1/	2,380	1,722	2,469	1,928	1,928	2,731	2,731
Private sector	2,846	4,080	3,462	4,768	4,768	5,196	5,196
Non financial	1,854	2,724	2,250	3,803	3,803	4,309	4,309
Financial	991	1,356	1,212	966	966	887	887
Short-term debt 2/	5,144	5,617	4,013	5,255	5,255	5,821	5,821
Public sector	695	552	339	769	769	769	769
Private sector	4,449	5,064	3,673	4,487	4,487	5,052	5,052
Gross reserves accumulation 3/ 4/	3,065	1,321	3,086	1,985	0	1,918	0
Available financing	20,357	17,740	21,896	20,376	17,562	22,730	20,094
Foreign direct investment (net)	8,342	4,118	2,535	6,540	5,567	7,431	6,446
o/w inward (net)	10,596	7,207	9,057	9,723	8,751	9,853	8,868
Medium and long-term debt disbursements	6,820	13,307	11,686	9,293	8,018	10,422	9,007
Public sector 1/	3,425	8,196	4,888	4,448	4,004	5,060	4,554
Private sector	3,395	5,111	6,798	4,845	4,014	5,363	4,453
Non financial	2,263	3,298	5,849	3,803	3,232	4,309	3,663
Financial	1,132	1,813	949	1,043	782	1,053	790
Public sector use of external assets 5/	-50	287	2,626	0	0	0	0
Short-term debt 6/	5,617	4,013	5,255	5,821	5,255	6,056	5,821
Public sector	552	339	769	769	769	769	769
Private sector	5,064	3,673	4,487	5,052	4,487	5,287	5,052
Private sector use of external assets 7/	395	-3,123	-958	-850	-850	-950	-950
Other capital flows (net) 8/	-767	-861	751	-428	-428	-229	-229
Financing gap analysis (in US\$ millions, unless specified)							
Financing needs (A+B-C)					5,510		5,745
<i>In percent of quota</i>					452		472
A. Current account shock					4,681		5,027
<i>In percent of quota</i>					384		413
B. Capital account shock					2,814		2,636
<i>In percent of quota</i>					231		216
Combined shock					7,494		7,663
<i>In percent of quota</i>					615		629
C. Reserve accumulation in baseline					1,985		1,918
Memorandum items:							
100 percent of quota (in SDR million)					774		774
100 percent of quota (in US\$ million)					1,218		1,218
Gross international reserves 4/	23,672	24,992	28,078	30,063	28,078	31,981	30,063
Gross international reserves / (st debt at remaining maturity + ca deficit)	144.2	132.9	152.7	144.5	134.9	155.6	146.3
Gross international reserves (months of imports of G&S)	7.4	6.5	6.5	6.6	6.1	6.6	6.2

Sources: Banco de la República and Fund staff estimates.

1/ Including financial public sector.

2/ Original maturity of less than 1 year. Stock at the end of the previous period.

3/ Estimate for 2009 includes the SDR allocation (US\$972 million).

4/ IMF definition that excludes Colombia's contribution to Fondo Latinoamericano de Reservas (FLAR) and includes valuation changes of reserves denominated in other currencies than U.S. dollars.

5/ Assumes build-up of Ecopetrol dividend abroad as a safeguard against long-term fiscal liabilities.

6/ Original maturity of less than 1 year. Stock at the end of the current period.

7/ Includes pension funds and other portfolio flows.

8/ Includes all other net financial flows, Colombia's contribution to FLAR, and errors and omissions.

Table 4. Colombia: Operations of the Central Government 1/
(In percent of GDP)

	2006	2007	2008	2009	Prel. 2010	2011	2012	Proj.		2015	2016
								2013	2014		
Total revenue	14.7	15.0	15.6	15.2	13.8	14.3	14.8	14.9	14.8	14.5	14.3
Current revenue	14.7	15.0	15.6	15.2	13.8	14.3	14.8	14.9	14.8	14.5	14.3
Tax revenue	13.4	13.4	13.4	12.8	12.3	12.6	13.1	13.2	13.0	12.8	12.6
Net income tax and profits	5.5	5.6	5.1	5.5	4.9	5.3	5.7	5.7	5.7	5.7	5.7
Goods and services	5.9	5.7	5.9	5.3	5.5	5.6	5.8	5.8	5.8	5.8	5.8
Value-added tax	5.6	5.4	5.6	5.1	5.2	5.3	5.5	5.6	5.6	5.6	5.6
Gasoline tax	0.3	0.3	0.3	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.2
International trade	0.9	1.0	0.9	0.8	0.8	0.7	0.6	0.6	0.6	0.6	0.6
Financial transaction tax	0.7	0.7	0.7	0.6	0.6	0.5	0.5	0.5	0.4	0.4	0.2
Stamp and other taxes	0.3	0.5	0.8	0.5	0.4	0.5	0.5	0.5	0.5	0.3	0.2
Nontax revenue	1.3	1.6	2.2	2.4	1.5	1.6	1.7	1.7	1.7	1.7	1.7
Property income	0.3	0.2	0.2	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0
Other	1.1	1.4	2.0	2.2	1.4	1.6	1.7	1.7	1.7	1.7	1.7
Total expenditure and net lending	18.1	17.7	17.9	19.2	17.7	18.5	17.8	17.6	17.3	16.5	16.2
Current expenditure	15.2	14.5	14.4	15.5	14.6	14.9	13.7	13.6	13.3	13.0	12.7
Wages and salaries	2.1	2.0	2.0	2.1	2.4	2.2	2.1	2.0	1.9	1.8	1.7
Goods and services	1.3	1.2	1.2	1.0	1.2	1.0	1.0	0.9	0.9	0.8	0.8
Interest	3.6	3.7	3.2	3.0	2.7	2.9	2.9	2.9	2.9	3.0	2.9
External	1.0	0.9	0.8	0.8	0.7	0.8	0.7	0.6	0.7	0.8	0.6
Domestic	2.6	2.8	2.4	2.2	2.0	2.1	2.2	2.2	2.2	2.2	2.2
Current transfers	8.2	7.6	8.0	9.4	8.4	8.7	7.8	7.8	7.5	7.4	7.4
Of which : fuel subsidies 2/	0.0	0.1	0.1	1.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital expenditure	2.8	3.1	3.5	3.7	3.0	3.6	4.0	4.0	3.9	3.4	3.4
Fixed capital formation	1.5	1.9	2.2	2.3	1.6	2.2	2.7	2.6	2.6	2.0	2.0
Capital transfers	1.2	1.3	1.2	1.4	1.4	1.4	1.4	1.4	1.4	1.4	1.4
Net lending	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-3.4	-2.7	-2.3	-4.1	-3.9	-4.2	-2.9	-2.7	-2.5	-2.0	-1.9
<i>Memorandum item:</i>											
Oil-related revenues 3/	0.9	1.1	1.2	2.3	0.7	0.9	1.6	1.7	1.6	1.6	1.6
Overall structural balance 4/	-3.5	-3.1	-3.8	-2.5	-3.6	-4.1	-3.0	-2.7	-2.5	-2.0	-1.9
Primary balance	0.2	1.0	0.9	-1.1	-1.1	-1.2	-0.1	0.2	0.4	1.1	1.0
Nominal GDP (in COP billions)	383,898	431,072	481,037	508,532	543,117	607,399	653,216	700,980	748,941	798,174	859,347

Sources: Ministry of Finance; Banco de la República; and Fund staff estimates and projections.

1/ Includes central administration only.

2/ Payments for fuel subsidies granted in 2007-08 were distributed across the 2007-2009 budgets. A fuel price stabilization fund was created at end-2008 to eliminate fuel subsidies.

3/ Includes income tax payments and dividends from Ecopetrol that correspond to earnings from the previous year.

4/ Adjusts for the output gap, oil price expectations, and fuel subsidies.

Table 5. Colombia: Operations of the Combined Public Sector 1/
(In percent of GDP)

	2006	2007	2008	2009	Prel.	Proj.					
					2010	2011	2012	2013	2014	2015	2016
Total revenue	27.3	27.2	26.3	26.5	24.5	25.2	25.9	25.9	25.7	25.4	25.2
Tax revenue	19.2	19.4	19.2	18.3	17.6	18.0	18.4	18.5	18.3	18.0	17.7
Nontax revenue	8.1	7.8	7.1	8.3	6.9	7.3	7.5	7.5	7.4	7.4	7.4
Financial income	1.2	1.4	1.3	1.7	1.2	1.0	1.0	1.0	1.0	1.0	0.9
Operating surplus of public enterprises	3.6	3.2	0.3	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Other	3.3	3.2	5.4	6.4	5.5	6.2	6.4	6.4	6.3	6.4	6.4
Total expenditure and net lending 2/	28.1	28.2	26.3	29.1	27.3	28.8	27.8	27.7	27.3	26.6	26.3
Current expenditure	22.6	21.8	21.3	22.9	21.4	22.2	20.9	20.8	20.5	20.4	20.0
Wages and salaries	5.8	5.6	5.5	5.7	5.8	5.6	5.4	5.4	5.3	5.2	5.0
Goods and services	3.6	3.6	3.4	3.2	3.3	3.1	3.1	3.1	3.1	3.0	3.0
Interest	3.9	4.1	3.5	3.3	3.0	3.2	3.2	3.2	3.2	3.5	3.2
External	1.1	1.0	0.8	0.8	0.8	0.9	0.8	0.7	0.7	1.0	0.7
Domestic	2.7	3.1	2.6	2.5	2.2	2.4	2.4	2.5	2.5	2.5	2.5
Transfers to private sector	7.3	7.2	7.4	8.7	8.1	8.5	7.5	7.5	7.3	7.2	7.2
Of which: fuel subsidies 3/	0.0	0.1	0.1	1.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other 4/	2.0	1.3	1.5	1.9	1.2	1.8	1.6	1.7	1.6	1.6	1.6
Capital expenditure	5.5	6.4	5.0	6.2	5.9	6.5	6.9	6.9	6.8	6.3	6.3
Statistical discrepancy	-0.2	0.2	-0.3	-0.2	-0.3	0.0	0.0	0.0	0.0	0.0	0.0
Nonfinancial public sector balance	-1.0	-0.8	-0.3	-2.8	-3.1	-3.5	-1.9	-1.7	-1.6	-1.2	-1.1
Quasi-fiscal balance (BR cash profits)	0.4	0.4	0.3	0.1	0.0	-0.1	0.0	0.0	0.0	0.0	0.0
Fogafin balance	0.2	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Net cost of financial restructuring 5/	-0.3	-0.3	-0.3	-0.2	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Combined public sector balance	-0.7	-0.7	-0.1	-2.7	-3.0	-3.5	-1.7	-1.5	-1.4	-1.0	-0.9
Overall financing	0.7	0.7	0.1	2.7	3.0	3.5	1.7	1.5	1.4	1.0	0.9
Foreign, net	0.4	0.1	-0.6	1.7	1.3	0.3	0.3	0.2	0.1	0.0	-0.3
Domestic, net	0.3	0.5	0.6	0.8	1.6	2.4	1.0	1.0	0.9	1.0	1.2
Privatization (including concessions)	0.0	0.0	0.1	0.2	0.1	0.7	0.4	0.4	0.4	0.0	0.0
<i>Memorandum items:</i>											
CPS overall structural balance 6/	-1.1	-1.5	-2.0	-1.2	-2.3	-3.5	-1.9	-1.7	-1.6	-1.2	-1.1
Oil-related revenues 7/	3.4	3.0	2.7	3.5	2.1	3.1	3.6	3.6	3.6	3.6	3.7
Total public debt 8/	36.8	32.7	30.8	36.3	36.7	35.8	35.6	34.9	34.3	33.7	32.7
Nominal GDP (in COP billions)	383,898	431,072	481,037	508,532	543,117	607,399	653,216	700,980	748,941	798,174	859,347

Sources: Ministry of Finance; Banco de la República; and Fund staff estimates and projections.

1/ Combined public sector includes the central, regional and local governments, social security, and public sector enterprises.

Figures for 2008 and projections reflect exclusion of Ecopetrol operations and privatization of health care, which reduces revenue and spending by about 2 percent of GDP and 1.5 percent of GDP, respectively, in 2008.

2/ Expenditure reported on commitments basis.

3/ Payments for fuel subsidies granted in 2007-08 were distributed across the 2007-2009 budgets. At end-2008, a fuel price stabilization fund was created to eliminate fuel subsidies.

4/ Includes adjustments to put spending on commitment basis and the change in unpaid bills of selected nonfinancial public enterprises.

5/ Interest payments on public banks restructuring bonds and mortgage debt relief related costs.

6/ Adjusts for the output gap, oil price expectations, fuel subsidies, and one-off additional pension-related revenues.

7/ Includes income tax payments and dividends from Ecopetrol that correspond to earnings from the previous year, and royalties to local governments.

8/ Includes Ecopetrol and Banco de la República's outstanding external debt.

Table 6. Colombia: Monetary Indicators

	2006	2007	2008	2009	2010
(In billions of Colombian pesos, unless otherwise indicated)					
Central Bank					
Net Foreign Assets	35,265	42,876	54,661	50,526	53,265
Gross official reserve assets	34,878	42,343	53,720	51,650	54,583
in billions of US\$	15.7	21.0	23.9	25.3	28.5
Short-term foreign liabilities	326	136	613	562	844
Other net foreign assets	1,257	1,161	2,106	1,955	1,865
Net domestic assets	-8,215	-9,964	-18,403	-10,958	-8,373
Net credit to the public sector	-284	-4,038	-1,792	622	-2,098
Net credit to the financial system	6,598	5,039	-143	-419	1,516
Other	-14,529	-10,965	-16,468	-11,160	-7,792
Monetary base	27,032	32,415	36,195	39,547	44,878
Currency in circulation	20,120	22,417	24,352	25,671	29,674
Deposit money banks reserves	6,896	9,970	11,832	13,865	15,157
Other deposits	16	29	12	10	47
Financial system					
Net foreign assets	34,751	37,886	49,670	48,267	44,516
in billions of US\$	15.0	18.4	21.4	24.2	23.0
Net domestic assets	88,469	106,762	121,706	136,915	161,883
Net credit to public sector	20,401	11,926	16,150	32,352	33,782
Credit to private sector	104,290	130,986	149,366	150,766	176,020
Other net	-36,222	-36,150	-43,809	-46,203	-47,918
Broad money	123,219	144,648	171,376	185,182	206,399
(Annual percentage change)					
y-o-y					
Credit to private sector	35.6	25.6	14.0	0.9	16.8
Currency	22.9	11.4	8.6	5.4	15.6
Monetary base	18.5	19.9	11.7	9.3	13.5
Broad money	18.0	17.4	18.5	8.1	11.5
(In percent of GDP)					
in percent of annual GDP					
Credit to private sector	27.2	30.4	31.1	29.6	32.4
Currency	5.2	5.2	5.1	5.0	5.5
Monetary base	7.0	7.5	7.5	7.8	8.3
Broad money	32.1	33.6	35.6	36.4	38.0
Memorandum items:					
Central bank inflation target	4.0-5.0	3.5-4.5	3.5-4.5	4.5-5.5	2.0-4.0
CPI inflation, eop	4.5	5.7	7.7	2.0	3.2
Exchange rate depreciation	-2.6	-9.5	11.4	-8.9	-6.4

Sources: Banco de la Republica; and Fund staff estimates.

Table 7. Colombia: Financial Soundness Indicators
 Total Banking System 1/
 (In percent, unless otherwise indicated; end-of-period values)

	2006	2007	2008	2009	2010
Capital Adequacy					
Regulatory capital to risk-weighted assets	15.4	16.0	15.4	17.2	18.0
Regulatory Tier 1 capital to risk-weighted assets	11.8	12.5	12.0	13.4	13.0
Capital (net worth) to assets	13.3	12.9	12.6	14.2	14.3
Asset Quality and Distribution					
Nonperforming loans to gross loans	2.7	3.2	3.9	4.0	2.9
Provisions to nonperforming loans	154.4	133.8	124.3	140.1	174.0
Gross loans to assets	65.0	70.3	71.2	64.3	67.9
Earnings and Profitability					
ROAA	4.0	4.0	3.6	3.5	3.9
ROAE	29.9	30.8	28.1	26.2	27.2
Interest margin to gross income	45.8	52.1	54.0	54.0	55.5
Noninterest expenses to gross income	53.3	45.1	46.1	43.2	47.0
Liquidity					
Liquid assets to total assets	6.0	7.5	8.2	9.2	7.5
Liquid assets to short-term liabilities	9.2	11.6	12.8	14.2	12.1
Deposit to loan ratio	101.4	94.7	94.9	98.8	93.5
Other					
Foreign-currency-denominated loans to total loans	4.4	6.3	6.6	4.2	6.9
Foreign-currency-denominated liabilities to total liabilities	4.5	8.5	8.9	6.6	11.2
Net open position in foreign exchange to capital	21.4	1.9	-0.1	1.7	-2.0

Sources: Superintendencia Financiera; and Creditedge (Moody's-KMV).

1/ All deposit taking institutions, while in former staff reports the coverage was limited to commercial banks.

Table 8. Colombia: Indicators of Fund Credit, 2009-16

	2009	Prelim.	Staff Projections					2016
		2010	2011	2012	2013	2014	2015	
Stocks from prospective drawings 1/								
Fund credit in millions SDR	0	0	3,870	3,870	3,870	2,903	968	0
In percent of quota	0	0	500	500	500	375	125	0
In percent of GDP	0	0	1.9	1.8	1.7	1.2	0.4	0
In percent of exports of goods and services	0	0	11.0	10.4	9.6	6.9	2.2	0
In percent of gross reserves	0	0	16.8	15.9	15.1	11.2	3.8	0
Flows from prospective drawings 2/								
Amortization	0	0	0	0	0	968	1,935	968
GRA Charges	0	0	28.3	58.1	58.0	56.3	33.1	5.8
Service Charge	0	0	19.4	0.0	0.0	0.0	0.0	0.0
Debt service due on GRA credit (millions SDR)	0	0	62.8	89.1	89.0	1,058.9	1,973.7	973.3
In percent of quota	0	0	8.1	11.5	11.5	136.8	255.0	125.7
In percent of GDP	0	0	0.0	0.0	0.0	0.2	0.3	0.2
In percent of exports of goods and services	0	0	0.1	0.1	0.1	1.0	1.8	0.8
In percent of gross reserves 2/	0	0	0.1	0.2	0.2	1.9	3.3	1.6
<i>Memorandum Item:</i>								
Total External Debt, assuming full drawing (% of GDP)	22.9	20.9	22.1	21.7	21.3	20.4	19.1	17.7
Total Debt Service, assuming full drawing (% of GDP)	6.3	4.7	5.2	5.5	5.3	6.4	7.3	5.4

Sources: IMF Finance Department; Colombian authorities, and Fund staff estimates.

1/ End of period. Assumes full drawings under the FCL upon approval. The Colombian authorities have expressed their intention to treat the arrangement as precautionary.

2/ Million SDRs, unless otherwise indicated. Calculations based on the rate of charge as of April 14, 2011.

Table 9. Colombia: External Debt Sustainability Framework, 2006-2016
(In percent of GDP, unless otherwise indicated)

	Actual			Staff Projections 1/							Debt-stabilizing non-interest current account 7/ -2.4	
	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015		2016
Baseline: External debt	25.0	21.2	19.7	22.9	20.9	20.2	19.9	19.5	19.2	18.7	17.7	
Change in external debt	-1.3	-3.8	-1.5	3.3	-2.0	-0.7	-0.3	-0.3	-0.3	-0.5	-0.9	0.0
Identified external debt-creating flows (4+8+9)	-3.9	-6.9	-2.9	0.5	-2.0	-0.9	-1.0	-1.0	-1.0	-1.2	-1.3	0.0
Current account deficit, excluding interest payments	0.2	1.4	1.7	0.9	2.0	0.8	1.0	0.8	1.1	0.7	0.7	2.4
Deficit in balance of goods and services	1.1	1.5	0.9	0.1	0.6	-1.1	-1.0	-1.2	-0.8	-0.9	-1.1	
Exports	17.8	16.2	18.1	16.3	15.5	17.6	17.6	18.0	17.7	17.9	18.0	
Imports	18.9	17.8	19.0	16.4	16.1	16.6	16.6	16.8	16.9	17.0	16.9	
Net non-debt creating capital inflows (negative)	-3.5	-3.9	-3.5	-1.8	-0.9	-2.1	-2.2	-2.0	-2.4	-2.4	-2.3	-2.3
Automatic debt dynamics 2/	-0.6	-4.5	-1.0	1.3	-3.1	0.4	0.3	0.2	0.3	0.5	0.2	-0.1
Contribution from nominal interest rate	1.7	1.5	1.2	1.2	1.1	1.3	1.2	1.1	1.1	1.3	1.0	1.0
Contribution from real GDP growth	-1.6	-1.3	-0.7	-0.3	-0.8	-0.9	-0.9	-0.8	-0.8	-0.8	-0.8	-0.7
Contribution from price and exchange rate changes 3/	-0.7	-4.6	-1.6	0.4	-3.4	...	...	...	...	...	...	-0.4
Residual, incl. change in gross foreign assets (2-3) 4/	2.6	3.1	1.4	2.8	0.0	0.2	0.7	0.7	0.6	0.7	0.4	0.0
External debt-to-exports ratio (in percent)	140.4	130.2	108.7	140.5	134.5	114.4	112.9	108.6	108.3	104.3	98.5	
Gross external financing need (in billions of US dollars) 5/	16.2	16.3	17.3	16.4	18.8	18.4	20.8	20.6	25.4	28.4	23.6	
in percent of GDP	10.1	7.7	7.3	7.0	6.5	5.9	6.3	5.9	6.9	7.3	5.7	
Scenario with key variables at their historical averages 6/						20.2	17.6	15.1	12.6	10.3	7.9	-2.8
Key Macroeconomic Assumptions Underlying Baseline												For debt stabilization
Real GDP growth (in percent)	6.7	6.9	3.5	1.5	4.3	4.6	4.5	4.5	4.5	4.5	4.5	4.5
GDP deflator in US dollars (change in percent)	2.7	22.6	8.1	-2.1	17.7	4.2	1.4	1.1	1.0	1.0	2.1	2.1
Nominal external interest rate (in percent)	7.1	7.7	6.5	6.0	5.8	6.6	6.1	5.6	5.9	7.2	5.9	5.9
Growth of exports (US dollar terms, in percent)	17.1	19.8	24.7	-10.4	16.9	23.7	5.7	8.0	3.9	6.7	7.2	
Growth of imports (US dollar terms, in percent)	22.9	23.4	19.6	-14.2	20.5	12.1	6.1	6.8	6.3	6.1	6.3	
Current account balance, excluding interest payments	-0.2	-1.4	-1.7	-0.9	-2.0	-0.8	-1.0	-0.8	-1.1	-0.7	-0.7	
Net non-debt creating capital inflows	3.5	3.9	3.5	1.8	0.9	2.1	2.2	2.0	2.4	2.4	2.3	

Source: IMF staff estimates.

1/ Does not assume any drawings under the Flexible Credit Line arrangement.

2/ Derived as $[-g - \pi(1+g) + \epsilon \pi(1+g)] / (1+g-\pi g)$ times previous period debt stock, with r = nominal effective interest rate on external debt, π = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, ϵ = nominal appreciation (increase in dollar value of domestic currency), and α = share of domestic-currency denominated debt in total external debt.

3/ The contribution from price and exchange rate changes is defined as $[-\pi(1+g) + \epsilon \pi(1+g)] / (1+g-\pi g)$ times previous period debt stock. π increases with an appreciating domestic currency ($\epsilon > 0$) and rising inflation (based on GDP deflator).

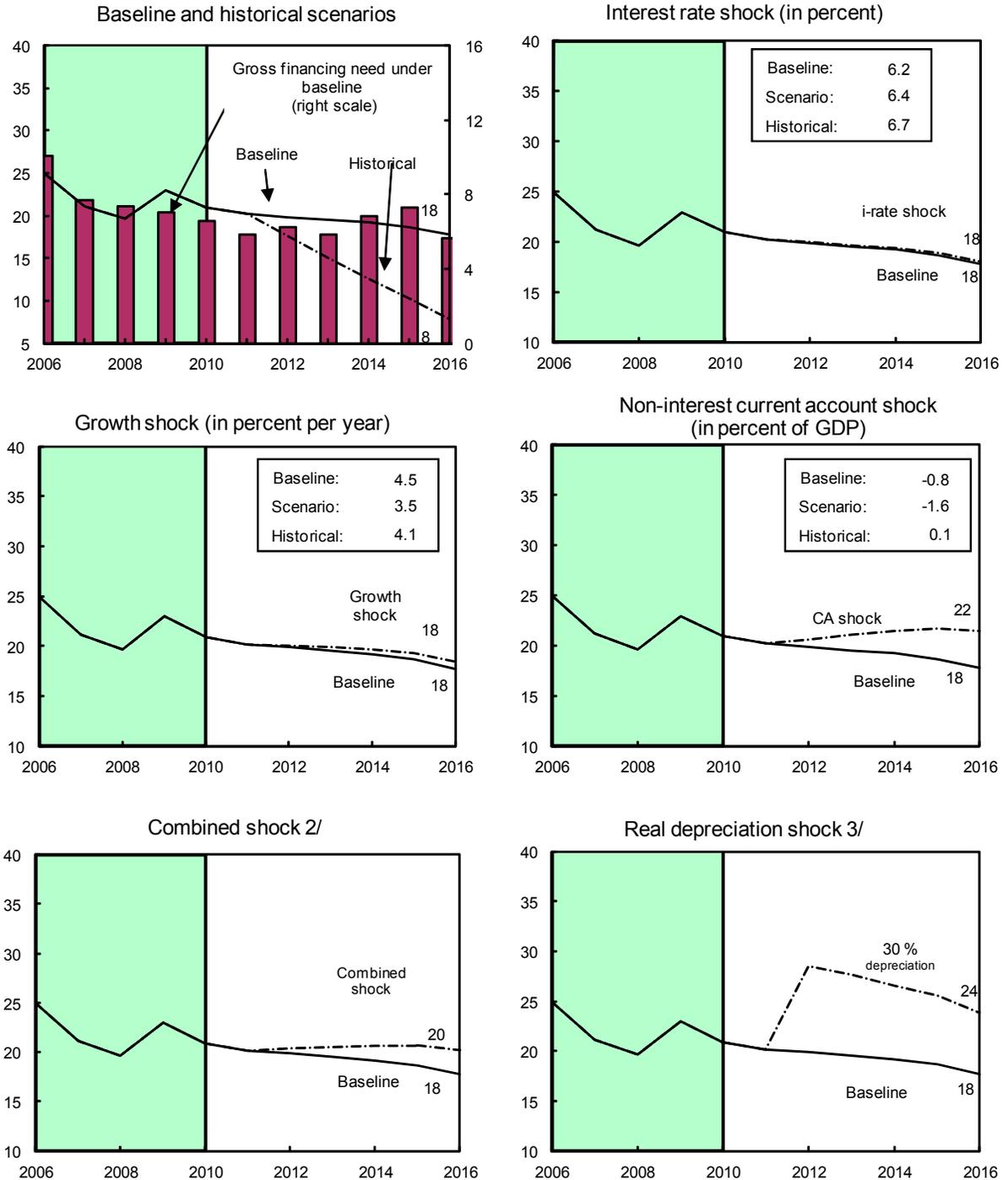
4/ For projection, line includes the impact of price and exchange rate changes.

5/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

6/ The key variables include real GDP growth, nominal interest rate, dollar deflator growth, and both non-interest current account and non-debt inflows in percent of GDP.

7/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Figure 6. Colombia: External Debt Sustainability: Bound Tests 1/
(External debt in percent of GDP)



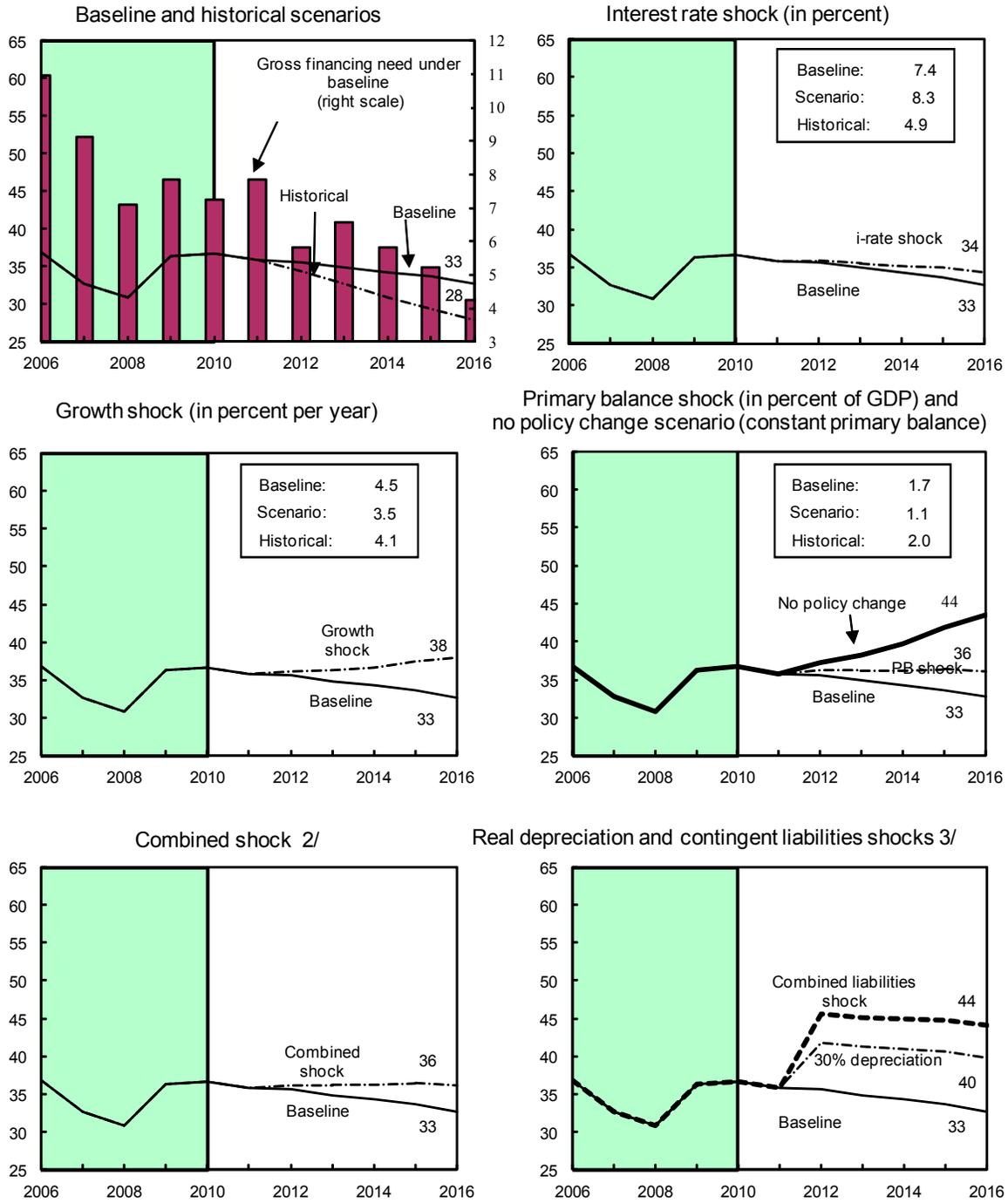
Sources: International Monetary Fund, Country desk data, and staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

3/ One-time real depreciation of 30 percent occurs in 2012, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Figure 7. Colombia: Public Debt Sustainability: Bound Tests 1/
(Public debt in percent of GDP)



Sources: International Monetary Fund, country desk data, and staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.

3/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2012, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Bogotá, April 20, 2011

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington, D.C.

Dear Mr. Strauss-Kahn,

We would like to thank the Fund for the two FCL arrangements that have been approved for Colombia since early 2009. The instrument has been extremely useful for Colombia, by enabling our country to have access to substantial international liquidity in a difficult and uncertain period. At the same time, the arrangements have provided a strong signal of the Fund's support of our solid policy framework and prudent macroeconomic management.

Although the world economy and global financial conditions have improved markedly since the onset of the global financial crisis, the global economic recovery is far from assured and remains subject to downside risks, stemming from fiscal weaknesses in advanced countries, fragilities in large financial systems, sharp movements in commodity prices, and persistent risks of a slowdown in global activity. These risks translate into an uncertain outlook for external demand of our products, workers' remittances, and capital flows.

Colombia's recovery from the effects of the global crisis has been steady but measured, and the output gap created by the crisis has not been closed yet. In this context, we consider a key priority to maintain a macroeconomic policy stance supportive of sustainable growth in domestic activity and to withdraw stimulus in an orderly way as conditions warrant. Faced with these difficult conditions, we would like to have the capacity to respond to large adverse external shocks without altering the main course of our macroeconomic policies and therefore believe it is critical to secure another arrangement with the IMF under the Flexible Credit Line.

After almost one year from our previous FCL request, we see essentially the same risks to our external position that, if they were to materialize, would create a large external financing shortfall. In fact, our estimates suggest that a similar set of shocks to those underlying the current FCL would actually create a larger impact on our balance of payments in absolute terms. This motivates us to request larger access under a new FCL arrangement (albeit still well less than in the 2009 FCL).

In addition, we welcome the opportunity under the enhancement of the FCL facility to seek an arrangement for a period of two years, which is a superior option in our view than annual arrangements. However, along with the longer time horizon comes additional uncertainty about the outer year, and this bolsters our interest in seeking a larger arrangement.

Based on the above considerations, we would like to make a request for a two-year FCL arrangement in the amount of SDR 3.87 billion (500 percent of quota). As we are confident that Colombia is well prepared to deal with the current external environment, we intend to treat the arrangement as precautionary. We request that immediately prior to the approval of this new FCL arrangement, the existing one be cancelled.

Our strong macroeconomic policies and solid institutional framework have allowed our country to maintain a comfortable external position with greatly reduced external vulnerabilities despite the global crisis. Our sovereign debt has been upgraded recently to investment grade by a major rating agency, remains relatively low, and our fiscal policy has been framed in the context of medium-term consolidation that we expect to be anchored by a fiscal rule (currently being debated in our Congress) that would limit the structural deficit of the central government to 2 percent of GDP starting in 2015.

A flexible exchange rate has served us well as an effective shock absorber, including in the current environment of strong private capital inflows. Our monetary policy framework, based on an inflation targeting regime, has helped us attain our long-term inflation range target (2–4 percent) since 2009 and has contributed to anchoring inflation expectations. Consistent with this commitment to low inflation, the Banco de la República has raised its policy rate 50 basis points in 2011 in anticipation of future price pressures. International reserve coverage in terms of imports, short-term debt and the money stock remains comfortable. As in the case of the public debt, the external debt-to-GDP ratio is relatively low and sustainable.

Our financial supervisory and regulatory framework is strong and banks remain healthy, liquid and profitable. The ratio of capital to risk-weighted assets for the banking system is well above requirements, and provisioning levels are very high. At the same time, bank credit to the private sector is recovering and is an important component of support to the economic recovery.

Overall, our track record of prudent macroeconomic policies and our very strong institutional framework provide ample assurances of our ability to withstand adverse shocks and signal our resolute commitment to maintain sound policies in the future and to continue to react as needed if further shocks were to materialize. Let us take this opportunity also to mention that the Banco de la República will continue providing Fund staff with all needed information, and that we have sent the requested authorizations to the bank's external auditors, in accordance with the safeguards policy for the FCL.

Our expectation is that the arrangement will continue bolstering confidence that Colombia is in a position to withstand a wide range of adverse external shocks. We fully concur with the views expressed by the Fund's Executive Board during the last Article IV consultation, namely, that Colombia is well placed to confront the challenges posed by a still uncertain global outlook.

Sincerely yours,

/s/

José Darío Uribe
Governor
Central Bank of Colombia

/s/

Juan Carlos Echeverry
Minister of Finance and Public Credit

INTERNATIONAL MONETARY FUND

Colombia—Assessment of the Impact of the Proposed Flexible Credit Line Arrangement on the Fund’s Finances and Liquidity Position

Prepared by the Finance and Strategy, Policy and Review Departments

(In consultation with other Departments)

Approved by Andrew Tweedie and James Roaf

April 22, 2011

1. **This note assesses the impact of the proposed Flexible Credit Line (FCL) arrangement for Colombia on the Fund’s finances and liquidity position, in accordance with the policy on FCL arrangements.**¹ The proposed arrangement would cover a two-year period and access would be in an amount of SDR 3.870 billion (500 percent of quota). It would succeed the existing FCL arrangement of SDR 2.322 billion (300 percent of quota), which would be cancelled immediately prior to the approval of the new arrangement. The full amount of access proposed would be available throughout the arrangement period, in one or multiple purchases.² The authorities intend to treat the arrangement as precautionary.

I. BACKGROUND

2. **Against the backdrop of a global economic and financial crisis, a one-year FCL arrangement in an amount equivalent to SDR 6.966 billion (900 percent of quota) was approved on May 11, 2009, which the authorities treated as precautionary.** This arrangement was succeeded by another one-year FCL arrangement in an amount equivalent to SDR 2.322 billion (300 percent of quota) approved on May 7, 2010, which was also treated as precautionary. Colombia’s strong economic fundamentals and institutional policy frameworks helped the authorities cushion the impact of the crisis through countercyclical monetary and fiscal policies, with the FCL arrangements providing additional insurance against a further deterioration of global conditions. No drawings have been made under either the May 2009 FCL arrangement or the existing arrangement approved in May 2010. As

¹ See *GRA Lending Toolkit and Conditionality—Reform Proposals* (3/13/09) and *Flexible Credit Line (FCL) Arrangements*, Decision No.14283-(09/29), adopted March 24, 2009, as amended.

² If the full amount is not drawn in the first year of the arrangement, subsequent purchases are subject to a review of Colombia’s continued qualification for the FCL arrangement.

discussed in Annex I, Colombia had five arrangements since 1999, but has not drawn on Fund resources since 1971.

3. **Colombia's level of total external debt is moderate and expected to remain sustainable even in the event of further significant negative shocks (Table 1).** External debt was declining relative to GDP during the years preceding the recent crisis. The global shock resulted in a temporary rise in external debt, which increased from 19.7 percent of GDP in 2008 to 22.9 percent in 2009, but resumed a downward trend in 2010 falling to 20.9 percent of GDP. The bulk of this debt is long term and owed by the public sector. Private sector external debt has declined to 7.2 percent of GDP. Over the medium term the external current account deficit is expected to decline as a share of GDP, and to be largely financed by FDI. Debt sustainability analysis suggests that external debt ratios would remain manageable even under significant negative shocks.³

Table 1. Colombia: Total External Debt, 2005 -10

	2005	2006	2007	2008	2009	2010
	(In Millions of US Dollars)					
Total External Debt	38,506	40,103	44,553	46,369	53,719	60,082
Private	14,317	13,803	15,734	16,921	16,590	20,753
Public	24,189	26,299	28,819	29,448	37,129	39,329
	(In Percent of GDP)					
Total External Debt	26.3	25.0	21.2	19.7	22.9	20.9
Private	9.8	8.6	7.5	7.2	7.1	7.2
Public	16.5	16.4	13.7	12.5	15.9	13.7

Source: Colombian authorities and IMF staff estimates.

4. **Colombia has no outstanding debt to the Fund.** Full drawing under the proposed FCL arrangement—which the authorities intend to treat as precautionary—would bring Colombia's outstanding use of GRA resources to SDR 3.870 billion.

5. **In case the full amount available under the proposed FCL arrangement is disbursed in 2011:**

- **Colombia's total external debt would remain moderate, with Fund credit representing still a relatively modest fraction:** total external debt and public external debt would initially reach 22.5 and 15.3 percent of GDP, respectively, with

³ A more detailed description of external and public debt is provided in the staff report.

Fund credit at 1.9 percent of GDP (Table 2). At its peak, Colombia's outstanding use of GRA resources would account for 8.7 percent of total external debt, 12.6 percent of public external debt, and 16.8 percent of gross international reserves.

- **External debt service would increase over the medium term, but would remain manageable.** Colombia's projected debt service to the Fund would peak in 2015 at about SDR 2 billion, or close to 0.8 percent of GDP.⁴ In terms of exports of goods and services, external debt service to the Fund would peak at 4.4 percent that year. It would account for about 28 percent of public external debt service, which would increase to 15.8 percent of exports of goods and services.

Table 2. Colombia: Capacity to Repay Indicators 1/

	2010	2011	2012	2013	2014	2015	2016
Exposure and Repayments (In SDR millions)							
GRA credit to Colombia	--	3,870.0	3,870.0	3,870.0	2,902.5	967.5	--
(In percent of quota)	--	(500.0)	(500.0)	(500.0)	(375.0)	(125.0)	(0.0)
Charges due on GRA credit 2/	--	64.2	89.1	89.0	91.3	37.7	5.4
Debt service due on GRA credit 2/	--	64.2	89.1	89.0	1,058.8	1,972.7	972.9
Debt and Debt Service Ratios 3/							
In percent of GDP							
Total external debt	20.9	22.1	21.7	21.3	20.4	19.1	17.7
Public external debt	13.7	15.3	15.1	14.9	14.2	13.0	11.9
GRA credit to Colombia	--	1.9	1.8	1.7	1.2	0.4	--
In percent of Gross International Reserves							
Total external debt	214.0	191.9	189.4	186.5	186.6	188.9	185.3
Public external debt	140.1	132.6	132.1	130.3	129.6	129.0	124.8
GRA credit to Colombia	--	16.8	15.9	15.1	11.2	3.8	--
In percent of Exports of Goods and Services							
Total external debt service	30.0	29.7	31.3	29.4	35.9	40.7	29.9
Public external debt service	11.7	10.2	11.2	10.5	14.4	15.8	9.9
Debt service due on GRA credit	--	0.2	0.2	0.2	2.5	4.4	2.0
In percent of Total External Debt							
GRA credit to Colombia	--	8.7	8.4	8.1	6.0	2.0	--
In percent of Public External Debt							
GRA credit to Colombia	--	12.6	12.0	11.6	8.6	3.0	--
U. S. dollars per SDR (period average)	1.53	1.57	1.56	1.56	1.56	1.56	1.55
U. S. dollars per SDR (end of period)	1.54	1.57	1.56	1.56	1.56	1.56	1.55

Sources: Colombian authorities, Finance Department, World Economic Outlook, and IMF staff estimates.

1/ Assumes full drawings under the FCL upon approval.

2/ Based on the rate of charge as of April 14, 2011. Includes surcharges under the system currently in force and service charges.

3/ Staff projections for external debt, GDP, gross international reserves, and exports of goods and services, as used in the staff report that requests the proposed FCL, adjusted for the impact of the assumed FCL drawing.

⁴ The figures on debt service used in this report are calculated assuming that the full amount available under the arrangement is purchased upon approval of the arrangement, and that all repurchases are made as scheduled.

6. **The impact on the Fund's liquidity, and on its potential exposure to credit risk, would be modest:**

- **The proposed arrangement would reduce the Fund's forward commitment capacity (FCC) by about 0.6 percent on a net basis (Table 3).**⁵ The liquidity impact of the proposed arrangement would be partially offset by the cancellation of the existing FCL arrangement, so that the net reduction in the FCC would be SDR 1.548 billion. In addition, the availability of supplementary resources under the recently activated NAB greatly bolstered the Fund's resources mitigating the possible impact of the proposed arrangement on the Fund's liquidity position.
- **If the resources available under the FCL arrangement were fully drawn, GRA credit to Colombia would be about 5.6 percent of total GRA credit.** This would make Colombia the seventh largest borrower among current arrangements, and reduce the concentration of Fund credit in the top five users of Fund resources from about 70 percent to 66 percent.
- **Potential GRA exposure to Colombia would be below the current level of the Fund's precautionary balances.** If the resources available under the arrangement were fully drawn, Fund credit to Colombia would be equivalent to about half of the Fund's current precautionary balances.

⁵ As of April 20, 2011 the FCC includes resources available under the NAB during the currently effective six-month activation period, which ends on September 30, 2011. See *The Fund's Liquidity Position – Review and Outlook* (4/13/11)

Table 3. FCL Arrangement for Colombia --Impact on GRA Finances
(In SDR millions, unless otherwise indicated)

	As of 4/5/11
Liquidity measures	
Current Forward Commitment Capacity (FCC) 1/	269,400
Net Impact on FCC on approval of FCL	1,548
Prudential measures, assuming full FCL drawing	
Fund credit to Colombia	
In percent of total GRA credit outstanding 2/	5.6
In percent of current precautionary balances	52.9
Fund credit outstanding to five largest debtors	
In percent of total GRA credit outstanding, before approval	69.5
In percent of total GRA credit outstanding, upon approval of the FCL 2/	65.7
Memorandum items	
Current precautionary balances (end-April 2010)	7,320
Total FCL commitments, including proposed FCL 3/	70,328
Quota of FTP members with actual and proposed FCLs, in percent of total quota of FTP members	3.1

Sources: Finance Department.

1/ The FCC is determined on the basis of ordinary resources and amounts made available under bilateral borrowing and note purchase agreements and under multilateral standing borrowing arrangements. It reflects activation of the NAB for a six-month period through September 30, 2011.

2/ Based on current Fund credit outstanding plus full drawings under the proposed FCL.

3/ Excluding Colombia's existing FCL.

II. ASSESSMENT

7. **The proposed arrangement has an overall modest and manageable impact on the Fund's liquidity.** The current liquidity position is sufficiently strong to accommodate the impact of the proposed arrangement, particularly so since the proposed cancellation of Colombia's existing FCL arrangement would partially offset the initial reduction in the FCC arising from the new arrangement. Nevertheless, in view of the uncertainty surrounding the recovery from the global crisis and the likelihood of continuing strong demand for Fund financing, a close monitoring of the liquidity position is warranted.

8. **Colombia intends to treat the FCL arrangement as precautionary, but the Fund's credit exposure would remain moderate even with a drawing.** Hence, given Colombia's sustained track record of implementing very strong policies, including during the global financial crisis, and its commitment to maintaining such policies in the future, the capacity to repay is projected to remain strong. Nonetheless, the scale of the Fund's potential exposure—in conjunction with the recent increase in lending to other members and the prospects for further credit expansion under already existing or possible new Fund arrangements—underscores the need to strengthen the Fund's precautionary balances.

ANNEX I. COLOMBIA: HISTORY OF IMF ARRANGEMENTS

Colombia had five Fund arrangements since 1999, but has not drawn on Fund resources since 1971 (Table I.1). A one-year FCL arrangement equivalent to SDR 6.966 billion was approved on May 11, 2009 to support Colombia's economic policies and bolster confidence during the crisis. A successor one-year FCL arrangement equivalent to SDR 2.322 billion was approved on May 7, 2010. Prior to the FCL arrangement approved in 2009, Colombia had a series of Stand-by Arrangements (SBAs) from the late 1950s to the mid-1970s. It last made purchases in 1971 and settled its remaining outstanding obligations to the Fund in 1972. Following a quarter century without Fund arrangements, Colombia's economic performance deteriorated markedly in 1998-99 as a result of external shocks and intensified domestic tensions. To address the economic difficulties, a three-year Extended Arrangement under the Extended Fund Facility (EFF) was approved in 1999 to support the authorities' economic reform program. No drawings were made under this arrangement, which was followed by two precautionary SBAs, the last of which expired in November 2006. In the period covered by these three Fund arrangements, Colombia successfully adopted wide ranging macroeconomic and structural reforms.

Table I.1. Colombia: IMF Financial Arrangements, 1999–2010
(In millions of SDR)

Year	Type of Arrangement	Date of Arrangement	Date of Expiration or Cancellation	Amount of New Arrangement	Amount Drawn	Purchases	Repurchases	Fund Exposure
1999	EFF	20-Dec-99	19-Dec-02	1,957	--	--	--	--
2000						--	--	--
2001						--	--	--
2002						--	--	--
2003	SBA	15-Jan-03	2-May-05	1,548	--	--	--	--
2004						--	--	--
2005	SBA	2-May-05	2-Nov-06	405	--	--	--	--
...								
2009	FCL	11-May-09	10-May-10	6,966	--	--	--	--
2010	FCL	7-May-10	6-May-11	2,322	--	--	--	--

Source: Finance Department.



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International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Approves New Two-Year US\$6.22 Billion Flexible Credit Line Arrangement for Colombia

The Executive Board of the International Monetary Fund today approved a successor two-year arrangement for Colombia under the Flexible Credit Line (FCL) in an amount equivalent to SDR 3.87 billion (about US\$6.22 billion). The Colombian authorities stated that they intend to treat the arrangement as precautionary and do not intend to draw on the line.

Colombia's first FCL was approved on May 11, 2009 ([see Press Release No. 09/161](#)) and a successor one-year arrangement was approved on May 7, 2010 ([see Press Release No. 09/186](#)).

Following the Executive Board discussion of Colombia, Mr. John Lipsky, First Deputy Managing Director and Acting Chairman of the Board, made the following statement:

“Colombia’s strong economic performance has been underpinned by a sound institutional framework and skillful macroeconomic management. Countercyclical policy support has paved the way for the recovery; a credible inflation targeting regime has anchored inflation expectations; and exchange rate flexibility has cushioned the impact of external shocks and large capital inflows. Strong supervisory and regulatory oversight has underpinned the soundness of the domestic financial system. Furthermore, FCL arrangements in 2009 and 2010 have contributed to preserving sentiment and market access.

“In view of the favorable near-term outlook, the authorities intend to unwind fiscal support and normalize monetary conditions as the recovery becomes self-sustaining and slack is taken up. Fiscal reforms in train will also strengthen the medium-term budgetary framework and economic prospects.

“In the authorities’ view, Colombia remains exposed to downside risks, including from severe commodity price fluctuations and other adverse external developments. Under these

circumstances, the authorities have requested a new FCL arrangement, which would provide appropriate insurance against shocks. The authorities intend to treat the arrangement as precautionary.

“The Executive Board today approved Colombia’s request for a two-year arrangement under the FCL. The augmented duration and size of this successor FCL—new features made possible by the recent IMF facilities reform—will allow the FCL to play an even stronger role in insuring Colombia against external risks while continuing to support the authorities’ overall macroeconomic strategy.”

**Statement by Maria Angelica Arbelaez, Alternate Executive Director for Colombia,
on the Request for a Successor Arrangement under Flexible Credit Line
May 6, 2011**

On behalf of my authorities, I thank staff and management for their positive response to our request for a new Flexible Credit Line (FCL). I also wish to express my authorities' gratitude for the two FCLs received by Colombia in 2009 and 2010.

The FCLs have been an important support to the broad-based policy response to the global crisis, which involved exchange rate flexibility, countercyclical fiscal and monetary policies and ensuring a cushion of international liquidity for the country. An adequate stock of international reserves and the access to the FCLs were key components of this strategy. In addition, the FCLs signaled the strength of the Colombian economy and policy framework.

Economic conditions in Colombia have improved since the last Article IV Consultation. The Central Bank had expected economic growth to be around 3 percent in 2010, but instead growth was 4.3 percent. Inflation (year-on-year) was 3.1 percent in December, close to the midpoint of the long term target range (2-4 percent). Further, the current account deficit for the year was at a manageable level of close to 3 percent of GDP, financed mostly by FDI inflows, while the combined public sector deficit reached 3 percent of GDP.

For 2011, the Central Bank recently raised its growth forecast to between 4 and 6 percent—with the latest point projection at 5.5 percent—and expects the current negative output gap to close before the end of this year. As a consequence, macroeconomic policy strategy has moved to exit from fiscal stimulus, to rebuild fiscal buffers and to tighten monetary policy.

Monetary and exchange rate policies

The Colombian authorities remain committed to the inflation targeting regime adopted in the late 1990s, which has served the economy very well, as it has brought down inflation and has increased monetary policy credibility. In addition, it has given the authorities the flexibility and opportunity to react to changing circumstances.

Accommodative monetary policy started to reverse in the beginning of 2011, as inflation expectations have increased recently, credit growth has been strong (19 percent year on year in February) and aggregate private demand maintains a dynamic pace (the growth rate in 2010 was significantly higher than expected). For the third successive month through April 2011, the board of directors of the Central Bank raised the benchmark interest rate by 25 basis points to 3.75 percent, after a long period of historically low interest rates (3 percent in nominal terms). Inflation was 3.19 percent in March and is expected to be around 3 percent by the end the year.

Colombia is also fully committed to exchange rate flexibility. The authorities see the exchange rate as the most important shock absorber to mitigate the effects of the surge in capital inflows, and their strategy gives more weight to fiscal reforms and to the program of pre-announced daily purchase of foreign exchange (US\$20 million per day). They have

found that this transparent, small and predictable intervention is more effective than a large-scale and unpredictable accumulation of international reserves. Colombia has also in place prudential measures to minimize systemic risk. As highlighted in Chapter IV of last October in the IMF's *Western Hemisphere Regional Economic Outlook*, the authorities have adopted a system of dynamic provisioning and bank-specific capital requirements, and the Central Bank relies on different tools—different limits on open foreign exchange positions—to minimize the emergence of vulnerabilities and mitigate potential adverse impacts of capital flows.

Fiscal policy

Colombia has put in place a solid and comprehensive fiscal institutional framework in order to anchor fiscal discipline and ensure debt sustainability, both at the central and regional levels. The Fiscal Responsibility and Transparency Law adopted in 2003, which includes a Medium-Term Fiscal Framework, sets the levels of fiscal deficit and financing. The Medium-Term Expenditure Framework establishes maximum levels of spending and priorities. These tools have been instrumental for fiscal consolidation.

Looking ahead, the government has submitted to Congress a Fiscal Rule, which not only limits the structural deficit of the Central Government to 2 percent of GDP from 2015 onwards, but also creates mechanisms to save the expected large increase of hydrocarbon revenues and develops rules to manage future countercyclical fiscal policy. The government has also presented to Congress a Constitutional Amendment to include fiscal sustainability as a general principle in the Constitution.

Fiscal buffers have allowed the Colombian authorities to adopt countercyclical measures to cope with the global crisis, but the authorities have started to shift towards a gradual consolidation. Although the adjustment is being delayed due to the severe flooding that the country is facing, the combined public sector deficit for 2011 is projected to be around 3.5 percent of GDP (slightly higher than that of 2010) and will decline further in 2012 to 1.7 percent of GDP. As a result, the public debt is projected to narrow to 35 percent of GDP in 2012. With the fiscal rule in place, a further gradual reduction of public debt is expected, reaching around 25 percent of GDP in 2020.

Request for the FCL

We want to convey to the Board the motivation behind the request for a new two-year FCL. As has been presented in the last issues of the Global Financial Stability Report (GFSR) and the World Economic Outlook (WEO), uncertainties and risks in the global economy remain. My authorities would like to have the FCL as an insurance against tail risks that, if realized, would involve a severe contraction of expenditure and production, even after a substantial reduction of international reserves. As shown in the staff document, assuming shocks in the stress scenario broadly similar in magnitude to those identified in the previous FCL, the resulting financing needs amount to US\$5.6 billion.

With regard to risks to the outlook, an increase in the price of oil, as the one recently seen, is good for the Colombian economy in the short run, as this is one of the country's main export products. In the long run, however, the increase might affect world economic growth that could translate into a highly uncertain outlook for Colombian terms of trade, external demand, workers' remittances, risk aversion and capital flows.

Further, although the Central Bank acquired US\$3 billion in 2010 through the program of daily purchases of international reserves currently in place, reserve indicators typically used to assess international liquidity remain similar to the levels seen in 2009. However, the authorities want to highlight that, as discussed in the last Article IV consultation, under low foreign currency and maturity mismatches, low pass-through and a credible macroeconomic policy framework, exchange rate flexibility will remain the main component of our response to an external shock.

As with the two previous FCLs, we intend to treat the new arrangement as precautionary. Support by the Fund for this request will send an important signal to markets about the Colombian authorities' commitment to keep implementing sound economic policies and to further enhance strong policy frameworks.

Finally, based on the Colombian perspective, the authorities want to offer some thoughts on the FCL that may be helpful in the current and future discussions of this type of arrangements. An analysis carried-out by the Colombian Central Bank shows that the approval of the FCL in 2009 helped reduce the EMBI spread for Colombia and to increase the consumer confidence index¹. This led to moderately higher GDP growth, lower depreciation of the peso and slightly lower inflation than what would have prevailed without the FCL.

¹ *"Impacto macroeconómico de la línea de crédito flexible con el Fondo Monetario Internacional"*, Banco de la República, March 11, 2011. This exercise was based on the dynamic stochastic general equilibrium model (DSGE) used at the Colombian Central Bank and on the application of econometric techniques to estimate the impact of the FCL on the EMBI and the consumer confidence index.