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2015 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR COLOMBIA

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2015 Article IV consultation with Colombia, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its May 18, 2015 consideration of the staff report that concluded the Article IV consultation with Colombia.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on May 18, 2015, following discussions that ended on March 24, 2015, with the officials of Colombia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on May 1, 2015.
- An **Informational Annex** prepared by the IMF.
- A **Statement by the Executive Director** for Colombia.

The document listed below has been or will be separately released.

Selected Issues Paper

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

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IMF Executive Board Concludes 2015 Article IV Consultation with Colombia

On May 18, 2015, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Colombia.[1]

Colombia has enjoyed strong growth over the past several years, among the highest in Latin America. Credible fiscal and inflation targeting frameworks have supported sound macroeconomic policy management, which underpinned robust economic performance during the last decade. Social indicators have improved steadily over this period. Public debt remained low, Colombia's foreign exchange reserve position strengthened, and the Flexible Credit Line arrangement provided a buffer against elevated external tail risks. The authorities continued to improve the fiscal policy framework and strengthen the social safety net.

Real GDP grew by 4.6 percent in 2014. Unemployment declined to an average of about 9 percent during the year. In the second half of 2014, global oil prices fell sharply by about 40 percent and the peso depreciated, especially in the fourth quarter. As inflation began rising to the mid-point of the target band, and given the slightly positive output gap, the central bank raised the policy rate by 125 basis points to 4.5 percent between May and August. The central government fiscal balance remained broadly unchanged from 2013, meeting the structural balance target, although the headline fiscal deficit increased slightly. The consolidated public sector deficit rose to 1.6 percent of GDP, pushing public debt to about 39 percent of GDP.

The current account deficit widened to 5.2 percent in 2014, but capital inflows were buoyant. Strong inflows of foreign direct investment and portfolio flows more than offset the current account deficit, and gross international reserves rose to 47 billion at year end. This level appears adequate for precautionary purposes but may be insufficient for tail risks. The current account deficit is projected to widen in 2015 due to the oil price decline, but would gradually narrow over

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

the medium term with the slight recovery in oil prices and growth in Colombia's trading partners, especially the U.S. Moreover, the sharp peso depreciation should help contain imports and spur non-traditional exports.

The banking system and corporate sector have remained in good financial health. Financial soundness indicators have been strong and financial system exposure to the oil sector is very low. Growth in credit to the private sector was buoyant, at 14.7 percent in 2014 (nominal year-over-year) and house price growth has slowed. Corporate profitability was strong, and liquidity remained adequate. Corporate and household debt has increased in 2014, but remains modest by international standards and leverage is within historical norms.

Growth is expected to slow to 3.4 percent in 2015 given a subdued outlook for investment, especially oil-related, and private consumption. Inflation rose to 4.6 percent in March, due to a weather-related agricultural output supply shock and some pass-through from exchange rate depreciation, but is expected to diminish to 3.6 percent year-over-year by end-December with inflation expectations remaining anchored within the target band of 2−4 percent. In response to lower corporate profits and a partial postponement of dividends from the state oil company, the central government announced an expenditure reduction of 0.7 percent of GDP in 2015, which will also act as a drag on growth. However, the impact of oil shock on the budget and economic growth will be mitigated by the sharp depreciation of the peso (20 percent vis-à-vis the U.S. dollar since mid-2014), and the operation of the fiscal rule, which allows a smoother adjustment to the permanent decline in wealth.

Growth is expected to gradually rise toward its potential (around 4.25 percent) over the medium term, supported by the government's Public-Private Partnership-based infrastructure program and a gradual recovery in oil prices and external demand. However, risks threaten on the downside, including higher interest rates and financial volatility, a protracted period of slower growth in advanced and emerging economies, economic or political stress in neighboring countries, and a delayed implementation of the infrastructure program.

Executive Board Assessment[2]

Executive Directors welcomed Colombia's continued robust economic performance and financial stability, underpinned by prudent management and strong policy frameworks including a fiscal rule, an inflation targeting regime, and a flexible exchange rate. Substantial progress has also been made in reducing unemployment and poverty in recent years. Directors noted, however, that Colombia is facing headwinds from the sharp fall in the price of oil, a key export.

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[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

Given elevated external risks, Directors stressed the need for stepped-up efforts to further enhance the resilience of the economy. They supported an eventual exit from the Flexible Credit Line arrangement with the Fund once external risks have receded.

Directors commended the authorities for their commitment to the structural fiscal rule. They highlighted the importance of mobilizing non-oil revenues to meet the authorities' medium term fiscal targets while protecting social and infrastructure spending. This requires a comprehensive tax reform, with the objectives of simplifying the tax structure, increasing progressivity, broadening the tax base, and improving tax administration. Directors looked forward to the recommendations of the recently established expert commission on these matters.

Directors supported the broadly neutral stance of monetary policy, but encouraged the authorities to stand ready to take appropriate action if growth falters. They noted that the current level of official international reserves provides adequate insurance in normal times, and that the exchange rate has adjusted flexibly in line with fundamentals. Directors considered that the widening current account deficit, largely financed through foreign direct investment, is likely to narrow over time on the back of the exchange rate depreciation and ongoing fiscal consolidation.

Directors noted that the financial system is sound, profitable, and well-provisioned, with low exposure to the oil sector. They commended the authorities for the progress in addressing cross-border risks and strengthening the regulatory and supervisory frameworks. Continued efforts are nonetheless crucial to boost the resilience of financial institutions, and to strengthen supervision of complex financial conglomerates. Directors also underscored the importance of further improving risk-based supervision, enhancing regional cooperation primarily in Central America, deepening the capital market, and promoting financial inclusion.

Directors welcomed the authorities' inclusive growth agenda. They agreed that key priorities are to reduce informality in the economy, improve competitiveness and infrastructure, and foster social mobility, especially through better education and health care. Directors recognized the benefits of the authorities' fourth generation road investment program—implemented with appropriate funding and safeguards—in reducing infrastructure gaps and helping diversify sources of growth. More broadly, they supported initiatives to promote private participation in the economy, including through divestiture of a public utility company.

Colombia: Selected Economic Indicators 1/

	2013	Est. 2014	Proj. 2015
	(Annual percentage changes, unless otherwise indicated)		
National Income and Prices			
Real GDP	4.9	4.6	3.4
Consumer price index (period average)	2.0	2.9	3.9
Consumer price index (end of period)	1.9	3.7	3.6
GDP deflator	1.9	1.8	1.0
Terms of trade (deterioration -)	-4.1	-3.2	-18.0
Real effective exchange rate (depreciation -)	-3.3	-5.3	-14.3
	(In percent of GDP, unless otherwise indicated)		
Public finances			
Central government balance	-2.3	-2.6	-2.6
Combined public sector	-1.1	-1.6	-3.4
Public debt 2/	35.6	38.7	39.7
External Sector			
Current account (deficit -)	-3.3	-5.2	-5.9
External debt	24.2	29.3	30.9
of which: Public sector	12.8	14.8	15.1
GIR in percent of short-term debt	181.9	187.0	198.8
Savings and Investment			
Gross domestic investment	24.2	26.0	24.0
Gross national saving	20.9	20.8	18.1
	(12-month percentage changes, unless otherwise indicated)		
Money and credit			
Broad money (M2)	13.4	10.0	13.0
Credit to the private sector	12.1	14.7	11.9
Interest rate (90-day time deposits; percent per year)			
Nominal	4.1	4.3	n.a.

Sources: Colombian authorities; and IMF staff estimates and projections.
1/ Based on information available on May 1, 2015.
2/ Includes Ecopetrol and Banco de la Republica's outstanding external debt.

INTERNATIONAL MONETARY FUND

COLOMBIA

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION

May 1, 2015

KEY ISSUES

Context. Prudent macroeconomic policies have underpinned Colombia's strong growth during the last few years, which exceeded that of most Latin American peers. Last year, the economy posted real growth of 4.6 percent, and average inflation remained near the center of the target range. Monetary and fiscal policies were mildly supportive of growth. The infrastructure agenda is expected to advance this year. Colombia's government is engaged in ongoing peace negotiations with the main guerilla group (FARC).

Outlook and risks. Starting from a position with slightly positive output gap, Colombia faces a large adverse terms of trade shock. Staff projects growth to slow to 3.4 percent in 2015 and gradually rise toward its potential (around 4¼ percent) over the medium-term supported by the government's PPP-based infrastructure program and a gradual recovery in oil prices and external demand. Risks are mainly on the downside, including higher interest rates and financial volatility, and a protracted period of slower growth in advanced and emerging economies, and a delayed implementation of the infrastructure program.

Macroeconomic policies. Strong headwinds from the severe oil price decline pose significant challenges to the near-term economic outlook. The structural fiscal rule will only partially shield expenditure plans from the oil shock and some fiscal tightening will be required to accommodate lower-than-expected oil revenues. A broadly neutral monetary policy stance will be consistent with achieving the inflation target in the near-term.

Medium-term challenges. Colombia's key challenge will be preserving macroeconomic stability while sustaining strong and inclusive growth through structural reforms. Revenue mobilization is urgently required to protect key social and infrastructure spending while adhering to the medium-term fiscal rule targets amid less favorable external conditions (weaker terms of trade and tighter financing conditions).

Approved By
Robert Rennhack and Mary Goodman

Discussions took place in Bogotá during March 10–24, 2015. The team comprised Valerie Cerra (Head), Izabela Karpowicz, Kristine Vitola, and Daniel Rodríguez-Delgado (all WHD), Christina Kolerus (SPR), and Mohamed Norat (MCM). María Angélica Arbeláez (OED) participated in most of the meetings. Zulima Leal provided research assistance, and Cristina Barbosa and Rob Newman provided editorial support.

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BACKGROUND

1. A strong policy framework and prudent macroeconomic policy management have underpinned Colombia's vigorous economic growth during the last several years, which has been among the highest in Latin America. Colombia's robust and broad-based growth in recent years has contributed to a decline in poverty, inequality, and unemployment (Figure 1). Economic stability has underpinned strong capital inflows, especially FDI, which have also benefited from steady upgrades in Colombia's sovereign credit rating, and, more recently, an increase in its weight in global bond indices. The central bank has taken advantage of the abundant capital inflows to rebuild net international reserves and the government has been able to lengthen the average maturity of its debt, issue at historically low yields, and widen the foreign investor base. The inflation targeting framework has served to maintain low and stable inflation and anchor inflation expectations. Prudent financial supervision and regulation have supported financial deepening and macro-financial stability.

2. Colombia's government is engaged in ongoing peace negotiations. The government has been holding peace talks with the main guerilla group (FARC), now counting some 8,000 members, since 2012. The parties have reached agreement on three out of six points on the peace agenda, and in early January 2015, President Santos announced the intention to discuss a bilateral ceasefire. A peace accord would end five decades of armed conflict.

3. Exchange regime and economic data. Colombia has a floating exchange rate regime (*de jure* and *de facto*). Colombia maintains an exchange restriction subject to Fund approval under Article VIII arising from the special regime for the hydrocarbon sector (IMF Country Report 13/35 for details). Data provision is adequate for surveillance.

4. Past Fund advice. Since the 2014 Article IV Consultation, the authorities have enacted a tax reform to raise revenue and have taken steps toward consideration of a broader tax reform. They have been implementing key recommendations from the 2012 FSAP Update. They continue to advance an agenda of inclusive growth, with measures set out in the recent development plan.

5. Colombia's Flexible Credit Line (FCL) arrangements have served the country well. The successive FCL arrangements have provided a cushion of international liquidity and complemented the authorities' countercyclical policy response to heightened external risks, including after the 2008–09 global financial crisis and during the euro area crisis. The arrangements have allowed the authorities to preserve policy frameworks and to rebuild buffers, while sending a positive signal to international financial markets on the strength of the economy. Empirical analysis conducted by the Colombian central bank and Fund staff's econometric analysis found that the FCL reduced the sovereign risk premium, improved consumer confidence and growth, eased exchange rate pressures,

and mitigate the confidence effect of a surge in sovereign yields after the taper talk episode in mid-2013.[1]

RECENT DEVELOPMENTS

6. Brisk growth continued in 2014, with mildly supportive macroeconomic policies. Despite strong headwinds from the external environment, real GDP increased by 4.6 percent in 2014, driven by domestic demand. An expansion of civil works and the government's mortgage subsidy program for middle-income households boosted construction activity. Strong economic growth underpinned historically low unemployment rates and increased labor formality. As inflation returned quickly to the midpoint of the target band from a low level in 2013 and Q1 growth surged to 6.3 percent, the central bank normalized the monetary stance, increasing the policy rate by 125 bps between May and August, to 4.5 percent (Figure 2). However, real interest rates remained moderately supportive. The central government fiscal balance remained broadly unchanged from 2013, and met the structural balance target embedded in the fiscal rule. However, subnational governments posted strong expenditure growth, which drove a widening of the consolidated public sector deficit to 1.6 percent of GDP and pushed public debt to about 39 percent of GDP (Figure 3).

7. From position of strong growth, Colombia confronted a severe oil price shock in the second half of 2014. The economy was operating slightly above potential in mid-2014 and inflation expectations were anchored near the center of the central bank's 2−4 percent target band. During the second half of 2014, oil prices plummeted by about 40 percent, leading to a moderation of portfolio inflows as well as a decline in asset prices, including sovereign debt and Ecopetrol securities (Figure 4). Reflecting some pass-through from a sharp peso depreciation (17 percent during Q4), and a weather-related agricultural output supply shock, inflation accelerated to 3.7 percent at end-December.

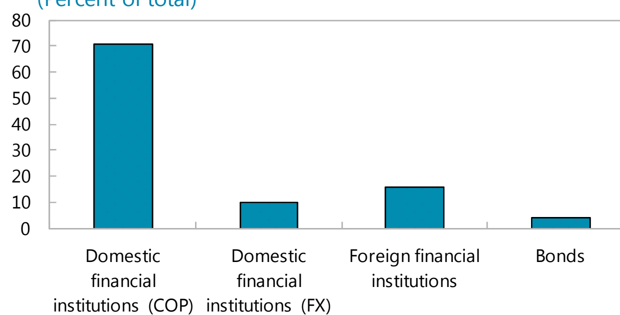
8. Despite a higher current account deficit, reserve buffers remained strong through 2014. The current account deficit widened to 5.2 percent of GDP, owing to strong import demand from buoyant economic activity and the temporary shutdown of the Cartagena oil refinery. Partly due to its favorable economic conditions, Colombia experienced heightened portfolio inflows from the beginning of the year, triggered by an increase in Colombia's weight in the J.P. Morgan's Emerging Markets Bond Index. Despite some moderation in the last part of the year, portfolio inflows (net 3.1 percent of GDP) added to the ample inward foreign direct investment (net 3.2 percent of GDP) to more than finance the current account deficit (Figure 5). Consequently, gross international reserves rose (by US$3.7 billion in 2014), reaching US$47 billion at end-2014, representing 131 percent of the reserve adequacy metric for commodity exporters (Figure 6). Total external debt remained low (28.6 percent of GDP).

[1] "Impacto macroeconómico de la línea de crédito flexible con el Fondo Monetario Internacional", Manuscript. Departamento de Modelos Macroeconómicos, Banco de la República, March 2011; Review of the Flexible Credit Line, the Precautionary and Liquidity Line, and the Rapid Financing Instrument, IMF, January 2014.

9. The banking system and corporate sector remained in good financial health. Financial soundness indicators remained strong (Figure 7 and Appendix I). Following the implementation of new enhanced capital standards in August 2013, capital adequacy declined marginally but stayed above the regulatory limit.[2] Growth in credit to the private sector was buoyant, at 14.7 percent (nominal y/y; Figure 4). Vulnerabilities stemming from the cyclical increases in house prices in recent years remained contained given low household leverage, a low share of mortgages in banks' portfolios and very conservative, forward looking loan-loss provisioning (Box 1). Corporate profitability was strong, and liquidity remained adequate. Corporate debt increased to some 29 percent of GDP of which over ⅔ was due to domestic banks, but remained modest by international standards and total leverage was within historical norms.[3] Moreover, the share of corporate debt in firms with weak debt servicing capacity-interest coverage ratios (EBITDA divided by interest expense) less than 2— has declined during 2010–14 by about 15 percent points to 1 percent.[4]

Corporate Sector Debt, June 2014

(Percent of total)



Source: Financial Stability Report, June 2014

10. The 4G PPP program was successfully launched, with a first wave of projects awarded. The authorities aim to attract private investment to reduce the existing infrastructure gap, which is most acute in the area of transportation, particularly roads. With that objective in mind, the PPP framework was strengthened recently through regulatory and institutional changes (i.e. standardization of contracts and better linking of government payments to project completion points; Box 2). According to the official timetable, project awardees would arrange their financing sources this year and start the building phase in 2016.

OUTLOOK AND RISKS

11. The severe oil price decline constitutes a strong headwind to the near-term economic outlook, although some rebound in conditions is expected over the medium term. Staff projects growth to slow to 3.4 percent in 2015, reflecting a deceleration of private investment, especially in the oil sector, a negative fiscal impulse (¶15), and a slowdown in private consumption. Oil production has been above 1 million bpd in the first quarter of 2015 and is projected to remain high throughout the year, benefitting from past investments in exploration and development,

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[2] The new capital adequacy measure better defines Tier 1 capital, but still includes a broader recognition of Tier 2 (subordinated debt) as capital and is not as strict in terms of deduction of future intangibles and goodwill from the base capital calculations relative to Basel III capital standards.

[3] Stress tests undertaken by the central bank in June 2014 indicate that the corporate sector is resilient to interest rate shock.

[4] GFSR, April 2015, Chapter 1.

improved pipelines, and competitive production costs (Box 3). However, oil companies' cutbacks in investment, mainly due to cash flow constraints after the fall in prices, will likely limit the growth of the sector over the medium term despite an expected partial recovery of oil prices by 2020. The negative growth impact of the terms of trade shock is expected to be partly offset by the authorities' fourth generation (4G) infrastructure investment program and a slight improvement in external demand, which would boost growth to about 4¼ percent by 2018. The growth dividend from the 4G infrastructure agenda is projected to be frontloaded, as construction of the first and second wave of projects— which constitute about US$14 billion out of a total program of US$25 billion (about 6.2 percent of 2014 GDP over 2014−22)—is expected to commence in 2016. The temporary upsurge in inflation (4.6 percent y/y in March) is projected to ease to 3.6 percent y/y by end-December, as food price increases begin unwinding and slower real GDP growth closes the output gap. Inflation expectations are expected to remain anchored within the target band. The current account deficit is projected to widen in 2015 due to the oil price decline, but would gradually narrow with the slight recovery in oil prices and growth in Colombia's trading partners, especially the U.S.

Contributions to GDP Growth

(Percent)

	2014	2015	2016
GDP	4.6	3.4	3.7
Consumption	3.9	2.3	2.8
Private	2.8	2.1	2.3
Public	1.1	0.2	0.5
Investment	3.2	-0.7	0.5
Private	2.5	-0.2	0.8
Public	0.5	-0.5	-0.3
Inventories	0.2	0.0	0.0
Net Exports	-2.8	3.0	0.3
Exports	-0.3	0.8	1.1
Imports	2.5	-2.2	0.8

12. Large risks threaten on the downside. A massive oil price shock has already materialized, far beyond risk scenarios envisaged only a year ago, and there are risks of a further decline and increased volatility in energy prices. While latest data still show relatively solid economic activity, the impact of the oil shock on the Colombian economy may turn out significantly worse than expected in the baseline outlook. Private investment is the most likely component of GDP to disappoint, particularly if FDI inflows slow significantly, and could lead to a more subdued medium-term growth outlook. Private consumption might also falter beyond the expected moderation in consumption of durable goods. Any delays in the implementation of the PPP program could undercut potential growth and competitiveness. At the same time, additional external risks loom. The global environment continues to toil under the legacy of financial fragility and a high debt overhang in many advanced countries. The main risks stem from the expected asymmetric exit from unconventional monetary policy in the U.S. where a faster decompression of term premiums could lead to rapidly rising yields and substantially higher volatility, which coupled with further dollar appreciation and surging global risk aversion could have strong knock-on effects on emerging markets' growth and commodity prices, including oil. Further, an intensification of sovereign distress in the Euro Area could generate a surge in bond yields, large movements in the value of major currencies, or an increase in global financial volatility. In the context of Colombia's greater economic vulnerability after the oil price decline, including a stronger reliance on portfolio inflows, such global shocks could lead to sharp repricing of Colombian assets and exchange rate, as well as spillovers to export revenue, FDI, and growth. In addition, further oil price decline stemming from weaker global

demand due to protracted period of slower growth, including in the Euro Area and China, or supply factors could lessen Colombia's exports receipts and FDI inflows, while economic distress in Central America could adversely affect the subsidiaries of Colombian banks that have expanded into the region.

Colombia: Risk Assessment Matrix[1]

	Likelihood	*Impact*	*Policy Advice*
Side-effects from global financial conditions:			
A surge in financial volatility: as investors reassess underlying risk and move to safe-haven assets given slow and uneven growth as well as asymmetric monetary exit.	High	High	Use the exchange rate and international reserves as shock absorber.
Protracted period of slower growth in advanced and emerging economies:			
Emerging economies: maturing of the cycle, misallocation of investment, and incomplete structural reforms leading to prolonged slower growth.	Medium	Medium	Use monetary policy to support growth; speed up execution of capital projects in the public sector.
Risks to energy prices:			
Increased volatility due to uncertainty about the persistence of the oil supply shock and the underlying drivers of the price decline.	High	High	Use the exchange rate and international reserves as shock absorber.
Persistently low prices triggered by supply factors reversing only gradually, and weaker demand.	Medium	High	Use the exchange rate and international reserves as shock absorber.
Growth slowdown and financial risks in China:			
Insufficient progress with reforms leads to a continued buildup of vulnerabilities, which over the medium term results in a significant growth slowdown.	Medium	Medium	Use the exchange rate as shock absorber. In the event the shock is large and protracted use and monetary policy stimulus and countercyclical expenditure adjustor under the fiscal rule.
Sharp slowdown in 2015-16. Growth falls significantly below target, possibly due to a severe housing downturn or a shock in the shadow banking sector, and absent offsetting stimulus.	Low	Medium	
Bond market stress from a reassessment in sovereign risk:			
Euro area: Sovereign stress re-emerges due to policy uncertainty, faltering reforms, and political and social upheaval, particularly in Greece.	Medium	Medium	Use the exchange rate and international reserves as shock absorber.
United States: protracted failure to agree on a credible plan for fiscal sustainability (medium-term).	Low	High	
Country-specific risks:			
Economic distress in Central America affecting Colombia's banks' subsidiaries	Low	Medium	Provide liquidity support to systemic institutions.
Political or economic distress in Venezuela	High	Medium/ Low	Use the exchange rate and international reserves as shock absorber.
Delay in the implementation of the PPPs due to insufficient financing or other obstacles.	Low	Medium	Re-prioritize projects towards those yielding higher growth, develop new financing instruments while avoiding to increase government exposure and alter optimum risk distribution.
Continued high growth of credit and house prices	Low	Low	Adopt prudential measures tailored to the risk profile of financial institutions.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.

13. The authorities broadly agreed with the outlook and characterization of risks. They projected near-term growth to be below potential, reflecting economic adjustment to the significant decline in national income associated with the fall in oil prices. They saw Colombia as more vulnerable to adverse shocks during this process of adjustment, and also considered that downside external risks had become more elevated. In particular, the authorities expressed concern that the continued delays in the normalization of U.S. monetary policy had increased vulnerabilities in global financial markets, which could exacerbate volatility and spur sharp capital flow reversals in emerging markets as soon as U.S. interest rates begin to rise. The still tepid economic recovery in advanced countries and slower growth in emerging markets posed a risk to external demand. The authorities underscored that regional risks had risen significantly, with growth in neighboring countries projected to decline, thereby undermining the potential export boost from the peso depreciation. The oil price shock is likely to dampen growth in Ecuador (which has also recently raised import tariffs), and to exacerbate the economic distress in Venezuela, both of which remain key destinations for Colombia's nontraditional exports. In addition, any potential civil unrest in Venezuela could spillover to Colombia's border areas, where unemployment could increase due to migration.

POLICY DISCUSSIONS

Discussions focused on the appropriate macroeconomic policy stance to adjust to the oil shock in 2015; policies to maintain fiscal, external, and financial sector stability; reforms to mobilize fiscal revenue; and actions to foster inclusive growth and competitiveness.

A. Near-Term Policy Stance: Mitigating the Impact of the Oil Shock

14. Staff and the authorities agreed that the macroeconomic framework provided sufficient buffers and flexibility to mitigate the impact of the oil price shock and smooth the adjustment to a lower level of national income. As a result of the strengthening of the fiscal framework (e.g. new royalty system; structural fiscal rule) during the last few years, and moderate levels of public debt, Colombia is in a strong fiscal position to absorb the oil price shock. In addition, the flexible exchange rate regime, credible inflation targeting framework, and comfortable level of foreign exchange reserves, complemented by the FCL from the Fund, provide the central bank with powerful tools to respond to shifts in cyclical economic and financial conditions. Indeed, the oil price shock led to a sharp depreciation of the peso (20 percent against the U.S. dollar and 14 percent in real effective terms estimated on average for 2015), which should boost exports in the non-resource sectors and partially offset the impact of lower oil prices on the domestic currency value of oil revenues. In addition, with inflation expectations well-anchored, there is ample space to adjust monetary policy rates if needed.

15. The structural fiscal rule will partially shield expenditures from the oil shock. The central government's structural balance rule includes an adjustment for the deviation of the actual oil price from the long-term price set by an expert committee in spring 2014, which helps protect

the expenditure envelope for 2015 (Box 4).[5] The headline deficit would widen to about 3.4 percent of GDP and gross public debt increase to 40 percent of GDP. Nonetheless, lower-than-expected income taxes and a partial deferral of Ecopetrol's dividend will affect structural fiscal revenues this year.[6] Consequently, the government enacted a tax reform in late 2014, targeting corporations, and announced a reduction in planned expenditures of about 0.7 percent of GDP for 2015, in order to comply with the fiscal rule target *ex post*. The decree-based expenditure adjustment would be confined to the central government, and be slightly more heavily tilted towards investment spending, but would also imply some (yet to be specified) across-the-board cuts in current outlays, possibly excluding education and compensation of civil victims of the conflict. The authorities acknowledged the potential (first round) negative impact of the expenditure cuts on growth, but suggested that fiscal multipliers in Colombia could be low (between 0.4 and 1).[7] By demonstrating their commitment to the rule, they also expected to reinforce confidence and private investment. The central government's negative fiscal impulse will be partly offset by strong expenditure execution at the subnational level ahead of elections in the fall. The authorities and the staff agreed that the experience with the oil shock will provide an opportunity for the fiscal rule committee to revisit the operation of the fiscal rule and the sensitivity of fiscal revenue to oil shocks.

16. With the economy operating close to potential, a broadly neutral monetary policy stance would support economic activity and be consistent with achieving the inflation target. The monetary policy rate, at 4.5 percent, is currently near its neutral level. The authorities pointed out that the exchange rate pass-through to prices is low (estimated at about 4 percent) because Colombia is relatively closed and the share of tradables in the CPI is only 26 percent (excluding food). In addition, domestic energy prices are also expected to decline and the currency depreciation is lower in trade-weighted terms. Therefore, inflation pressures are expected to unwind later this year, especially as the disinflationary impact of the slowdown in domestic demand takes hold. Staff advised that if growth slows more than expected there would be scope for monetary policy easing as long as inflation expectations remain anchored. With the peso broadly aligned with fundamentals, and already strong buffers, the pace of reserve accumulation will likely abate as reflected by the central bank's decision to suspend foreign currency purchases during the first quarter of 2015.

[5] Most of Colombia's oil revenue accrues to the public sector. Ecopetrol, with 88 percent government ownership, constitutes 65 percent of oil exports.

[6] Includes lower dividends and income tax from 2014 Ecopetrol profits, and subdued income tax collection this year (pre-payments of the 2016 tax bill) from oil companies. The government also decided to smooth the shortfall in income accrued by Ecopetrol, postponing part of the mandated dividend transfers to 2016. The strategy would improve Ecopetrol's cash flow and also smooth central government revenues as dividends are expected to decline in 2016.

[7] There is no broad consensus in the size of fiscal multipliers in the literature. Recent empirical estimates for expenditure multipliers in emerging and low income countries range from -0.4 to 1.7 (IMF Working Paper/14/93).

Medium Term Outlook

(Percent of GDP, unless otherwise indicated)

			Projections					
	2013	2014	2015	2016	2017	2018	2019	2020
Real GDP (percent)	4.9	4.6	3.4	3.7	4.0	4.2	4.3	4.3
Consumer prices (end of period)	1.9	3.7	3.6	3.2	3.0	3.0	3.0	3.0
External current account balance	-3.3	-5.2	-5.9	-5.0	-4.4	-4.2	-4.0	-3.7
Combined public sector balance 1/	-1.1	-1.6	-3.4	-2.8	-2.7	-2.4	-2.1	-1.9
Overall balance of payments balance	1.8	1.2	-0.3	-0.1	0.4	0.4	0.4	0.4
Total public gross debt	35.6	38.7	39.7	39.3	39.2	38.8	38.2	37.3
Total public net debt	24.8	28.4	30.5	30.8	31.3	31.5	31.4	31.0

Sources: Colombian authorities; and Fund staff estimates.

1/ Includes the quasi-fiscal balance of Banco de la República, sales of assets, phone licenses, and statistical discrepancy.

B. Adjusting Fiscal Policy to the Dimmer Medium-Term Outlook

17. The subdued outlook for oil revenues represents an important challenge for achieving medium-term fiscal targets.[8] The authorities' medium-term fiscal framework implies a 1½ percent of GDP reduction in the structural deficit between 2015 and 2020 with structural oil revenues declining as a percent of GDP. While this path will represent a mild annual fiscal withdrawal (average fiscal impulse at -0.3 percent of GDP), under unchanged tax policy, consolidation would require primary expenditure cuts of about 1½ percent of GDP (text table), leaving limited room to accommodate social and infrastructure expenditure pressures.9 Similarly, regional and local governments will face expenditure constraints arising from the subdued medium-term outlook for oil-related royalties. In the near term, the fiscal balance of the subnational governments is expected to improve as the start of a new administration is typically associated with lower expenditure execution. While public debt is now some 4 percentage points higher than a year ago at 38.7 percent of GDP—due to the widening of the central government deficit and the valuation effects of the peso depreciation—it will gradually decline over time and remain in line with other investment-grade countries and sustainable (Table 8 and Figure 8). Additional downward revisions to the oil price outlook would, however, further constrain expenditure plans and increase debt levels (Box 4). [10]

[8] Oil revenues (dividends and income tax) are indirectly related to both exports and domestic sales. For Ecopetrol (which represents about 62 percent of oil production), domestic sales represented 37 percent of total sales in 2014. The rest of the oil companies are mostly devoted to the export market. Further, direct fuel consumption taxes amounted to 0.3 percent of GDP in 2014.

[9] The baseline scenario does not assume new tax measures, and the gradual decline in central government revenues as a fraction of GDP is due to a reduction in oil-related revenues. Further, the outlook for expenditure in the baseline scenario is broadly based on the 2014 Medium-Term Fiscal Framework (MTFF) which includes a plan for achieving the consolidation path mandated by the fiscal rule through reductions in expenditure, including a moderation in investment (about ½ percent of GDP between 2015 and 2020). The 2015 MTFF will be published in June and would be in line with the expenditure priorities arising from the upcoming National Development Plan 2014−18.

[10] Staff projections are broadly guided by the authorities MTFF, which includes the expected outlays related to PPP investment program, existing pension programs, and some existing programs to compensate victims of the civil conflict (e.g. Victims' Law; Law 1448 of 2011).

Medium-Term Fiscal Outlook (in percent of GDP; unless otherwise indicated)

	2014	2015	2016	2017	2018	2019	2020	2020-2015
Central Government								
Headline balance	-2.6	-2.6	-2.6	-2.2	-2.0	-1.7	-1.4	1.2
Expenditure	19.7	18.3	18.1	17.6	17.5	17.0	16.7	-1.6
Primary expenditure	17.3	15.7	15.6	15.2	15.2	14.7	14.4	-1.3
o/w Investment	3.8	2.1	2.1	2.0	2.0	1.8	1.6	-0.5
Structural balance (staff estimate)	-3.2	-2.8	-2.1	-2.0	-1.9	-1.6	-1.4	1.4
Structural primary non-oil balance	-3.2	-1.4	-1.2	-0.8	-0.6	-0.2	0.1	1.5
Fiscal Impulse	0.0	-1.8	-0.2	-0.4	-0.2	-0.4	-0.3	
Structural balance (authorities' parameters) 1/	-2.3	-2.2						
Consolidated Public Sector								
Headline Balance	-1.6	-3.4	-2.8	-2.7	-2.4	-2.1	-1.9	1.5
Structural balance (staff estimate)	-2.3	-3.0	-2.0	-2.2	-2.1	-2.0	-1.8	
Structural primary non-oil balance	-3.3	-2.6	-1.8	-1.7	-1.3	-1.1	-0.8	1.8
Fiscal Impulse	0.3	-0.7	-0.9	0.0	-0.4	-0.3	-0.3	
Memo items:								
Output gap (percent of potential GDP)	0.4	0.0	-0.2	-0.2	-0.1	0.0	0.0	
Brent price (US dollars per barrel)	98.9	61.5	68.9	72.0	74.5	76.6	78.5	
Long-run oil price (Brent; US dollars per barrel) 1/	87.5	87.1	83.5	79.8	76.4	75.4	76.0	
Public sector gross debt	38.7	39.7	39.3	39.2	38.8	38.2	37.3	
Public sector net debt	28.4	30.5	30.8	31.3	31.5	31.4	31.1	

Source: National authorities and Fund staff estimates.

1/ The key parameter in the calculation of the structural balance is the long-run oil price. The official structural balance relies on the fixed price determined by the expert committee every year, while the staff's estimate is based on a MA(4,1,4) filter applie to the currently available oil price path set by WEO. The former estimate is relevant to measure compliance with the fiscal rule; while the latter aims to measure the underlying fiscal position.

2/ Obtained through a MA(4,1,4) filter.

18. The authorities agreed on the urgent need to mobilize revenue in order to protect social and infrastructure spending, especially given falling oil revenues. They concurred that additional revenue, gained through tax reform and better enforcement, would help replace the expected decline in oil revenues and finance key social and infrastructure expenditure programs which could bolster the outlook for inclusive medium-term growth, while complying with the fiscal rule targets. Therefore, the government established an independent expert commission in early 2015 to advise on options for tax reform. As a pragmatic first step, with the potential to boost revenue in time for the 2016 budget, the authorities were considering revamping the tax system for non-profit organizations, which had proliferated in recent years. They also reassured staff that the expenditure plans set out in the forthcoming MTFF would be well-aligned with the new National Development Plan (NDP) agenda. Further, they thought that a potential peace agreement was not likely to entail significant unfunded mandates but would facilitate stronger agricultural development and create political and social support for future reforms.

19. Staff and the authorities agreed on the broad objectives for tax reform. Revenues should be mobilized in a way that simplifies the existing tax structure, increases progressivity, broadens the tax base, and facilitates private investment by ensuring international competitiveness. Staff advised that the tax system currently imposes a comparatively high burden on companies, and will continue to over the medium term as the wealth tax on companies is phased out and replaced

by higher corporate income taxes. Some options for a broad tax reform could include strengthening the income tax system and increasing the VAT rate and base (Box 5).[11] Staff considers that if sufficient revenues could be gained from these sources, they could help reduce existing non-conventional taxes (e.g., personal wealth tax, financial transaction tax, VAT on capital goods) to foster investment and growth.[12] The authorities believe that the personal wealth tax has been an important instrument for achieving more progressivity. There was also consensus that enormous gains in revenue could be achieved through improving tax administration, including by imposing criminal penalties for tax evasion, increasing the number of officials, and strengthening the information technology of the tax administration authority.

20. The authorities remain confident of the success of their infrastructure program. Although Colombia compares well with peers in some areas of infrastructure, such as the quality of electricity supply, a significant road infrastructure deficit generates bottlenecks and hinders competitiveness and inclusive growth. The fourth generation (4G) infrastructure program of road concessions is being implemented in a context of a much strengthened risk framework, which includes a framework Law, standardized PPP contracts, contingency planning, and ex-post financing of functional units. Continued efforts are underway to develop alternative financing options and instruments for risk hedging, including by amending the financial regulatory framework to facilitate participation of institutional investors. Colombian banks and pension funds are already showing strong interest despite their limited experience with project financing. The first set of roads concessions has been awarded and the authorities expect contractors to establish financing agreements by year end. The authorities intend to use proceeds from the prospective sale of the power company Isagen to increase resources in the development fund. They consider that infrastructure investment would support aggregate demand in the short run, offsetting part of negative growth impact of the terms of trade shock, and raise long-run potential growth by about 0.7 percent (estimate of the national planning department, DNP).

21. The details of a potential peace agreement remain uncertain, but the impact on fiscal spending is likely to be manageable. A peace agreement would likely entail continued expenditures for the re-integration of demobilized combatants (up to 0.1 percent of GDP), victims' reparations (1 percent of GDP), health, and education benefits for victims, most of which would likely reflect programs that have already been included in the MTFF. Financing for additional outlays would likely include redistribution of government assets through the ongoing land and rural development reforms, and be partly financed also through lower military spending. As security has considerably improved over the last decade, risk premia have come down and the investment climate has improved. However, while there might be some further gains from stability, any

[11] The traditional corporate income tax (CIT) could be replaced with a higher corporate income surcharge (CREE) which has a broader base (e.g. fewer deductions). The traditional personal income tax could be substituted with an extended alternative minimum tax (IMAN).

[12] The VAT regime does not grant a credit for VAT paid on the purchases of capital goods. This feature is a deviation from standard practice, disproportionally affects capital-intensive activities and is an important contributor to the overall corporate tax burden.

additional peace dividend for growth would likely materialize beyond the medium-term horizon, given long implementation lags for land reform and rural development.

C. Preserving External Stability

22. The current account, currently adjusting to a new equilibrium, is weaker than fundamentals and desirable policy settings, while the real exchange rate has adjusted quickly in line with fundamentals. The External Balance Assessment (EBA) methodologies assessing the current account directly show a gap of around 2 percent of GDP (adjusted for potential oil reserves) whereas the EBA REER methodology estimates the exchange rate fully in line with fundamentals (Box 6). The difference between these results highlights the transition to the new equilibrium of lower oil prices. Prices have adjusted quickly, with a REER depreciation of 18 percent at end-2014, but import compression and the growth in exports of non-traditional goods will occur more gradually. The CA gap is therefore expected to narrow in the medium term. The remaining gap reflects Colombia's very high levels of investment and elevated repatriation of profits. The authorities noted that the current account deficit is temporarily somewhat higher than historical levels and agreed that the exchange rate was in line with fundamentals by the end of 2014. They emphasized that the peso is allowed to float freely and has depreciated more than other currencies in the region since mid 2014, driven mainly by oil prices and to a lesser extent by expectations of U.S. monetary policy normalization and the widening of global risk premia.

23. Due to the oil price shock, the current account deficit is projected to widen in 2015, but remain predominantly financed by FDI inflows. Oil export receipts are projected to drop significantly in 2015 due to the fall in global oil prices, but lower profit repatriation of foreign-owned firms and a decline in imports should partially compensate the impact on the current account. FDI inflows are expected to moderate from recent high levels (from 4.2 percent of GDP in 2014 to 3.3 percent by 2020), but will finance about 80 percent of the current account deficit over the medium-term. As a result, the current account deficit will continue to be financed largely through stable funding sources, as in the past.

24. The current account is expected to strengthen over the medium term. Staff and the authorities expect the current account deficit to narrow going forward as the peso depreciation supports growth of non-traditional exports and reduces growth of capital and consumer imports after a lag, although the associated improvement in the trade balance would be partly offset by a higher cost of external debt. The authorities pointed to a similar delayed improvement in the current accounts of other countries in the region following a negative terms of trade shock (e.g., Chile's copper price shock in 2009). Over the medium-term, oil export receipts are projected to increase as prices partly recover and help offset some decline in oil production in response to decline in oil-related investment (Box 3). The authorities concurred that further efforts to diversify the economy would lower reliance on oil receipts and help dampen current account volatility, while productivity-enhancing labor market reforms, and efforts to diversify export markets and products would improve competitiveness. They noted, in addition, that the planned fiscal consolidation would play a role in strengthening the current account balance over the medium term.

25. The authorities have built an adequate level of international reserves, adapting their intervention to changing external conditions. Staff and the authorities concurred that Colombia has an adequate reserve buffer for normal times, though they might be insufficient to cope with tail risks. The authorities reiterated that reserve ratios prevailing prior to the global financial crisis of 2008–09 had proved to be an important buffer in confronting that large external shock. Therefore, the central bank took advantage of abundant capital inflows through 2014 to rebuild external buffers. As of end-2014, the stock of international reserves covered approximately 7 months of imports and about 100 percent of 2015 gross external financing needs, but reserves measured relative to short-term external debt plus the current account deficit are still below pre-crisis ratios. As reserve ratios increased and in light of the significant depreciation of the peso, in line with its fundamental value, the central bank halted its foreign exchange purchases in 2015.

D. Safeguarding Macro-Financial Stability

26. The financial system is sound, and exposure to the oil sector is limited. Financial indicators are strong (Table 7). Because oil sector companies do not borrow domestically and finance themselves largely through re-investment of profits, and some issuance of local bonds, banks' exposure the oil sector is extremely low (about 1–3 percent of assets), mitigating the risk from the oil shock to direct lending portfolios. Non-banks' exposure to the oil sector is also moderate and does not pose macro-stability risks.

- Financial sector institutions[13] exposure to the oil sector, including loans and bonds, is concentrated in Ecopetrol (97 percent) whose liquidity position remains strong and with moderate leverage. There is also no evidence of high concentration in the volume of deposits of oil companies at any of the credit institutions.

- Exposure to oil shares in the repo and futures markets and to oil securities in private debt arbitrage trading is small.[14]

- Some individual non-systemic insurance companies and broker-dealers' investment portfolios have a significant share of their equity exposed to oil companies.

- Households' exposure to the oil sector is negligible. Less than 5 percent of shares of the three major oil companies were held by minority shareholders at end-2014. Individual shareholders (domestic and foreign) kept 0.018 percent of shares of Ecopetrol, 0.15 percent of shares of Pacific Rubiales and 19 percent of Canacol.

[13] Including banks, financial corporations, fiduciary institutions, insurance companies, pension funds, cooperatives, and the stock exchange.

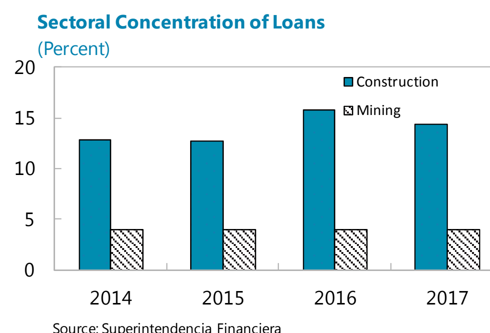
[14] At end-December 2014, exposure to Ecopetrol stock in standardized derivatives market represented 1.2 percent of this market. Pacific Rubiales standardized derivatives consisted of 0.6 percent of the standardized derivatives market.

- According to a central bank stress test conducted in June 2014, the banking sector would remain solvent even under an extreme macroeconomic shock.[15] A liquidity stress test suggests that the liquidity coverage ratio would remain well above the regulatory minima of 100 percent for banks and non-banks.

27. Risks from the credit cycle appear moderate and the macro-financial system is stable on both microprudential and macroprudential dimensions. While financial sector vulnerability risk has increased reflecting a recent pick-up in credit and is marginally above the "low" threshold in the last quarter of 2014, banking system balance sheets have remained strong and buffers are ample (Appendix I). Moreover, while household and corporate leverage has been increasing, it remains low and the low exposure to the oil sector is expected to dampen the effect of the oil shock on households and corporate borrowing and consumption. The authorities agreed that house price increases have stabilized more recently, as the mortgage subsidy on middle-income households was discontinued, and do not pose a significant risk to the banking sector.

28. Credit growth has remained robust, at 14.7 percent in 2014. Colombian corporates replaced credit lines from foreign banks with domestic credit due to the exchange rate depreciation, contributing to strong credit growth. Moreover, ample liquidity, in part due to strong capital inflows and imperfect sterilization of reserve purchases, and strong competition between banks have fuelled substantial payroll and consumer loan growth, which will need to be monitored closely against potential worsening of underwriting standards and turnaround in the economic cycle. Credit growth was also boosted by government's housing subsidy program targeted to middle-income households and will continue to be strong going forward through financing of the 4G infrastructure program (see below). Although consumer lending for durable goods is expected to slow, due mainly to lower credit demand as economic activity and private consumption moderates, total credit growth will continue to outpace nominal GDP growth. This is in line with the authorities' financial inclusion policy which has resulted in credit deepening and will boost microfinance going forward, and the strong drive for home ownership that will support mortgages as incomes continue growing.

Sectoral Concentration of Loans
(Percent)



Source: Superintendencia Financiera

29. According to scenario analysis, Colombian banks have sufficient capacity to help finance the 4G infrastructure program. The financial system supervisor (*Superintendencia Financiera de Colombia*, SFC) ran a macro-financial scenario to gauge the banking system's capacity to fund Col$14 billion (30 percent of total financial need) of fourth generation (4G), PPP-based road infrastructure projects. The scenario assumed staff's baseline macroeconomic projections for

[15] The combined shock consists of an 8 percent decline in real GDP, an increase in the real interest rate to 12 percent, 17 percent fall in house prices, and an increase in unemployment rate to 15 percent.

2016 and 2017 and normal growth of credit and provisioning. The results indicate that bank financing for 4G is manageable without crowding out lending to other sectors or unduly increasing concentration and banks could maintain strong capitalization. The authorities were optimistic about bank's appetite for financing the 4G projects, including because of lower business prospects for other credit lines due to the cooling of the consumer lending cycle and slowdown in activity.

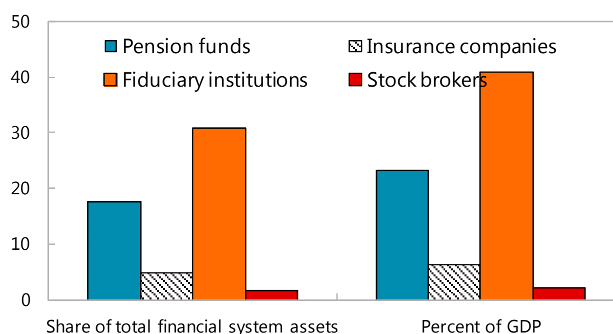
30. Colombian banks' large presence in Central America continues to pose risks. Economic risks have declined in some of the Central American countries where Colombian banks have expanded in recent years, as these countries benefit from close linkages to the U.S. and lower energy costs. However, concerns persist over lower loan quality, higher FX exposures, and weaker prudential standards and AML/CFT framework. The absence of common regulatory and supervisory standards and confidentiality obstacles on information sharing create challenges for cross-border supervision, including for AML/CFT purposes. A network contagion analysis suggests that, at this point in time, Colombian banking conglomerates are systemic for the region (including Central America and Panama) while they are not vulnerable to shocks on individual banks in other countries. However, banks' capital, while currently above regulatory minima, could prove insufficient against risks run by banking groups in case of system-wide shocks. Moreover, removing goodwill from banks' capital results in a more negative scenario in which Colombia becomes significantly more contagious for the region and its banks more vulnerable to shocks. Consideration should be given to strengthening capital buffers further and building a regional body in charge of financial stability that would act as a forum for the coordination of regional macro-prudential surveillance (Box 7 and Selected Issues Paper).

31. The Colombian authorities are making good progress in implementing FSAP recommendations, including those that help address cross-border risks. Draft laws granting independence and legal protection of the supervisor, and laws awarding regulatory powers over holding companies of financial conglomerates currently lie before Congress. Extended delays in approving the laws would weaken supervisory oversight of the financial system. The SFC continues to move ahead with risk-based supervision to enable the supervisor, together with banks and nonbanks, to tailor prudential requirements to the risks that their operations entail. The authorities noted that while work on addressing risk from financial conglomerates has progressed, assessing risks from mixed conglomerates remains challenging given complex family ownership and offshore structures where SFC regulatory reach is limited. The Ministry of Finance is working on proposals to implement the Basel III capital adequacy measure, Basel II (Pillar 2) buffers, the capital conservation buffers, and domestic systemically important banks' (D-SIB) buffers for large internationally active Colombian banks. These measures build on an already enhanced capital adequacy measure (introduced in 2013) and will provide increased loss absorbency for Colombian banks against cross-border and domestic risks once fully implemented (Box 8).

32. The continued growth of nonbank financial intermediation raises additional challenges for supervision. Credit growth outside the banking system has been robust and broker-dealers

have been growing in size, with some large entities accounting for around 30 percent of key public debt and derivatives markets.[16] Since the collapse of a large broker-dealer, Interbolsa, in 2012, regulations such as the management of liquidity risk of broker-dealers and investor protections were strengthened. The authorities agreed that notwithstanding such enhancements, risks from a larger presence of systemic broker-dealers in capital markets require continued monitoring. To that end, the SFC continues to move ahead with risk-based supervision to enable the supervisor to tailor prudential requirements to the risks that their operations entail, which would also instill better risk management practices at banks and nonbanks.

33. The derivatives market has grown in recent years and its regulatory regime needs to be further simplified. The regulatory framework for derivatives in Colombia has sought to to address risks from growing transactions but in doing so it has created a complex and fagmented framework that could be simplified. The authorities have pointed that the current framework has provided clarity which has in turn allowed such a large scaling up of derivatives transactions. To address risks they are developing analytical and supervisory tools for on-site and off-site surveillance of derivatives transactions. Their risk-based approach to supervision currently addresses counterparty risk, including risks flowing from institutions' regional exposure, and should be upgraded to monitor concentration risk as well as leverage and collateral quality in the OTC derivatives market (Box 9, and Selected Issues Paper).



34. Development of capital markets should focus on creating depth and enhancing liquidity. Liquidity in interbank money markets (e.g. repo) tends to be concentrated at overnight maturities while money markets at maturities beyond the overnight are illiquid. This limits the scope of Colombian capital markets to provide liquidity management and financial intermediation services for a variety of corporate (financial and non-financial) institutions. While good progress has been made to limit counterparty access to routine open market operations, thereby encouraging counterparties to manage liquidity through the money markets, further development of money markets could benefit from imposing a higher cost of overnight credit, and from a greater issuance of short-term government securities.

E. Fostering Inclusive Growth

35. The authorities' structural reform agenda, enshrined in the national development plan, targets key areas to foster inclusive growth. Despite significant progress over the past decade,

[16] Total nonbank financial system assets amounted to Col$532.2 billion in June 2014 (72.5 percent of GDP).

Colombia's poverty, inequality, youth unemployment, and informality are still elevated (Box 10). Labor market formalization has improved as a result of the 2012 tax reform, which lowered taxation on labor (see Selected Issues Paper). However, the high minimum wage relative to the average wage hinders further formalization gains, particularly for youth and unskilled labor. Going forward, plans to streamline the requirements to make formal contributions to pension and health systems could further reduce labor informality and strengthen the social safety net. Female labor participation should also increase through easier access to maternity leave benefits. Streamlined regulation, aligned with OECD standards, could lower uncertainty for firms and facilitate resource planning. A centralized database of vacancies at municipal level, developed by the Labor Ministry, is expected to support the search and application processes of first-job seekers, mainly unemployed youth. The development plan's goal to improve access to quality education would help reduce inequality and promote medium-term growth prospects. The authorities are also working on a pension reform that would strengthen the safety net of the poor through expanded coverage of non-contributory pensions (with 2 million recipients compared to the current 1.3 million). Efforts to foster innovation and economic diversification are also planned and, a potential peace accord would provide further opportunities for institution building and rural development, which will help improve growth prospects and inclusiveness, and strengthen competitiveness.

36. Financial inclusion remains one of the main tools for fighting poverty and marginalization. Over the past year, the main achievements on the financial inclusion front have been the launch of the electronic money issuers license and the implementation of the centralized electronic movable property registry. These initiatives have the potential to lower transaction costs, promote usage of new products, and contribute to financial deepening and inclusion. The authorities are currently setting up the regulatory framework to operationalize electronic deposit taking institutions, while the movable property registry will benefit from new regulation to lower the period for the execution of guarantees and from the improved methodology for asset valuation. Concomitantly, various national institutions are coordinating to provide financial education through schools and media, which should also contribute to financial system stability. Given that informal finance remains pervasive in Colombia and may underlie the low usage of bank accounts, household surveys could be expanded and deepened to incorporate questions on the role of informal finance for different segments of the population throughout the country (see Selected Issues Paper).

STAFF APPRAISAL

37. Supportive economic policies underpinned strong economic growth in 2014 despite a worsening of global conditions. Real GDP grew by 4.6 percent last year, among the highest in the region, supported by strong aggregate demand resulting in part from a broadly neutral fiscal policy and an accommodative monetary stance. After the collapse in oil prices during the second half of the year, growth ebbed to 3.5 percent y/y in the fourth quarter.

38. The strong and flexible macroeconomic framework is expected to moderate the growth slowdown in 2015 following the severe oil shock. A subdued outlook for investment, especially oil-related, and private consumption and some fiscal tightening will cause growth to slow to 3.4 percent. However, the sharp real effective exchange rate depreciation should help contain imports and gradually spur non-traditional exports. The recent rise in inflation reflects temporary factors and slower growth is expected to close the output gap; thus, a broadly neutral monetary policy stance remains consistent with achieving the inflation target, and staff sees scope for easing if growth falters. The structural fiscal rule helps protect key expenditure programs from cyclical oil and output fluctuations, and the government's decision to adhere to the rule *ex post* rightly bolsters fiscal policy credibility. Plans for the fiscal rule committee to revisit the operation of the fiscal rule and the sensitivity of fiscal revenue to oil shocks are welcome.

39. The outlook is clouded by large downside risks. Especially during its adjustment to the negative terms of trade shock that has already materialized, Colombia is exposed to heightened risk of additional adverse external shocks, including a further decline in commodity prices, deterioration in global financial conditions, and negative growth shocks in key trading partners. Oil prices may fall further or be exposed to bouts of volatility. Economic slowdown or stress in neighboring countries would limit the potential to take advantage of the peso depreciation. A bumpy normalization of monetary policy in the U.S. or an intensification of sovereign distress in the Euro Area could generate a surge in bond yields, large movements in the value of major currencies, or an increase in global financial volatility.

40. The oil shock has amplified the urgency of mobilizing fiscal revenue to protect key social spending. The structural fiscal rule has served the country well; however, amid the weaker oil revenue outlook, it will be necessary to increase fiscal revenues to meet medium-term targets and simultaneously protect key social and infrastructure needs. The recently formed expert advisory commission is a welcome step. Revenues should be mobilized in a way that simplifies the existing tax structure, increases progressivity, broadens the tax base, and facilitates private investment by ensuring international competitiveness. Equally important, tax administration reforms should further advance, including by imposing criminal penalties for tax evasion, and strengthening human and technological resources of the tax administration authority.

41. Moving forward with infrastructure investment is key to improving competitiveness and boosting growth. The authorities' infrastructure program, including the fourth generation of road concessions to be executed through public-private partnerships (PPPs), is expected to address

a key bottleneck for Colombia's strong and inclusive growth. Efforts to develop alternative financing options and instruments for risk hedging should continue while other potential sources of financing should be tapped, including from multilateral institutions and from the sale of government assets, such as the power company Isagen, to increase resources in the national development fund. Colombian banks have sufficient capacity to help finance the 4G infrastructure program without crowding out lending to other sectors. Efforts to develop alternative financing options and instruments for risk hedging should continue.

42. Recent efforts have further strengthened financial supervision and regulation, but some remaining areas warrant continued attention. Financial soundness indicators are strong and exposure to the oil sector is very limited. Recent work has advanced risk-based supervision including from financial conglomerates. However, supervision of complex financial conglomerates and exposure to concentration risk continue to pose challenges. A deeper framework to monitor and stress-test a wide variety of cross-border risks is required, given the recent expansion of Colombian banks into other countries in the region, primarily in Central America. A clear timeline for the implementation of the Basel III capital adequacy measure for large internationally active banks would also be an important step forward.

43. The external position of the economy is strong, and international reserves appear adequate for precautionary purposes. The current account deficit is weaker than implied by fundamentals while the real exchange rate is broadly in line with fundamentals. Moreover, risks to external stability are mitigated by a stable financing of the current account deficit, still largely through foreign direct investment. The central bank has appropriately taken advantage of periods of strong capital inflows over the past few years to strengthen international reserves, which are adequate but might be insufficient to cope with tail risks.

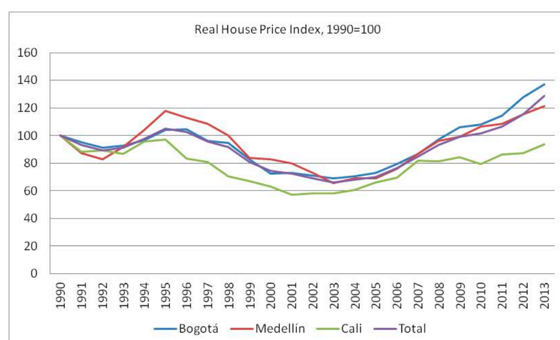
44. Measures to foster more inclusive growth would be welcome. While poverty has declined, improvement in income inequality has lagged in recent years. Further reducing poverty, unemployment, inequality, and informality will require structural reforms in the labor market, and the fiscal and financial sectors. The high level of the minimum wage relative to the average wage might be hindering employment opportunities for the youth and unskilled.
Expanding non-contributory pension coverage would strengthen the safety net of the elderly poor. Financial inclusion could be fostered by promoting financial education, encouraging competition in the banking sector to lower costs, and shortening the period for the guarantees on movable property.

45. Staff does not recommend approval of the retention of the exchange restriction arising from the special regime for the hydrocarbon sector, since the authorities have no plans for its removal.

46. Staff recommends that the next Article IV consultation takes place on the standard 12–month cycle.

Box 1. House Prices and Household Debt

Housing prices have increased rapidly in recent years, raising concerns that the market may be undergoing a bubble. House prices have nearly doubled in real terms over the last decade, equally for subsidized and commercial housing, and are almost 40 percent above their peak in 1996. The price hikes have outstripped increases in construction prices and were mainly driven by a rising trend in the capital and two other large cities. However, the increase in housing prices has been less pronounced after adjusted for income levels and the quality of newly constructed housing. House price increases have also surpassed rental increases (a common indicator used to gauge the relationship between prices and fundamentals). However, household income has also increased strongly in the recent decade, alleviating the burden of mortgages on households and boosting demand for housing.



The exposure of households and the financial sector to house price developments continues to be low (see Selected Issues Paper for the 2014 Article IV Staff Report). The growth of mortgages in banks' loan portfolios remains high, although it has slowed marginally to 17.3 percent in real terms in September 2014. Credit risks are, however, mitigated by a low overall stock of mortgages (about 10.5 percent of total loans), conservative provisioning, and lower housing finance interest rates, which are capped to the lowest rates prevailing for other type of lending. Banks have also been moving towards greater amounts of fixed rate funding for mortgages from variable rates, which should strengthen profitability in a low interest rate environment. Moreover, housing loans extended in recent years have shown less deterioration compared to those made in the past. At 17.5 percent of GDP and 28 percent of disposable income, household debt is moderate, and debt service-to-disposable income is low (9 percent).[1] Although slightly higher than a year ago, LTVs remain low (52 percent).

The government has supported housing construction and finance through tax incentives and interest subsidies. The programs are primarily designed to support social housing to low-income earners. However, in 2013, the government introduced a mortgage interest rate subsidy for middle-income earners as a counter-cyclical measure to spur construction. The program was effective as a temporary fiscal measure to support growth, and was since discontinued,

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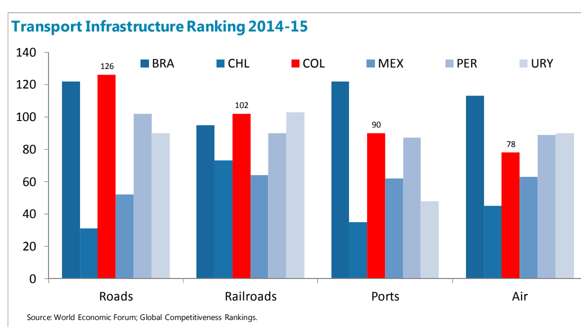
[1] Consumer loans constitute about 67 percent of household debt.

Box 2. Infrastructure Investment in Colombia

Poor infrastructure quality is a drag on Colombia's potential growth and competitiveness. Total infrastructure investment averaged 4.3 percent of GDP during 1980−2000, but has slowed down to 3.2 percent of GDP over the last decade. Bottlenecks in fiscal, legal, and environmental areas have been the main impediments to infrastructure investment, with the transport sector most affected. Over 2002−08, transport infrastructure investment was below 1 percent of GDP per year, and only in 2009−13 reached 2 percent of GDP.

Colombia's infrastructure gap is most acute in road transport. Various studies indicate that infrastructure quality is relatively low and logistic costs are high both at regional and global level. In the World Bank's 2014 Logistics Performance Index, Colombia ranks 97th among 160 countries. The country ranks 93th among 189 economies in the World Bank's 2015 Doing Business indicator related to ease of cross-border trade, which also partly reflects high inland transportation costs. Furthermore, World Economic Forum ranked Colombia 126 among 144 countries in terms of road infrastructure quality in 2015, the lowest ranking in the country's overall infrastructure quality and the worst performance among regional peers.



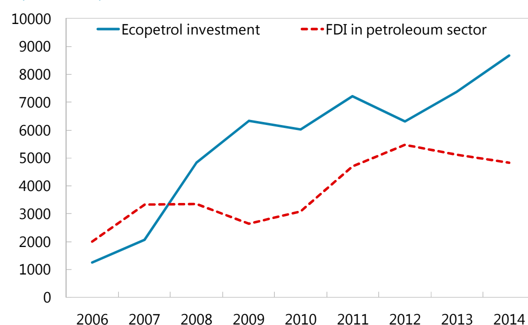
During 2010−14 the authorities undertook regulatory and institutional changes to enhance the efficiency infrastructure investment and facilitate financing by institutional investors. The institutional framework was strengthened by creating the Vice-Ministry of Infrastructure, the National Infrastructure Agency (ANI), and the National Development Bank (FDN). The 2012 PPP law addressed numerous bottlenecks: (i) eliminated the possibility for the private sector to request cash advances; (ii) limited amendments to PPP contracts to a maximum of 20 percent of the value of the original contract; (iii) linked government payments to the quality of infrastructure services provided; (iv) required that the decision to pursue a PPP be based on sound socio-economic and technical studies; (v) defined the responsibilities of the parties involved in the PPP process; (vi) included an improved gateway process for the Ministry of Finance; and (vii) regulated unsolicited proposals for PPPs. The Infrastructure Law was expedited to address bottlenecks in the relocation of utilities networks and purchase of land. In addition, the 2014 regulatory framework amendments related to investment regimes and larger individual credit limits for institutional investors are expected to incentivize domestic private sector participation in projects.

The authorities are undertaking an ambitious 4G infrastructure investment program totaling about Col$48 trillion (US$25 billion, about 6.2 percent of 2014 GDP) over 2014–22. Fiscal outlays (in the MTFF) would be around 0.4 percent of GDP per year, including contribution to a contingency fund. Implementation of the program is planned in three waves: 9 projects in the first wave (about US$7 billion), 9 projects in the second wave (about US$6−7 billion), and 12 projects in the third wave (about US$6−7 billion). The first wave projects have already been awarded and financing agreements are expected by end 2015. The bidding process for the second wave projects is expected to be completed in May, with financing agreements required within a year. Bidding for the third wave projects has not commenced yet.

To finance investment, concessionaires will need to attract funding from various sources. Authorities target the following structure of potential financing: (i) local banks—30 percent; (ii) foreign banks—26 percent; (iii) equity of the concessionaries (domestic and foreign)—20 percent; (iv) private capital funds—14 percent, attracting institutional investors for the construction stage; and (v) multilateral institutions (FDN)—10 percent. After the construction phase, project maintenance and repayment of debt incurred in the construction phase would be financed from the concessionaries' tolls, future cash appropriations from the budget, and income received from commercial activities in the concession area.

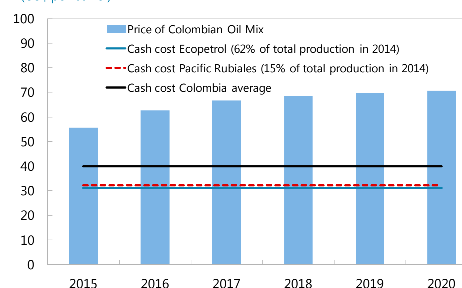
Box 3. Oil Sector Prospects

Since 2006, an increase in investment supported a strong expansion in oil production. Oil production expanded by about 90 percent between 2006 and 2013, and surpassed one million barrels per day. The 2.5 percent decline in 2014 was due in part to security and other operational constraints but it has recovered in recent months. An important factor behind this expansion is the government's measures to improve the investment climate for foreign oil companies. FDI and Ecopetrol investment more than tripled over this period.



Sources: Haver and Ecopetrol financial statements.

While production costs remain competitive, cash flow constraints have driven oil companies to scale down investment plans. Oil companies are actively timing their capital expenditures, especially exploration-related, to revenue inflows; some companies are also considering divesting from non-core activities to finance capital expenditures. The two largest operators, Ecopetrol and Pacific Rubiales, announced strong cuts to their investment plans, by 25 percent and 50 percent respectively. Given the still competitive extraction costs (30–40 dollars per barrel) for 70 percent of Ecopetrol's production and the need to keep extraction wells active to prevent permanent loss of output, near-term oil production will be protected. However, the fall in investment weakens the medium-term production outlook. The authorities' draft development plan includes a 2018 oil production target of 980 kbpd—14 percent below the target announced in the 2014 medium-term fiscal framework; oil production would decline by about 8 percent between 2015 and 2020.[1]



Sources: WEO, Ecopetrol, Pacific Rubiales and Colombian Petroleum Association

In this context, the authorities' draft development plan targets measures to improve oil-contract flexibility. Amid lower oil prices, more flexible targets for exploration and production would improve competitiveness especially for medium-size oil companies. The draft development plan also includes measures to foster better recovery rates at existing fields as well as tax incentives (expected to be included in the expenditure envelope of the next MTFF) for off-shore exploration and production.

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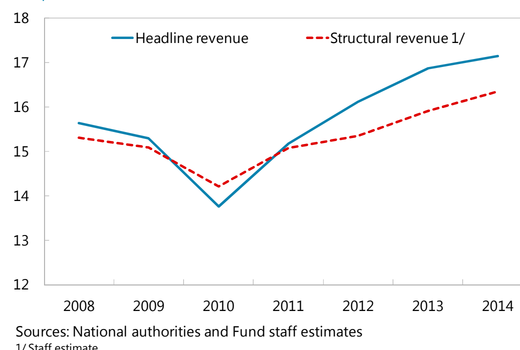
[1] From *Bases del Plan Nacional de Desarrollo* 2014–2018, p. 213; and *Marco Fiscal de Mediano Plazo 2014*, p. 151.

Box 4. Oil Shock and Colombia's Fiscal Rule

In Colombia, the fiscal rule represents an important buffer against cyclical fluctuation in oil prices and GDP. The rule (which became effective in 2012) includes a numerical target path for the central government's structural deficit which is computed by removing the impact of the cyclical variation of oil prices and GDP on fiscal revenue. Further, the rule calls for a gradual fiscal consolidation—about ¾ percent of GDP reduction of the structural deficit during 2016 and 2022. Something important to highlight is the fact that for each budget, the long-run price is determined by an expert committee that meets in April of the previous year.

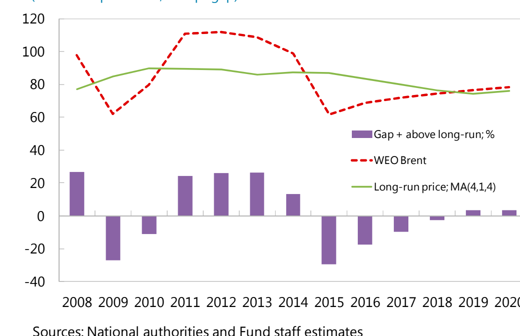


Sources: National authorities and Fund staff estimates
1/ Staff estimate

The recent revision to the oil price outlook has both a cyclical and a permanent component. Using as the long-run price a symmetric moving average—MA(4,1,4); which is also used by the expert committee—staff's estimates suggest that while the headline oil price (Brent) would decline by about 37 percent y/y in 2015, the long-run price for 2015 would be only about 10 percent lower than the long-run price calculated for 2014 one year ago. This represents an example of how the fiscal rule can shield fiscal policy from fluctuations in oil prices. However, during 2016 to 2020, as the moving average incorporates the lower outlook for prices, the long-run price would decline by some 13 percent which also represents an example of the type of permanent shock the rule is designed to pass-through into the fiscal framework.

Sources: National authorities and Fund staff estimates

Staff estimates' suggest the new oil price path will represent an important headwind for achieving the fiscal consolidation required by the rule. After halving in 2015, structural oil revenues would further decline by 0.4 percent of GDP by 2020 amid the weak outlook for oil production (about 8 percent production decline by 2020). Absent revenue mobilization measures, fiscal expenditure would have to be reduced by about 1¾ percentage points of GDP—reflecting the combination of the required consolidation and reduction in structural oil revenues.



Sources: National authorities and Fund staff estimates

Box 4. Oil Shock and Colombia's Fiscal Rule (concluded)

Alternative scenarios further illustrate the direct connection between the oil price outlook and the expenditure envelope allowed under the rule. Two scenarios are considered.[1] (1) Continued low oil prices: the world oil prices remaining at its 2015 level over the medium term. (2) Return to high oil prices: oil prices recovering to the levels expected a year ago (at the time of the 2014 Article IV consultation). Under the first scenario, expenditure levels would have to be 0.15 percent of GDP lower than in the baseline in order to achieve the structural deficits targets. In contrasts, scenario 2 would allow expenditure to be on average about 0.2 percent of GDP higher.

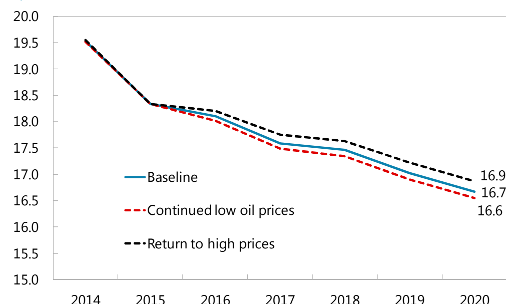
Alternative Oil Price Scenarios (Brent; US$ per barrel)

	2014	2015	2016	2017	2018	2019	2020
Baseline							
Headline price	98.9	61.5	68.9	72.0	74.5	76.6	78.5
Long-run price	87.5	87.1	83.5	79.8	76.4	75.4	76.0
Continued low oil prices							
Headline price	98.9	61.5	61.5	61.5	61.5	61.5	61.5
Long-run price	84.1	82.0	76.6	71.0	65.7	61.5	61.5
Return to high prices							
Headline price	98.9	100.7	95.6	92.5	90.6	89.1	89.1
Long-run price	98.9	99.9	97.5	94.9	92.7	90.3	90.3

Sources: WEO and Fund staff estimates.

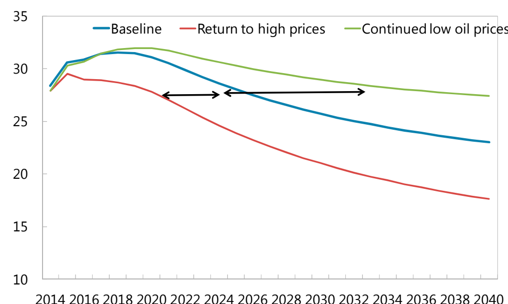
Different outlooks for oil prices will also have implications for debt accumulation. Within the fiscal rule, net debt accumulation (reduction) becomes the key tool to respond to cyclical declines (increases) in GDP and oil prices. Case in point, net debt levels would about 1 percentage points of GDP higher by 2020 under the scenario of continued low oil prices. In contrast, net debt levels would be about 3.5 percent of GDP lower by 2020 if oil prices were to return to high levels. The impact on the debt trajectory would be long-lasting; for instance, the net debt levels that would be achieved in 2025 under the baseline, would take about 7 extra years if oil prices were to remain low.[2] It follows that achieving a defined path for structural balances does not ensure also achieving a desired debt target.

Expenditure envelope under difference scenarios
(in percent of GDP)



Sources: National authorities and Fund staff estimates

Public Sector Net Debt
(in percent of GDP)



Sources: National authorities and Fund staff estimates.

[1] The analysis does not include the effect that different oil prices could have on the exchange rate and GDP.

[2] The analysis assumes no further reductions in the central government's structural deficit after 2022—the last year for which the fiscal rule defines a specific numerical target.

Box 5. Recent Tax Reforms and the Road Ahead[1]

The 2012 tax reform has had mixed success in achieving its goals of improving progressivity and lowering the burden on labor income. The 2012 reform aimed to improve progressivity and reduce the tax burden on labor which was hindering formality and competitiveness while being revenue neutral. The reform was designed to be revenue neutral and included the reorientation of taxes in favor of personal income, introducing a minimum personal income tax (IMAN/IMAS) and away from labor, partially replacing social security contributions with corporate profit-based taxes (CREE). In terms of results, labor formality has increased compared to the period preceding the reform. However, progressivity of the system did not improve markedly as personal income taxation has increased only marginally.

At the same time, the revenue performance of the reform was somewhat below expectations. The IMAN's very narrow tax base has facilitated evasion. Further, as the CREE was built on top of the existing corporate tax code, it has inherited some of its loopholes and room for evasion. As a result, the reform's yield has been lower than expected, albeit it is relatively early to do a full assessment. Further, the earmarking of CREE to compensate foregone social security revenue has reduced budget flexibility somewhat.

The 2014 reform was designed as a short-term tool to offset scheduled revenue declines. The reform was approved last year, and became effective in 2015. The reform yield (1.5 percent of GDP until 2018) was designed to make up for the scheduled elimination of the wealth tax and financial transaction tax (FTT) and some expected decline oil revenue due in part to a dimmer outlook for production costs and prices. The reform measures include the gradual increase of CREE (from 9 percent in 2014 to 18 percent in 2018) for middle and large firms (annual profits in excess of US$0.4 million) and the continuation of the personal wealth tax and financial transaction tax until 2018.The reform also phases out the firm-level wealth tax over this period. The reform entails a combined relatively high level of corporate tax rate of 43 percent (CREE + corporate tax rate of 25 percent) which could hinder investment; further conditioning the rate of CREE on firm's profit level might lead to further distortions.[2]

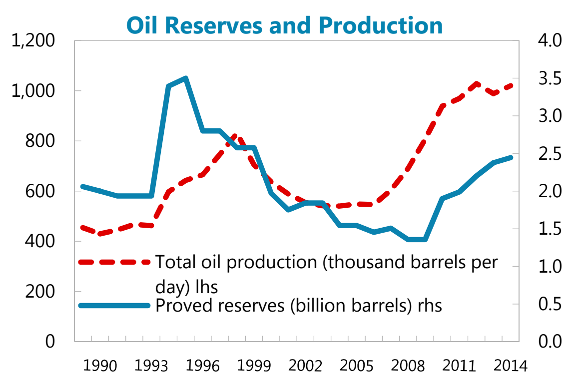
Future revenue mobilization efforts should build upon instruments introduced in the 2012 tax reform. CREE's simplified exemption structure could replace traditional corporate taxation; similarly, the traditional personal income tax system can be replaced by an improved IMAN by eliminating loopholes for high income individuals, increasing rates and widening the tax base to cover middle income individuals. The tax base of the VAT could be further expanded and its rate increased. At the same time, replacing existing non-conventional taxes (personal wealth tax, FTT, VAT on capital goods) with alternative revenue sources could foster investment and growth.

[1] Based on FAD TA report "Reforma de 2012 y Nuevos Retos de la Política Tributaria," November 2014.

[2] FAD TA report estimates a combined corporate tax burden of about 55 percent of profits including the impact of corporate income tax, corporate income surcharge (CREE), and VAT on capital goods.

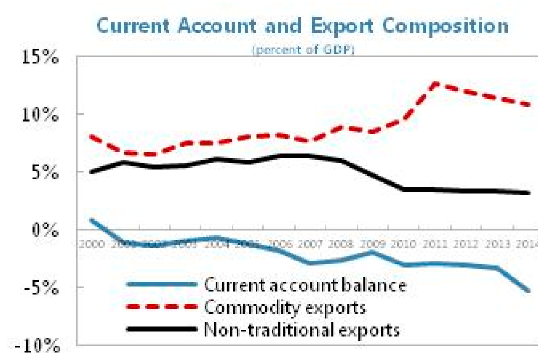
Box 6. External Sector Assessment

Colombia's current account, temporarily adjusting to a new equilibrium, is weaker than implied by medium term fundamentals and desirable policies. The External Balance Approach (EBA) External Sustainability (ES) estimates suggest that the CA is about 2 percent below the level needed to stabilize Colombia's NIIP over the medium term. The EBA CA method estimates a CA gap of 5 percent of GDP, reflecting a very high unexplained residual and poor model fit in the case of Colombia, which is—to a large extent—due to the treatment of oil reserves.[1] The equation measures the years of proven reserves remaining relative to current production. Colombia's ratio is somewhat low, but has been stable, reflecting the sharp rise in both proven reserves and production. Adjusting the methodology to include potential instead of proven oil reserves, which would be justified given Colombia's high reserve recovery rate to date[2], the CA gap falls to 2 percent of GDP, similar to the ES method. This gap is likely to be temporary and to narrow over the medium term as the country adjusts to a new equilibrium of lower oil prices. The remaining gap reflects Colombia's high levels of investment and elevated repatriation of profits.



The exchange rate has adjusted quickly and is in line with fundamentals. EBA's real effective exchange rate (REER) method suggests that the exchange rate was overvalued by only 1.4 percent at end 2014. This result is consistent with the full flexibility of Colombia's exchange rate regime, as demonstrated recently by the quick adjustment to the sizable terms of trade shock. In fact, the REER depreciated by 18 percent y-o-y at end-2014, returning to levels preceding the global financial crisis and the subsequent commodity boom.

The CA deficit has widened since 2000 mainly driven by strong imports from investment and consumption, declining remittances, and weaker manufacturing exports. In 2014, the deficit reached 5.2 percent of GDP and is expected to widen to 5.9 percent in 2015 mainly reflecting the 40 percent decline in oil prices since mid 2014. Due to the significantly depreciated exchange rate, import compression will help contain the worsening of the trade balance already in 2015. This would be in line with the REO (2015)[3] results as well as the authorities' estimations, according to which import elasticities have increased in recent years.



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[1] The EBA CA methodology estimated the current account norm at +3.2 percent of GDP in 2013, compared to 2.6 percent of GDP in 2012, largely due to the introduction of years remaining of proven oil reserves (as a proxy for oil wealth) as a new variable in the model. The oil industry officials (including foreign multinational companies) share the view that the country's oil resources are substantially larger than indicated by the proven reserves measure, as further supported by a high ratio of potential oil reserves to proven reserves.

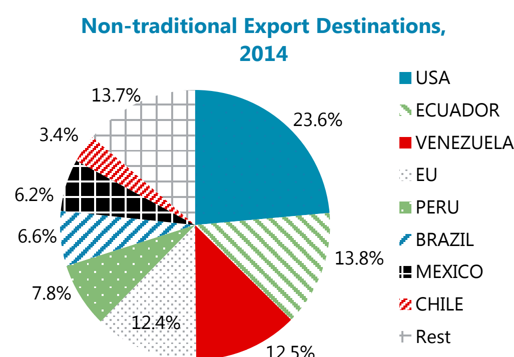
[2] With significantly lower oil investment, the transformation of potential into proven reserves is likely to slow at current low prices, but oil stocks will remain in place even if not converted into commercially viable proven reserves in the short term. In addition, initial off-shore explorations have already started.

[3] IMF Regional Economic Outlook, April 2015.

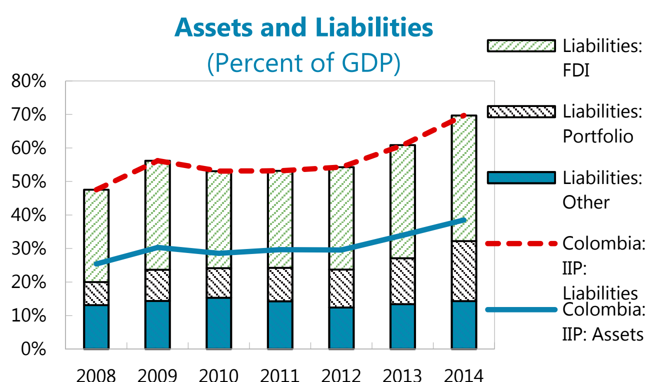
Box 6. External Sector Assessment (concluded)

Backed by a significantly depreciated exchange rate, the CA is projected to improve gradually. Non-traditional exports were around 5 percent of GDP before the global financial crisis and could reach these levels again, notably with more competitive prices and improvements in infrastructure. However, based on studies on export elasticities for Colombia, recently estimated at 0.5 over two years, the impact is likely to occur with a lag.[4] Moreover, firms will have to reorient toward new export markets given the situation in neighboring countries, including new tariffs in Ecuador and economic stress in Venezuela, two key export destinations for non-traditional exports.

Colombia has seen a strong increase in capital inflows in 2014, triggered by an increase in Colombia's weight in the J.P. Morgan's Emerging Markets Bond Index. Portfolio inflows, mainly invested in longer term government securities, have overtaken FDI inflows for the first time in 2014. FDI remains strong at around 3 percent of GDP but is expected to decline by 20 percent in 2015 due to falling oil-related investment. Given Colombia's relatively high competitiveness, FDI would pick up in the medium term to continue financing a major share of the CA deficit.



The NIIP is at moderate levels and mainly in the form of FDI, but liabilities have increased and are expected to grow further. Colombia's NIIP reached about -30 percent of GDP at end 2014. Liabilities amounted to 70 percent of GDP—an increase of 10 percentage points relative to 2013—with FDI liabilities (40 percent of GDP) twice as large as portfolio liabilities. With the CA deficit widening to about 6 percent in 2015 and significant depreciation of the peso, the NIIP is projected at -40 percent in 2015. Due to medium term CA deficits of around 4 percent, the NIIP is likely to further decline and stabilize at -47 percent. While the NIIP is sustainable, recent trends in portfolio investments could lead to heightened vulnerability to global financial volatility. Notably, portfolio liabilities increased on average by 26 percent in the past 5 years, twice as high as the average growth rate of FDI liabilities.



The floating exchange rate has been a key shock absorber and reserve buffers remain adequate. Colombia remains committed to a floating exchange rate which was demonstrated by the recent depreciation of the peso. These developments also led to a halt in reserve accumulation, but strong buffers had been built up in past years with foreign exchange reserves amounting to 131 percent of the adjusted ARA metric in 2014.

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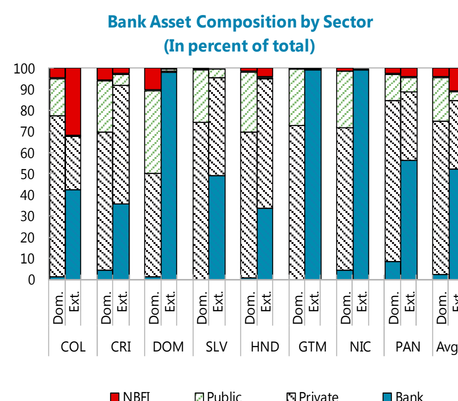
[4] Martha Misas and María Teresa Ramírez, 2004, "Long-run income and price elasticities of demand for Colombian nontraditional exports: a multivariate cointegration framework," Applied Economics, No. 36:9, pp. 931-938.

Box 7. Financial Integration: A Network Contagion Analysis

Colombian large banking groups have seized opportunities for diversification through regional expansion in recent years. Colombian banks have expanded mainly in Central America and Panama following withdrawal of global banks (in particular, HSBC and GE) in response to tighter post-crisis regulatory and supervisory environment. Benefits of this expansion included higher profitability and diversification from Colombia's GDP and commodity cycles. The low interest rate environment after the financial crisis also generated abundant liquidity allowing banks and banking groups to finance bank purchases. Today, Colombian banks hold 29 subsidiaries in 12 countries which account for 1/3 of domestic assets.



Colombian conglomerate headquarters and their subsidiaries act as an important connection hub for different parts of the network. Colombia has sizable bilateral linkages with U.S. and Panama, with the latter accounting for the largest counterpart of interbank exposures within the region. Further, interbank exposures account for 43 percent of external exposures in Colombia, while direct external exposures to private sector and non-bank financial institutions play a more significant role than in other countries.

Colombian conglomerates are of systemic importance for the region.[1] A baseline simulation of interbank contagion suggests that, while Colombia appears moderately contagious for the region, its banks are not vulnerable. The stress test computes a cumulative macro impact from an individual bank shock to the whole system taking into account two possible spillover channels: a credit shock and a funding shock. In the simulations, spillovers are transmitted only through on-balance sheet interbank connections, although there may be other possible inter-group contagion channels not covered by this exercise. Interbank contagion remains in large part concentrated in the country where the shocks originated, although there are some cross-border spillovers, while exposures to non-bank financial institutions are generally limited. Capital losses induced by shocks in the banks are smaller in Colombia than in other countries considered suggesting that, while some countries appear less fragile individually than as a system, Colombia clearly benefits from regional integration. This occurs because, on average, Colombian banks have higher capital above regulatory requirements which provides loss absorbing capacity and shelters them from the significant size of interbank exposures they have in other countries. However, removing goodwill from banks capital results in a more negative scenario in which Colombia becomes significantly more contagious for the region and its banks more vulnerable to shocks.

Despite significant progress in recent years, existing institutions in the region are insufficient for a comprehensive cross-border supervision of regional financial conglomerates and economic groups. Consideration should be given to building a regional body in charge of financial stability, building from exiting forums and Ministries of Finance. The body would act as a forum for the coordination of regional macro-prudential surveillance but would also have the regulation authority over specific aspects that are relevant for the region as a whole.

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[1] Systemic banks are those with a many large connections to other relatively systemic banks.

Box 8. Summary of Progress with Implementation of FSAP Reforms

The authorities have made good progress in implementing recommendations of the 2012 FSAP Update. Gains have been achieved in a few high priority short-term reform areas, including independence and legal protection of supervisors, and supervision and regulation of holding companies of financial conglomerates. Some progress has also been achieved in the area of bank regulation and money markets, but gaps are still evident and further effort will be necessary.

The FSAP recommended that the authorities strengthen independence and legal protection of supervisory staff. Specifically, it was suggested to include the requirement to appoint the superintendent for a fixed term—or require a public explanation of the reasons for dismissal—and amend the legal framework to clarify that liability for failure to perform the regulatory mandate in good faith is equivalent to acting in bad faith. The authorities have put a draft law before Congress which will strengthen independence of the Superintendent by requiring a clear fixed-term appointment and reasons for removal. SFC staff will be provided legal assistance and protection from lawsuits when acting in good faith. This will enable supervisory decisions to occur with greater autonomy and independence. A key issue will be to ensure passage of draft law without extended delays.

The FSAP recommended, as a high priority, to approve a law that gives SFC supervisory and regulatory powers over the holding company of a financial conglomerate. The draft law defines a financial holding company (FHC) and the SFC is provided power to supervise FHCs with special powers to obtain information from domestic and foreign entities not currently subject to supervision. The SFC can order changes to conglomerates if any entity presents a risk to the group. However, prudential regulations are established by the government which could result in weaker enforcement actions for conglomerates. The SFC has no enforcement powers over non-financial institutions that form part of mixed conglomerates, enabling unregulated entities to bypass prudential norms.

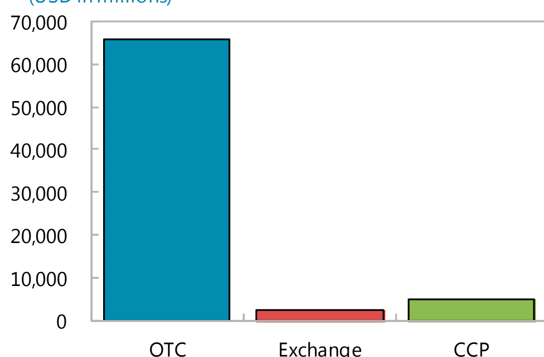
Adopting Basel II Pillar 2 supervisory framework to strengthen bank regulation was also deemed a high priority reform. Progress in this area is good but further developments are necessary. Risk based supervision (RBS) is being developed only for lending institutions and insurance companies, but other non-banks are not yet covered. The SFC has developed an integrated supervision framework to monitor risks on a forward-looking, granular, and at a business model level. Moreover, RBS will also take many years to be implemented fully and, together with stress tests, will facilitate tailoring capital requirements to concentration and country risks faced by large banking groups and conglomerates.

In money markets, the range of counterparties in open market operations (OMOs) should be narrowed. Authorities have limited access to OMOs by non-systemic counterparties. This should help enhance own liquidity risk management by broker-dealers and reduce moral hazard. However, RBS is still evolving, including for broker-dealers some of whom could pose liquidity and contagion risks to financial system. It could therefore be envisaged to widen the range of supervised counterparties temporarily in crisis times for financial stability reasons. Development of longer-maturity money markets would be helped by increasing the cost of overnight credit and the issuance of short-term government securities. Finally, sharing of supervisory data between the SFC and the central bank through MoUs should ensure that confidentiality concerns do not limit exchange of information that is deemed essential for ensuring financial system stability.

Box 9. Colombia's Framework for Supervision and Regulation of Derivatives

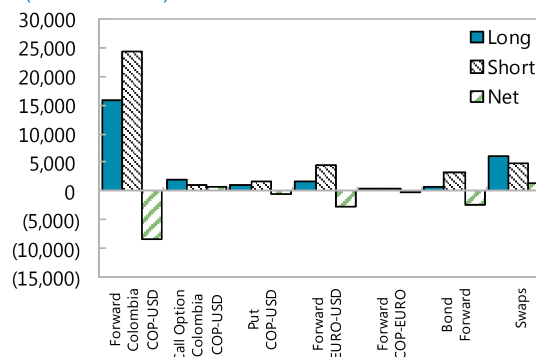
The derivatives market in Colombia has grown in recent years, mainly to hedge currency and maturity mismatches for real sector currency exchange transactions. The over-the-counter (OTC) derivatives market is the largest market, dwarfing derivatives traded at the Colombia Stock Exchange or other trading platforms, including standardized derivatives cleared through the Central Counterparty Risk Clearinghouse. Equity-based derivatives (including on stock index) and local commodities-based derivatives (including based on electricity) are traded only in small volumes. At end-2014, gross derivatives exposures in the OTC market amounted to US$65 billion. Net exposures in the OTC derivatives market remain manageable though identifying counterparty concentrations of large long and short positions should remain a priority.

End-2014 Gross Derivatives Exposures
(USD in millions)



Sources: SFC, CRCC.

End-2014 Derivatives Exposures by Instrument and Position
(USD in millions)



Sources: SFC, CRCC.

Colombia's derivatives regulatory regime has evolved over time to meet the needs of the growing market. Derivatives regulation was originally intended to meet the needs of exchange rate hedging, with regulation issued by the central bank (BR). Over time, the regulatory framework changes have facilitated development of the derivatives market, by enabling authorizations and restrictions for financial institutions in undertaking derivative transactions. At the same time, regulation sought to address risks from that expansion by ensuring all credit exposures are fairly priced using standard legal agreements and appropriate risk measures (such as value-at-risk). However, development of financial regulations has created a regime characterized by duplication that can be difficult to comply with and enforce.

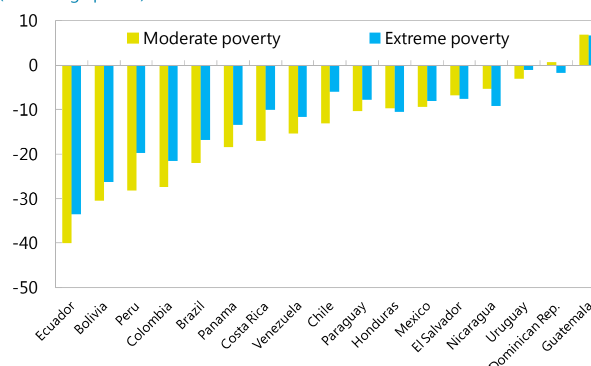
Efforts to provide greater clarity and enforceability should focus on streamlining existing regulation and procedures. Responsibility for supervising derivatives is currently shared between the SFC and the BR. Regulation by the BR should be confined to matters related to exchange rate issues and avoid going beyond strict exchange rate regulation. Continued coordination and data sharing for risk assessment and prudential and conduct enforcement remains key to this relationship. Moreover, risk-based supervision could be further upgraded to monitor and address concentration risk as well as leverage and collateral quality in the OTC derivatives market.

The BR and the SFC should enhance existing joint working arrangements and information to develop analytical and supervisory tools for surveillance of derivatives transactions. The availability of a wider information set than each regulator has access to, and development of techniques for joint analysis of derivatives transactions and exposures will allow a connected and comprehensive view of the risks that such transactions pose for financial stability. Another area of interest includes strengthening on-site and off-site supervision of derivatives transactions, from the viewpoint of risks flowing from institutions' regional exposure.

Box 10. Poverty and Income Inequality in the Last Decade

During the last decade, strong growth and effective economic policies led to a remarkable decline in poverty and the revival of the middle class. After suffering its worst economic crisis in recent years at the end of the 1990's, that increased the share of population living below US$4 per day (PPP) in Colombia to 60 percent, favorable economic conditions related to the commodity boom, improvements in the security environment, and several well-targeted social programs helped to almost halve poverty to 32.9 percent in 2012. The middle class (US$10–50 per day; PPP) also suffered with the reversal in growth shrinking by almost half to 11 percent of the population in 2000, while was on the rise among peer countries. Nonetheless, faster GDP growth by the end of the 2000's pushed many people from poverty or vulnerable classes to a rising middle class of roughly 22 percent of the population in 2010, yet small compared to other countries in the region.

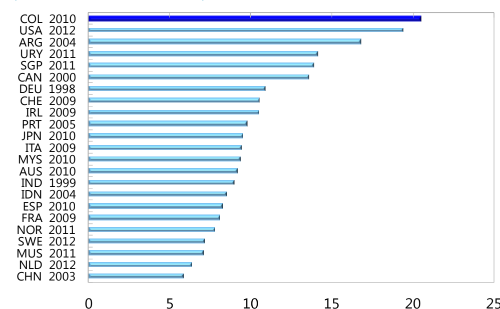
Latin America: Changes in Poverty Rates in the 2000's
(Percentage points)



Source: SEDLAC. Moderate poverty corresponds to poverty heacount ratios at $PPP a day, while extreme poverty refers to poverty headcount ratios at $2.5 PPP a day.

While income inequality has fallen it remains among the highest in the world. Colombia is among the most unequal countries in the world with the Gini coefficient at 53.8 in 2014. Small reductions in the Gini in recent years were related mainly to decreases in labor income inequality, demographic factors (decline in dependency ratios and increasing share of adults with labor earnings), and expansion in public transfers. While income of the poor grew at faster rates than average income in the last decade—particularly between 2008 and 2011 at 4 percent, the concentration of income among the top 1 percent remains among the highest in the world, with the richest holding around 20 percent of the total national income.

Top 1 Percent Income Share
(Percent, latest data available)



Source: The World Top Income Database.

Various economic and social factors explain the high levels of inequality in Colombia.

- Labor market. Income inequality stems mostly from labor income inequality which arises in part from high wage-skilled gap and high levels of informality.

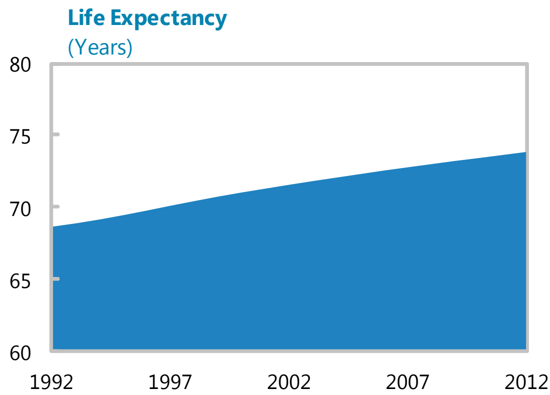
- Education. Colombia has achieved important gains in primary and secondary enrollment, however access to high quality education is very uneven across income groups and tertiary education is completed mostly by the better-off.

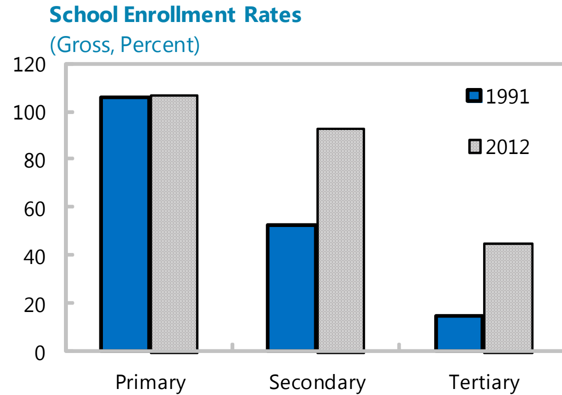
- Pensions. Pensions are an important contributing factor to overall inequality. Moreover, pension coverage is low by international standards, and also highly concentrated among the rich.

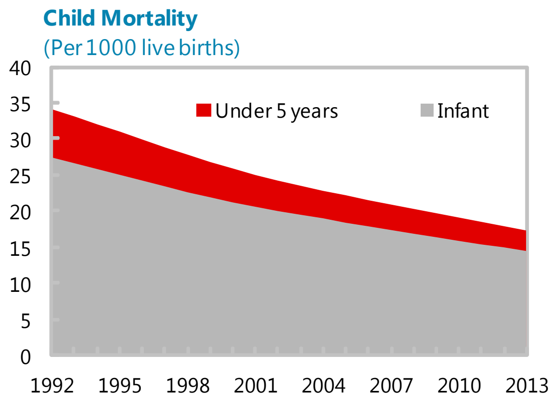
- Tax and transfers system. Social transfers in Colombia have a limited impact on income inequality and the tax system is regressive and evasion is rampant especially among the better-off.

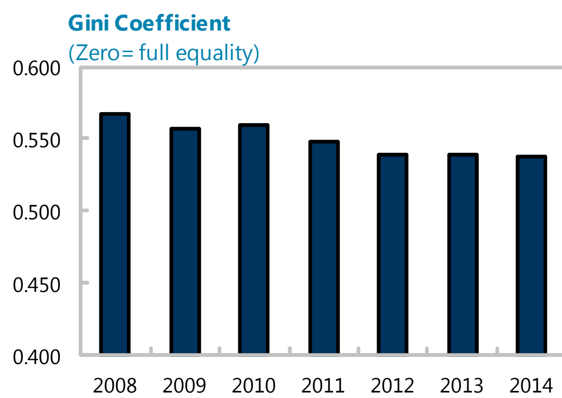
A sustainable and steady reduction of income inequality will require coordinated efforts in the areas listed above. Success in reducing inequality would in turn improve the prospects for achieving strong economic growth over the medium and long-term.

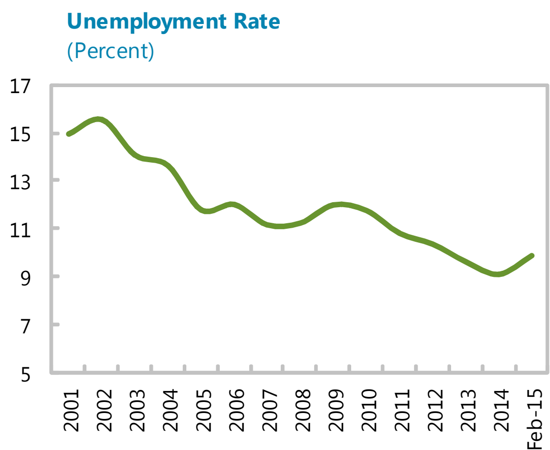
Figure 1. Colombia: Social Indicators

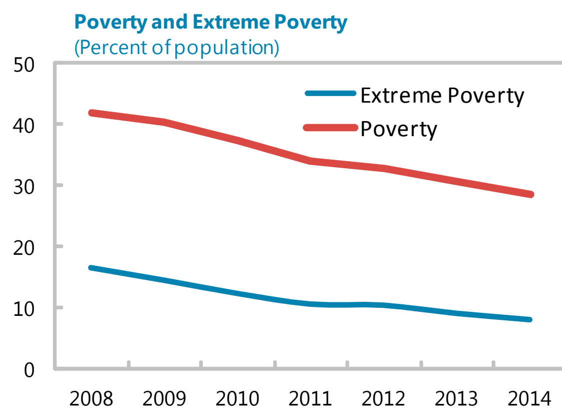








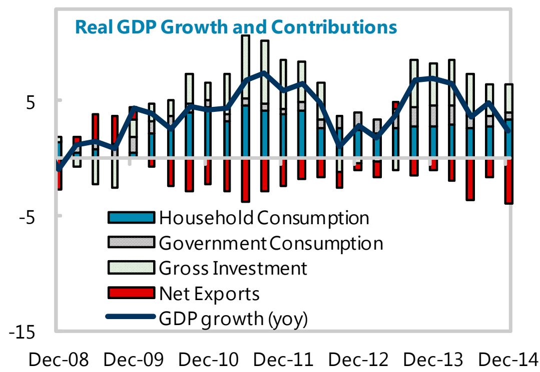




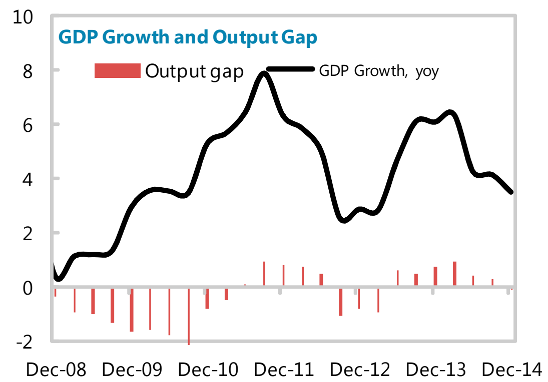
Sources: World Development Indicators; and DANE.

Figure 2. Colombia: Recent Economic Developments

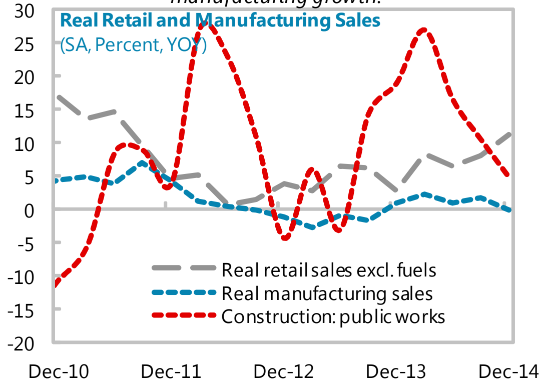
Driven by domestic demand…



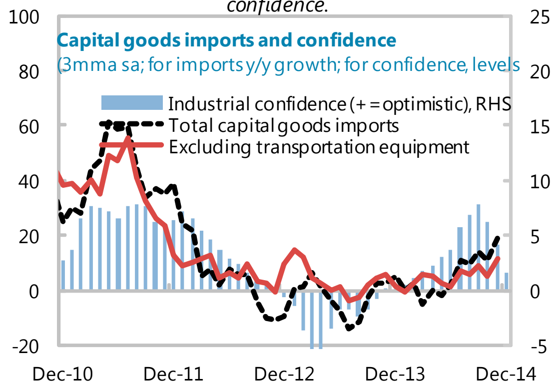
…economic growth was strong in 2014…



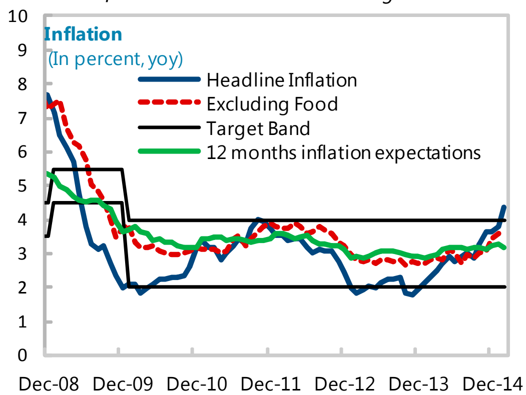
…reflecting robust construction, retail sales and manufacturing growth.



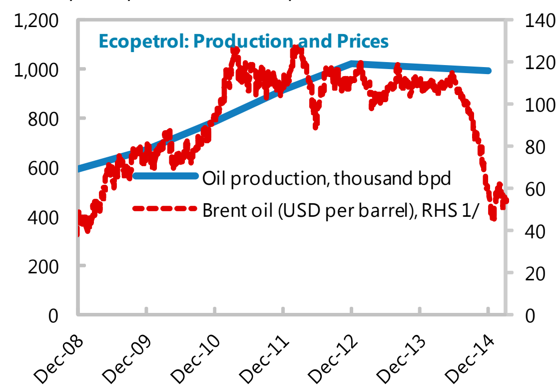
Investment remained strong in line with business confidence.



Inflation remained within the target band.

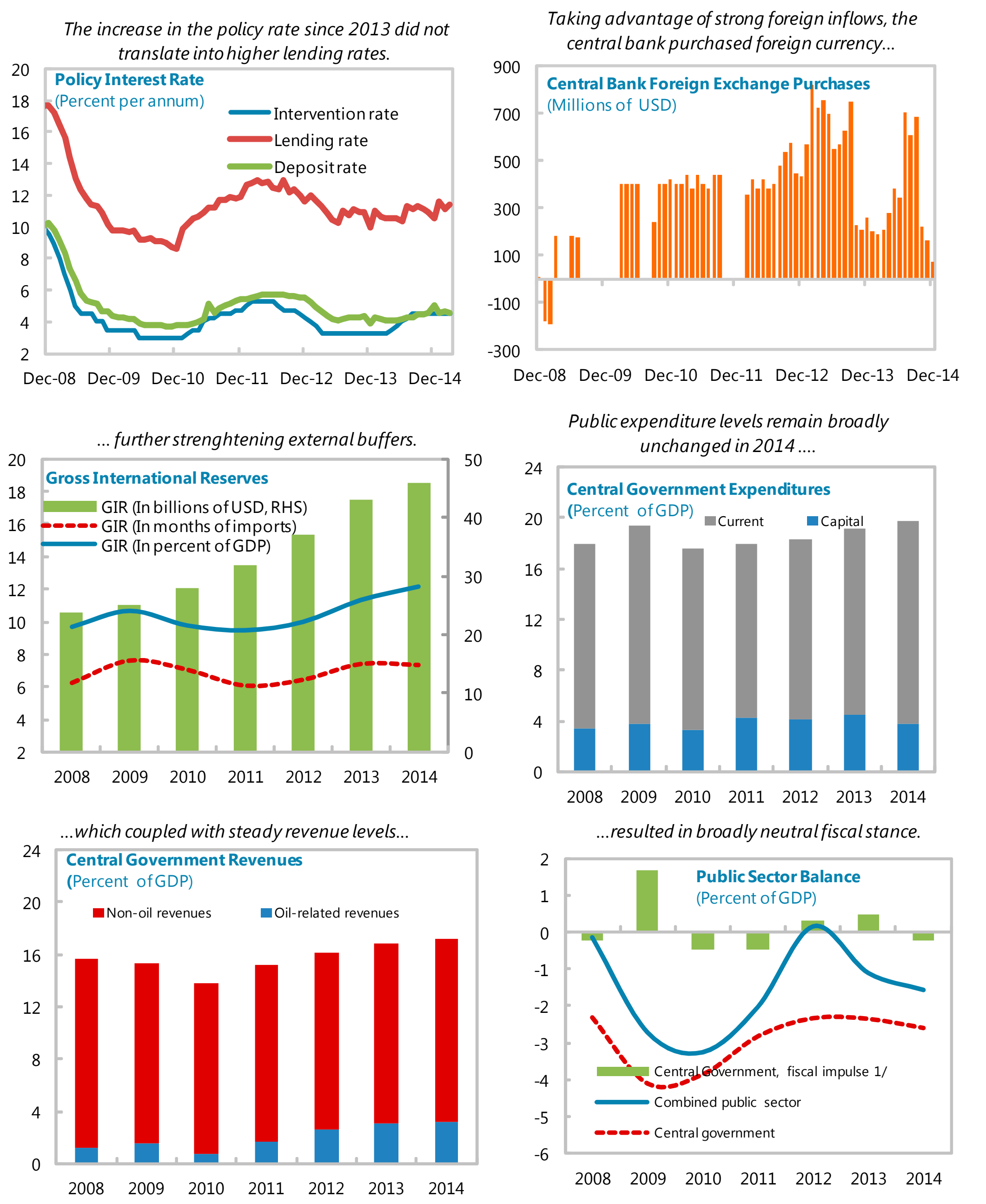


Oil prices plummeted while production has leveled off.



Source: Banco de la República; DANE; Bloomberg; and Fund staff estimates.
1/ Colombia mix follows closely Brent oil prices.

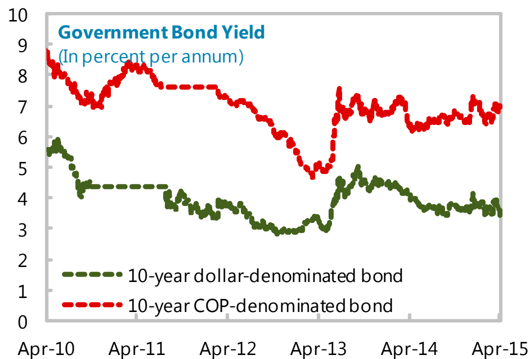
Figure 3. Colombia: Macroeconomic Policies



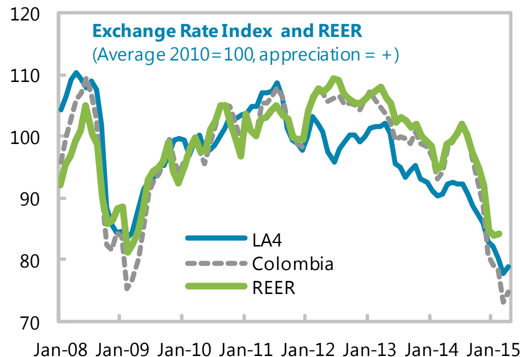
Sources: Banco de la República; and Fund staff estimates.
1/ Corresponds to the change in the structural primary balance.

Figure 4. Colombia: Recent Macro-Financial Developments 1/

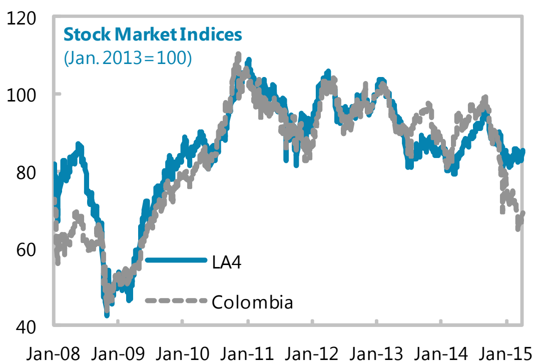
Government debt yields increased ...



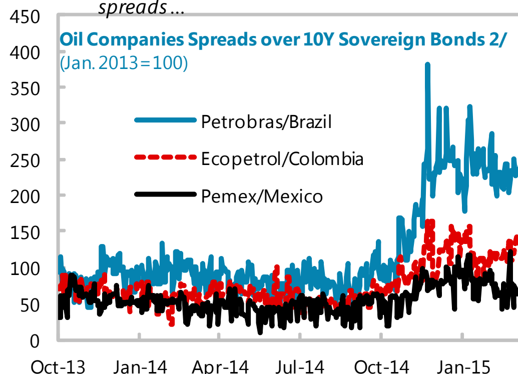
... as the peso depreciated against other currencies...



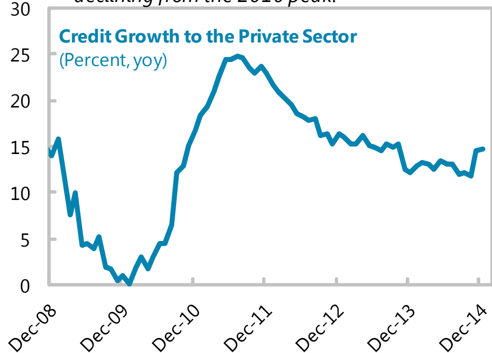
... and local assets prices declined.



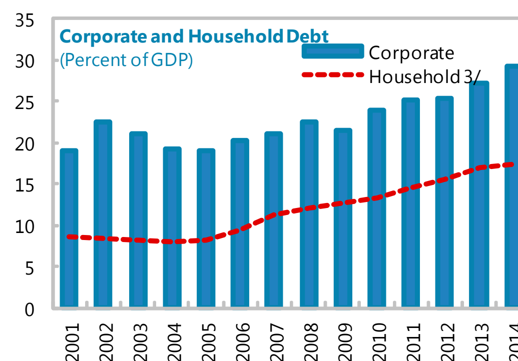
Ecopetrol spreads increased more than the sovereign spreads ...



Private credit was strong in 2014 although declining from the 2010 peak.

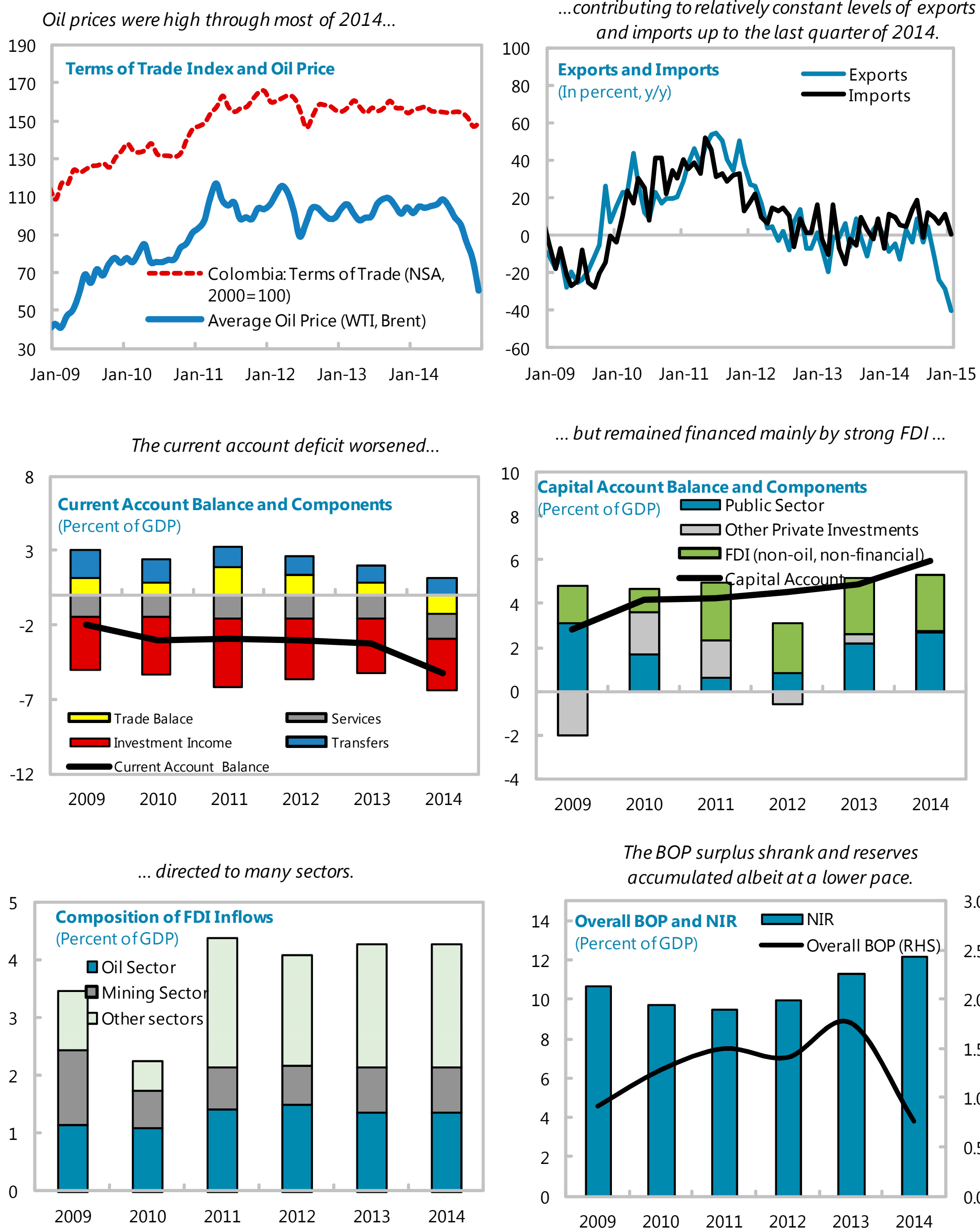


Households and corporate debt increased but remained moderate.



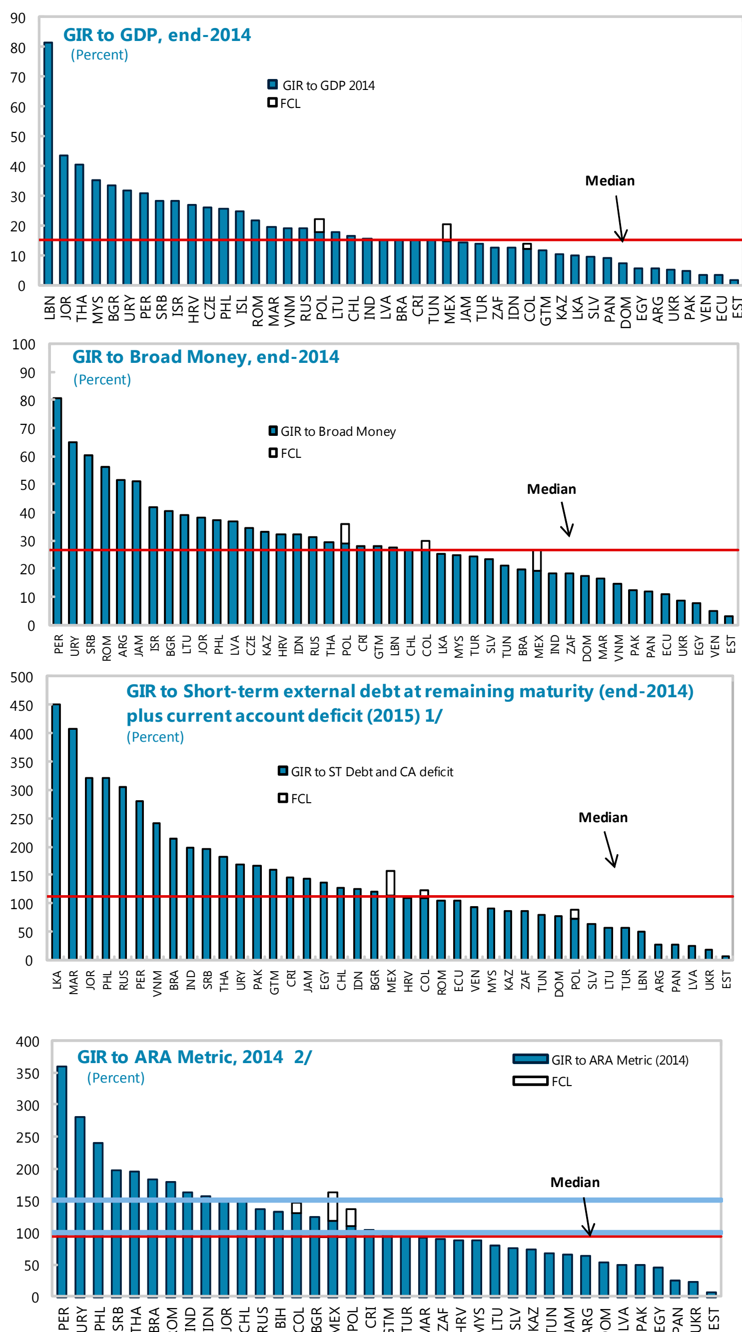
Source: Banco de la República; DANE; Bloomberg; and Fund staff estimates.
1/ LA4 corresponds to the average of Brazil, Colombia, Peru and Mexico.
2/ Spreads are calculated using yields on 2024 soveing bonds in USD and 2023 bonds for oil companies.
3/Data for 2014 refers to June 2014.

Figure 5. Colombia: External Sector Developments



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

Figure 6. Colombia: Reserve Coverage in an International Perspective



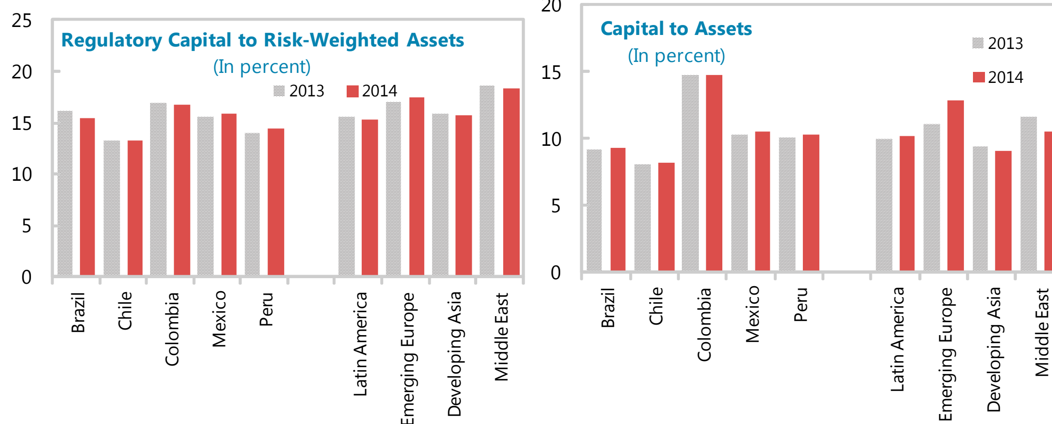
Sources: World Economic Outlook ; IFS; and Fund staff estimates.

1/ The current account is set to zero if it is in surplus.

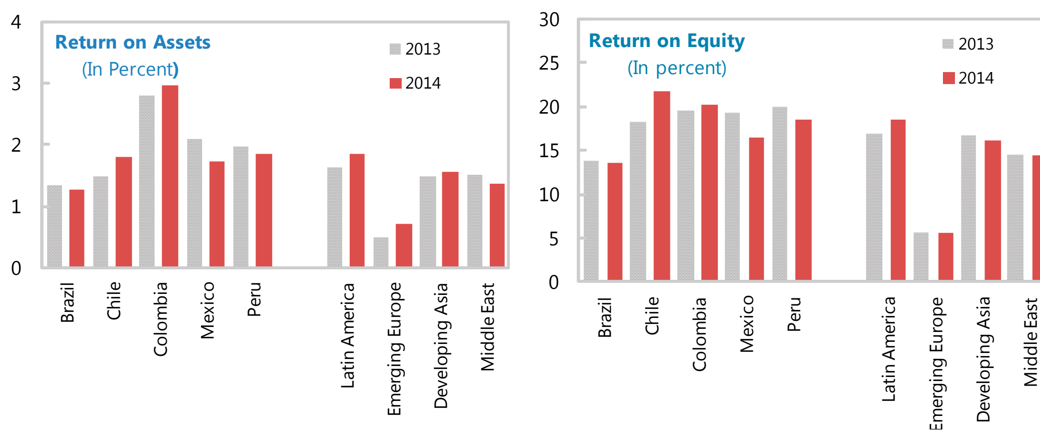
2/ The blue lines denote the 100-150 percent range of reserve coverage regarded as adequate for a typical country under this metric. Colombia's metric reflects the adjustor for commodity exporters.

Figure 7. Colombia: Financial Soundness Indicators: Colombia and Other Emerging Markets

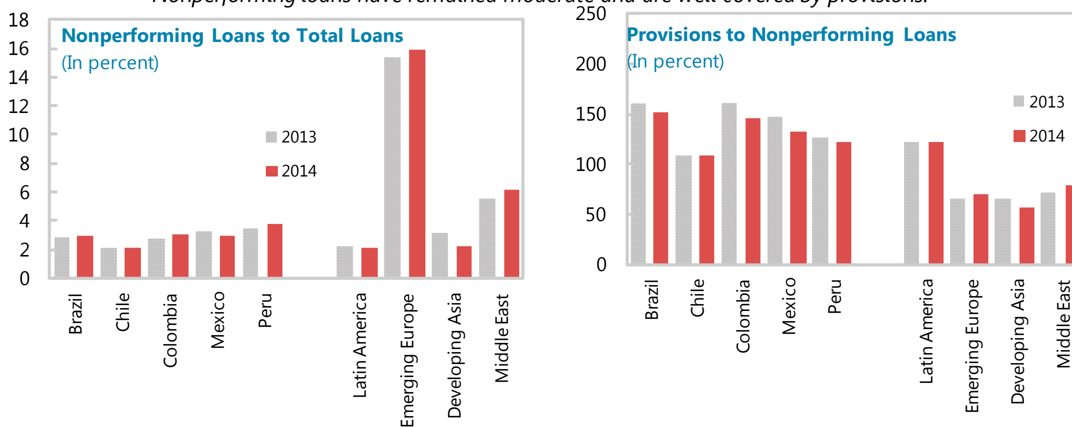
Colombian banks remained well capitalized…



…and profitable.



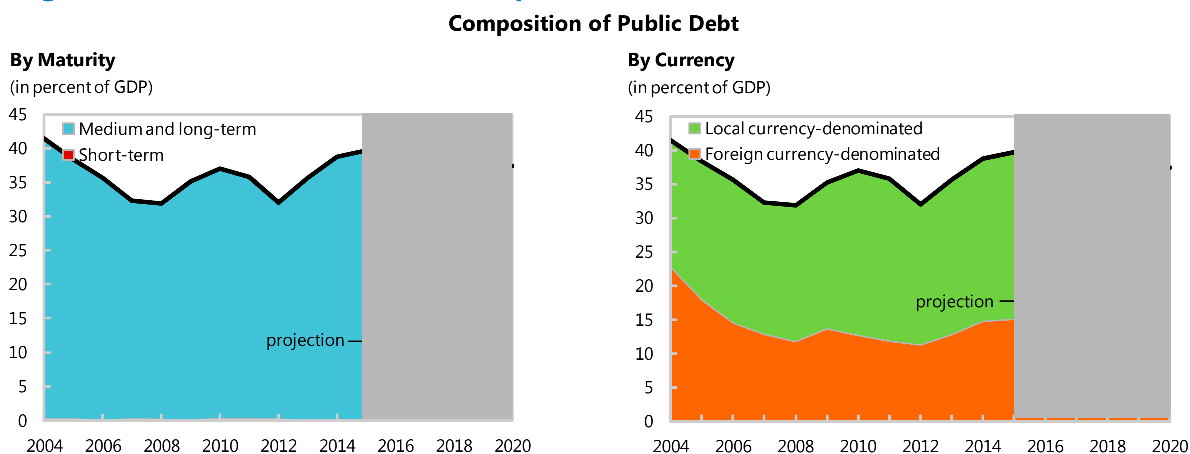
Nonperforming loans have remained moderate and are well covered by provisions.



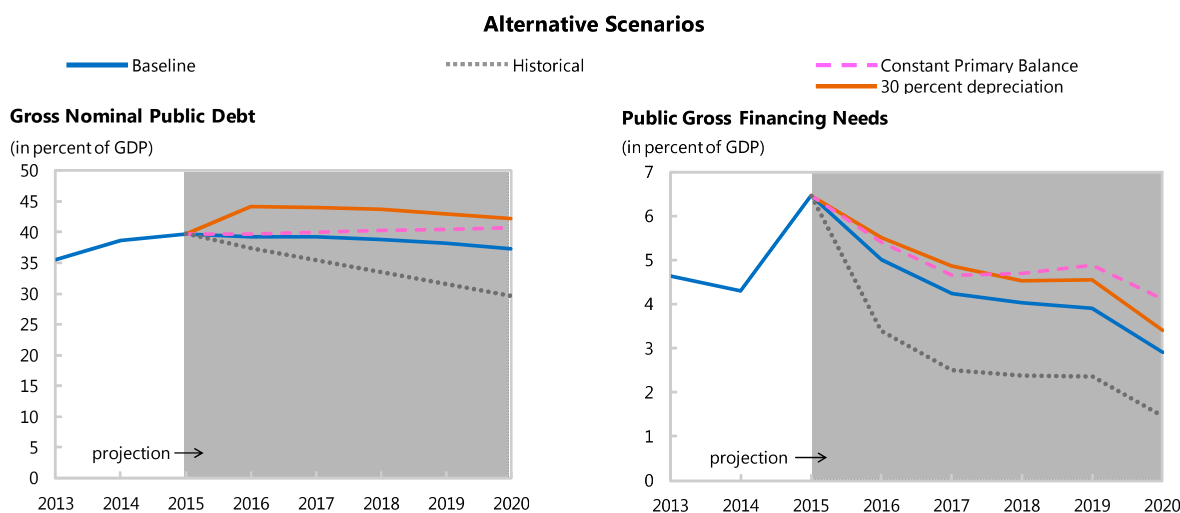
Source: Financial Soundness Indicators.
Note: Data for 2014 corresponds to the latest available.

Figure 8. Colombia: Public DSA—Composition of Public Debt and Alternative Scenarios

Composition of Public Debt



Alternative Scenarios



Underlying Assumptions

(in percent)

Baseline Scenario	2015	2016	2017	2018	2019	2020
Real GDP growth	3.4	3.7	4.0	4.2	4.3	4.3
Inflation	1.0	3.7	3.1	3.0	2.9	3.0
Primary Balance	0.0	0.4	0.4	0.6	0.9	1.0
Effective interest rate	8.9	8.3	8.1	8.0	8.0	8.0
Constant Primary Balance Scenario						
Real GDP growth	3.4	3.7	4.0	4.2	4.3	4.3
Inflation	1.0	3.7	3.1	3.0	2.9	3.0
Primary Balance	0.0	0.0	0.0	0.0	0.0	0.0
Effective interest rate	8.9	8.3	8.1	8.0	8.0	8.0

Historical Scenario	2015	2016	2017	2018	2019	2020
Real GDP growth	3.4	4.8	4.8	4.8	4.8	4.8
Inflation	1.0	3.7	3.1	3.0	2.9	3.0
Primary Balance	0.0	1.9	1.9	1.9	1.9	1.9
Effective interest rate	8.9	8.3	8.1	8.1	8.0	7.9
30 percent depreciation						
Real GDP growth	3.4	3.7	4.0	4.2	4.3	4.3
Inflation	1.0	3.7	3.1	3.0	2.9	3.0
Primary Balance	0.0	0.4	0.4	0.6	0.9	1.0
Effective interest rate	8.9	9.2	8.0	7.9	7.9	7.9

Source: Fund staff estimates.

Table 1. Colombia: Selected Economic and Financial Indicators

I. Social and Demographic Indicators

Population (millions), 2014	47.7	Unemployment rate, December 2014 (percent)	9.1
Urban population (percent of total), 2013	75.9	Physicians (per 1,000 people), 2010	1.5
GDP, 2014		Adult illliteracy rate (ages 15 and older), 2011	6.4
per capita (US$)	7,928	Gross primary school enrollment rate, 2012	106.9
in billions of COP	710,257	Access to water (percent of population), 2011	92.9
in billions of US$	378	Gini coefficient, 2014	53.8
Life expectancy at birth (years), 2012	73.8	Poverty rate ($2 a day (PPP)), 2012	12.0
Mortality rate, (under 5, per 1,000 live births), 2013	16.9	Extreme poverty rate ($1.25 a day, PPP), 2012	5.6

II. Economic Indicators

			Projections					
	2013	2014	2015	2016	2017	2018	2019	2020
	(In percentage change, unless otherwise indicated)							
National income and prices								
Real GDP	4.9	4.6	3.4	3.7	4.0	4.2	4.3	4.3
GDP deflator	1.9	1.8	1.0	3.7	3.1	3.0	2.9	3.0
Consumer prices (average)	2.0	2.9	3.9	3.4	3.0	3.0	3.0	3.0
Consumer prices (end of period)	1.9	3.7	3.6	3.2	3.0	3.0	3.0	3.0
External sector								
Exports (f.o.b.)	-2.1	-5.5	-21.4	12.0	8.0	5.1	4.4	3.9
Imports (f.o.b.)	0.8	8.0	-15.6	4.5	4.3	3.9	3.5	3.7
Export volume	4.0	0.3	4.8	6.7	5.3	4.1	4.0	3.1
Import volume	2.7	10.9	-7.7	3.0	3.1	3.1	2.9	3.2
Terms of trade (deterioration -)	-4.1	-3.2	-18.0	3.4	1.3	0.2	-0.2	0.3
Real effective exchange rate (depreciation -)	-3.3	-5.3	-14.3	2.6	1.8	0.8	0.9	0.9
Money and credit								
Broad money	13.4	10.0	13.0	13.0	13.5	13.5	13.5	13.5
Credit to the private sector	12.1	14.7	11.9	9.8	12.0	12.0	12.0	12.1
	(In percent of GDP)							
Central government balance	-2.3	-2.6	-2.6	-2.6	-2.2	-2.0	-1.7	-1.4
Central government structural balance	-3.3	-3.2	-2.8	-2.1	-2.0	-1.9	-1.6	-1.4
Combined public sector balance 1/	-1.1	-1.6	-3.4	-2.8	-2.7	-2.4	-2.1	-1.9
Public debt	35.6	38.7	39.7	39.3	39.2	38.8	38.2	37.3
Public debt, excluding Ecopetrol	34.0	37.1	38.2	37.9	37.8	37.6	37.4	36.5
Gross domestic investment	24.2	26.0	24.0	23.5	23.4	23.4	23.3	23.2
Gross national savings	20.9	20.8	18.1	18.5	19.0	19.2	19.3	19.5
Current account (deficit -)	-3.3	-5.2	-5.9	-5.0	-4.4	-4.2	-4.0	-3.7
External debt 2/	24.2	29.3	30.9	29.4	28.2	27.1	25.9	24.5
Of which: public sector	12.8	14.8	15.1	14.4	13.9	13.3	12.7	12.0
GIR in percent of short-term debt 3/	181.9	187.0	198.8	174.5	180.9	166.1	175.0	179.1
	(In percent of exports of goods and services)							
External debt service	29.9	44.7	58.2	47.6	49.1	46.9	49.8	47.0
Of which: public sector	7.4	10.0	13.0	9.1	11.2	8.3	11.1	7.4
Interest payments	5.9	7.6	10.2	7.7	7.1	6.8	6.5	5.8
Of which: public sector	3.9	4.4	6.1	4.6	4.2	4.0	3.7	3.2
	(In billions of U.S. dollars; unless otherwise indicated)							
Overall balance of payments	6.7	4.4	-0.8	-0.3	1.7	1.7	2.0	2.1
Exports (f.o.b.)	60.3	57.0	44.8	50.2	54.2	56.9	59.5	61.8
Of which: Petroleum products	32.0	28.9	18.3	21.0	22.5	23.0	23.3	23.3
Of which: Coffee	1.9	2.5	2.0	2.2	2.4	2.5	2.6	2.7
Gross official reserves 4/	43.2	46.8	46.0	45.7	47.4	49.2	51.1	53.3
Share of ST debt at remaining maturity + CA deficit	99	105	112	106	109	104	109	112
In months of imports of goods and services	6.9	8.7	8.2	7.8	7.7	7.7	7.7	8.0

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

1/ Includes the quasi-fiscal balance of Banco de la República, sales of assets, phone licenses, and statistical discrepancy.
2/ Does not include Banco de la República's outstanding external debt.
3/ GIR refers to Gross International Reserves.
4/ Excludes Colombia's contribution to FLAR and includes valuation changes of reserves denominated in currencies other than U.S. dollars.

Table 2a. Colombia: Summary Balance of Payments (In millions of US$)

	2013	2014	2015	2016	2017	2018	2019	2020
			Projections					
			(In million of USD, unless otherwise indicated)					
Current account balance	**-12,476**	**-19,781**	**-19,361**	**-17,968**	**-17,057**	**-17,363**	**-17,892**	**-17,883**
Trade balance	3,180	-4,694	-7,283	-4,260	-2,574	-2,044	-1,571	-1,510
Exports, f.o.b.	60,281	56,982	44,799	50,179	54,189	56,944	59,462	61,782
Coffee	1,884	2,473	1,980	2,163	2,378	2,497	2,622	2,727
Petroleum products	32,011	28,885	18,305	21,029	22,500	22,988	23,259	23,297
Non-traditional	12,447	11,846	11,846	13,472	14,888	16,216	17,482	18,850
Other	13,939	13,777	12,668	13,515	14,423	15,243	16,099	16,908
Imports, f.o.b.	57,101	61,676	52,082	54,438	56,762	58,987	61,032	63,292
Services (net)	-5,898	-6,586	-5,356	-5,433	-5,714	-6,085	-6,495	-7,049
Income (net)	-14,175	-12,857	-11,062	-12,797	-13,503	-14,195	-15,031	-14,581
Interest (net)	-3,097	-4,129	-4,181	-2,603	-1,858	-1,283	-953	-596
Of which: Public sector	-2,126	-2,516	-2,612	-1,766	-1,593	-1,428	-1,288	-1,007
Other Income (net)	-11,430	-8,303	-6,880	-10,194	-11,645	-12,912	-14,078	-13,985
Current transfers (net)	4,416	4,357	4,339	4,522	4,733	4,961	5,205	5,257
Financial account balance	**18,671**	**23,946**	**18,529**	**17,656**	**18,805**	**19,087**	**19,860**	**19,997**
Public sector (net)	8,366	11,470	7,719	4,905	3,597	3,749	3,842	4,011
Nonfinancial public sector	8,715	11,262	7,616	4,706	3,591	3,734	3,850	4,019
Medium- and long-term (net)	6,141	6,955	2,806	2,254	1,721	1,416	1,122	914
Disbursements	7,918	10,115	5,963	4,406	5,584	3,788	5,682	3,460
Amortization	1,651	3,041	3,044	2,045	3,761	2,275	4,467	2,421
Other long-term flows	-125	-119	-113	-108	-102	-97	-92	-125
Short term 1/	2,574	4,307	4,810	2,453	1,871	2,318	2,728	3,106
Of which: change in public assets	-184	1,389	102	99	94	80	101	111
Financial public sector	-349	208	104	199	5	15	-8	-8
Private sector (net)	10,305	12,476	10,810	12,751	15,208	15,338	16,018	15,986
Nonfinancial private sector (net)	7,769	12,356	10,038	11,888	14,231	14,461	15,339	15,405
Direct investment	8,548	12,155	9,753	11,156	12,623	13,077	13,665	14,380
Direct investment abroad	7,652	3,899	2,346	1,191	1,219	1,246	1,273	1,300
Direct investment in Colombia	16,200	16,054	12,099	12,347	13,841	14,323	14,938	15,680
Leasing finance	186	11	-580	18	116	202	285	97
Long-term loans	505	43	471	85	295	50	253	78
Short term 2/	-1,470	147	394	630	1,198	1,132	1,137	849
Financial private sector (net)	2,536	120	772	862	977	877	678	581
Valuation changes/Contribution to FLAR 3/	-539	-746	0	0	0	0	0	0
Overall balance of payments	6,699	4,433	-832	-312	1,748	1,724	1,968	2,114
Net errors and omissions	505	268	0	0	0	0	0	0
Changes in GIR 4/	**6,160**	**3,688**	**-832**	**-312**	**1,748**	**1,724**	**1,968**	**2,114**
Memorandum Items:								
Current account balance (in percent of GDP)	-3.3	-5.2	-5.9	-5.0	-4.4	-4.2	-4.0	-3.7
Oil Price (Colombian mix US$ per barrel)	100.3	91.9	55.5	62.7	66.6	68.5	69.8	70.7
Gross international reserves (in US$ billion)	43.2	46.8	46.0	45.7	47.4	49.2	51.1	53.3
In percent of short-term external debt 5/	361.5	364.1	373.9	351.9	335.6	325.1	322.2	325.0
In percent of ST external debt plus CA	99.2	105.5	111.9	105.7	108.8	103.5	108.6	111.8
In months of prospective GNFS imports	6.9	8.7	8.2	7.8	7.7	7.7	7.7	8.0
Nominal GDP (US$ billion)	380.1	377.9	329.6	357.4	387.3	415.6	446.1	479.3

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

1/ Deposit flows of public sector entities abroad.

2/ Includes net portfolio investment.

3/ FLAR is Fondo Latinoamericano de Reservas.

4/ IMF definition.

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

Table 2b. Colombia: Summary Balance of Payments (In percent of GDP)

			Projections					
	2013	2014	2015	2016	2017	2018	2019	2020
Current account balance	**-3.3**	**-5.2**	**-5.9**	**-5.0**	**-4.4**	**-4.2**	**-4.0**	**-3.7**
Trade balance	0.8	-1.2	-2.2	-1.2	-0.7	-0.5	-0.4	-0.3
Exports, f.o.b.	15.9	15.1	13.6	14.0	14.0	13.7	13.3	12.9
Coffee	0.5	0.7	0.6	0.6	0.6	0.6	0.6	0.6
Petroleum products	8.4	7.6	5.6	5.9	5.8	5.5	5.2	4.9
Non-traditional	3.3	3.1	3.6	3.8	3.8	3.9	3.9	3.9
Other	3.7	3.6	3.8	3.8	3.7	3.7	3.6	3.5
Imports, f.o.b.	15.0	16.3	15.8	15.2	14.7	14.2	13.7	13.2
Services (net)	-1.6	-1.7	-1.6	-1.5	-1.5	-1.5	-1.5	-1.5
Income (net)	-3.7	-3.4	-3.4	-3.6	-3.5	-3.4	-3.4	-3.0
Interest (net)	-0.8	-1.1	-1.3	-0.7	-0.5	-0.3	-0.2	-0.1
Of which : Public sector	-0.6	-0.7	-0.8	-0.5	-0.4	-0.3	-0.3	-0.2
Other Income (net)	-3.0	-2.2	-2.1	-2.9	-3.0	-3.1	-3.2	-2.9
Current transfers (net)	1.2	1.2	1.3	1.3	1.2	1.2	1.2	1.1
Financial account balance	4.9	6.3	5.6	4.9	4.9	4.6	4.5	4.2
Public sector (net)	2.2	3.0	2.3	1.4	0.9	0.9	0.9	0.8
Nonfinancial public sector	2.3	3.0	2.3	1.3	0.9	0.9	0.9	0.8
Medium- and long-term (net)	1.6	1.8	0.9	0.6	0.4	0.3	0.3	0.2
Disbursements	2.1	2.7	1.8	1.2	1.4	0.9	1.3	0.7
Amortization	0.4	0.8	0.9	0.6	1.0	0.5	1.0	0.5
Other long-term flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Short term 1/	0.7	1.1	1.5	0.7	0.5	0.6	0.6	0.6
Financial public sector	-0.1	0.1	0.0	0.1	0.0	0.0	0.0	0.0
Private sector (net)	2.7	3.3	3.3	3.6	3.9	3.7	3.6	3.3
Nonfinancial private sector (net)	2.0	3.3	3.0	3.3	3.7	3.5	3.4	3.2
Direct investment	2.2	3.2	3.0	3.1	3.3	3.1	3.1	3.0
Direct investment abroad	2.0	1.0	0.7	0.3	0.3	0.3	0.3	0.3
Direct investment in Colombia	4.3	4.2	3.7	3.5	3.6	3.4	3.3	3.3
Leasing finance	0.0	0.0	-0.2	0.0	0.0	0.0	0.1	0.0
Long-term loans	0.1	0.0	0.1	0.0	0.1	0.0	0.1	0.0
Short term 2/	-0.4	0.0	0.1	0.2	0.3	0.3	0.3	0.2
Financial private sector (net)	0.7	0.0	0.2	0.2	0.3	0.2	0.2	0.1
Valuation changes/Contribution to FLAR 3/	-0.1	-0.2	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance of payments	1.8	1.2	-0.3	-0.1	0.5	0.4	0.4	0.4
Net errors and omissions	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum Items:								
Current account balance (in percent of GDP)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Oil Price (Colombian mix US$ per barrel)	100.3	92.8	49.1	56.7	61.4	64.2	65.4	66.0
Gross international reserves	11.4	12.4	14.0	12.8	12.3	11.8	11.5	11.1
In percent of short-term external debt 5/	361.5	364.1	373.9	351.9	335.6	325.1	322.2	325.0
In percent of ST external debt plus CA	99.2	105.5	111.9	105.7	108.8	103.5	108.6	111.8
In months of prospective GNFS imports	6.9	8.7	8.2	7.8	7.7	7.7	7.7	8.0
Nominal GDP (US$ billion)	378.4	386.3	341.0	362.6	387.6	414.6	442.4	472.5

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

1/ Deposit flows of public sector entities abroad.

2/ Includes net portfolio investment.

3/ FLAR is Fondo Latinoamericano de Reservas.

4/ IMF definition.

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

Table 3a. Colombia: Operations of the Central Government (In percent of GDP) 1/

			Projections					
	2013	2014	2015	2016	2017	2018	2019	2020
	(In percent of GDP, unless otherwise indicated)							
Total revenue	**16.9**	**17.1**	**15.7**	**15.5**	**15.3**	**15.4**	**15.4**	**15.3**
Current revenue	**14.3**	**14.6**	**14.2**	**14.0**	**13.9**	**14.0**	**13.9**	**13.9**
Tax revenue	**14.2**	**14.5**	**14.1**	**13.9**	**13.8**	**13.9**	**13.8**	**13.8**
Net income tax and profits 2/	6.3	6.3	6.1	6.0	6.4	6.7	6.7	6.7
Goods and services	4.9	5.3	5.2	5.3	5.2	5.2	5.2	5.1
Value-added tax	4.9	5.3	5.2	5.3	5.2	5.2	5.2	5.1
International trade	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Financial transaction tax	0.8	0.8	0.4	0.4	0.4	0.4	0.4	0.4
Stamp and other taxes	1.6	1.6	1.8	1.7	1.3	1.0	1.0	1.0
Nontax revenue	**2.7**	**2.6**	**1.6**	**1.6**	**1.5**	**1.5**	**1.5**	**1.5**
Property income	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2
Other	2.6	2.6	1.5	1.4	1.4	1.4	1.3	1.3
Total expenditure and net lending	**19.2**	**19.7**	**18.3**	**18.1**	**17.6**	**17.5**	**17.0**	**16.7**
Current expenditure	**14.6**	**15.9**	**16.2**	**16.0**	**15.6**	**15.4**	**15.2**	**15.1**
Wages and salaries	2.1	2.2	2.3	2.3	2.2	2.2	2.1	2.1
Goods and services	0.9	0.9	0.9	0.8	0.8	0.7	0.7	0.6
Interest	2.3	2.4	2.6	2.5	2.4	2.4	2.4	2.3
External	0.5	0.6	0.7	0.7	0.7	0.6	0.6	0.6
Domestic	1.7	1.8	1.9	1.8	1.8	1.8	1.8	1.7
Current transfers	9.3	10.4	10.4	10.4	10.1	10.1	10.0	10.0
Capital expenditure	**4.5**	**3.8**	**2.1**	**2.1**	**2.0**	**2.0**	**1.8**	**1.6**
Fixed capital formation	3.2	2.4	1.0	1.0	1.0	1.0	0.9	0.9
Capital transfers	1.3	1.4	1.1	1.1	1.0	1.0	0.9	0.7
Overall balance	**-2.3**	**-2.6**	**-2.6**	**-2.6**	**-2.2**	**-2.0**	**-1.7**	**-1.4**
Memorandum items:								
Oil-related revenues 3/	3.1	3.1	1.4	1.1	1.0	1.0	1.0	0.9
Structural balance 4/	-3.3	-3.2	-2.8	-2.1	-2.0	-1.9	-1.6	-1.4
Adjusted overall balance 5/	-2.7	-2.7	-2.8	-2.8	-2.4	-2.2	-1.8	-1.5
Structural primary non-oil balance	-3.2	-3.2	-1.4	-1.2	-0.8	-0.6	-0.2	0.1
Fiscal Impulse	0.9	0.0	-1.8	-0.2	-0.4	-0.2	-0.4	-0.3
Non-oil balance	-5.5	-5.5	-4.0	-3.7	-3.3	-3.0	-2.6	-2.2
Primary balance	0.0	-0.2	0.0	-0.1	0.2	0.4	0.7	1.0
Nominal GDP (in Col $ trillion)	710.3	756.2	789.8	849.3	910.9	977.5	1,049.2	1,127.2

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

1/ Includes central administration only.

2/ The increase in tax revenue in 2012 reflects the elimination of the fixed asset tax credit, which was part of the end-2010 tax reform.

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

4/ In percent of potential GDP. Adjusts non-commodity revenues for the output gap and commodity revenues for differentials between estimated equilibrium oil price and production levels. Adjustments are made to account for fuel subsidy expenditures and the accrual of Ecopetrol dividends.

5/ Excludes private pension transfers from revenues.

Table 3b. Colombia: Operations of the Central Government (In trillions of Col$) 1/

	2013	2014	2015	2016	2017	2018	2019	2020
			Projections					
			(In trillions COL$, unless otherwise indicated)					
Total revenue	**119.7**	**129.5**	**123.9**	**131.6**	**139.7**	**150.8**	**161.2**	**172.7**
Current revenue	**101.8**	**110.4**	**111.8**	**118.8**	**126.6**	**136.7**	**146.3**	**156.8**
Tax revenue	**100.8**	**109.6**	**111.0**	**117.9**	**125.6**	**135.7**	**145.2**	**155.6**
Net income tax and profits 2/	44.8	47.4	47.9	51.1	58.1	65.1	70.2	75.8
Goods and services	34.8	40.2	41.2	44.6	47.2	51.1	54.2	57.6
Value-added tax	34.6	40.2	41.2	44.6	47.2	51.1	54.2	57.6
International trade	3.9	3.6	4.3	4.5	4.8	5.0	5.2	5.6
Financial transaction tax	5.9	6.3	3.4	3.6	3.9	4.2	4.5	4.8
Stamp and other taxes	11.4	12.1	14.3	14.1	11.6	10.2	11.0	11.8
Nontax revenue	**19.0**	**19.9**	**12.9**	**13.7**	**14.1**	**15.0**	**16.0**	**17.0**
Property income	0.5	0.6	1.4	1.5	1.6	1.8	2.0	2.3
Other	18.4	19.3	11.5	12.2	12.5	13.2	14.0	14.7
Total expenditure and net lending	**136.4**	**149.1**	**144.8**	**153.8**	**160.2**	**170.7**	**178.7**	**188.0**
Current expenditure	**103.5**	**120.2**	**127.8**	**135.7**	**141.7**	**150.9**	**159.5**	**169.7**
Wages and salaries	15.2	16.6	18.5	19.5	20.5	21.5	22.5	23.6
Goods and services	6.0	6.4	6.7	6.8	6.8	6.9	6.8	6.8
Interest	16.4	18.1	20.6	21.3	22.3	23.7	25.1	26.3
External	3.5	4.5	5.7	5.8	6.0	6.2	6.5	6.6
Domestic	12.3	13.6	14.9	15.4	16.2	17.4	18.6	19.7
Current transfers	65.8	79.0	81.9	88.1	92.2	98.9	105.1	112.9
Capital expenditure	**32.2**	**28.9**	**16.9**	**18.0**	**18.3**	**19.6**	**18.9**	**18.1**
Fixed capital formation	22.7	18.1	8.1	8.7	9.3	10.0	9.7	10.4
Capital transfers	9.5	10.7	8.8	9.3	9.0	9.6	9.3	7.7
Overall balance	**-16.6**	**-19.6**	**-20.9**	**-22.2**	**-20.4**	**-19.9**	**-17.4**	**-15.3**
Memorandum items:								
Oil-related revenues 3/	22.2	23.8	10.8	9.4	9.6	9.9	10.0	10.0
Structural balance 4/	-23.5	-24.2	-22.0	-18.2	-18.1	-18.5	-16.9	-15.5
Adjusted overall balance 5/	-19.1	-20.2	-22.5	-23.4	-21.8	-21.4	-19.0	-17.0
Structural primary non-oil balance	-22.8	-24.3	-11.1	-9.9	-7.4	-5.9	-2.3	1.0
Fiscal Impulse	6.1	0.0	-14.3	-2.0	-3.2	-2.0	-4.1	-3.5
Non-oil balance	-38.9	-41.9	-31.7	-31.5	-30.0	-29.8	-27.4	-25.3
Primary balance	-0.3	-1.5	-0.2	-0.9	1.8	3.8	7.6	11.1

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

1/ Includes central administration only.

2/ The increase in tax revenue in 2012 reflects the elimination of the fixed asset tax credit, which was part of the end-2010 tax reform.

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

4/ Adjusts non-commodity revenues for the output gap and commodity revenues for differentials between estimated equilibrium oil price and production levels. Adjustments are made to account for fuel subsidy expenditures and the accrual of Ecopetrol dividends.

5/ Excludes private pension transfers from revenues.

Table 4a. Colombia: Operations of the Combined Public Sector (In percent of GDP) 1/

	2013	2014	2015	2016	2017	2018	2019	2020
			Projections					
	(In percent of GDP, unless otherwise indicated)							
Total revenue	**28.1**	**28.2**	**26.3**	**26.1**	**25.9**	**25.9**	**25.8**	**25.7**
Tax revenue	19.8	20.1	19.7	19.5	19.4	19.5	19.5	19.4
Nontax revenue	8.3	8.1	6.6	6.6	6.5	6.4	6.3	6.2
Financial income	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Operating surplus of public enterprises	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other 2/	7.8	7.6	6.1	6.1	6.0	5.9	5.8	5.7
Total expenditure and net lending 3/	**29.1**	**29.6**	**29.6**	**28.8**	**28.5**	**28.2**	**27.8**	**27.5**
Current expenditure	21.5	22.1	22.8	22.6	22.4	22.1	21.9	21.6
Wages and salaries	5.2	5.3	5.3	5.2	5.2	5.1	5.1	5.0
Goods and services	3.1	3.1	3.1	3.1	3.0	3.0	2.9	2.9
Interest	2.6	2.8	3.3	3.2	3.0	3.0	3.0	2.9
External	0.6	0.7	1.1	1.0	1.0	0.9	0.9	0.8
Domestic	2.0	2.1	2.2	2.1	2.1	2.1	2.1	2.0
Transfers to private sector	7.8	8.0	8.0	8.0	8.0	8.0	8.0	8.0
Other 4/	2.7	2.9	3.1	3.1	3.1	3.0	2.9	2.8
Capital expenditure	7.6	7.6	6.8	6.3	6.2	6.1	6.0	5.9
Statistical discrepancy	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Nonfinancial public sector balance	**-0.9**	**-1.4**	**-3.3**	**-2.7**	**-2.6**	**-2.3**	**-2.1**	**-1.8**
Quasi-fiscal balance (BR cash profits)	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
Fogafin balance	0.1	0.0	0.1	0.1	0.1	0.1	0.1	0.1
Net cost of financial restructuring 5/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Combined public sector balance	**-1.1**	**-1.6**	**-3.4**	**-2.8**	**-2.7**	**-2.4**	**-2.1**	**-1.9**
Overall financing	**1.1**	**1.6**	**3.4**	**2.8**	**2.7**	**2.4**	**2.1**	**1.9**
Foreign, net	1.2	2.5	2.3	1.3	0.9	1.0	1.2	0.8
Domestic, net	-0.1	-0.9	1.1	1.5	1.8	1.4	1.0	1.1
Memorandum items:								
Overall structural balance 6/	-2.2	-2.3	-3.0	-2.0	-2.2	-2.1	-2.0	-1.8
Adjusted overall balance	-1.4	-1.8	-3.6	-3.0	-2.8	-2.5	-2.3	-2.0
Structural primary non-oil balance	-3.0	-3.3	-2.6	-1.8	-1.7	-1.3	-1.1	-0.8
Fiscal Impulse	1.0	0.3	-0.7	-0.9	0.0	-0.4	-0.3	-0.3
Non-oil balance	-5.6	-6.0	-5.9	-5.0	-4.8	-4.4	-4.0	-3.7
Primary balance 7/	1.0	0.7	-0.6	-0.2	-0.1	0.2	0.3	0.5
Oil-related revenues 8/	4.8	4.7	2.5	2.2	2.1	2.0	1.9	1.8
Total public debt 9/	35.6	38.7	39.7	39.3	39.2	38.8	38.2	37.3
Nominal GDP (In trillion COP)	710.3	756.2	789.8	849.3	910.9	977.5	1,049.2	1,127.2

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

1/ The combined public sector includes the central, regional and local governments, social security, and public sector enterprises. Excludes Ecopetrol.

2/ Includes royalties, dividends and social security contributions.

3/ Expenditure reported on commitments basis.

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

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

6/Adjusts non-commodity revenues for the output gap and commodity revenues for differentials between estimated equilibrium oil price and production levels. Adjustments are made to account for fuel subsidy expenditures and the accrual of Ecopetrol dividends. Excludes private pension transfers from revenues.

7/ Includes statistical discrepancy.

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

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

Table 4b. Colombia: Operations of the Combined Public Sector (In trillions of Col$) 1/

	2013	2014	2015	2016	2017	2018	2019	2020
			Projections					
					(In trillion Col$)			
Total revenue	**199.9**	**213.5**	**207.5**	**221.7**	**236.0**	**253.3**	**270.5**	**289.2**
Tax revenue	140.8	152.3	155.6	165.8	177.0	190.8	204.3	219.2
Nontax revenue	59.0	61.3	51.9	55.9	59.0	62.5	66.1	70.0
Financial income	3.8	3.8	3.9	4.2	4.6	4.9	5.2	5.6
Operating surplus of public enterprises	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other 2/	55.3	57.5	47.9	51.7	54.4	57.6	60.9	64.4
Total expenditure and net lending 3/	**206.6**	**224.1**	**233.6**	**244.9**	**259.9**	**275.6**	**292.1**	**309.6**
Current expenditure	152.7	166.9	180.1	191.7	203.7	216.2	229.4	243.5
Wages and salaries	36.9	39.7	41.8	44.6	47.3	50.3	53.5	56.9
Goods and services	22.3	23.8	24.8	26.3	27.7	29.3	30.9	32.6
Interest	18.7	21.2	26.0	26.8	27.7	29.4	31.0	32.6
External	4.2	5.2	8.7	8.8	8.9	9.1	9.3	9.5
Domestic	14.6	16.0	17.2	18.0	18.8	20.3	21.7	23.1
Transfers to private sector	55.4	60.5	63.2	67.9	72.9	78.2	83.9	90.2
Other 4/	19.3	21.7	24.3	26.1	28.0	29.0	30.1	31.2
Capital expenditure	53.9	57.2	53.5	53.2	56.2	59.3	62.6	66.1
Statistical discrepancy	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Nonfinancial public sector balance	**-6.7**	**-10.6**	**-26.1**	**-23.2**	**-23.9**	**-22.3**	**-21.6**	**-20.5**
Quasi-fiscal balance (BR cash profits)	-1.7	-1.2	-1.3	-1.6	-1.5	-1.7	-1.8	-1.9
Fogafin balance	0.6	-0.1	0.7	0.8	0.9	0.9	1.0	1.1
Net cost of financial restructuring 5/	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Combined public sector balance	**-7.8**	**-11.8**	**-26.6**	**-24.0**	**-24.6**	**-23.0**	**-22.4**	**-21.3**
Overall financing	7.8	11.8	26.6	24.0	24.6	23.0	22.4	21.3
Foreign, net	8.4	18.6	18.2	11.1	8.3	9.4	12.4	9.4
Domestic, net	-0.6	-6.8	8.5	13.0	16.3	13.5	10.0	12.0
Memorandum items:								
CPS overall structural balance 6/	-15.8	-17.7	-23.9	-17.4	-20.1	-20.3	-21.2	-20.8
Adjusted overall balance	-10.3	-13.9	-28.2	-25.3	-25.9	-24.5	-24.0	-23.0
Structural primary non-oil balance	-21.5	-25.1	-20.9	-14.9	-15.7	-13.2	-11.3	-8.8
Fiscal Impulse	6.8	2.2	-5.4	-7.5	-0.3	-3.7	-2.9	-3.4
Non-oil balance	-39.8	-45.5	-46.9	-42.3	-44.0	-42.9	-42.5	-41.4
Primary balance 7/	10.9	9.4	-0.7	2.8	3.2	6.4	8.6	11.3
Oil-related revenues 8/	34.1	35.3	19.5	18.9	19.5	19.9	20.1	20.1
Total public debt 9/	252.8	292.5	313.6	333.8	357.1	379.7	400.9	421.0

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

1/ The combined public sector includes the central, regional and local governments, social security, and public sector Excludes Ecopetrol.

2/ Includes royalties, dividends and social security contributions.

3/ Expenditure reported on commitments basis.

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

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

6/Adjusts non-commodity revenues for the output gap and commodity revenues for differentials between estimated equilibrium oil price and production levels. Adjustments are made to account for fuel subsidy expenditures and the accrual of Ecopetrol dividends.

7/ Includes statistical discrepancy.

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

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

Table 5. Colombia: Monetary Indicators

	2011	2012	2013	2014	Projection 2015
	(In billions of COP, unless otherwise indicated)				
Central Bank					
Net Foreign Assets	61,750	65,356	83,092	112,111	114,791
Gross official reserve assets	63,566	65,824	88,928	112,101	113,416
in billions of US$	32.7	37.2	46.3	46.9	47.3
Short-term foreign liabilities	1,575	403	5,770	25	2,066
Other net foreign assets	2,117	2,096	2,298	2,812	3,441
Net domestic assets	-10,408	-8,892	-17,993	-42,429	-38,112
Net credit to the public sector	-4,624	-8,008	-14,526	-21,026	-18,886
Net credit to the financial system	3,078	1,831	3,732	6,771	6,082
Other	-8,863	-2,715	-7,199	-28,174	-25,308
Monetary base	51,342	56,464	65,099	69,682	76,679
Currency in circulation	33,367	35,063	39,751	45,429	47,388
Deposit money banks reserves	17,946	21,374	25,254	24,170	21,577
Other deposits	29	27	94	83	83
Financial system					
Net foreign assets	47,389	53,145	67,826	92,815	94,636
in billions of US$	24.4	30.0	35.3	38.8	39.4
Net domestic assets	202,773	237,166	261,480	269,526	391,489
Net credit to public sector	32,455	34,824	33,151	30,800	41,586
Credit to private sector	216,234	251,410	281,747	323,152	361,766
Other net	-45,916	-49,068	-53,417	-84,426	-76,679
Broad money	250,162	290,310	329,307	362,341	409,446
	(Annual percentage change)				
Credit to private sector	23.0	16.3	12.1	14.7	11.9
Currency	12.4	5.1	13.4	14.3	4.3
Monetary base	14.4	10.0	15.3	7.0	10.0
Broad money	17.6	16.0	13.4	10.0	13.0
	(In percent of GDP)				
Credit to private sector	34.8	37.8	39.7	42.7	45.8
Currency	5.4	5.3	5.6	6.0	6.0
Monetary base	8.3	8.5	9.2	9.2	9.7
Broad money	40.2	43.7	46.4	47.9	51.8
Memorandum items:					
Central bank inflation target	2.0-4.0	2.0-4.0	2.0-4.0	2.0-4.0	2.0-4.0
CPI inflation, eop	3.7	2.4	1.9	3.7	3.6
Nominal GDP (In billion COP)	621,615	664,473	710,257	756,152	789,794

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

Table 6. Colombia: Medium-Term Outlook

	2013	2014	2015	2016	2017	2018	2019	2020
			Projections					
	(In percent of GDP, unless otherwise indicated)							
Real GDP	4.9	4.6	3.4	3.7	4.0	4.2	4.3	4.3
Consumer prices (end of period)	1.9	3.7	3.6	3.2	3.0	3.0	3.0	3.0
Gross national savings	20.9	20.8	18.1	18.5	19.0	19.2	19.3	19.5
Private sector	14.6	14.9	14.8	15.2	15.7	15.7	15.6	15.7
Public sector	6.2	5.8	3.2	3.3	3.3	3.6	3.7	3.8
Gross domestic investment	24.2	26.0	24.0	23.5	23.4	23.4	23.3	23.2
Private sector	17.1	18.8	17.5	17.5	17.6	17.6	17.7	17.7
Public sector	7.1	7.2	6.5	6.0	5.9	5.8	5.7	5.6
	(In percent change)							
Credit to the private sector								
Commercial	10.8	15.5	12.3	9.8	12.0	12.0	12.0	12.1
Consumption	10.5	12.5	5.3	3.5	5.1	4.7	4.2	3.7
Mortgage	26.2	17.9	23.8	20.9	22.2	21.4	20.7	20.2
Microcredit	15.8	8.9	31.3	26.5	26.7	25.0	23.7	22.7
Total	12.1	14.7	11.9	9.8	12.0	12.0	12.0	12.1
Nonfinancial public sector 1/								
Revenue	28.1	28.2	26.3	26.1	25.9	25.9	25.8	25.7
Expenditure	29.1	29.6	29.6	28.8	28.5	28.2	27.8	27.5
Current expenditure	21.5	22.1	22.8	22.6	22.4	22.1	21.9	21.6
Capital expenditure	7.6	7.6	6.8	6.3	6.2	6.1	6.0	5.9
Primary balance 2/	1.7	1.4	0.0	0.4	0.4	0.7	0.9	1.1
Overall balance 2/	-0.9	-1.4	-3.3	-2.7	-2.6	-2.3	-2.1	-1.8
Combined public sector balance	-1.1	-1.6	-3.4	-2.8	-2.7	-2.4	-2.1	-1.9
External financing	1.2	2.5	2.3	1.3	0.9	1.0	1.2	0.8
Domestic financing	-0.1	-0.9	1.1	1.5	1.8	1.4	1.0	1.1
External current account balance	-3.3	-5.2	-5.9	-5.0	-4.4	-4.2	-4.0	-3.7
Trade balance	0.8	-1.2	-2.2	-1.2	-0.7	-0.5	-0.4	-0.3
Exports	15.9	15.1	13.6	14.0	14.0	13.7	13.3	12.9
Imports	15.0	16.3	15.8	15.2	14.7	14.2	13.7	13.2
Capital and financial account balance	4.9	6.3	5.6	4.9	4.9	4.6	4.5	4.2
Public sector	2.2	3.0	2.3	1.4	0.9	0.9	0.9	0.8
Private sector	2.7	3.3	3.3	3.6	3.9	3.7	3.6	3.3
Overall balance	1.8	1.2	-0.3	-0.1	0.4	0.4	0.4	0.4
Gross public sector debt 3/	35.6	38.7	39.7	39.3	39.2	38.8	38.2	37.3
Domestic debt	22.8	23.9	24.6	24.9	25.3	25.5	25.5	25.3
External debt	12.8	14.8	15.1	14.4	13.9	13.3	12.7	12.0
Gross public sector debt, excluding Ecopetrol	34.0	37.1	38.2	37.9	37.8	37.6	37.4	36.5
Total public net debt	24.8	28.4	30.5	30.8	31.3	31.5	31.4	31.0
Memorandum items:								
Nominal GDP (in billion Col$)	710,257	756,152	789,794	849,300	910,917	977,503	1,049,161	1,127,233
Crude oil, spot price	104.1	96.2	58.1	65.7	69.7	71.8	73.1	74.0
Crude oil, spot price (Colombian mix)	100.3	91.9	55.5	62.7	66.6	68.5	69.8	70.7

Sources: Colombian authorities, and Fund staff estimates and projections.
1/ Excludes Ecopetrol.
2/ Includes statistical discrepancy.
3/ Includes debt of the non-financial public sector, plus Ecopetrol, FOGAFIN and FINAGRO.
Gross debt minus financial assets (public sector deposits in domestic and foreign financial institutions).

Table 7. Colombia: Financial Soundness Indicators

Total Banking System 1/

(In percent, unless otherwise indicated; end-of-period values)

	2009	2010	2011	2012	2013	2014
Capital Adequacy						
Regulatory capital to risk-weighted assets	17.2	17.3	16.9	18.1	17.0	17.0
Regulatory Tier 1 capital to risk-weighted assets	13.4	13.0	13.4	13.7	12.0	11.7
Capital (net worth) to assets	14.2	14.2	14.3	14.7	14.8	14.9
Asset Quality and Distribution						
Nonperforming loans to gross loans	4.0	2.9	2.5	2.8	2.8	2.9
Provisions to nonperforming loans	140.1	175.0	182.0	163.9	160.7	151.3
Gross loans to assets	64.3	67.9	70.4	69.6	68.2	68.6
Earnings and Profitability						
ROAA	3.5	3.4	3.3	3.1	2.8	2.9
ROAE	26.2	23.7	23.0	21.2	19.5	19.8
Interest margin to gross income	54.0	55.6	58.4	58.7	61.3	60.6
Noninterest expenses to gross income	43.2	47.0	49.3	47.2	47.0	44.6
Liquidity						
Liquid assets to total assets 2/	9.2	7.5	8.6	32.4	30.5	27.2
Liquid assets to short-term liabilities 2/	14.2	12.1	13.9	52.1	49.0	44.5
Deposit to loan ratio	98.8	93.5	91.4	94.7	96.3	91.6
Other						
Foreign-currency-denominated loans to total loans	4.2	6.9	7.7	7.5	7.3	8.4
Foreign-currency-denominated liabilities to total liabilities	6.6	9.4	10.5	9.4	10.2	12.7
Net open position in foreign exchange to capital	5.3	4.5	4.8	9.2	10.7	12.5

Source: Superintendencia Financiera
1/ All deposit taking institutions.
2/ Data after 2011 refers to broader definition of liquid assets in line w ith international standards.

Table 8. Colombia: Indicators of External Vulnerability 1/

(In billions of U.S. dollars unless otherwise indicated)

			Projections					
	2013	2014	2015	2016	2017	2018	2019	2020
External indicators								
Exports of GNFS 1/	67.2	63.9	52.1	58.0	62.4	65.5	68.3	70.9
Imports of GNFS 1/	69.9	75.2	64.8	67.7	70.7	73.6	76.4	79.5
Terms of trade (12-month percent change)	-4.1	-3.2	-18.0	3.4	1.3	0.2	-0.2	0.3
Current account balance	-12.5	-19.8	-19.4	-18.0	-17.1	-17.4	-17.9	-17.9
In percent of GDP	-3.3	-5.2	-5.9	-5.0	-4.4	-4.2	-4.0	-3.7
Capital and financial account balance	18.7	22.6	18.7	17.8	18.9	19.2	20.0	20.1
Of which: Foreign direct investment (net)	8.5	12.2	9.8	11.2	12.6	13.1	13.7	14.4
Of which: Portfolio investment (net)	0.7	3.2	6.0	2.6	2.4	2.9	3.3	3.6
Total external debt	90.7	99.2	101.9	105.6	109.4	112.5	115.4	117.5
In percent of gross international reserves	210.1	211.7	221.4	231.1	230.5	228.8	225.7	220.6
Short-term external debt 2/	11.9	12.9	12.3	13.0	14.1	15.1	15.9	16.4
Of which : Public sector	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Of which : Private sector	11.4	12.4	11.8	12.5	13.6	14.6	15.4	15.9
Amortization of MLT external debt (in percent of GNFS	8.7	18.4	23.4	18.7	21.2	18.5	21.2	18.8
External interest payments (in percent of GNFS exports)	5.9	7.6	10.2	7.7	7.1	6.8	6.5	5.8
Gross international reserves 3/ 4/	43.2	46.8	46.0	45.7	47.4	49.2	51.1	53.3
In months of prospective GNFS imports	6.9	8.7	8.2	7.8	7.7	7.7	7.7	8.0
In percent of broad money	24.5	25.9	26.9	23.5	21.3	19.4	17.8	16.3
In percent of short-term external debt 2/	361.5	364.1	373.9	351.9	335.6	325.1	322.2	325.0
In percent of short-term external debt on residual plus current account deficit	99.2	105.5	111.9	105.7	108.8	103.5	108.6	111.8
Nominal exchange rate (COP/US$, period average)	1,869	2,001	2,396	2,376	2,352	2,352	2,352	2,352
Real effective exchange rate (percentage change, + = appreciation)	-3.3	-5.3	-14.3	2.6	1.8	0.8	0.9	0.9

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

1/ GNFS stands for goods and nonfactor services; MLT stands for medium and long-term.

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.

Table 9. Colombia: Public Sector Debt Sustainability Analysis (DSA)—Baseline Scenario

(in percent of GDP unless otherwise indicated)

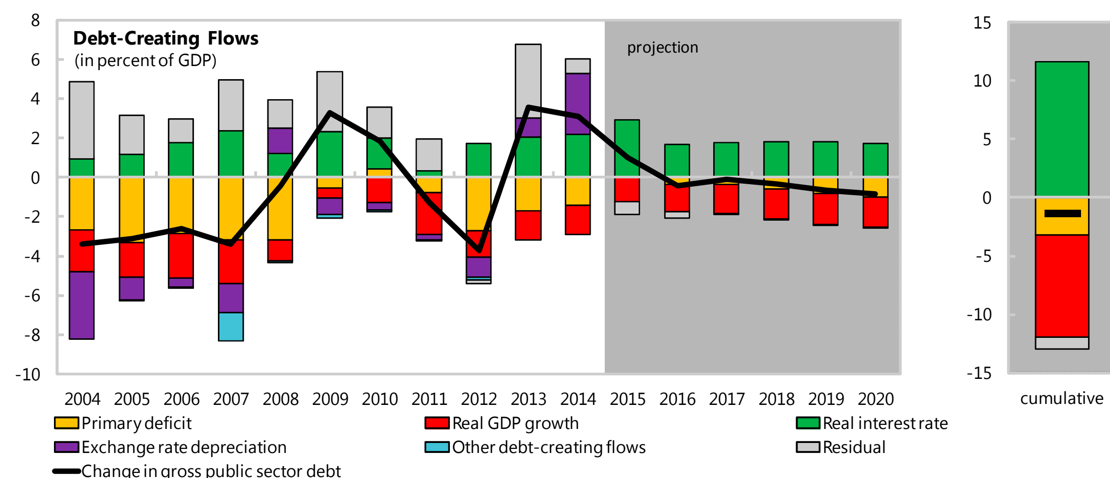
Debt, Economic and Market Indicators [1]

	Actual			Projections					
	2004-2012 [2]	2013	2014	2015	2016	2017	2018	2019	2020
Nominal gross public debt	35.5	35.6	38.7	39.7	39.3	39.2	38.8	38.2	37.3
Public gross financing needs	7.5	4.6	4.3	6.5	5.0	4.2	4.0	3.9	2.9
Real GDP growth (in percent)	4.8	4.9	4.6	3.4	3.7	4.0	4.2	4.3	4.3
Inflation (GDP deflator, in percent)	5.4	1.9	1.8	1.0	3.7	3.1	3.0	2.9	3.0
Nominal GDP growth (in percent)	10.5	6.9	6.5	4.4	7.5	7.3	7.3	7.3	7.4
Effective interest rate (in percent) [4]	10.2	8.8	8.4	8.9	8.3	8.1	8.0	8.0	8.0

As of April 02, 2015		
Sovereign Spreads		
EMBIG (bp) 3/		218
5Y CDS (bp)		155
Ratings	Foreign	Local
Moody's	Baa2	Baa2
S&Ps	BBB	BBB+
Fitch	BBB	BBB+

Contribution to Changes in Public Debt

	Actual			Projections							
	2004-2012	2013	2014	2015	2016	2017	2018	2019	2020	cumulative	debt-stabilizing primary balance [9]
Change in gross public sector debt	-1.4	3.6	3.1	1.0	-0.4	-0.1	-0.4	-0.6	-0.9	-1.3	
Identified debt-creating flows	-3.3	-0.2	2.4	1.7	-0.1	-0.1	-0.3	-0.6	-0.8	-0.3	
Primary deficit	-2.1	-1.7	-1.4	0.0	-0.4	-0.4	-0.6	-0.9	-1.0	-3.2	0.2
Primary (noninterest) revenue and grants	26.6	28.1	28.2	26.3	26.1	25.9	25.9	25.8	25.7	155.6	
Primary (noninterest) expenditure	24.5	26.4	26.8	26.3	25.7	25.5	25.3	24.9	24.6	152.4	
Automatic debt dynamics [5]	-1.0	1.5	3.8	1.6	0.3	0.3	0.3	0.2	0.2	2.9	
Interest rate/growth differential [6]	-0.1	0.6	0.6	1.6	0.3	0.3	0.3	0.2	0.2	2.9	
Of which: real interest rate	1.5	2.1	2.2	2.9	1.7	1.8	1.8	1.8	1.7	11.6	
Of which: real GDP growth	-1.6	-1.5	-1.5	-1.3	-1.4	-1.5	-1.5	-1.6	-1.5	-8.7	
Exchange rate depreciation [7]	-0.9	1.0	3.1	...	...	...	...	...	...	...	
Other identified debt-creating flows	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Privatization proceeds (negative)	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Short-term debt 1/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [8]	1.9	3.7	0.7	-0.6	-0.3	0.0	0.0	0.0	0.0	-1.0	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ EMBIG.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as $[(r - \pi(1+g) - g + ae(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as $r - \pi(1+g)$ and the real growth contribution as -g.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as $ae(1+r)$.

8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Table 10. Colombia: External Debt Sustainability Framework, 2011–20

(In percent of GDP, unless otherwise indicated)

	Actual				Projections 1/						
	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Debt-stabilizing non-interest current account 7/
Baseline: External debt	22.8	20.9	24.2	29.3	30.9	29.4	28.2	27.1	25.9	24.5	**-2.6**
Change in external debt	0.1	-2.0	3.3	5.0	1.7	-1.6	-1.1	-1.2	-1.2	-1.4	
Identified external debt-creating flows (4+8+9)	-2.3	-3.2	0.4	2.1	7.3	0.4	-2.0	0.2	-1.7	-0.1	
Current account deficit, excluding interest payments	1.9	2.2	2.3	4.0	4.1	3.5	3.0	2.8	2.7	2.5	
Deficit in balance of goods and services	-0.3	0.2	0.7	3.0	3.8	2.7	2.1	2.0	1.8	1.8	
Exports	19.0	18.4	17.7	16.9	15.8	16.2	16.1	15.8	15.3	14.8	
Imports	18.7	18.6	18.4	19.9	19.7	18.9	18.3	17.7	17.1	16.6	
Net non-debt creating capital inflows (negative)	-1.9	-4.2	-2.2	-3.2	-3.0	-2.3	-4.1	-2.1	-3.8	-2.1	
Automatic debt dynamics 2/	-2.3	-1.1	0.4	1.4	6.1	-0.9	-0.8	-0.5	-0.5	-0.6	
Contribution from nominal interest rate	1.0	0.9	0.9	1.3	2.0	1.5	1.4	1.4	1.3	1.2	
Contribution from real GDP growth	-1.3	-0.8	-1.0	-1.1	-1.1	-1.1	-1.1	-1.1	-1.1	-1.0	
Contribution from price and exchange rate changes 3/	-2.1	-1.2	0.4	1.2	...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 4/	2.3	1.2	2.9	2.9	-5.6	-1.9	0.8	-1.4	0.5	-1.3	
External debt-to-exports ratio (in percent)	120.4	113.6	137.2	173.1	195.6	180.9	175.3	171.8	168.9	165.7	
Gross external financing need (in billions of U.S. dollars) 5/	23.9	32.1	28.6	43.5	44.4	41.2	43.3	43.6	47.5	47.1	
in percent of GDP	7.1	8.7	7.5	11.5	13.5	11.5	11.2	10.5	10.7	9.8	
Scenario with key variables at their historical averages 6/					**20.1**	**17.8**	**17.3**	**15.6**	**14.9**	**13.5**	**-3.1**
Key Macroeconomic Assumptions Underlying Baseline											
Real GDP growth (in percent)	6.6	4.0	4.9	4.6	3.4	3.7	4.0	4.2	4.3	4.3	
GDP deflator in US dollars (change in percent)	9.9	5.7	-2.1	-4.9	-15.6	4.6	4.2	3.0	2.9	3.0	
Nominal external interest rate (in percent)	5.1	4.4	4.6	5.2	5.9	5.4	5.3	5.2	5.2	5.1	
Growth of exports (U.S. dollar terms, in percent)	39.2	6.5	-1.2	-4.8	-18.4	11.3	7.5	4.9	4.3	3.7	
Growth of imports (U.S. dollar terms, in percent)	31.8	9.4	1.5	7.6	-13.9	4.5	4.4	4.1	3.8	4.0	
Current account balance, excluding interest payments	-1.9	-2.2	-2.3	-4.0	-4.1	-3.5	-3.0	-2.8	-2.7	-2.5	
Net non-debt creating capital inflows	1.9	4.2	2.2	3.2	3.0	2.3	4.1	2.1	3.8	2.1	

Source: Fund staff estimates.

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

2/ Derived as [r - g - p(1+g) + ea(1+r)]/(1+g+p+gp) times previous period debt stock, with r = nominal effective interest rate on external debt; p = change in domestic GDP deflator in US dollar terms, g= real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency debt in total external debt.

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

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

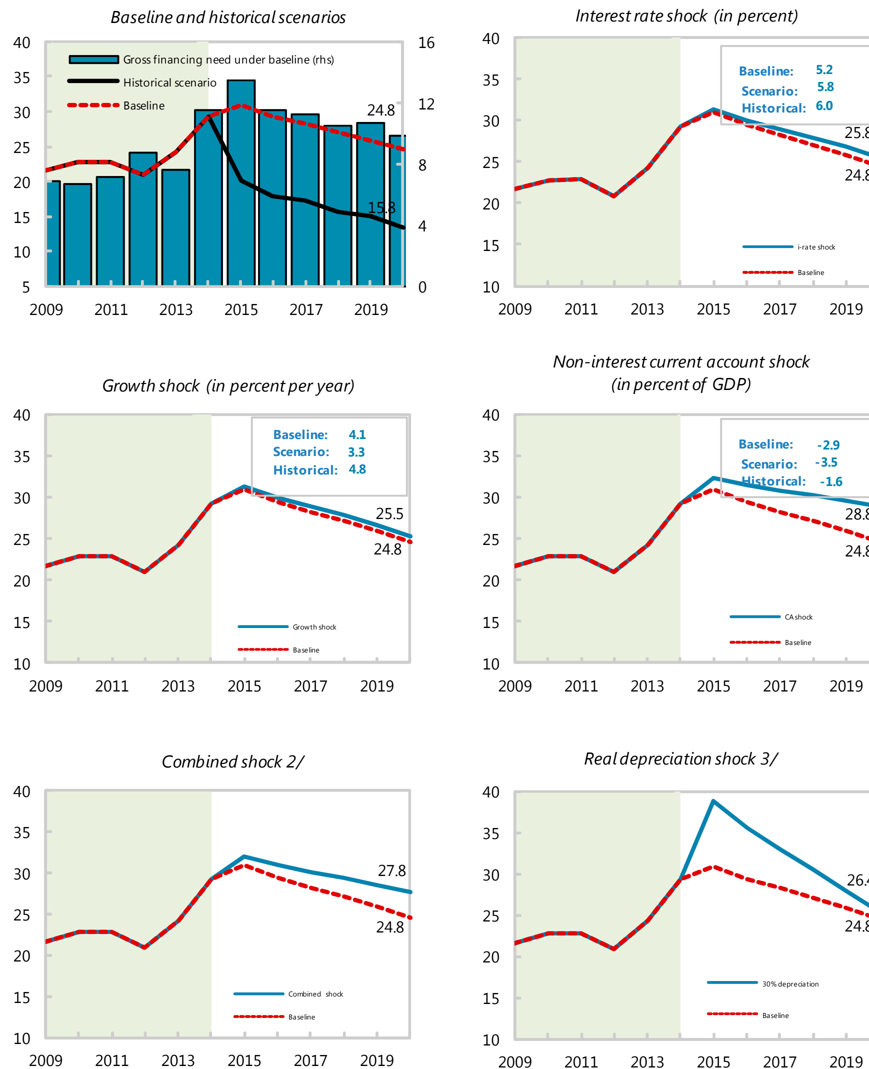
5/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

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 9. Colombia: External Debt Sustainability: Bound Test 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.

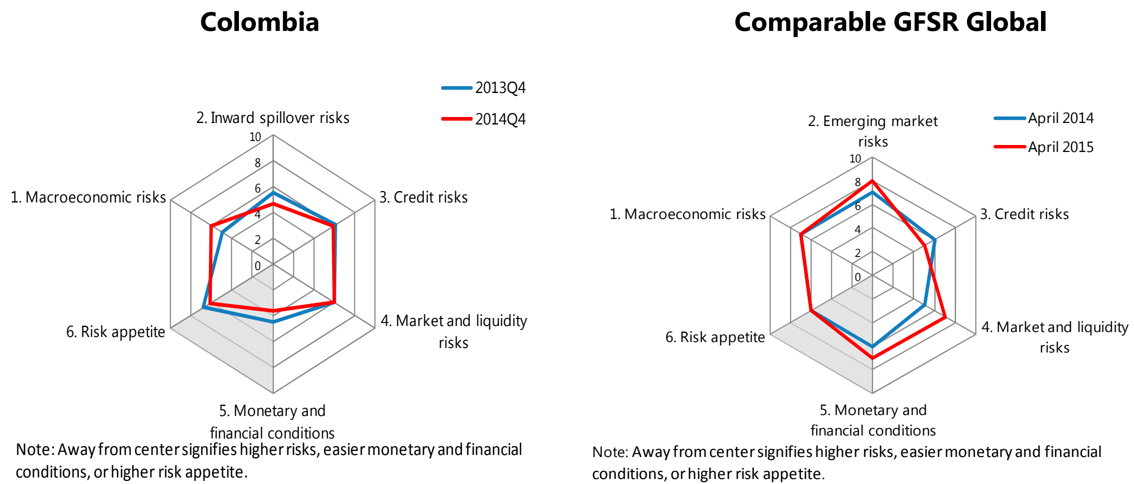
2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

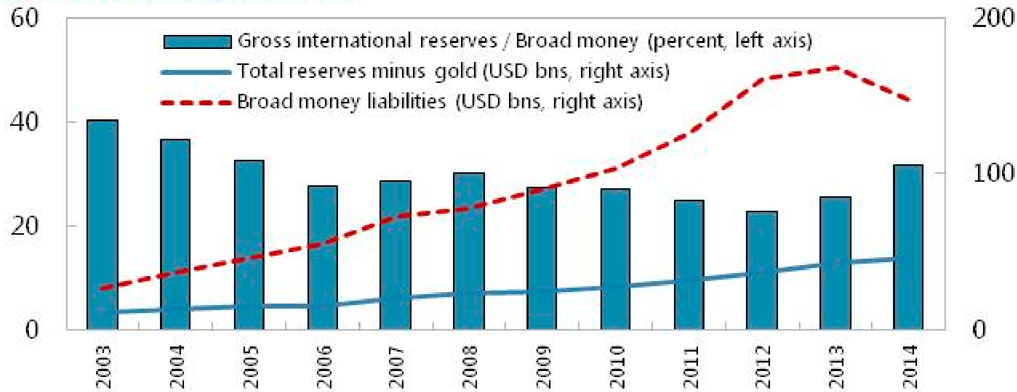
3/ One-time real depreciation of 30 percent occurs in 2013, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

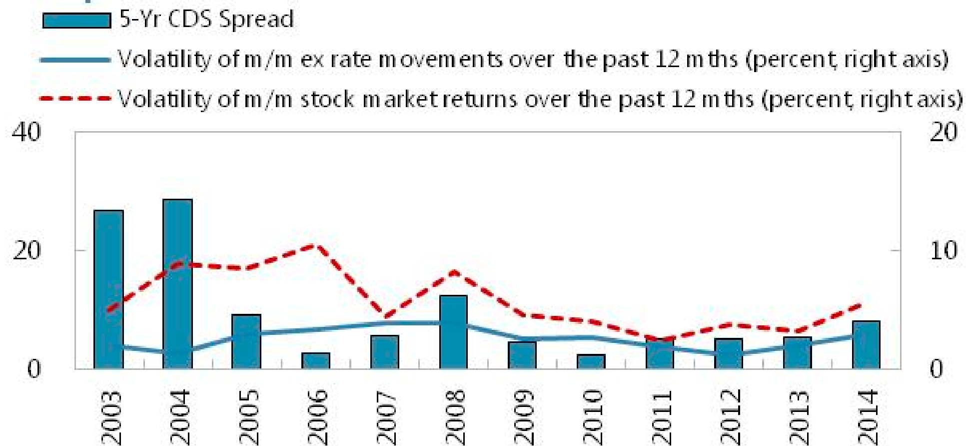
Appendix I. Colombia: Macro-Financial Stability Assessment

Macro Financial Stability Map

Figure 1. Macro-Financial Stability Map







Source: IMF.

Colombia's macro-financial system is stable. A comparison of Colombia's latest macro financial stability map with the same period a year before, shows that the macro-financial system remains stable on both microprudential and macroprudential dimensions, albeit with some signs of increased macroeconomic risk (Figure 1) reflecting an increase in bank credit and a rise in CDS spreads. The level of macroeconomic risk is consistent with the level reported in the April 2015 Global Financial Stability Report. Inward spillover risks have declined since end-2013, on account of some improvement in the ratio of reserves to broad money. The reduction in risk appetite reflects recent increases in CDS spreads, and heightened exchange rate and stock market volatility. The tightening in monetary and financial conditions reflects a decline in real broad money growth.

Financial Sector Risk Assessment

Table. Colombia: Financial Soundness Indicators Map

	2008Q4	2009Q4	2010Q4	2011Q4	2012Q4	2013Q4	2014Q1	2014Q2	2014Q3	2014Q4
Overall Financial Sector Rating	M	L	L	L	L	L	L	L	L	M
Credit cycle	n.a.	L	L	L	L	L	L	L	L	M
Change in credit / GDP ratio (pp, annual)	0.7	-1.2	2.4	2.6	3.0	1.8	1.8	1.8	1.9	3.1
Growth of credit / GDP (%, annual)	2.4	-4.0	8.1	8.1	8.5	4.8	4.6	4.7	4.7	7.7
Credit-to-GDP gap (st. dev)	n.a.	-1.9	0.3	1.1	1.5	-0.1	-0.7	-0.6	-1.0	-0.5
Balance Sheet Soundness	M	L	L	L	L	L	L	L	L	L
Balance Sheet Structural Risk	L	L	L	L	L	L	L	L	L	L
Deposit-to-loan ratio	94.9	98.8	93.5	91.4	94.7	96.3	96.9	94.3	94.0	91.6
FX liabilities % (of total liabilities)	8.9	6.6	9.4	10.5	9.4	10.2	10.7	10.0	11.1	12.7
Balance Sheet Buffers	M	L	L	L	L	L	L	L	L	L
Leverage	L	L	L	L	L	L	L	L	L	L
Leverage ratio (%)	12.6	14.2	14.2	14.3	14.7	14.8	14.7	14.7	14.8	14.9
Profitability	L	L	L	L	L	L	L	L	L	L
ROA	3.6	3.5	3.4	3.3	3.1	2.8	3.4	3.0	2.9	2.9
ROE	28.1	26.2	23.7	23.0	21.2	19.5	23.5	20.2	19.8	19.8
Asset quality	H	L	L	L	M	L	L	L	L	M
NPL ratio	3.9	4.0	2.9	2.5	2.8	2.8	3.0	3.0	3.1	2.9
NPL ratio change (%, annual)	21.8	2.0	-28.6	-12.8	10.5	0.5	-4.0	3.3	4.2	5.2

Vulnerability codes:
High
Moderate
Low

Sources: Fund staff estimates based on authorities data.

The financial sector vulnerability risk is assessed as "medium" while balance sheets are sound. The overall financial rating has moved from "low" to "medium" vulnerability in the last quarter of 2014, on account of strong credit growth that has pushed the change in the credit-to-GDP indicator marginally above the threshold of 3 percent. However, non-performing loan ratios of deposit-taking institutions remain low, and provisioning has been strong (151.3 percent), mitigating risks from the slight pick-up in credit. Banks have large buffers, with a capital adequacy ratio above regulatory minima (17.1 percent, against the minimum requirement of 9 percent), strong profitability (ROE 19.8) and low leverage (14.9 percent).

INTERNATIONAL MONETARY FUND

COLOMBIA

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

May 1, 2015

Prepared By
The Western Hemisphere Department
(In collaboration with other Departments)

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FUND RELATIONS

(As of April 6, 2015)

Membership status: Joined: December 27, 1945; Article VIII.

General Resources Account:

	SDR million	Percent Quota
Quota	774.00	100.00
Fund holding of currency (Exchange rate)	486.61	62.87
Reserve position	287.39	37.13

SDR Department:

	SDR million	Percent Quota
Net cumulative allocation	738.32	100.00
Holdings	723.56	98.00

Outstanding Purchases and Loans: None.

Latest Financial Arrangements:

			In million of SDR	
Type	Date of Arrangement	Expiration Date	Amount Approved	Amount Drawn
FCL	Jun 24, 2013	Jun 23, 2015	3,870.00	0.00
FCL	May 6, 2011	May 5, 2013	3,870.00	0.00
FCL	May 7, 2010	May 5, 2011	2,322.00	0.00
FCL	May 11, 2009	May 6, 2010	6,966.00	0.00
Stand-by	May 2, 2005	Nov 2, 2006	405.00	0.00
Stand-by	Jan 15, 2003	May 2, 2005	1,548.00	0.00

Projected Payments to the Fund (in SDR million):

	forthcoming				
	2015	2016	2017	2018	2019
Principal					
Charges/interest	0.01	0.01	0.01	0.01	0.01
Total	0.01	0.01	0.01	0.01	0.01

Implementation of HIPC Initiative: Not applicable.

Implementation of Multilateral Debt Relief Initiative (MDRI): Not applicable.

Exchange Rate Arrangement: Colombia's exchange rate arrangement is classified as flexible regime (*de jure* and *de facto*) subject to certain intervention rules specified by the central bank. Colombia maintains an exchange restriction subject to Fund approval under Article VIII arising from the special regime for the hydrocarbon sector.

Article IV Consultation: The last Article IV Consultation was concluded on May 19, 2014 (Country Report No.14/141).

FSAP participation and ROSCs: The FSAP took place in 2000 and was updated in 2008 and 2013. A data ROSC took place in 2006 and a fiscal ROSC in 2003.

Technical Assistance:

Department	Time of Delivery	Purpose
STA	Jan-14	National Accounts Statistics
STA	Jan-14	Consumer Prices/Producer Price
MCM	Jul-14	Bank Supervision & Regulations
FAD	Jul-14	RA Gap
FAD	Jun-14	Customs Administration
FAD	Feb-15	Tax Policy
FAD	Nov-14	Public Financial Management
FAD	Sep-14	Tax and Customs Administration
FAD	Oct-14	Tax Administration

WORLD BANK RELATIONS[1]

The current IBRD Country Partnership Strategy (CPS) for FY 12–16 aims to support selectively Colombia's National Development Plan. The World Bank Group (WBG) is stepping up efforts to enhance development impact through selectivity, as a means to provide added value to the country. The WBG has been carrying out activities for which the Government or the private sector have expressed explicit need through financial, knowledge, and convening services. Activities are managed under an enhanced thematic business model approach, aimed at improving the impact of the Bank's engagement in Colombia. These activities are combined as a results-focused package of support grouped under three strategic themes: (a) Expanding Opportunities for Social Prosperity; (b) Sustainable Growth with Enhanced Climate Change Resilience; and (c) Inclusive Growth with Enhanced Productivity. Each of these strategic themes has three areas of results with specified outcomes. In some cases, outcomes in this CPS cannot solely be attributed to the WBG since activities are often jointly accomplished with the Government or other partners.

For FY 14–16 the lending program is expected to be US$870–1,025 million per annum. Actual delivery of the lending program will depend on Colombia's performance, IBRD lending capacity, demand from other borrowers, global economic developments, and disbursement profiles that keep exposure within the country limits. Trust funds have continued to be an integral part of the Bank's engagement with Colombia. As trust fund resources are not predictable for the purpose of the CPS, the WBG is ensuring that activities financed by trust funds follow the thrust of this strategy in agreement with the government counterparts.

As of April 2015, Colombia is IBRD's 7th largest Bank borrower with US$7.9 billion in outstanding debt. The active portfolio is composed of 15 IBRD and 1 stand-alone GEF project with IBRD net commitments of US$2.8 billion. Colombia also has a considerable Trust Fund portfolio with US$61 million represented in a variety of sectors, with close to 42 percent (US$26 million) in small and micro trust funds under US$5 million. In FY 15, 2 large DPF operations for US$1.4 billion were approved. The pipeline for FY 16 includes two DPFs of US$700 million each for Sustainable Development and Growth and Convergence, respectively, as well as potential one IPFs in support of Plan Pacifico and Financial Systems Strengthening, each. A Multi-Donor Trust Fund has been launched for support of the peace agenda and post-conflict initiatives. The WB chairs the steering committee. Current overall contributions are at US$6.5 million, of which the Swedish Development Cooperation contributed SKr 19.5 million and the WB-administered State and Peace Building Fund US$4 million.

IFC's outstanding portfolio in Colombia is US$779 million in 60 projects. It is the 10th largest portfolio worldwide and 3rd regionally. In terms of commitments, the top sectors are: finance and insurance (55 percent), transport and warehousing (14 percent), oil, gas and mining (8 percent) and electric power (6 percent). In terms of products, 44 percent is in loans and guarantees and 56 percent in equity and equity-type products. Participants' outstanding loans total US$353 million.

[1] Prepared by the World Bank staff.

Operational Portfolio (IBRD/IDA and Grants)
As of April 2015
(In millions of U.S. Dollars)

Closed Projects	206
Active Projects	15
IBRD/IDA	
Total Disbursed (Active)	2.757
Of which has repaid	127.5
Total Disbursed (Closed)	4.842
Of which has been repaid	1.960
Total Disbursed (Active +Closed)	7.599
Of which has been repaid	2.088
Total Undisbursed (Active)	1.391

Loan Information (IBRD)
As of March 2015
(In millions of U.S. Dollars)

FY*	2008	2009	2010	2011	2012	2013	2014
Total Disbursements	638	1,240	1,592	488	396	780	642
Repayment Amount	381	170	258	277	241	416	538
Net Disbursements	257	1,070	1,334	211	155	364	104

* Fiscal Year : July - June 30

International Finance Corporation (IFC) Portfolio
As of March 2015

Debt ($m)	Equity ($m)	Quasi Equity ($m)	Total ($m)	Guarantee
353	263	163 (Loan + Equity)	779	4

Investment Business – Top sectors and Clients

Sector 1	Finance & Insurance
Sector 2	Transportation & Warehousing
Sector 3	Oil, Gas, and Mining
Sector 4	Collective Investment Vehicles
Sector 5	Electric Power
Top client	DAVIVIENDA I

INTER-AMERICAN DEVELOPMENT BANK RELATIONS[1]

The Bank is developing the new country strategy with Colombia (2015–18) and identifies three policy areas of dialogue with the government: productivity, effectiveness of public management and social mobility. These areas are part of a comprehensive vision for the development process of the country, aimed at a vision where the country can achieve a path of sustainable growth and become a developed country in the long run. There are cross-cutting requirements associated with this objective and to growth and overcome conditions of poverty and inequity, which are: (i) increase tax-fiscal revenues in order to ensure a sizable flow of public goods, and (ii) recognizing both infrastructure development, and human and social capital development as necessary factors for greater productivity and strengthen the middle class.

The sovereign guarantee lending envelope under the current Strategy (2014–18) was estimated at US$852 million per year, which total US$3.4 billion for the years 2012 to 2014. In 2014, the Bank approved 5 operations for US$1032 million in sovereign guarantee operations.

The Bank portfolio is currently composed of 25 sovereign guarantee operations, totaling US$2.3 billion, with a disbursed percentage of 34 percent. Operations are concentrated in infrastructure (50 percent), governance (31 percent) and social development (20 percent).[2] The non-reimbursable technical cooperation portfolio includes 131 operations, with an approved value of US$58 million.

The current portfolio of private sector initiatives (non-sovereign guarantee) in Colombia totals US$209 million. The Inter-American Investment Corporation has a portfolio of US$87 million.

Colombia Sovereign Loan Portfolio
As of February 28, 2015

	Number of Operations	Current Approved US$M	Disbursement (Percent)
Infrastructure	13	1,138	28
Governance	10	721	7
Social Development	2	446	8
TOTAL	**25**	**2,305**	**34**

[1] Prepared by Inter-American Development Bank staff.

[2] Includes Policy Based Loans.

STATISTICAL ISSUES

(As of March 31, 2015)

A. Assessment of Data Adequacy for Surveillance

Data provision is adequate for surveillance.

Real Sector

The National Department of Statistics (DANE) is responsible for the compilation of the national accounts, although the Banco de la República (BdR) compiles the financial accounts. Annual and quarterly estimates of GDP by the production and the expenditure approaches use 2005 as the reference year. GDP compilation conforms to the methodological recommendations of the System of National Accounts 1993 (1993 SNA) and some recommendations of the 2008 SNA. The rebasing of the national accounts' base year included a methodological change regarding the volume measures from a fixed-base Laspeyres index to a Laspeyres chain index with 2005 as the reference year. The main implications of the rebasing are that the 2000 and 2005 series are not comparable and the chain index is associated with non-additivity of the components. The rebasing also resulted in an upward revision of the nominal GDP, reflecting improvements in source data. DANE currently compiles a monthly indicator of economic activity for internal purposes, but has decided to start disseminating it to the general public during the third quarter of 2014.

DANE is also responsible for price statistics. It currently compiles and disseminates the consumer price index (CPI) and the producer price index (PPI). The basket and weights of the CPI were updated in 2008 according to the latest Income-Expenditure Survey (2006–2007), which resulted in an increase in the number of products collected. DANE is currently updating the PPI, which is expected to be available during the third quarter of 2014.

Government Finance Statistics

The Ministry of Finance and Public Credit (MFPC) is responsible for the compilation of public revenue, expenditure, and financing data. The Colombian authorities have reaffirmed their commitment to adopt the GFSM 2001 framework, enhance inter-institutional coordination, and increase the resources allocated to compiling government finance statistics. While significant progress has been made, there is still a need to take additional steps. In the short term, these include: adopting a common list of public sector entities, and disseminating high-frequency data on a national and international level. The General Accounting Office (GAO) has developed a single accounting framework for the public sector based on International Public Sector Accounting Standards and maintains a financial management information system containing accounting information of all public sector units. The MFPC's Macroeconomic Policy Unit and the GAO developed a bridge table that converts national accounting classification to the GFSM 2001 framework to compile GFS on accrual and cash bases, which are reported annually to the IMF's Statistics Department for publication in the Government Finance Statistics Yearbook.

Financial Sector Statistics

The BdR is in charge of compiling data on the financial sector, while the Financial Superintendence (FS) and the Superintendence of Securities compile data in their respective areas. Fund technical assistance missions have placed special emphasis on issues supportive of data quality, including interagency cooperation and procedures to ensure data consistency.

External Sector Statistics

The BdR is in charge of compiling and disseminating balance of payments statistics. Quarterly data have been produced since 1994, and the BdR adopted the BPM5 standard in 1998. Balance of payment statistics have been extended to cover transactions in the free trade zones. Improved surveys, particularly in the services sector, have enhanced coverage and consistency and financial account data are now based on actual disbursement rather than registers.

The 2005 data ROSC mission recommended that the BdR, in consultation with the DANE, develop a methodology to include unrecorded trade in the balance of payments on a timely basis. Although DANE developed a methodology to estimate unrecorded trade, the BdR does not include these estimates in the balance of payments statistics. Also, the BdR has been working to identify government bonds issued abroad and held by residents, but the task has not been completed yet due to coverage issues. In line with the mission's recommendations, the BdR reclassified some FDI equity transactions to portfolio equity, and adjusted the related investment income series accordingly.

The BdR also compiles and disseminates data on International Investment Position statistics, External Debt statistics, and the Data Template on International Reserves and Foreign Currency Liquidity. Colombia reports data to the Coordinated Portfolio Investment Survey (CPIS).

B. Data Standards and Quality

Colombia subscribes to the Special Data Dissemination Standard (SDDS) and metadata are posted on the Fund's Dissemination Standards Bulletin Board (DSBB).

A data ROSC was published in October 2006.

C. Reporting to STA

Colombia reports annual GFS to STA for general government and its subsectors on accrual and cash bases for publication in the Government Finance Statistics Yearbook (GFS Yearbook). Data for the consolidated general government are only available from 2008 onward after a major revision was performed in stock data. Currently, no high frequency data are reported for publication in IFS. However, an action plan currently being implemented by the authorities is aimed to address this issue. Colombia is also expected to start reporting debt statistics for the IMF-WB Public Sector Debt Statistics database. The BdR uses the standardized report forms for reporting monetary data for the central bank (Form 1SR), other depository corporations (Form 2SR), and other financial corporations (Form 4SR) to STA. The FS reports 11 of the 12 core financial soundness indicators (FSIs) and 10 of 13 encouraged FSIs for deposit takers on a regular monthly basis.

Colombia: Table of Common Indicators Required for Surveillance

As of April 6, 2015

	Date of Latest Observation	Date Received	Frequency of Data[1]	Frequency of Reporting[1]	Frequency of Publication[1]	Memo Items: Data Quality – Methodological Soundness[8]	Memo Items: Data Quality – Accuracy and Reliability[9]
Exchange Rates	Apr. 9, 2015	Apr. 10, 2015	D	W	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[2]	Dec. 2014	Mar. 2015	M	M	M		
Reserve/Base Money	Dec. 2014	Mar. 2015	D	W	W	LO, O, LO, LO	O, O, O, O, O
Broad Money	Dec. 2014	Mar. 2015	D	W	W		
Central Bank Balance Sheet	Jan. 2015	Mar. 2015	M	M	M		
Consolidated Balance Sheet of the Banking System	Dec. 2014	Mar. 2015	M	M	M		
Interest Rates[3]	Apr. 4, 2015	Apr. 7, 2015	D	W	D		
Consumer Price Index	Mar. 2015	Apr. 6, 2015	M	M	M		
Revenue, Expenditure, Balance and Financing Composition[4] – General Government (GG)[5]	Q3 2014	Mar. 2015	Q	Q	Q	O, O, LO, O	LO, O, O, O, NO
Revenue, Expenditure, Balance and Composition of Financing[4] – Central Government	Feb. 2015	Mar. 2015	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[6]	Feb. 2015	Mar. 2015	M	M	M		
External Current Account Balance	Q4 2014	Mar. 2015	Q	Q	Q	O, LO, LO, LO	O, O, O, O, LO
Exports and Imports of Goods and Services	Q4 2014	Mar. 2015	Q	Q	Q		
GDP/GNP	Q4 2014	Mar. 2015	Q	Q	Q	O, LO, O, O	LO, O, LO, LO, NO
Gross External Debt	Dec. 2014	Mar. 2015	M	M	M		
International Investment Position[7]	Q4 2014	Mar. 2015	Q	Q	Q		

[1] Daily (D); Weekly (W); Monthly (M); Bi-monthly (B); Quarterly (Q); Annually (A); Irregular (I); Not Available (NA).
[2] Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.
[3] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[4] Foreign, domestic bank, and domestic nonbank financing.
[5] The GG consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[6] Including currency and maturity composition.
[7] Includes external gross financial asset and liability positions vis-à-vis nonresidents.
[8] Reflects the assessment provided in the data ROSC published in October 2006 for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O); largely observed (LO); largely not observed (LNO); not observed (NO); and not available (NA).
[9] Same as Footnote 8, except referring to international standards concerning (respectively) source data, assessment of source data, statistical techniques, assessment and validation of intermediate data and statistical outputs, and revision studies.

Statement by Maria Angelica Arbelaez, Alternate Executive Director for Colombia
May 18, 2015

The Colombian authorities are grateful to the mission team for the constructive and fruitful discussions held in Bogota. They broadly agree with the staff's assessment and policy recommendations.

Economic outlook

The Colombian economy has continued to show resilience while reducing unemployment with a 4.6 percent growth in 2014. However, the recent deterioration of the terms of trade stemming mainly from the collapse in oil prices, coupled with low growth in Europe and deceleration in China as well as in other Colombian trade partners in Latin America, has changed the economic outlook. Growth is projected to slow down to around 3.5 percent in 2015 and start to recover in 2016 to converge in the next years to a long-term growth of around 4.5 percent.

The authorities expect that part of the decline in oil prices is of a permanent nature that will negatively impact national income. In this scenario, the economy needs to adjust to a new reality in the coming years, and lower domestic absorption may be foreseen. Recent data show a deceleration in consumption and investment in some natural resource sectors and lower proceeds from commodity exports.

However, some factors may compensate for the economic decline: the reduction in poverty and the strength and formalization observed in the labor market can mitigate the slowdown in consumption; investment in public works and construction is expected to remain strong; and depreciation will gradually bolster non-traditional exports and curve imports. In addition, the ambitious package of infrastructure projects (4G) whose construction begins in 2016 is estimated to support growth and to add around 0.7 percentage points to the potential output, and the re-entrance into operation of the Cartagena oil refinery late this year will also bolster manufacturing performance.

The authorities acknowledge that the room for countercyclical policies to offset growth slowdown may be limited: fiscal space is restricted by the fiscal rule, and the scope for supportive monetary policy depends on the magnitude of the slowdown, inflation expectations and the degree of the pass-through of depreciation to inflation. In this context, the authorities are focusing their efforts on moving ahead with structural reforms to boost non-traditional tradable sectors and help them make the most use of the recovery in the US and of free trade agreements recently signed by Colombia.

The authorities agree with staff that risks threaten on the downside. The main hazards stem from instability and higher volatility in global financial markets associated with monetary

policy normalization in the US and intensification of sovereign distress in the Euro Area, rising vulnerabilities in emerging markets, and lower growth in Europe, China and important Colombian trading partners. In addition, a further decline in oil prices would have a pronounced impact on investment and growth. To face global financial risks, the authorities are committed to maintaining good macroeconomic policies and strong fundamentals, floating exchange rate, keeping an adequate level of international reserves and closely monitoring banks, corporate and households' balance sheets.

Fiscal policy

The fiscal stance embedded in the Medium-Term Fiscal Framework is well-anchored by the fiscal rule. According to new data released by the Ministry of Finance on May 19th, the Central Government posted a structural deficit of 2.30 percent of GDP, smaller to the 2.32 percent recorded in 2013, and a headline deficit of 2.43 percent, similar to that of 2013 (2.36%). The Combined Public Sector reached a deficit of 1.8 percent of GDP due to a reduction in the surplus of sub-national governments resulting from the political cycle and higher investment. For 2015 the situation is more challenging, as oil-related revenues are expected to drop and debt service to increase as a result of the exchange rate depreciation. Owing to the smoothing of the mining and economic cycles, the fiscal rule allows this year for a higher total deficit. The rest of the adjustment will come from increasing revenues from the tax reform approved in December 2014, and a budget cut, although protecting social spending.

Under the new normal of oil prices, the government is fully aware that further revenue mobilization will be needed in the years to come in order to comply with the fiscal rule. Indeed, it commissioned a group of independent experts to design a comprehensive tax reform, which counts on the advice of multilateral organizations, such as the IMF and OECD. Among others topics, the group will focus on tax administration, VAT, personal income taxes, non-profit organization taxes and tax simplification. The final blueprint has to be submitted to the government by the end of October 2015, but proposals on specific areas will be delivered before that deadline in order to have time to go through Congress, if necessary.

Complying with the fiscal rule is a priority for the authorities, even in the midst of less favorable conditions. They are convinced on the virtual cycle of fiscal discipline: lower fiscal deficit leads to higher confidence, lower interest rates, more investment, stronger economic growth and higher tax revenues. Fiscal consolidation is also necessary to strengthen the current account balance over the medium term.

Monetary Policy and External Position

Inflation targeting serves the economy well and inflation expectations are firmly anchored. In 2014 inflation was 3.6 percent and it is expected to finish this year in the upper part of the target range of 2-4 percent. Headline inflation went up due to agricultural supply shocks and some pass-through effect from depreciation, but it is projected to abate by the end of the year. Core inflation measures are within the target range. The monetary policy stance has remained supportive in the context of an economy expected to slowdown starting from near full utilization of productive capacity. Looking ahead, the room for monetary easing will depend on whether the expected slowdown exceeds or falls short of the adjustment required to ensure the nominal and financial stability of the economy, on the extent to which inflation expectations remain anchored to target and on the size of the pass-through effect. Fueled by capital flows, the central bank (*Banco de la República*) continued to build up international reserves in 2014 and stopped its program of FX purchases by the end of that year, as reserve buffers became broadly adequate for normal times and most indicators were close to pre-crisis levels.

Exchange rate flexibility has been the main shock absorber and the peso depreciated quickly and strongly, although it is broadly aligned with fundamentals. The current account deficit widened last year to 5.2 percent of GDP, and is expected to narrow gradually in dollar terms as domestic absorption adjusts and expenditure switching effects kick in. As a percentage of GDP the deficit will remain close to 5 percent due to the impact of the real depreciation of the COP on the dollar valuation of GDP. The reduction in dollar terms of the current account deficit will be mirrored by declines in FDI and portfolio inflows. The decrease in FDI will be especially felt in the oil and mining sectors. The reduction in portfolio investment will occur after an atypical year in 2014, when the increase of the weight of Colombian local public bonds in Emerging Economy benchmark indices induced record inflows of this kind.

Financial sector

The financial sector is sound, profitable and well provisioned and capitalized. As mentioned by staff, the authorities have been making significant progress in adopting the FSAP recommendations. Given that 2015 will be marked by lower growth, depreciated exchange rate and lower oil prices, the authorities are devoting their efforts to preventing negative spillovers to the financial system both through adopting regulatory measures and implementing a strict vigilance. As an example, following its mandate to monitor the financial system's stability, the Financial Superintendency conducted stress tests on the loans associated with the oil sector, which accounts for 1.9 percent of the total portfolio. The results show that even under a downgrade in the rating scale of these loans (up to three notches), the impact on the capital adequacy ratio of credit institutions is limited and would not pose a significant threat to the vulnerability of the financial system. Risks to the financial

sector stemming from depreciation are also limited given low exposure to foreign currency and mismatches, both in banks and corporate.

The Colombian authorities are committed to strengthening financial institutions capital and moving forward with the adoption of best practices in line with Basel III and Pillar 2 of Basel II. Nevertheless, it is important to analyze the regulatory framework in a comprehensive way. There are some more conservative aspects of the Colombian regulation than the principles proposed by the international standard setting bodies and some others in which regulatory measures taken in the country already cover some of the aspects raised by international best practices. Accordingly, the comparisons made among jurisdictions regarding solvency levels should consider these characteristics.

Authorities continue to closely monitor financial stability risks. Data show that household debt has increased in line with deeper financial inclusion, reaching historically high levels (30 percent of disposable income) while the financial burden has also risen, but remains below the level established by the IMF as risky. Corporate private debt is also manageable (37 percent of GDP), with a low share of foreign currency denominated debt (11 percent of GDP) and no evidence of large currency mismatches. The regulation of foreign currency in banks' balance sheets is strict, so their exposure and currency mismatches are contained.

Structural Reforms

A comprehensive development plan[1] is being discussed by Congress outlining the social and economic strategies, policies and targets for the next four years. It is founded on three pillars: peace, equity and education which will be developed through, among others, the following cross-cutting strategies: improving competitiveness and infrastructure, social mobility, and rural transformation. On infrastructure, besides the 4G project, other measures are envisaged to enhance urban transportation, broaden access to technologies of information and communication and bolster social housing. On social mobility, actions are concentrated on improving education, attention to early childhood, health care services delivery, and labor market. In addition, important measures will be adopted and powers granted to the government to reform the agricultural sector, redesign the institutionality and modify land management. Finally, the plan also incorporates actions to boost competitiveness and reduce informality.

Social progress

We welcome staff's analyses on social aspects in the selected issues papers. Although there is still much to be done, Colombia has made enormous progress on reducing poverty,

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[1] El Plan Nacional de Desarrollo 2014-2018 *"Todos por un nuevo País"*

inequality and informality, as well as on boosting financial inclusion. Indeed, between 2010 and 2014 4, 4 million people were lifted out of poverty and 2.6 million out of extreme poverty. The poverty rate declined from 37.2 percent to 28.5 percent in four years, and extreme poverty from 12.3 percent to 8.1 percent. The government's goals are to reach 25 percent of poverty and 6 percent of extreme poverty by 2018. Inequality has also decreased although slowly. Colombia has put in place many measures to achieve more inclusive growth, but time is needed to bear fruit. For example, a tax reform was undertaken in 2012 with the main objective of reducing inequality and generating formal employment. Increasing education attainment and improving quality are also key priorities of the Development Plan. Although it takes time to have an impact on inequality, better education, lower poverty, higher formal employment and financial inclusion are powerful tools to tackle it. Indeed, unemployment declined from 12 percent in 2010 to 9.1 percent in 2014, with the majority of new employment being in the formal sector, as presented by staff.