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IMF Country Report No. 09/23

Colombia: 2008 Article IV Consultation—Staff Report; Staff Statement; Public Information Notice on the Executive Board Discussion; 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 2008 Article IV consultation with Colombia, the following documents have been released and are included in this package:

- The staff report for the 2008 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on November 7, 2008 with the officials of on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on December 19, 2008. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- A staff statement of January 14, 2009, updating information on recent developments.
- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its January 14, 2009 discussion of the staff report that concluded the Article IV consultation.
- 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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INTERNATIONAL MONETARY FUND

COLOMBIA

Staff Report for the 2008 Article IV Consultation

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

Approved by Gilbert Terrier and Tessa van der Willigen

December 19, 2008

Executive Summary

- ***Context and recent developments.*** Colombia's growth prospects and financial markets have been affected by the ongoing turbulence in global markets. CDS spreads and equity prices have moved broadly in line with the rest of Latin America, while EMBI and corporate bond spreads have risen more. So far, there have been no disruptions to debt or interbank markets. External credit lines to domestic financial institutions have been affected only modestly, although there has been an increase in interest rates. Risks from increased spillovers from abroad are substantial.

- ***Key policy recommendations***:

    - *Further strengthen financial safety nets.* There is scope for greater clarity in the sequencing of actions and definition of responsibilities of different institutions regarding bank resolution. It would also be desirable to strengthen the deposit insurance system over the medium term.

    - *Continue with a flexible monetary policy to maintain the projected path toward a soft landing.* Continued close monitoring of forward-looking indicators of economic activity and of inflation expectations will be needed to determine the pace at which monetary policy can ease as headline inflation declines.

    - *Maintain the fiscal targets currently envisaged for 2009.* This will help keep financing needs low and public debt ratios on a declining path, bolstering confidence. With revenues likely to be lower than budgeted, some expenditure reductions may be required, although the fiscal stance would remain expansionary.

- ***Authorities' views.*** The authorities concurred with staff on the importance of strong financial safety nets. There was also broad agreement on the appropriate stance for monetary and fiscal policy.

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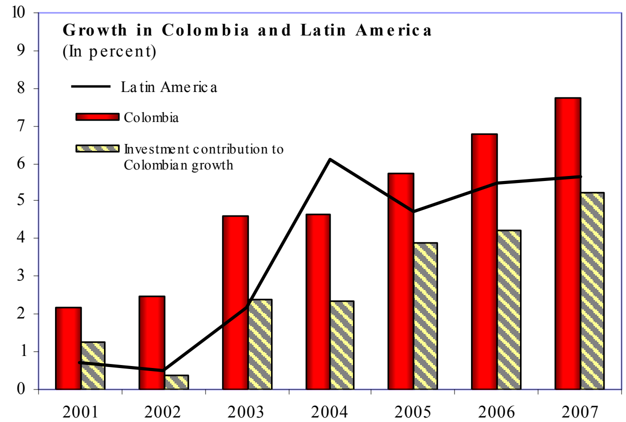
I. BACKGROUND

1. ***Sound economic policies have contributed to strong economic performance in recent years***. Supported by wide-ranging structural reforms, strong macroeconomic policies, and favorable external conditions, economic growth has picked up significantly since 2003, exceeding the regional average by a substantial margin in 2005–07 (Figure 1). Growth has been underpinned by a large increase in private investment, which has also benefited from a sharp improvement in domestic security. Improved fundamentals, and sizeable foreign direct investment (FDI), have led to an appreciation of the currency. Export growth has been solid and broad-based, aided by increased productivity and strong economic growth in Colombia's key trading partners.

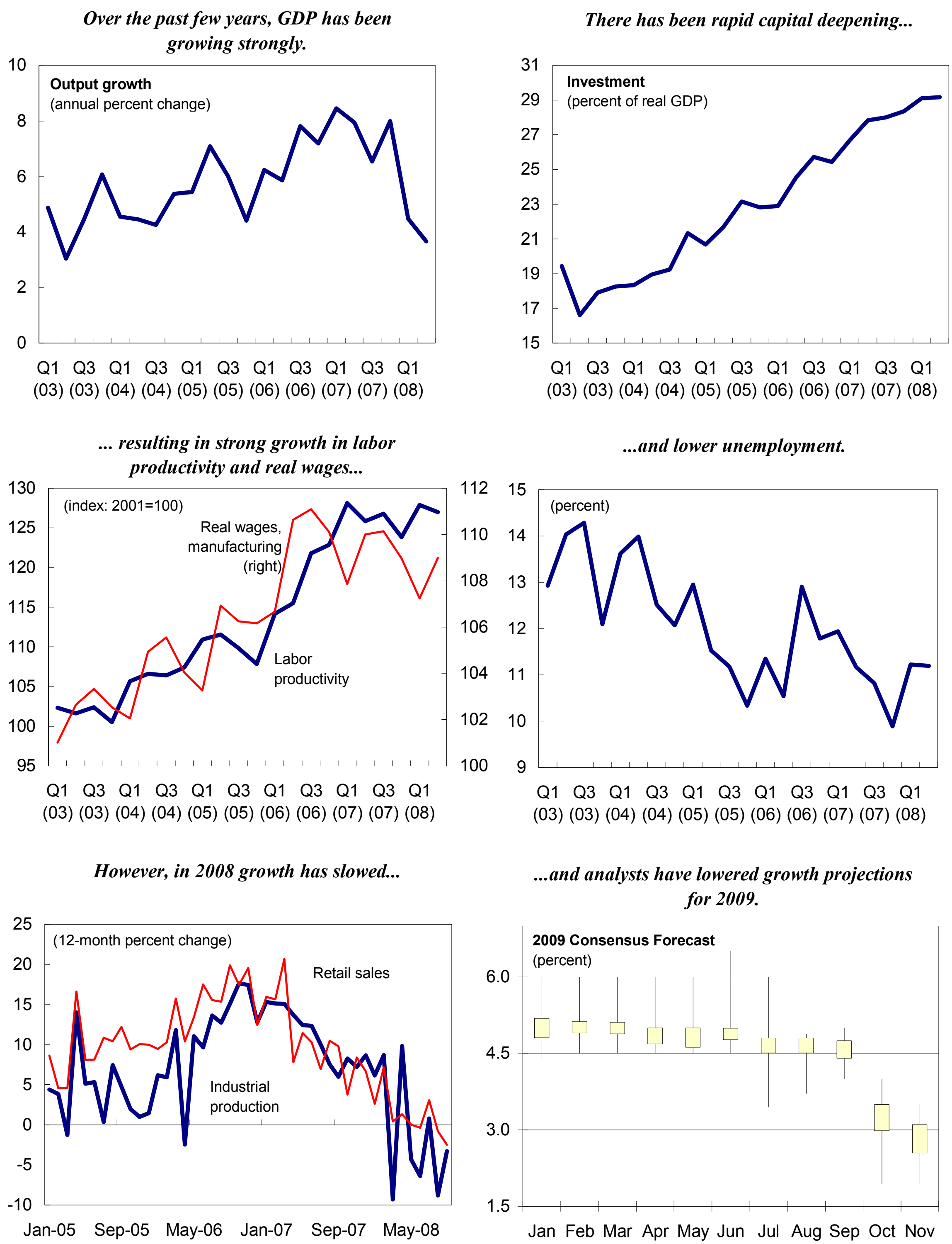


2. ***This performance has been accompanied by a significant reduction in macroeconomic vulnerabilities***. Fiscal discipline and strong economic growth have contributed to large declines in public debt ratios, which are now close to the average for emerging market countries with investment grade status. The composition of public debt has also improved, with a significant reduction in exposure to exchange rate and rollover risks. External debt has fallen substantially, helping reduce foreign financing needs to modest levels, and international reserves have increased sharply. Colombia's flexible exchange rate regime has enhanced the economy's resilience to shocks, helping facilitate adjustment to changes in external conditions. The financial system has accumulated significant buffers, while foreign participation in financial markets has remained limited. In this context, Colombia is in a generally strong position to confront the challenges posed by global economic and financial shocks.

II. RECENT DEVELOPMENTS

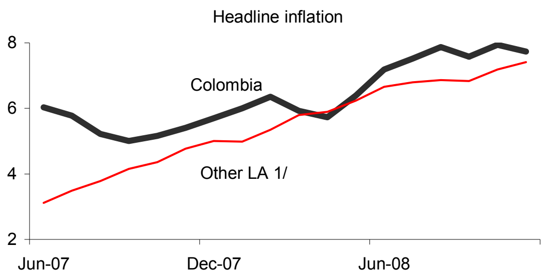
3. ***Economic growth has slowed in 2008 as a result of less buoyant domestic demand conditions and, more recently, the effects of global shocks.*** GDP growth declined from 7¼ percent in the second half of 2007 (y/y) to 4 percent in the first half of 2008, reflecting the effects of monetary tightening to address overheating pressures and the under-execution of public investment. Weakening commodity prices and world economic activity, as well as the effects of global financial market turbulence, have also dampened the pace of economic activity since mid-year. For 2008 as a whole, economic growth is projected at 3½ percent.

Figure 1. Colombia: Real Sector Developments

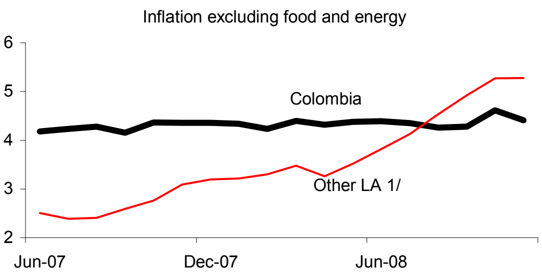


Sources: Banco de la República; Department of National Statistics; Consensus Forecast; and Fund staff calculations.

4. ***As in other countries of the region, higher inflation remains a challenge*.** Inflation (y/y) stood at 7¾ percent in November, well above the Banco de la República (BdR)'s end-year target range of 3½–4½ percent. Overheating pressures are dissipating only slowly, and the output gap remained positive in the first half of 2008. Nontraded goods inflation—a good indicator of underlying demand pressures—rose in the first half of this year (Figure 2). Inflation expectations remain outside the BdR's medium-term inflation target (2–4 percent), with survey-based data pointing to expectations for end-2009 inflation of about 5¼ percent.



1/ Average for Brazil, Chile, Mexico and Peru.



1/ Average for Brazil, Chile, Mexico and Peru.

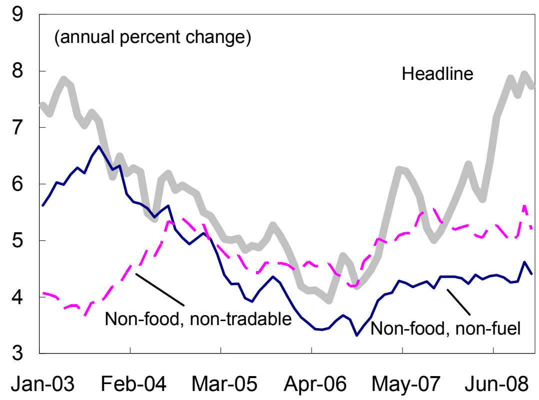
5. ***Monetary policy has tightened, but fiscal policy remains expansionary.*** With additional increases in the policy rate, to 10 percent by mid-2008 (a 400 basis point increase since April 2006), credit growth has slowed significantly. Despite a mid-year decision to cut government outlays by about ¼ percent of GDP relative to the original budget, the structural balance in 2008 has weakened, owing partly to strong growth in primary current expenditures (Figure 3).

6. ***The exchange rate has been highly volatile and rules for foreign exchange (FX) intervention have undergone frequent modification.*** The peso appreciated by about 15 percent in real effective terms between end-2007 and mid-June 2008 (Figure 4). Citing prudential considerations, the BdR stepped up its FX intervention in June, replacing the US$150 million monthly options-based auctions introduced in March with daily US$20 million purchases in the spot market. To facilitate sterilization, the BdR raised reserve requirements on deposits. In June, BdR suspended its automatic FX intervention rule (which sought to smooth out volatility), as continued implementation of the rule would have forced the sale of reserves to support the peso. In early October, against the backdrop of a weakening peso, the BdR suspended its daily purchases of foreign exchange. The automatic intervention rule was also reintroduced, but with a wider band (5 percent, compared with 2 percent).[1] Since mid-year, the real effective exchange rate has weakened by an estimated 20 percent, reflecting the decline of commodity prices and turbulence in international financial markets.

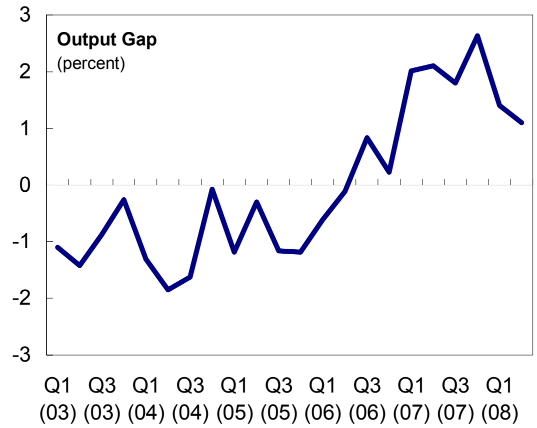
[1] Under the rule, the BdR places exchange rate options of US$180 million when the 20-day moving average of the bilateral exchange rate with the U.S. dollar changes by 5 percent or more.

Figure 2. Colombia: Inflation and Monetary Policy Developments

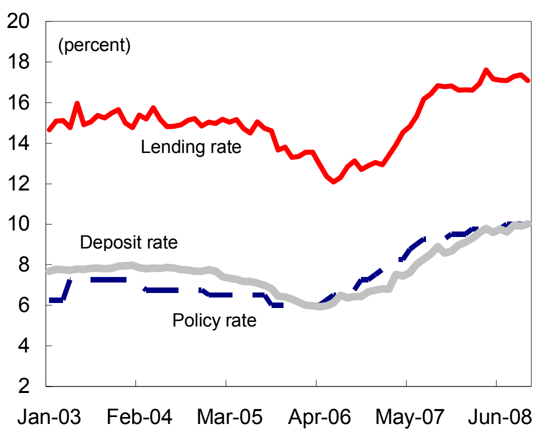
Inflation has picked up since mid-2007, largely reflecting fuel and food prices...



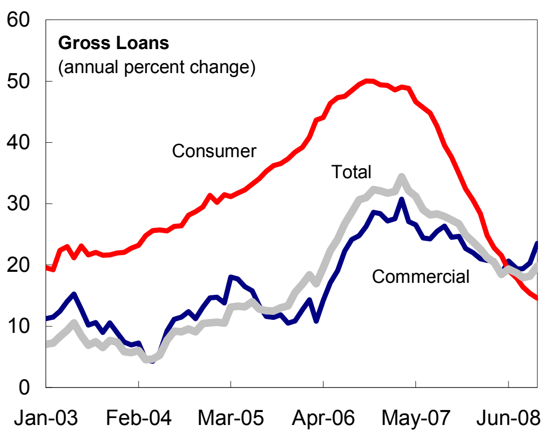
... but also domestic demand pressures.



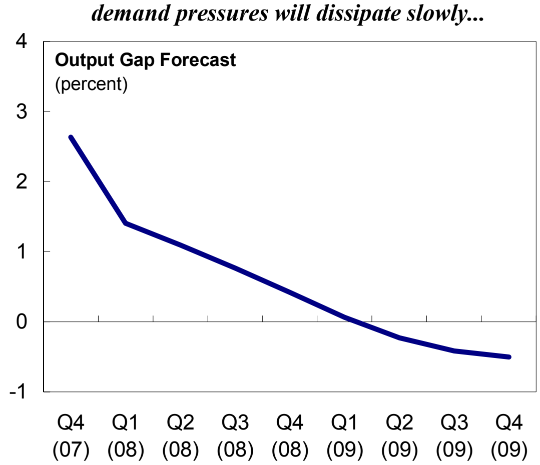
Monetary policy has been tightened...



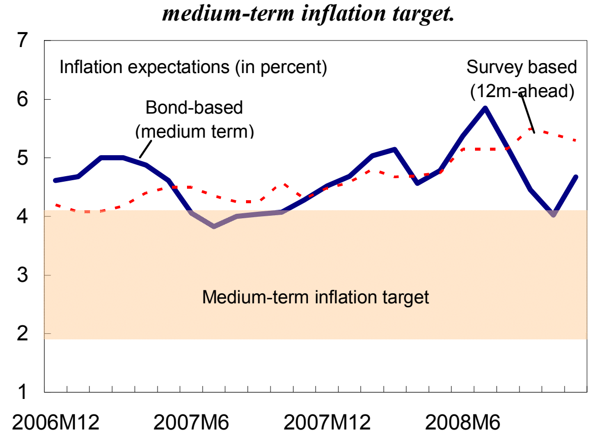
... leading to a slowdown in credit growth.



While the economy is expected to slow down, demand pressures will dissipate slowly...

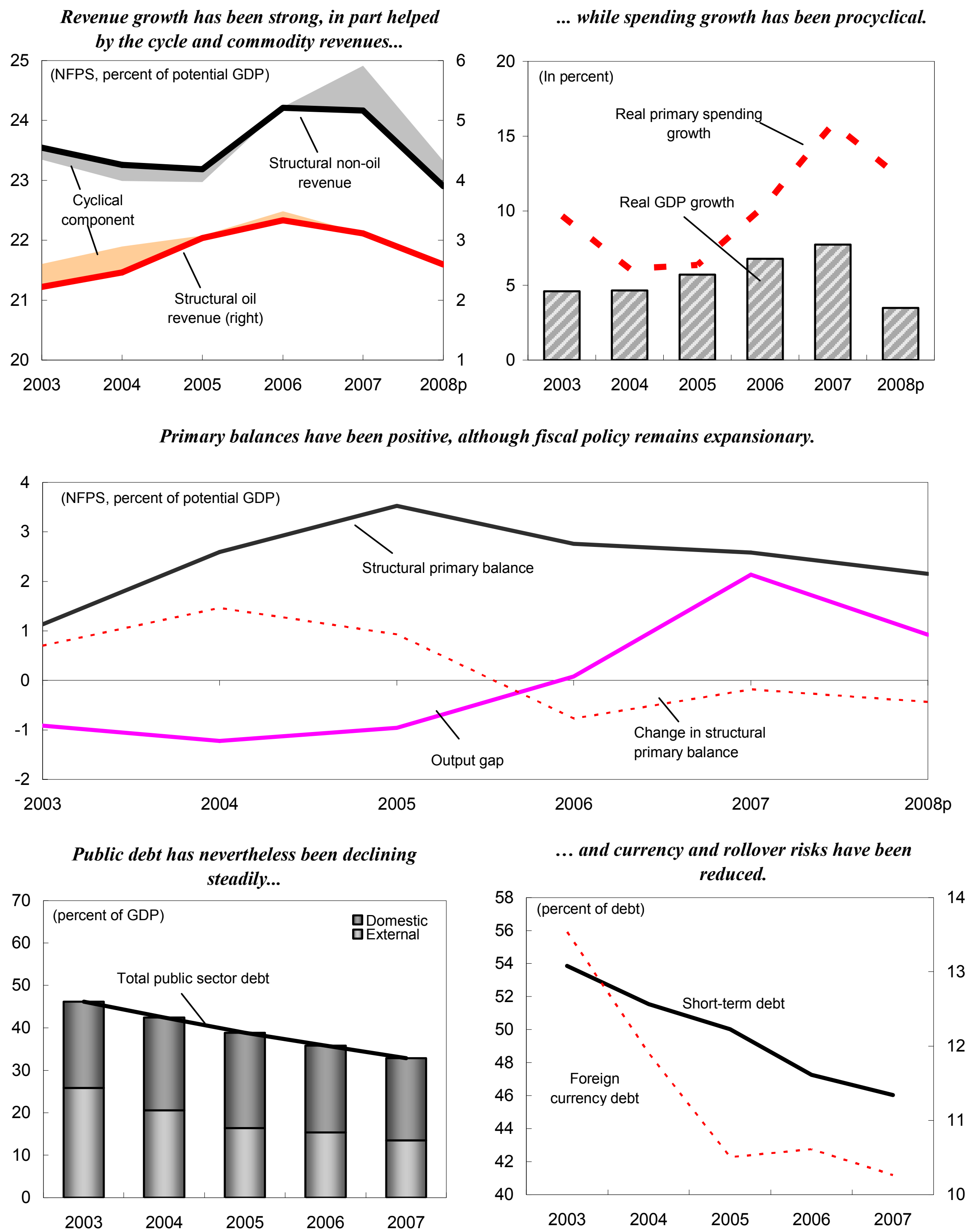


...and inflation expectations remain above the medium-term inflation target.



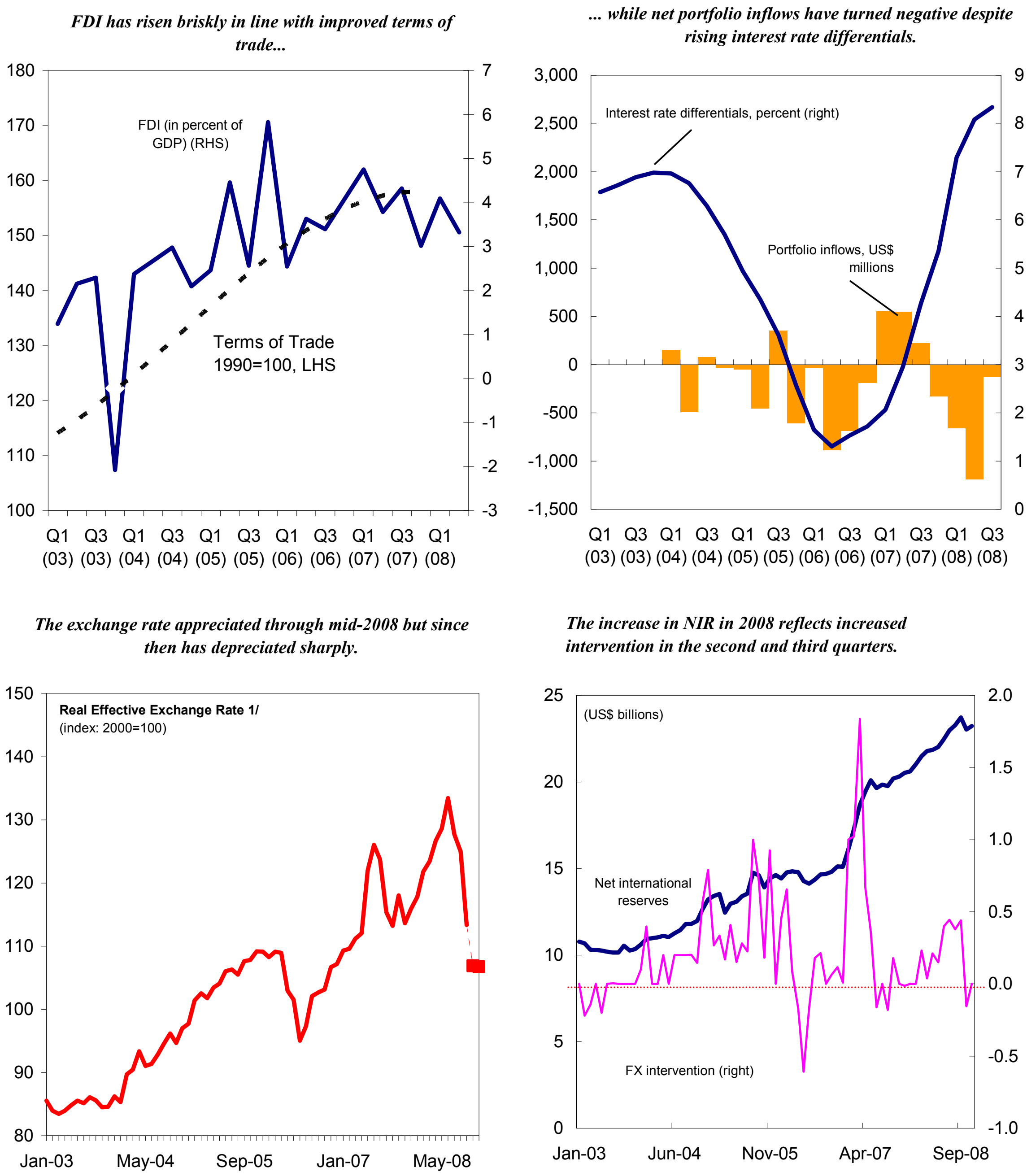
Sources: Banco de la República; Department of National Statistics; Superintendencia Financiera de Colombia; and Fund staff estimates and projections.

Figure 3. Colombia: Fiscal Sector Developments [1/]



Sources: Ministry of Finance; Banco de la República; and Fund staff estimates and projections.
1/ Reflects exclusion of Ecopetrol operations and the privatization of health care in 2008. This results in a reduction of revenue and spending of about 2 percent of GDP and 1.5 percent of GDP, respectively.

Figure 4. Colombia: Capital Account and Exchange Rate Developments



Sources: Banco de la República; Information Notice System; and Fund staff estimates and projections.
1/ An increase denotes appreciation. The last observations are estimates based on changes in the nominal effective exchange rate.

7. ***Capital controls were tightened at mid-year, but subsequently eliminated during the market turbulence of October.*** Capital controls on non-FDI inflows were imposed in mid-2007, with an important objective being the reduction of appreciation pressures. The controls resulted in a decline in foreign borrowing; nevertheless, as other inflows, including FDI, remained strong, appreciation pressures persisted through mid-2008. In May 2008, the controls were tightened by imposing a minimum stay for FDI inflows, and an increase in the unremunerated reserve requirement on portfolio inflows from 40 percent to 50 percent. In early September, the controls were loosened, and fully eliminated in October.

8. ***The effect of the global turbulence on the Colombian financial markets has broadly followed regional patterns, albeit with some differences.*** Since mid-September, CDS spreads and equity prices have generally moved in line with the rest of the region, although EMBI and corporate bond spreads have risen more (Figure 6).[2] External trade credit lines to domestic banks have been affected only modestly, although interest rates have risen and maturities have shortened. Interest rates on long-term domestic debt have also increased substantially. Interbank and debt markets, however, continue to function normally.

Recent Financial Market Developments
(As of cob December 05, 2008)
(In percent, unless otherwise indicated)

	Change since September 12, 2008	
	Colombia	Other Latin America 1/
Equities	-24	-29
Nominal exchange rate (U.S. dollar) 2/	-14	-24
EMBI+ spread (basis points)	344	256
5-year credit default swaps (basis points)	220	239
Corporate bond spread (basis points)	557	392

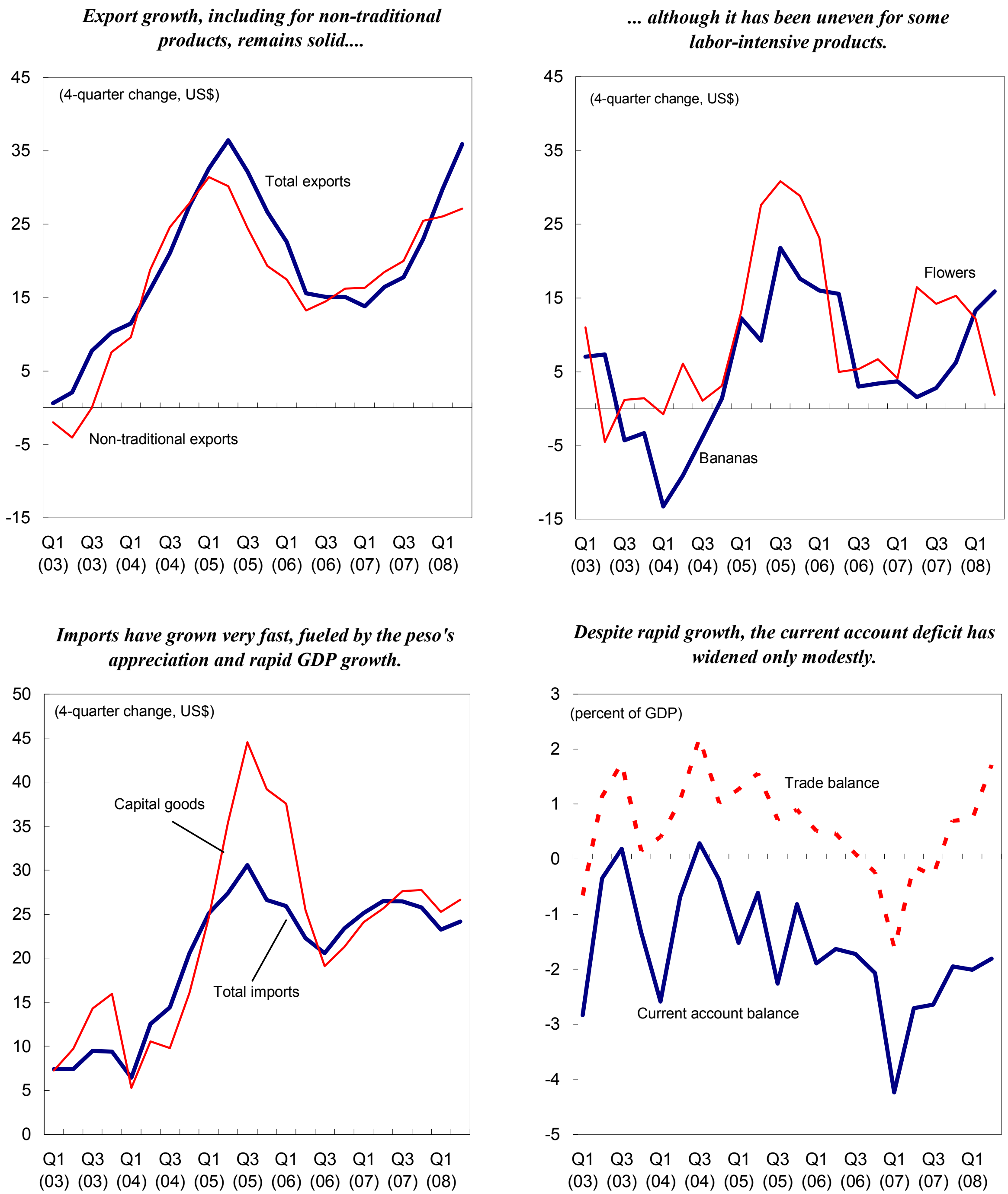
Sources: Bloomberg; Credit Suisse; and Deutsche Bank.

1/ Unweighted average for Brazil, Chile, Mexico, and Peru. Corporate bond spread data excludes Peru.
2/ A negative value denotes a depreciation.

9. ***The authorities have acted swiftly to bolster confidence and ensure that the private sector retains access to credit in the wake of the global crisis.*** They have secured financing from multilateral institutions (MDBs) for 2009, which is expected to allow the public sector to meet its external financing requirements without recourse to market sources. They have also reaffirmed their commitment to the 2009 fiscal targets to limit financing needs. Arrangements are being made to line up additional, contingent, financing from MDBs. The authorities have also secured multilateral financing for the state-owned foreign trade bank (BANCOLDEX) to provide loans to banks and corporates in the event of disruptions to external credit lines. As a preventive measure, the BdR has reduced reserve requirements (by the equivalent of 0.2 percent of GDP) and injected liquidity through open market operations. The monitoring of liquidity by the Financial Sector Superintendency has also intensified.

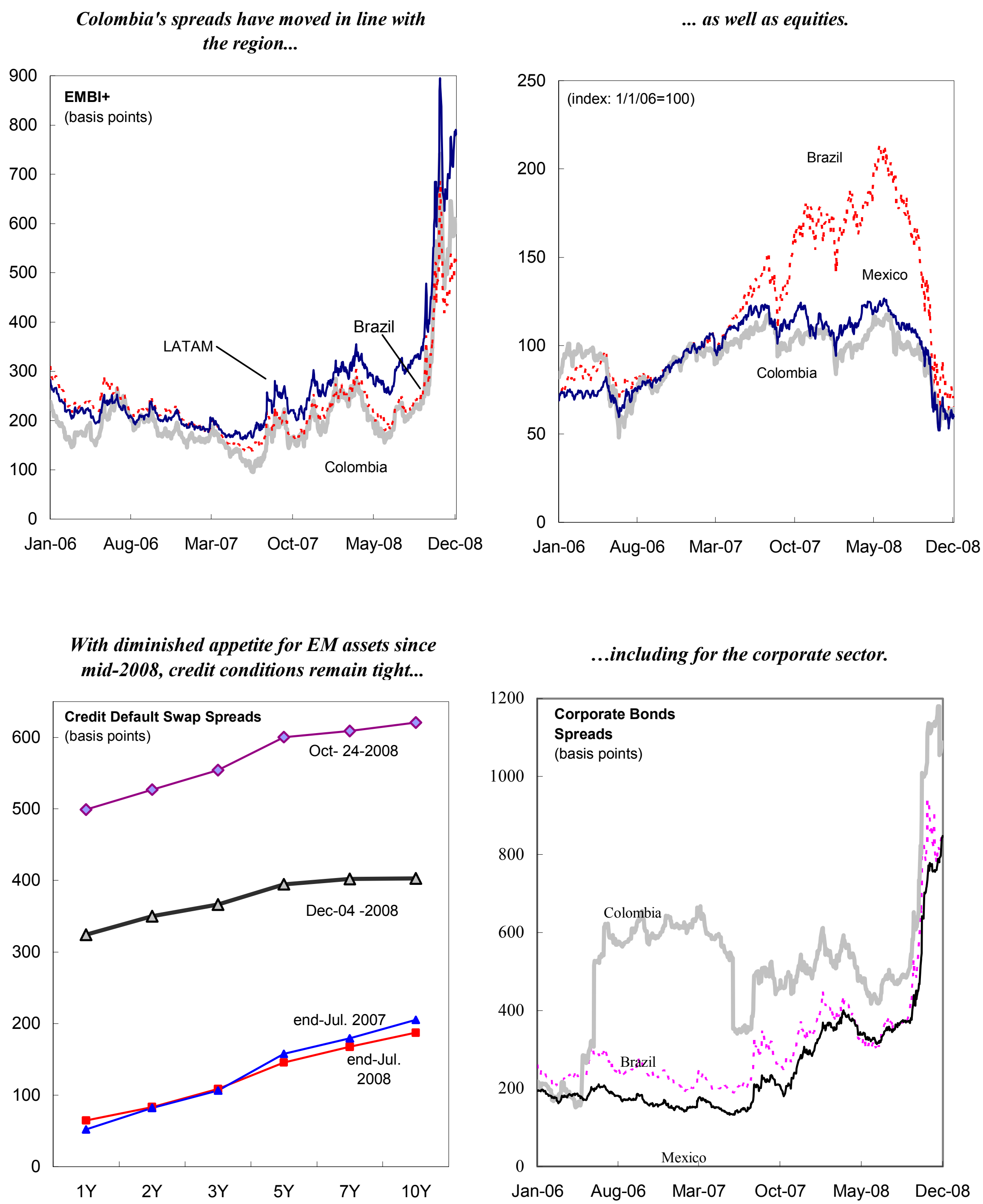
[2] The larger increase in Colombia's EMBI spread in part reflects the lower duration of its bonds, as increases in the short end of the yield curve for emerging market sovereign debt have been larger than those at the long end.

Figure 5. Colombia: External Current Account Developments



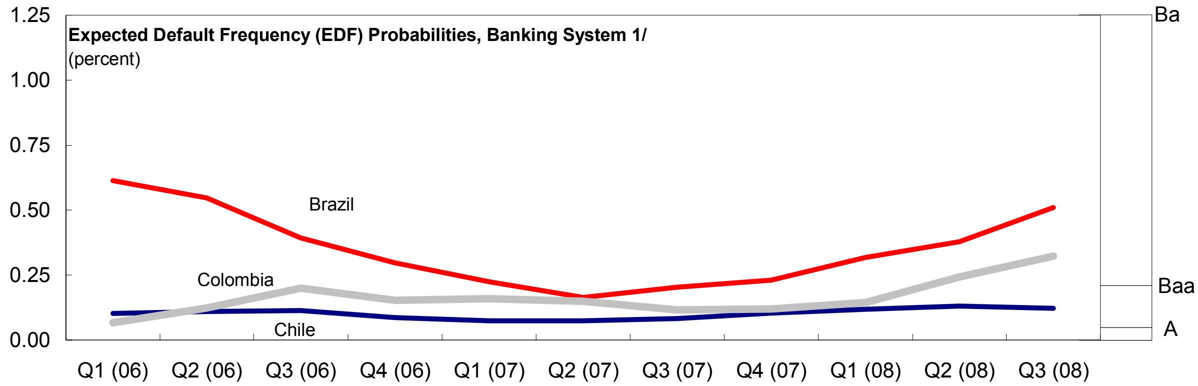
Sources: Banco de la República; and Fund staff estimates and projections.

Figure 6. Colombia: Financial Sector Developments



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

10. ***Despite the slowdown in economic growth and sharp downward movement of asset prices, financial soundness indicators remain solid***. Although nonperforming loan ratios (NPLs) have risen—especially for consumer credit—banks are well provisioned and profitable, and expected default probabilities, while rising, remain very low. There is no evidence of an extraordinary reduction of activity by subsidiaries of foreign banks, which account for about 20 percent of banking system assets, compared with 30 percent for the region as a whole. External credit lines only account for a small share of banking system liabilities (2½ percent), and reliance on nondeposit funding is moderate, at about 25 percent.



Sources: Creditedge (Moody's-KMV).
1/ EDF refers to the probability that the banking system will default on non-equity obligations.This is based on the contingent claims approach, which uses equity market data to estimate risk indicators. The right axis shows the Moody's rating corresponding to the EDFs shown on the left scale.

III. Outlook for 2009 and the Medium Term

11. ***Economic growth is expected to slow in 2009 in the face of harsher external conditions.*** Staff projects that growth will decline to 2 percent in 2009, before rebounding to about 4 percent in 2010 in line with the expected recovery in the global economy. Over the medium term, staff projects growth at 4½–5 percent, consistent with estimated potential growth. Inflation is projected to decline to under 5 percent by end-2009, and to gradually converge to the medium-term target of 2–4 percent. Consistent with the authorities' medium-term fiscal projections, the budget deficits would average about 1 percent of GDP over the next 5 years and public debt would decline to 26 percent of GDP by 2013. The current account deficit would rise slightly to about 3¼ percent of GDP in 2008–09, before declining over the medium term as nontraditional exports recover.[3]

[3] The difference between the underlying and projected external current account deficit is small. See Appendix I for details.

Macroeconomic Outlook (Based on Authorities' Policies)

	2006	2007	2008	2009	2010	2011	2012	2013
	(Annual percentage change)							
Real GDP growth	6.8	7.7	3.5	2.0	4.0	4.8	5.0	5.0
Inflation, eop	4.5	5.7	7.5	4.8	3.8	3.7	3.5	3.3
	(In percent of GDP)							
Structural primary balances								
Central government	0.0	0.6	-0.1	0.4	0.7	0.6	0.5	0.4
NFPS	2.8	2.6	2.2	1.8	1.9	1.7	1.9	1.6
Combined public sector balance	-0.7	-0.6	-0.8	-1.2	-1.1	-1.0	-0.9	-0.9
Total public debt	35.9	32.8	31.7	29.7	28.7	27.9	26.9	26.0
External current account balance	-1.8	-2.8	-3.2	-3.2	-2.7	-2.5	-2.2	-2.0
Financial account inflows	1.8	5.0	4.0	3.6	3.1	2.9	2.6	2.3
Of which: FDI	3.4	3.9	3.5	3.4	3.1	3.0	2.8	2.6

Sources: Colombian authorities; and Fund staff estimates and projections.

12. ***Risks to growth are weighted to the downside.*** The external environment continues to pose important risks to economic activity. Staff analysis indicates that a shock to global growth would have a significant effect on the Colombian economy, mainly through its effects on export growth. A sharp deceleration of growth in Venezuela could also have a significant impact on economic activity (see paragraph 24), given its substantial share of exports (17 percent in 2007). A further deepening of global financial turmoil could also result in additional increases in borrowing costs or disruptions in credit markets, reducing growth.

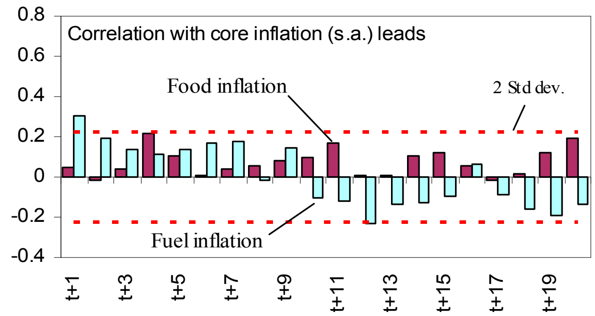
13. ***The inflation forecast is subject to a certain level of uncertainty.*** High inflation expectations pose an upside risk. In addition, an adverse outcome from minimum wage negotiations could increase inflationary pressures. The second-round effects of higher food and fuel prices increases appear to have been well contained, consistent with Colombia's experience under its inflation targeting regime (Box 1). However, the depreciation of the peso in the second half of 2008 poses a risk through its effects on the prices of tradable goods. With respect to downside risks, inflation could fall faster than expected if economic activity or commodity prices were to fall below staff projections.

IV. Policy Discussions

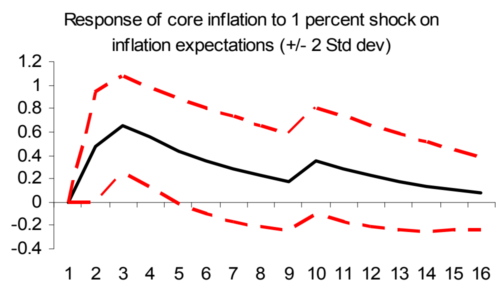
14. ***The discussions centered on the macroeconomic and financial sector risks posed by global shocks and the appropriate policy responses***. Within this context, the dialogue focused on three related themes: (a) the stability of the financial system; (b) the risks to external stability in the current global environment; and (c) the policy options for achieving macroeconomic stability under difficult global conditions.

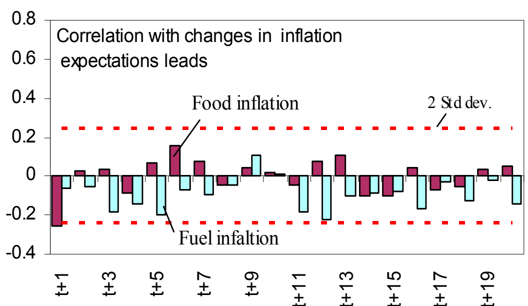
Box 1. Second-Round Effects of Food and Fuel Price Increases in Colombia

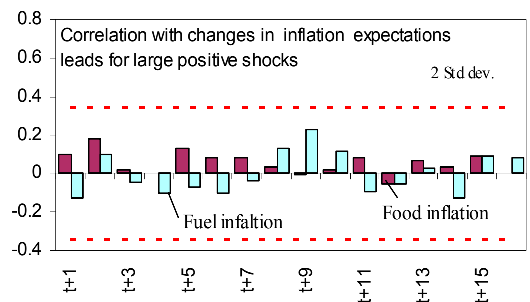
The second-round effects of food and fuel prices shocks have been well contained. Despite large increases in food and fuel prices—resulting in higher headline inflation—core inflation has increased relatively little. Between January 2007 and October 2008, core inflation increased ¾ percentage point, while food and fuels increased by 7¼ and 6½ percentage points, respectively. Over 2002–08, the correlation between food and fuel inflation and future core inflation (monthly) was statistically insignificant, suggesting limited second-round effects from food and fuel shocks under Colombia's inflation-targeting regime.



Developments in food and fuel inflation have also had little effect on inflation expectations. There appears to be little correlation between shocks to food and fuel inflation—even for large and positive shocks—and market expectations regarding future inflation, as measured on the basis of bond market data. Inflation expectations nonetheless remain important. Impulse responses from Vector Autocorrelations (VARs) indicate that a one percentage point increase in expectations is associated with an increase in annualized core inflation of about 0.6 percentage points two months later, which only slowly subsides. These results underscore the importance of firmly grounding expectations to help place inflation on a declining path.





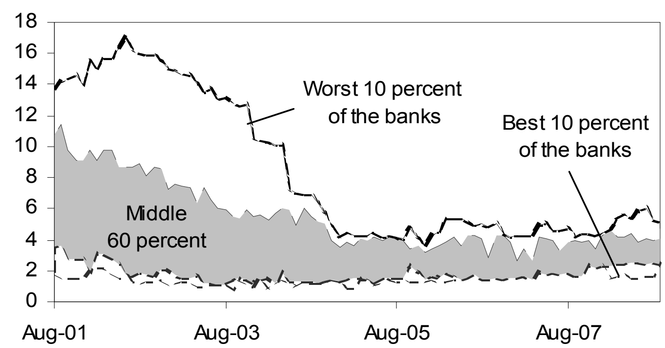


The future effect of the exchange rate depreciation on inflation is more uncertain. A BdR study suggests that the pass-through is small, particularly if the economy is growing below potential—about 20 percent after one year. However, confidence intervals are quite large, which implies significant risks to the outlook in light of the large depreciation in the second half of 2008.

Challenges to financial stability

15. ***The financial sector has significant buffers to help resist a worsening of financial conditions, but risks remain.*** While financial soundness indicators are strong, NPL ratios have risen over the past few years, most notably for consumer credit. In light of the slowdown in economic activity, the authorities agreed that credit risk, especially in consumer lending—for which the nonperforming loan ratio had reached 7 percent—should continue to be closely monitored. Staff analysis suggests that real sector developments have important effects on the health of the financial system.[4] Liquidity ratios in the banking system, while declining, appear adequate, as short-term assets exceed short-term liabilities by a healthy margin. The results of stress-testing by the authorities also suggest that, under extreme scenarios where deposits drop sharply, liquidity would likely remain adequate in all institutions of systemic importance. Stress tests combining several large shocks (e.g., to liquidity and credit quality) suggest that the banking system would remain solvent under a number of extreme scenarios, albeit with significant effects on liquidity and bank profitability.[5] Exchange rate risks for the financial system are low, as foreign currency liabilities are small and there are strict regulations limiting net open foreign exchange positions.

Colombia: Nonperforming loan ratio, 2001-2008 1/



1/ Weighted by total assets.

16. ***Staff welcomed the authorities' plans to enhance the financial system's capacity to respond to a possible worsening in global conditions.*** In addition to the reduction in reserve requirements and the injection of liquidity through open market operations, the authorities plan to broaden the range of assets that can be used in repo operations, facilitating the provision of liquidity support. They are also considering requiring banks to temporarily limit the distribution of dividends to help provide an additional cushion against unexpected losses.

17. ***Staff welcomed the intensification of activities by the Financial Surveillance Committee.*** The Committee provides a useful vehicle for coordinating activity across the financial sector superintendency, the ministry of finance, the BdR, and the deposit insurance

[4] See chapter 1 of *Selected Issues* paper for an assessment of the effects of economic growth and financial market developments (including those abroad) on the banking sector.

[5] For additional details, see the September 2008 *Reporte de Estabilidad Financiera* (Financial Stability Report), available at http://www.banrep.gov.co/documentos/publicaciones/report_estab_finan/2008/analisis.pdf.

agency (FOGAFIN). The work of the Committee in assessing potentially adverse scenarios and developing contingency plans is especially important, and could be helpful in identifying areas where further strengthening of financial safety nets is needed. Staff suggested that this work draw on the BdR's assessments of alternative macroeconomic scenarios and their implications for financial stability. The authorities concurred that to assist the development of contingency plans undertaken by the Financial Surveillance Committee, it would be useful to clarify the circumstances under which emergency liquidity support would be forthcoming.

18. ***Staff and the authorities agreed on the desirability of further improving financial sector safety nets.*** The framework for bank resolution is well established, but there is room for greater clarity in describing the sequencing of actions and responsibilities of different institutions to help ensure that the process can be undertaken in a timely manner. Regarding deposit insurance, a more expedited process for returning funds to depositors, as well as the elimination of the deductible, would be desirable. Over the longer term, a review of the coverage of deposit insurance could also be considered. The authorities intend to request Fund technical assistance in this area.

19. ***Staff welcomed other steps to improve the assessment of financial sector risks over the past year.*** A quarterly survey of credit conditions has been initiated, and an assessment of financial risks related to developments in economic activity in Venezuela and the United States has been undertaken. Looking forward, the authorities agreed that there was scope for further improvements in reporting risk assessments in the BdR's financial stability report. Drawing on the work of the Financial Surveillance Committee, this could include the results of stress tests encompassing different scenarios affecting international financial markets of relevance to emerging markets.

20. ***The dissemination of information on financial and corporate sector derivative positions could also be strengthened.*** The BdR collects data on a daily basis on on-shore derivative positions of both the financial and corporate sectors, but this information is not widely circulated or reported.[6] The authorities welcomed staff's recommendation to include these data in the BdR's financial stability reports.

21. ***Additional progress has been made in expanding the derivatives markets and improving the regulatory framework.*** Interest rate derivatives for five-year government bonds were introduced in mid-year, and the legal framework governing the regulation and taxation of derivatives has been strengthened. A reference interest rate, an essential component for further development of derivatives markets, has also been established.

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[6] For an overview of recent developments in financial indicators in the corporate sector, see Chapter 2 of the *Selected Issues* paper.

22. ***The authorities have closed fraudulent pyramid schemes.*** In mid-November, the government closed the operations of all the major schemes and began a process to liquidate assets and return the recovered funds to investors. They have also enacted legislation that strengthens the authorities' legal powers to proceed swiftly against these illegal operations. Early estimates suggest that the size of assets controlled by the schemes was less than ½ percent of GDP. The closing of the schemes has had no systemic effect on the financial system. Nevertheless, the social consequences have been significant, given the large number of participants involved in these schemes. To help address these social costs, the authorities have reallocated funds in the 2008 budget toward targeted social spending. They have indicated that investors that participated in these schemes will not be bailed out.

23. ***Staff suggested a more ambitious agenda for financial sector reforms.*** The government's financial sector reform program currently being considered by congress envisages, *inter alia*, the development of a multi-tier pension system providing a greater range of choices to pension plan participants. Staff saw merit in the proposed reforms, but also recommended broadening their scope to address other longstanding issues in the financial system, including the need to improve creditor rights and strengthen the independence of the financial sector superintendent. The authorities pointed out that the current reform proposal contains a provision for increasing the autonomy of the Superintendent in the form of assistance for legal costs. They also noted that proposals to strengthen creditor rights were planned for development at a later stage.

Risks to external stability in the current global environment

24. ***Risks to external stability from sudden shifts in the external current account balance remain important.*** The current account deficit is projected to remain broadly constant as a share of GDP in 2008–09, before starting to decline over the medium term. Export growth has been vigorous in recent years, although it is projected to moderate. Export receipts, which had benefited from high commodity prices, are projected to soften in the coming years but could experience large declines if global growth weakened significantly more than expected. Staff estimated that with a one-standard deviation shock to commodity prices, the current account deficit would worsen by 2¼ percentage points of GDP.[7] Economic developments in Venezuela—which had grown above trend in recent years—also remain an important source of uncertainty. Staff estimates that a one standard deviation negative shock to Venezuelan growth would reduce Colombian exports by ½–1 percentage point of GDP.

25. ***Colombia's moderate level of vulnerabilities and flexible exchange rate regime should continue to help offset the risks from unsettled global capital markets.*** Colombia compares well with other emerging market countries, including those at investment grade, on

[7] The scenario comprises a one-standard deviation reduction in the projected 2009 prices of oil (to about US$31 per barrel), nickel, and coal.

most vulnerability indicators. External financing requirements remain less than half the level of such countries, while international reserves are large (10 percent of GDP). Rollover risks and external financing needs for the public sector are low. External gross financing needs of the private sector are estimated at 4 percent of GDP for 2009, with the financial sector accounting for about 25 percent of this total. Continued flexibility of the exchange rate should allow Colombia to adjust rapidly to changing global financial conditions. Furthermore, under a scenario in which the peso depreciates sharply, external and public debt burdens would still remain manageable (Tables A.1 and A.2). Stress testing also indicates that corporate sector balance sheets would be robust to large changes in the exchange rate.[8] Staff analysis suggests that the real exchange rate remains consistent with fundamentals (Box 2).

Selected Vulnerability Indicators, 2008 1/
(In percent of GDP, unless otherwise indicated)

	Colombia	Median, sample of 49 emerging market countries	Median of emerging investment grade countries
External sector			
Gross reserves in percent of short-term debt at remaining maturity	176.6	143.7	109.0
Total gross external debt	22.7	40.3	40.9
Current account balance	-3.2	-3.8	-2.5
Foreign direct investment	3.5	3.7	3.4
Gross external financing requirement 2/	6.9	14.8	16.1
Public sector			
Overall balance	-0.8	-1.6	-1.4
Public sector gross debt	31.7	39.2	29.3
Of which: Exposed to exchange rate risk 3/	12.5	16.4	4.9
Exposed to rollover risk (ST debt, residual maturity) 4/	3.3	4.9	5.1
Financial system 5/			
Capital adequacy ratio, in percent	13.3	13.6	12.2
Non-performing loans, in percent of total loans	4.1	3.0	2.5
Return on average assets, in percent	4.0	1.6	1.4
Change in credit-to-GDP ratio, in percentage points 6/	1.3	4.1	5.2

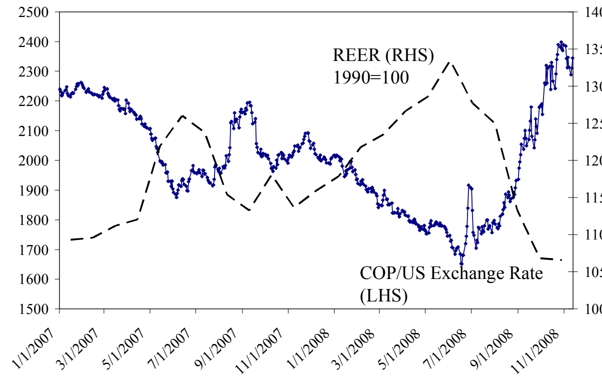
Source: Fund staff estimates.

1/ Projection unless otherwise indicated.
2/ Current account balance plus maturing external debt.
3/ Debt in foreign currency or linked to the exchange rate, domestic and external.
4/ Short-term debt and maturing medium- and long-term debt, domestic and external, excluding external debt to official creditors.
5/ June 2008 data, except for Colombia (September data).
6/ Credit to the private sector.

[8] See Chapter 2 of the *Selected Issues* paper.

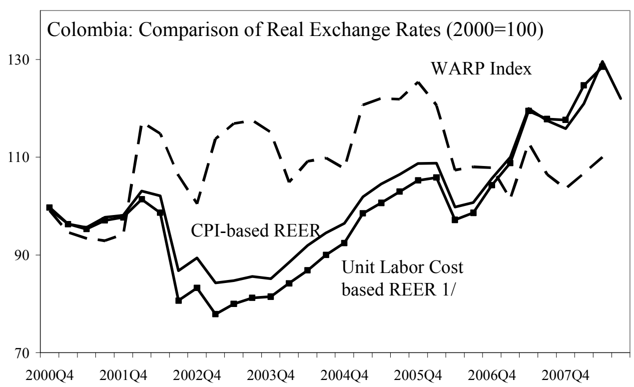
Box 2. Assessing Colombia's Exchange Rate

The Colombian peso appreciated briskly in the first half of 2008, but since then has reversed course. Over the first half of 2008, it appreciated by about 15 percent in real terms, based on differences in consumer price inflation and exchange rates in Colombia's trading partners. Since then, with the decline in commodity prices and increased global financial turbulence, the rate has fallen by about 20 percent in real terms.



Source: Datastream and INS.

From a longer term perspective, most—but not all—measures suggest that the exchange rate has experienced significant appreciation in recent years. Based on the consumer price based measure, the real exchange rate, at mid-year, reached nearly its most appreciated level in a decade. Developments in the unit labor cost-based real exchange rate show a similar trend, and suggest that the peso appreciated markedly from end-2005 to mid-2008. During this period, fundamentals also improved, including stronger FDI, improved terms of trade, and a favorable business climate. However, a real exchange rate measure based on the Weighted Average Relative Price (WARP)—calculated using relative purchasing power and shifting trade weights—indicates a different picture, with some depreciation during this period.[1] This is mainly driven by the strengthening of Colombia's regional trade and a decrease in bilateral prices with respect to Latin America trading partners.

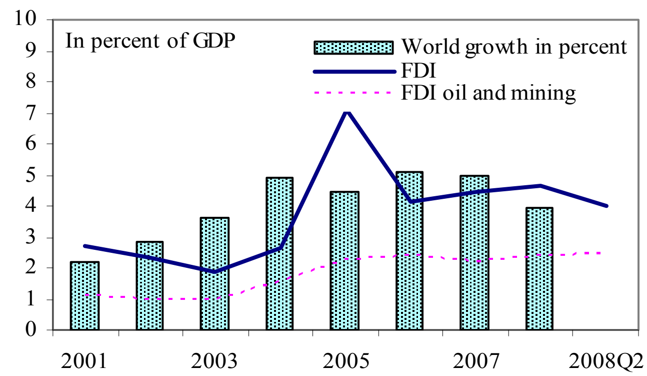


1/ Based on partner countries with ULC data, which comprises 56 percent of Colombia's trade

Empirical estimates of the equilibrium exchange rate suggest that the current value of the peso is consistent with fundamentals. Taking into account changes in the exchange rate and fundamentals since the last CGER estimate in September 2008—when the rate was estimated to be 5 percent over its equilibrium value—staff estimates that the rate is close to its equilibrium value.

[1] Thomas, C.P., J. Marquez, and S. Fahle, "Measuring U.S. International Relative Prices: A Warp View of the World," FRB International Finance Discussion Paper No. 917, 2008.

26. ***There continue to be risks to the capital account.*** FDI has tended to follow a procyclical pattern, and weaker prospects for world and domestic growth could lead to a more pronounced reduction in inflows than projected. In recent years, the energy and mining sectors have accounted for about half of Colombia's FDI. The authorities saw the risk of a sizable and immediate decline of FDI in these sectors as low, given still-attractive prices and contractual commitments of foreign firms to execute specific investment projects. Non-FDI outflows could also be higher than expected in a scenario where risk aversion toward emerging market assets increases. These risks are offset, to some extent, by the small foreign participation in financial markets and the cautious baseline forecast, which already assumes a net outflow.



Policies for achieving macroeconomic stability under difficult global conditions

27. ***There was agreement that developments in commodity prices and world growth were the key channels through which a more adverse global scenario would affect the economy.*** A sharp drop in commodity prices and world activity would reduce growth and place pressure on the banking system's health. Sizable foreign exchange reserves, combined with the mobilization of additional multilateral financing under the authorities' contingency plan, would provide an important buffer in the case of less favorable conditions in capital markets.

28. ***Staff and the authorities concurred that risks to both growth and inflation should be considered in determining the appropriate stance for macroeconomic policies.*** The uncertain global outlook underscored that policies would need to be flexible to avoid a sharp reduction in economic activity. At the same time, continued progress in inflation was also important. Low inflation had been a pillar of Colombia's macroeconomic stability and has enabled an investment climate conducive to high rates of capital formation. In this context, the authorities' firm resolve to place inflation on a downward path was highly appropriate.

Monetary and exchange rate policies

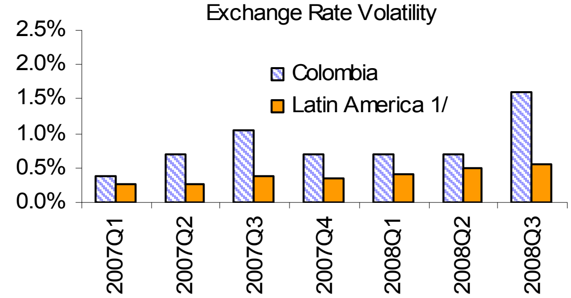
29. ***The mission team supported the monetary policy stance oriented toward guiding the economy to a soft landing.*** Staff viewed as appropriate the BdR's continued close watch of forward-looking indicators of economic activity and inflation expectations to guide the course of monetary policy. As inflation and inflation expectations decline, there should be scope for a gradual reduction in the policy rate or further reduction in reserve requirements. With substantially weaker commodity prices and global growth, demand pressures were also

expected to diminish. Staff and the authorities agreed that this would provide room for monetary easing to maintain domestic economic activity, provided that the inflation targets were not put at risk. Continued exchange rate flexibility would also be important to allow the economy to adjust well to external shocks.

30. ***The mission endorsed the authorities' plan to achieve a gradual reduction in inflation toward the long-term target range of 2–4 percent.*** The authorities have announced a target range of 4½–5½ percent for 2009, and a reduction from 5 percent to 4 percent for the mid-point of the target range in 2010. Staff viewed these targets as striking the right balance between achieving an ambitious reduction in inflation and providing a credible downward path toward the long-term objective.

31. ***Staff recommended greater stability in the rules for FX intervention over the longer term.*** Frequent changes in targets for reserve accumulation during 2008, and rules for exchange rate intervention, may have contributed to uncertainty regarding monetary policy. They may also have played a part in Colombia's high exchange rate volatility, which has exceeded the Latin American average over the past two years. Staff welcomed the widening of the band (from 2 percent to 5 percent) for the automatic intervention rule. With the wider band, intervention should be triggered only infrequently. Staff also saw a role for discretionary intervention in the current unsettled environment, but with a clear view to addressing disorderly conditions. The authorities indicated that FX intervention in 2008 had been guided by the goal of accumulating international reserves which, in their view, had not generated uncertainty about the objectives of monetary policy.

Colombia and Latin America: Average Daily Exchange Rate Volatility



1/ Average for Argentina, Brazil, Chile, Colombia, Mexico, and Peru.

32. ***Staff encouraged the authorities to study further the effects of pension fund regulations on the foreign exchange market.*** Pension funds are active in daily trading in the exchange rate market. Existing pension fund regulations, which require minimum returns over a short time period, provide a strong penalty for deviations from average performance in the industry and encourage herd behavior. Staff argued that this may have contributed to large and sudden movements of pension fund assets between peso- and foreign-currency denominated assets, exacerbating volatility. In this context, staff suggested further examination of the minimum return regulations. Consideration could be given to making minimum return regulations more flexible by, for example, lengthening the time period considered for estimating the minimum return. The authorities noted that actual returns in Colombia had typically been far from those required by minimum return rules, which made it unlikely that these rules had played a role in exchange rate volatility.

33. ***The views of staff and the authorities differed on the merits of capital controls and their effectiveness.*** Staff's econometric analysis suggested that the controls—which were in place from May 2007 through October 2008—had a statistically significant effect on foreign borrowing.[9] These inflows, however, had been modest in the pre-controls era relative to other capital flows.[10] The controls were found to have no significant effect on other non-FDI inflows, and there was no robust evidence that they reduced the sensitivity of the exchange rate to interest rate differentials. Staff noted that a large share of capital flows had been excluded from the controls (including portfolio investment by pension funds), which may have limited their impact. The controls were also associated with a significant increase in exchange rate volatility. In light of their limited effectiveness and adverse effects on volatility and asset market development, staff saw significant drawbacks to the controls. The authorities, however, were of the view that the controls had helped protect financial stability by preventing a large build-up of foreign-currency debt by the private sector, which could have generated domestic instability in the context of the global financial crisis. They saw the controls as a potentially useful tool that could be employed again, if required by circumstances.

34. ***Colombia maintains two exchange measures subject to Article VIII.***[11] An exchange restriction and multiple currency practice arise from a tax on remittances abroad of nonresident profits earned before 2007 and retained in the country for less than five years. The Board has approved the retention of this restriction and multiple currency practice until April 15, 2009. Colombia also maintains an exchange restriction arising from the special regime for the hydrocarbons sector.

Fiscal policy

35. ***The mission team endorsed the authorities' commitment to maintain the fiscal targets in the medium-term fiscal plan.*** The plan envisaged some fiscal stimulus in 2009, but a broadly neutral stance in 2010 onward. Maintaining the commitment to the deficit targets in 2009 will likely require some reduction in expenditure growth relative to the budget, given the probability that revenues will be lower than envisaged because of weaker economic growth and lower commodity prices. The authorities noted that with the increased budget deficit in 2009, and increase in long-term government bond rates, domestic financing conditions had tightened considerably, which limited the scope for a more expansionary policy in the near term. Staff and the authorities agreed that adhering to the deficit target would assure markets that public debt would continue to decline as a percent of GDP and that financing needs for the public sector remain modest, helping maintain confidence in Colombia's commitment to reducing fiscal vulnerabilities.

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[9] See Chapter 4 of the *Selected Issues* paper.

[10] During the first four months of 2007—the period of strongest inflows before the implementation of the controls—net foreign borrowing amounted to about ¾ percentage point of GDP on an annualized basis.

[11] See Appendix II.

36. ***Under a more adverse scenario for growth, the authorities indicated that financing conditions would continue to be a key factor in determining the fiscal policy stance.*** Staff's analytical work supported this approach, as it indicated that the effects of the fiscal stance on output were heavily influenced by the impact of fiscal easing on expectations and domestic interest rates (Box 3).[12] While not ruling out the case for fiscal stimulus under these circumstances, staff agreed that a cautious approach would remain appropriate.

37. ***Medium-term fiscal risks related to the health system and special tax zones should be carefully assessed.*** Recent rulings by the constitutional court—requiring important changes to the structure and coverage of the health system—could have substantial fiscal costs from 2010 onward. The likely expansion of special tax zones (*zonas francas*), following the government decree of 2007, could also lead to a significant loss of revenues over time.[13] The staff team recommended a careful assessment of these risks, including consideration of appropriate policy responses to offset their potential impact on the public finances. The authorities indicated that they remained committed to the medium-term fiscal targets and stressed that, if necessary, appropriate measures would be adopted to ensure meeting these targets.

38. ***The authorities concurred with the staff suggestion to explore the adoption, over the medium term, of a fiscal rule to limit the procyclicality of fiscal policy.*** The rule would set a floor for the central government structural balance, and could be incorporated into the existing medium-term fiscal framework, which aims at further reductions in public debt ratios. By setting a floor for the structural balance, the rule would adjust the nominal deficit target (as a share of GDP) in light of changing cyclical conditions. This would help communicate to markets that any weakening of fiscal balances during downturns would be temporary. Given uncertainties regarding oil revenues, staff suggested that the rule could focus on establishing a floor for the nonoil structural balance.

39. ***Staff welcomed the authorities' efforts to reduce the procyclical effects of royalties on local government expenditures.*** Local governments had benefited from the increase in oil prices in recent years through the effect on royalties, and could accrue higher royalty revenues in the future as hydrocarbons and mining production increase. The proposal recently submitted to congress—which creates a "rainy day fund" for a share of hydrocarbons and mining royalties—is a positive step to control the procyclicality of local government spending over the longer term.

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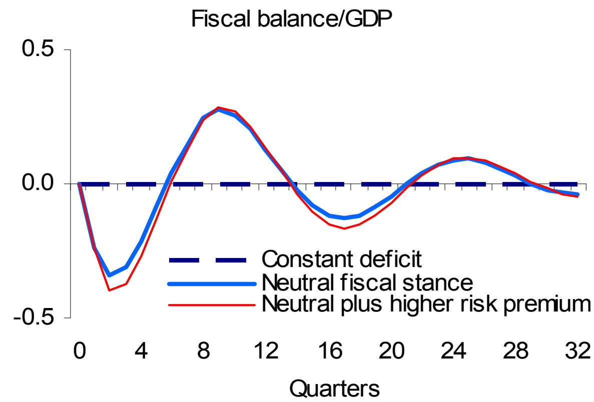
[12] See also Chapter 3 of *Selected Issues* paper.

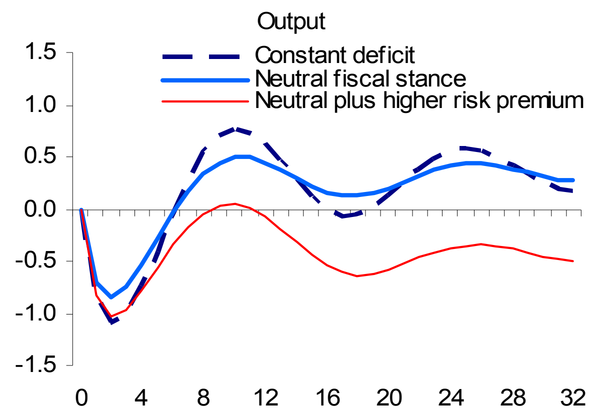
[13] See IMF Country Report No. 08/31.

Box 3. Financing Conditions and the Impact of Fiscal Policy

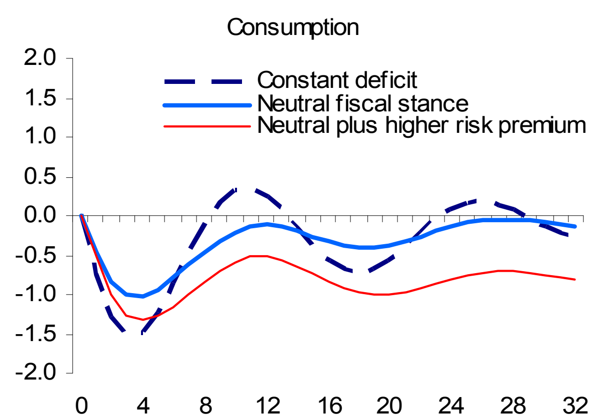
The ability of fiscal policy to stabilize output, in the face of external shocks, is dependent on financing conditions. Simulations from the Global Integrated Monetary and Fiscal (GIMF) model developed for Colombia suggest that the effects on growth of different fiscal policy responses to an external shock are linked to underlying financing conditions. This can be illustrated by comparing the impact of fiscal policy in responding to a negative external demand shock with no changes in financing conditions against a scenario in which conditions are tighter.



Fiscal policy can contribute to stabilizing the economy if financing is not an issue. Based on simulations of policy responses to an external demand shock, a cyclically neutral policy, by letting automatic stabilizers work, improves the stability of output and consumption compared to a constant deficit rule.



Fiscal policy is less effective if financing conditions deteriorate. Simulations incorporating an increase in the interest rate risk premia—which could occur if the expectations of a higher deficit trigger financing concerns—suggest that an accommodative fiscal policy could potentially be ineffective in stabilizing output and consumption.



40. ***Plans for advancing structural fiscal reforms are modest***. The government plans to sell its stake in a major electricity company (ISAGEN) in 2009, as well as smaller regional electricity companies. The authorities also hope to achieve a further strengthening of tax administration, which is expected to yield a significant decline in evasion and boost public revenues.

41. ***Staff encouraged the authorities to rejuvenate the agenda of fiscal reform.*** The efficiency of the tax system could be improved by phasing out the financial transactions tax, reducing exemptions and the number of VAT rates, and cutting taxes on labor. The authorities broadly agreed on the desirability of these reforms. They saw no political scope, however, for additional tax reform during the remainder of the current administration. On the expenditure side, the mission team urged the authorities to reduce budget rigidities, such as revenue earmarking, which continue to hamper fiscal management. The authorities noted that earlier reforms to pensions and intergovernmental transfers had indirectly helped increase budget flexibility by restraining spending on some of the largest categories of outlays.

V. Staff Appraisal

42. ***Colombia's economy has performed well in recent years, but now faces the challenge of harsher external conditions.*** Led by private investment, growth exceeded the average for Latin America in 2005–07. Public debt has declined sharply as a percent of GDP, aided by high growth and prudent fiscal policies. As in the rest of the region, the pace of economic activity is expected to moderate in 2009 with the weakening of the global economic environment. A flexible approach will be required to maintain macroeconomic stability in the near future.

43. ***A review and strengthening of the crisis prevention framework is important in light of the turmoil in global financial markets.*** Staff welcomes recent efforts to strengthen monitoring and financial safety nets, as well as measures to prevent liquidity problems in the banking system. While financial safety nets in Colombia are generally sound, there is scope for further strengthening the bank resolution process and deposit insurance system, and to clarify the circumstances under which emergency liquidity support would be provided. Recent efforts to expand the assessment of financial sectors risks are welcome, and could be strengthened further by extending stress testing to a broader range of macroeconomic scenarios, and to alternative scenarios of global financial conditions.

44. ***As in other countries in the region, inflation has risen and remains a policy challenge.*** While higher inflation has been led mainly by global shocks to food and fuel prices, overheating pressures have also played a role. Inflation is projected to exceed the target in 2008, while inflation expectations remain above the medium-term target. Reducing inflation will be essential for maintaining an environment in which investment and growth can flourish in a sustainable manner over the medium term.

45. ***The Banco de la República's skillful management of monetary policy is steering the economy toward a soft landing.*** Monetary policy has been tightened substantially over the past 2½ years, and the current policy stance is consistent with a reduction of inflation toward the medium-term target. Continued close monitoring of forward-looking indicators of economic activity and of inflation expectations will be needed to determine the pace at which monetary policy can be eased as headline inflation declines.

46. ***The flexible exchange rate regime has helped Colombia maintain external stability.*** The real exchange rate is estimated to be consistent with fundamentals. Looking forward, the exchange rate should continue to be allowed to move flexibly, as this will help Colombia adjust to changes in the external environment. Greater stability in exchange rate intervention practices would also strengthen the policy framework. In this context, the reintroduction of the volatility rule, with a wider band, is welcome. The elimination of capital controls is also a positive step, given their potentially negative effects on financial sector development and exchange rate volatility.

47. ***Maintaining the fiscal targets incorporated in the medium-term fiscal plan will help underpin confidence during a period of global turbulence.*** The plan incorporates some fiscal stimulus in 2009, but a broadly neutral stance from 2010 onward. Maintaining the current targets will help assure markets that public debt ratios will continue to decline and that public financing needs will remain modest. Were growth to turn out much lower than expected, financing conditions would be a key factor in determining the scope for an easing of fiscal policy. Over the medium-term, consideration could be given to the adoption of a fiscal rule to further strengthen the policy framework.

48. ***There is scope to strengthen structural reforms.*** In the financial sector, progress on expanding the derivatives markets and improving the regulatory framework has continued, and the proposed development of a multi-tier pension system is welcome. The reform agenda could nevertheless be further expanded to encompass a strengthening of creditor rights and greater independence for financial sector supervisors. Further progress in improving the efficiency of the tax system, and tackling budget rigidities, also remains important.

49. ***There have been no changes in Colombia's exchange measures since the last Article IV consultation.*** Staff recommends approval of the retention of the restriction and multiple currency practice arising from taxing remittances of nonresident profits earned prior to 2007, given that they are of a temporary nature, maintained for balance of payments reasons, and non-discriminatory in application. Staff does not recommend approval of the retention of the restriction derived from the special regime in the hydrocarbons sector, since there is no timetable for its removal.

50. It is recommended that the next Article IV consultation be held on the 12-month cycle.

Table 1. Colombia: Selected Economic and Financial Indicators

I. Social and Demographic Indicators

Population (millions), 2007	47.5	Physicians (per 100,000 people), 1990-2004	135.0
GDP, 2007		Adult illiteracy rate (percent ages 15 and older), 2004	7.2
per capita (US$)	4,341	Sustainable access to safe water, 2004	
in billions of Col$	428,301	(percent of population)	93.0
in billions of US$	206.3	Gini index, 2003	58.6
Unemployment rate, Apr. 2008 (percent)	11.0	Inequality (ratio of richest 20% to poorest 20%), 2003	25.3
Life expectancy at birth (years) (HDI), 2000-05	72.2	Poverty rate, 2006	45.1
Under 5 mortality rate (per 1,000 live births), 2005	21.4	Extreme poverty rate, 2006	12.0

II. Economic Indicators

					Projections	
	2004	2005	2006	2007	2008	2009
	(Percentage changes, unless otherwise indicated)					
National income and prices						
Real GDP	4.7	5.7	6.8	7.7	3.5	2.0
GDP deflator	8.3	6.1	6.8	3.9	8.7	4.6
Consumer prices (average)	5.9	5.0	4.3	5.5	7.0	5.7
Consumer prices (end of period)	5.5	4.9	4.5	5.7	7.5	4.8
External sector (on the basis of US$)						
Exports (f.o.b.)	24.7	26.2	15.9	21.4	21.3	-9.9
Imports (f.o.b.)	19.8	26.8	23.5	25.4	18.4	-5.4
Terms of trade (deterioration -)	8.1	12.6	2.8	3.5	5.8	-13.1
Real effective exchange rate (depreciation -)	13.4	11.6	-1.9	8.2	...	...
Central government						
Revenue	31.2	14.8	22.8	14.8	17.4	17.4
Expenditure	32.7	10.3	16.8	9.9	15.9	15.5
Money and credit						
Broad money	19.2	17.6	18.0	17.4	35.9	6.7
Credit to the private sector	29.8	11.3	38.5	23.5	17.5	...
Interest rate (90-day time deposits; percent per year) 1/						
Nominal	7.8	6.3	6.8	9.2	9.9	…
Real	2.3	1.4	2.3	3.5	2.4	…
	(In percent of GDP)					
Central government balance	-4.7	-4.1	-3.4	-2.7	-2.6	-2.5
Nonfinancial public sector balance	-1.3	0.0	-1.0	-0.8	-0.9	-1.5
NFPS primary balance	2.8	3.4	2.9	3.3	2.6	1.7
Combined public sector balance	-1.1	0.0	-0.7	-0.6	-0.8	-1.2
Foreign financing	0.4	-1.4	0.3	0.3	1.1	0.8
Domestic financing 2/	0.7	1.4	0.4	0.3	-0.4	-0.4
Privatization	0.0	0.0	0.0	0.0	0.1	0.8
Public debt	42.4	38.8	35.9	32.8	31.7	29.7
Gross domestic investment	20.1	21.6	24.3	24.9	24.3	22.1
Gross national savings	19.3	20.3	22.5	22.0	21.2	19.0
Current account (deficit -)	-0.8	-1.3	-1.8	-2.8	-3.2	-3.2
External debt	31.5	26.2	23.4	20.9	22.7	21.3
Of which: public sector	20.6	16.4	15.3	13.5	14.6	14.1
NIR in percent of short-term debt	99.0	108.1	147.0	182.6	176.6	167.9
	(In percent of exports of goods, services, and income)					
External debt service	37.8	45.8	35.4	25.3	24.0	27.0
Of which: public sector	18.3	31.0	20.0	14.5	12.3	10.8
Interest payments	11.7	11.8	9.4	9.1	8.8	9.0
Of which: public sector	8.4	8.7	6.4	6.3	6.1	6.2
	(In millions of U.S. dollars)					
Overall balance of payments	2,541.1	1,728.7	22.8	4,710.8	2,044.2	954.8
Exports (f.o.b.)	17,224	21,729	25,181	30,577	37,092	33,423
Of which: Petroleum products	4,227	5,559	6,328	7,318	11,090	7,502
Coal	1,854	2,598	2,913	3,495	4,990	5,389
Coffee	949	1,471	1,461	1,714	2,025	1,757
Net official reserves	13,197	14,721	15,127	20,244	22,873	23,377
Net official reserves (in months of imports of goods and services)	6.4	5.8	4.9	5.5	6.3	6.0

Sources: Colombian authorities; UNDP Human Development Report 2007/08; World Development Indicators; and Fund staff estimates and projections.

1/ Data for 2008 refer to June.

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

Table 2. Colombia: Operations of the Combined Public Sector 1/
(In percent of GDP)

					Projections					
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Total revenue	**25.9**	**26.1**	**27.7**	**28.0**	**26.2**	**27.5**	**25.3**	**24.8**	**24.5**	**24.4**
Tax revenue	14.6	14.9	19.5	19.8	20.1	20.3	19.4	18.9	18.6	18.4
Nontax revenue	11.3	11.1	8.2	8.2	6.1	7.2	5.9	5.9	5.9	5.9
Financial income	1.3	1.3	1.2	1.5	1.1	1.0	0.9	0.9	0.9	0.9
Operating surplus of public enterprises	2.9	3.3	3.6	3.3	0.1	0.1	0.1	0.1	0.1	0.1
Of which : Ecopetrol	2.9	3.1	3.5	3.1	0.0	0.0	0.0	0.0	0.0	0.0
Other	7.1	6.6	3.4	3.5	4.9	6.1	4.9	5.0	4.9	5.0
Total expenditure and net lending 2/	**26.9**	**26.2**	**28.6**	**29.0**	**27.1**	**29.0**	**26.7**	**26.1**	**25.7**	**25.6**
Current expenditure	**22.1**	**21.2**	**23.0**	**22.4**	**21.5**	**22.7**	**21.2**	**20.6**	**20.2**	**20.1**
Wages and salaries	5.9	5.7	5.9	5.8	5.6	5.7	5.5	5.5	5.3	5.3
Goods and services	3.8	3.6	3.6	3.8	3.4	3.0	3.1	3.0	2.9	2.9
Interest	4.1	3.4	3.9	4.2	3.5	3.2	2.8	2.8	2.5	2.6
External	1.6	1.4	1.2	1.0	0.8	0.8	1.1	1.1	0.9	1.0
Domestic	2.4	2.0	2.8	3.1	2.7	2.4	1.7	1.6	1.7	1.6
Transfers to private sector	6.7	6.7	7.4	7.3	7.7	8.9	8.0	7.8	7.7	7.7
Of which: from social security	5.9	5.8	6.5	6.6	6.9	7.2	7.2	7.1	7.1	7.1
Other 3/	1.6	1.8	2.0	1.4	1.3	1.7	1.7	1.6	1.6	1.6
Capital expenditure	**4.8**	**5.0**	**5.6**	**6.6**	**5.6**	**6.3**	**5.5**	**5.5**	**5.6**	**5.5**
Fixed capital formation (cash basis)	4.8	4.9	5.5	6.5	5.5	6.3	5.5	5.4	5.5	5.4
Transfers	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other (including floating debt) 3/	0.1	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Net lending	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Statistical discrepancy	-0.3	0.1	-0.2	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Nonfinancial public sector balance	**-1.3**	**0.0**	**-1.0**	**-0.8**	**-0.9**	**-1.5**	**-1.4**	**-1.3**	**-1.2**	**-1.2**
Quasi-fiscal balance (BR cash profits)	0.4	0.2	0.4	0.4	0.2	0.3	0.3	0.2	0.2	0.2
Fogafin balance	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Net cost of financial restructuring 4/	-0.5	-0.4	-0.3	-0.3	-0.3	-0.2	-0.1	0.0	0.0	0.0
Combined public sector balance	**-1.1**	**0.0**	**-0.7**	**-0.6**	**-0.8**	**-1.2**	**-1.1**	**-1.0**	**-0.9**	**-0.9**
Memorandum items:										
NFPS primary balance	2.8	3.4	2.9	3.3	2.6	1.7	1.4	1.4	1.3	1.4
NFPS primary structural balance	2.6	3.5	2.8	2.6	2.2	1.8	1.9	1.7	1.9	1.6

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

1/ Reflects exclusion of Ecopetrol operations and privatization of health care for 2008-13. This results in a reduction of revenue and spending of about 2 percent of GDP and 1.5 percent of GDP, respectively, in 2008.

2/ Expenditure reported on commitments basis.

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

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

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

					Projections					
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Total revenue	**13.3**	**13.7**	**14.7**	**15.1**	**15.8**	**17.4**	**16.0**	**15.4**	**15.2**	**15.1**
Current revenue	**13.3**	**13.7**	**14.7**	**15.1**	**15.8**	**17.4**	**16.0**	**15.4**	**15.2**	**15.1**
Tax revenue	12.3	12.6	13.4	13.5	14.1	14.8	14.4	13.9	13.8	13.8
Net income tax and profits	5.3	5.2	5.6	5.6	5.2	5.8	5.6	5.5	5.5	5.5
Goods and services	5.3	5.5	5.8	5.7	6.4	6.7	6.7	6.6	6.5	6.5
Value-added tax	5.0	5.2	5.5	5.5	6.1	6.4	6.4	6.4	6.3	6.3
Gasoline tax	0.4	0.3	0.3	0.3	0.3	0.3	0.2	0.2	0.2	0.2
International trade	0.7	0.8	1.0	1.0	1.0	1.1	1.0	1.0	1.0	1.0
Financial transaction tax	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Stamp and other taxes	0.2	0.3	0.3	0.5	0.8	0.5	0.4	0.0	0.0	0.0
Nontax revenue	1.1	1.1	1.3	1.6	1.7	2.6	1.6	1.5	1.4	1.3
Property income	0.2	0.2	0.3	0.2	0.2	0.1	0.1	0.1	0.1	0.1
Other	0.9	0.9	1.1	1.4	1.6	2.4	1.4	1.4	1.3	1.2
Total expenditure and net lending	**18.0**	**17.8**	**18.1**	**17.8**	**18.4**	**19.9**	**18.4**	**17.8**	**17.6**	**17.5**
Current expenditure	**15.1**	**15.1**	**15.3**	**14.6**	**15.0**	**16.4**	**15.6**	**14.9**	**14.6**	**14.4**
Wages and salaries	2.4	2.1	2.2	2.0	2.1	2.2	2.2	2.1	2.0	1.9
Goods and services	1.2	1.3	1.3	1.2	1.2	1.1	1.2	1.2	1.1	1.1
Interest	3.2	2.9	3.5	3.7	3.2	2.9	3.0	2.8	2.8	2.8
External	1.4	1.3	1.0	0.9	0.8	0.7	0.8	0.7	0.7	0.7
Domestic	1.9	1.7	2.4	2.8	2.4	2.2	2.2	2.1	2.1	2.1
Other expenditure 2/	0.4	0.2	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Current transfers 3/	7.8	8.6	8.1	7.6	8.5	10.1	9.1	8.8	8.7	8.6
Capital expenditure	**2.8**	**2.6**	**2.8**	**3.2**	**3.3**	**3.4**	**2.8**	**2.9**	**2.9**	**3.0**
Fixed capital formation	1.2	1.3	1.5	1.9	2.1	2.1	1.5	1.6	1.7	1.8
Capital transfers	1.6	1.3	1.2	1.3	1.3	1.3	1.3	1.3	1.3	1.2
Net lending	0.1	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.0
Overall balance	**-4.7**	**-4.1**	**-3.4**	**-2.7**	**-2.6**	**-2.5**	**-2.4**	**-2.4**	**-2.3**	**-2.4**
Memorandum item:										
Primary balance	-1.4	-1.2	0.1	1.0	0.6	0.4	0.6	0.4	0.4	0.4
Structural primary balance	-1.3	-1.0	0.0	0.6	-0.1	0.4	0.7	0.6	0.5	0.4

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

1/ Includes central administration only.

2/ Includes change in the budget carryover. A negative number corrects for current cash payments of expenditures incurred in previous periods.

3/ Includes interest payment to the rest of the nonfinancial public sector.

Table 4. Colombia: Monetary Indicators

	2003	2004	2005	2006	2007	Sep-08
(In billions of Colombian pesos, unless otherwise indicated)						
Central Bank						
Net Foreign Assets	31,680	33,442	35,192	35,647	43,240	53,683
Gross international reserves	30,857	32,635	34,557	34,878	42,343	52,428
in billions of US$	10.9	13.2	15.2	15.7	21.0	24.0
Short-term foreign liabilities	218	269	398	326	136	621
Other net foreign assets	1,457	1,266	1,228	1,257	1,161	2,069
Net domestic assets	-15,049	-14,165	-12,372	-8,615	-10,825	-23,412
Net credit to the public sector	2,862	-202	-1,541	-284	-4,038	-7,633
TES	3,193	975	2,594	2,439	1,331	170
Other	-331	-1,177	-4,135	-2,722	-5,369	-7,803
Net credit to the financial system	3,626	2,513	3,954	6,598	5,039	-892
Other	-21,537	-16,476	-14,784	-14,930	-11,825	-14,888
Monetary base	16,615	19,262	22,805	27,032	32,415	30,270
Currency in circulation	12,036	13,784	16,377	20,120	22,417	19,476
Deposit money banks reserves	4,530	5,441	6,412	6,896	9,970	10,773
Other deposits	48	36	16	16	29	22
Financial system						
Net foreign assets	28,466	34,724	34,933	37,351	43,170	54,566
in billions of US$	10.0	14.0	15.4	16.8	21.4	25.0
Net domestic assets	46,009	54,081	69,530	85,868	101,478	103,085
Net credit to public sector	20,933	23,039	28,102	20,587	14,321	9,719
Credit to private sector	57,177	74,239	82,660	114,502	141,363	163,009
Other net	-32,101	-43,197	-41,231	-49,221	-54,206	-69,643
Broad money	74,476	88,805	104,463	123,219	144,648	157,650
(Annual percentage change)						
Credit to public sector, net	64.1	10.1	22.0	-26.7	-30.4	11.0
Credit to private sector	8.8	29.8	11.3	38.5	23.5	21.1
Currency	20.5	14.5	18.8	22.9	11.4	7.6
Monetary base	17.8	15.9	18.4	18.5	19.9	16.2
Broad money	10.6	19.2	17.6	18.0	17.4	17.6
(In percent of GDP)						
Credit to public sector, net	7.9	7.7	8.4	5.4	3.3	2.1
Credit to private sector	21.7	24.8	24.6	29.9	33.0	34.8
Currency	4.6	4.6	4.9	5.3	5.2	4.2
Monetary base	6.3	6.4	6.8	7.1	7.6	6.5
Broad money	28.2	29.7	31.1	32.2	33.8	33.7
(In percent, unless otherwise indicated)						
Memorandum items:						
Central bank inflation target (end-year)	5.9	5.5	4.5-5.5	4.0-5.0	3.5-4.5	3.5-4.5
CPI inflation	6.5	5.5	4.9	4.5	5.7	7.6
Exchange rate depreciation	-2.9	-13.3	-5.3	-2.6	-9.5	8.5
Nominal GDP (COP billions)	263,888	299,067	335,547	382,818	428,301	468,305

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

Table 5. Colombia: Summary Balance of Payments

	2005	2006	2007	Projections 2008	2009	2010	2011	2012	2013
	(In millions of U.S. dollars)								
Current account balance	**-1,881**	**-2,982**	**-5,859**	**-7,665**	**-6,964**	**-6,569**	**-6,360**	**-6,176**	**-5,988**
Trade balance	1,595	322	-596	193	-1,479	-142	854	1,370	2,263
Exports, f.o.b.	21,729	25,181	30,577	37,092	33,423	38,173	40,613	44,640	47,883
Coffee	1,471	1,461	1,714	2,025	1,757	1,691	1,729	1,811	1,961
Petroleum products	5,559	6,328	7,318	11,090	7,502	9,035	9,336	10,753	11,113
Non-traditional	9,863	11,749	15,174	16,914	17,032	19,075	20,853	23,055	25,160
Other	4,836	5,642	6,370	7,063	7,132	8,371	8,695	9,021	9,649
Imports, f.o.b.	20,134	24,859	31,173	36,899	34,902	38,315	39,759	43,270	45,621
Services (net)	-2,102	-2,119	-2,607	-2,587	-2,641	-2,849	-2,989	-3,273	-3,511
Income (net)	-5,456	-5,929	-7,886	-10,683	-8,263	-9,331	-9,624	-9,955	-10,691
Interest (net)	-2,051	-1,693	-1,754	-2,270	-2,095	-2,019	-1,639	-1,642	-1,762
Of which: public sector	-1,587	-1,208	-1,279	-1,501	-1,489	-1,578	-1,549	-1,602	-1,747
Other Income (net)	-3,405	-4,236	-6,132	-8,413	-6,168	-7,312	-7,984	-8,313	-8,929
Current transfers (net)	4,082	4,743	5,231	5,412	5,419	5,753	5,398	5,682	5,951
Financial account balance	**3,240**	**2,944**	**10,343**	**9,671**	**7,769**	**7,401**	**7,162**	**7,138**	**6,953**
Public sector (net)	-2,974	-432	2,198	2,746	1,676	1,577	1,431	1,432	1,233
Nonfinancial public sector	-2,129	722	1,928	2,709	1,765	1,499	1,337	1,320	1,129
Medium- and long-term (net)	-1,189	2,085	1,298	1,561	1,613	2,868	47	-395	-316
Disbursements	4,312	5,869	4,096	3,775	3,184	4,921	1,689	2,025	2,242
Amortization	5,501	3,784	2,798	2,213	1,571	2,052	1,642	2,420	2,558
Other long-term flows	-47	-46	-19	-20	-20	-20	-20	-20	-20
Short term 1/	-893	-1,317	649	1,168	173	-1,349	1,311	1,735	1,466
Of which: change in public assets	-849	-1,598	-662	1,183	173	-1,349	1,311	1,735	1,466
Financial public sector	-845	-1,154	270	37	-90	78	94	112	103
Private sector (net)	6,214	3,376	8,144	6,925	6,093	5,824	5,731	5,706	5,720
Nonfinancial private sector (net)	6,126	3,433	7,913	6,290	6,036	5,815	5,650	5,636	5,647
Direct investment	5,590	5,558	8,127	8,595	7,523	7,456	7,650	7,711	7,835
Direct investment abroad	4,662	1,098	913	839	849	860	870	882	893
Direct investment in Colombia	10,252	6,656	9,040	9,434	8,372	8,316	8,521	8,592	8,728
Leasing finance	116	62	116	278	-242	-107	-106	192	-27
Disbursements	378	501	656	711	681	727	730	777	806
Amortization	262	439	540	433	923	834	836	584	834
Long-term loans	-436	-79	913	0	-338	-210	393	548	592
Disbursements	1,948	2,837	2,991	2,206	3,043	3,996	4,324	4,930	4,539
Amortization	2,385	2,916	2,078	2,206	3,381	4,206	3,931	4,382	3,947
Short term 2/	857	-2,108	-1,243	-2,582	-908	-1,324	-2,288	-2,815	-2,753
Financial private sector (net)	88	-57	231	635	58	9	81	70	74
Net errors and omissions	**370**	**61**	**227**	**39**	**0**	**0**	**0**	**0**	**0**
Changes in GIR 3/	**1,729**	**23**	**4,711**	**2,044**	**805**	**832**	**802**	**962**	**965**
Changes in NIR, program definition 3/	**1,525**	**405**	**5,117**	**2,630**	**504**	**543**	**554**	**567**	**579**
Memorandum Items:									
Current account balance (in percent of GDP)	-1.3	-1.8	-2.8	-3.2	-3.2	-2.7	-2.5	-2.2	-2.0
Oil Price (Colombian mix)	49.8	58.3	66.2	91.5	51.7	61.2	65.0	68.4	70.5
Gross international reserves (months of imports of G&S) 4/	5.9	5.0	5.8	6.9	6.5	6.5	6.1	5.9	5.6

Sources: Banco de la República; and Fund staff estimates and projections.
1/ Includes movements of short-term assets owned by the public sector abroad.
2/ Includes net portfolio investment.
3/ Does not include valuation changes of reserves denominated in other currencies than U.S. dollars.
4/ Not including Fund purchases under the standby arrangement.

Table 6. Colombia: Financial Soundness Indicators 1/
(In percent, unless otherwise indicated; end-of-period values)

	2002	2003	2004	2005	2006	2007	Jun-08	Sep-08	Oct-08
Capital Adequacy									
Regulatory capital to risk-weighted assets	12.2	13.0	14.2	14.7	13.1	13.6	13.9	13.3	13.1
Regulatory Tier 1 capital to risk-weighted assets	9.6	10.3	10.7	10.4	9.7	10.5	10.9	10.6	10.4
Capital (net worth) to assets	11.0	11.6	12.1	12.3	12.0	12.1	12.0	12.0	11.8
Asset Quality and Distribution									
Nonperforming loans to gross loans	8.7	6.8	3.3	2.7	2.6	3.3	3.9	4.1	4.1
Provisions to nonperforming loans	86.7	98.1	149.7	166.9	153.6	132.6	116.3	115.7	115.3
Government securities to assets	18.4	18.0	23.8	24.9	15.5	12.2	11.2	12.3	11.7
Gross loans to assets	52.1	50.9	52.0	52.3	60.6	64.3	65.1	65.6	66.2
Earnings and Profitability									
ROAA	1.1	1.9	2.7	2.7	2.5	2.4	2.5	4.0	4.3
ROAE	9.6	17.1	23.0	22.1	20.2	19.5	21.0	32.8	35.5
Interest margin to gross income	35.6	37.4	38.9	40.2	46.6	54.4	54.6	54.0	54.0
Interest income to gross income	19.4	30.3	39.3	42.8	39.6	44.9	49.5	49.6	48.9
Operating expenses to gross income	80.6	69.7	60.7	57.2	60.4	55.1	50.5	50.4	51.1
Liquidity									
Liquid assets to total assets	19.7	18.7	20.6	20.8	14.0	13.0	12.2	12.7	12.3
Liquid assets to short-term liabilities	30.2	29.0	31.2	31.3	20.7	19.3	18.6	19.3	18.5
Other									
Expected default probability (banking system average)	4.7	1.2	0.1	0.1	0.1	0.1	0.3	0.3	0.4

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

1/ Total banking system.

Table 7. Colombia: Medium-Term Outlook

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
I. Output and Prices										
(Annual percentage changes)										
Real GDP	4.7	5.7	6.8	7.7	3.5	2.0	4.0	4.8	5.0	5.0
Consumer prices										
End of period	5.5	4.9	4.5	5.7	7.5	4.8	3.8	3.7	3.5	3.3
(In percent of GDP, unless indicated otherwise)										
II. Saving and Investment										
Gross national savings	19.3	20.3	22.5	22.0	21.2	19.0	19.6	20.2	20.6	20.7
Private sector	14.0	13.6	18.3	17.4	17.0	15.0	14.6	15.5	15.1	15.2
Public sector 1/	5.3	6.7	4.2	4.7	4.2	4.0	5.0	4.8	5.5	5.5
Gross domestic investment	20.1	21.6	24.3	24.9	24.3	22.1	22.3	22.8	22.8	22.7
Private sector	13.5	15.0	19.4	19.5	18.7	17.0	16.6	17.7	17.5	17.4
Public sector 1/	6.6	6.7	4.9	5.4	5.6	5.1	5.7	5.1	5.3	5.3
External current account balance	-0.8	-1.3	-1.8	-2.8	-3.2	-3.2	-2.7	-2.5	-2.2	-2.0
III. Nonfinancial and Consolidated Public Sector										
Nonfinancial public sector 2/										
Revenue	25.9	26.1	27.4	27.5	26.2	27.5	25.8	25.0	24.6	24.5
Expenditure	26.9	26.2	28.2	28.5	27.1	29.0	27.2	26.4	25.8	25.7
Current expenditure	22.1	21.2	22.7	22.0	21.5	22.7	21.5	20.5	19.8	19.5
Capital expenditure	4.8	5.0	5.5	6.5	5.6	6.3	5.6	5.9	6.0	6.2
Primary balance 3/	2.8	3.4	2.9	3.3	2.6	1.7	1.8	1.6	1.8	1.7
Overall balance 3/	-1.3	0.0	-1.0	-0.8	-0.9	-1.5	-1.4	-1.3	-1.2	-1.2
Combined public sector balance	-1.1	0.0	-0.7	-0.6	-0.8	-1.2	-1.1	-1.0	-0.9	-0.9
External financing	0.4	-1.4	0.3	0.3	1.1	0.8	0.6	0.1	0.1	-0.1
Domestic financing	0.6	1.4	0.4	0.3	-0.4	-0.4	0.5	0.9	0.8	1.0
Privatization	0.1	0.0	0.0	0.0	0.1	0.8	0.0	0.0	0.0	0.0
IV. Balance of Payments										
External current account balance	-0.8	-1.3	-1.8	-2.8	-3.2	-3.2	-2.7	-2.5	-2.2	-2.0
Trade balance	1.2	1.1	0.2	-0.3	0.1	-0.7	-0.1	0.3	0.5	0.8
Exports	15.1	15.0	15.5	14.8	15.3	15.2	15.9	16.0	16.1	16.1
Imports	14.0	13.9	15.3	15.1	15.2	15.9	15.9	15.7	15.6	15.3
Capital and financial account balance	2.8	2.2	1.8	5.0	4.0	3.6	3.1	2.9	2.6	2.3
Public sector	0.0	-2.1	-0.3	1.1	1.1	0.8	0.7	0.6	0.5	0.4
Private sector	2.8	4.3	2.1	3.9	2.8	2.8	2.5	2.4	2.1	1.9
Overall balance	2.2	1.2	0.0	2.3	0.8	0.4	0.4	0.4	0.4	0.3
V. Debt										
Total public gross debt 4/	42.4	38.8	35.9	32.8	31.7	29.7	28.7	27.9	26.9	26.0
Domestic debt	21.8	22.4	20.5	19.3	17.2	15.6	14.1	14.2	14.4	14.5
External debt	20.6	16.4	15.3	13.5	14.6	14.1	14.6	13.6	12.5	11.5
Total public net debt 5/	33.5	28.4	25.4	21.6	22.7	21.2	20.9	20.7	20.3	19.9
Memorandum items:										
CPS structural primary balance	2.6	3.5	2.8	2.6	2.2	1.8	1.9	1.7	1.9	1.6
Central government structural primary balance	-1.3	-1.0	0.0	0.7	-0.1	0.4	0.7	0.6	0.5	0.4
Nominal GDP (billions of COP)	299,067	335,547	382,818	428,301	481,639	513,907	559,258	606,326	658,077	715,672
Crude oil, spot price	37.8	53.4	64.3	71.1	97.5	54.3	64.8	71.3	75.0	77.5
Crude oil, spot price (Colombian mix)	37.3	49.8	58.3	66.2	91.5	51.7	61.2	65.0	68.4	70.5

Sources: Colombian authorities; and Fund staff estimates and projections.

1/ The definition of public savings and investment changes starting in 2006 and includes only the general government.
2/ Excludes ECOPETROL for 2008-12.
3/ Includes statistical discrepancy.
4/ Includes debt of the non-financial public sector plus FOGAFIN and FINAGRO.
5/ Defined as gross debt minus financial assets (deposits).

Table A1. Colombia: External Debt Sustainability Framework

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2003	2004	2005	2006	2007			2008	2009	2010	2011	2012	2013	Debt-stabilizing non-interest current account 6/
Baseline: External debt	40.0	31.5	26.2	23.5	20.8			**22.7**	**21.3**	**21.3**	**20.1**	**18.8**	**17.7**	**-2.7**
Change in external debt	-0.2	-8.5	-5.3	-2.7	-2.7			1.9	-1.4	0.0	-1.3	-1.2	-1.2	
Identified external debt-creating flows (4+8+9)	0.7	-9.2	-9.4	-4.3	-6.1			-1.3	-0.5	-1.2	-1.4	-1.5	-1.5	
Current account deficit, excluding interest payments	-1.4	-1.3	-0.6	0.1	1.4			2.2	1.9	1.5	1.4	1.1	0.9	
Deficit in balance of goods and services	0.9	0.3	0.3	1.1	1.5			1.2	1.8	1.3	0.8	0.7	0.4	
Exports	16.6	15.6	16.6	16.7	16.1			19.9	16.9	18.0	17.8	18.0	17.8	
Imports	17.5	15.8	17.0	17.8	17.6			21.1	18.7	19.3	18.6	18.6	18.2	
Net non-debt creating capital inflows (negative)	-0.9	-2.4	-3.8	-3.3	-3.8			-4.2	-3.4	-3.1	-3.0	-2.8	-2.6	
Automatic debt dynamics 1/	3.0	-5.6	-5.0	-1.2	-3.6			0.6	1.0	0.4	0.2	0.2	0.2	
Contribution from nominal interest rate	2.6	2.2	1.7	1.7	1.3			1.2	1.5	1.2	1.2	1.1	1.1	
Contribution from real GDP growth	-1.9	-1.5	-1.4	-1.6	-1.4			-0.6	-0.5	-0.8	-1.0	-0.9	-0.9	
Contribution from price and exchange rate changes 2/	2.4	-6.2	-5.3	-1.3	-3.6			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	-0.9	0.7	4.0	1.6	3.4			3.2	-0.9	1.2	0.2	0.3	0.3	
External debt-to-exports ratio (in percent)	241.6	202.5	157.7	140.6	129.2			113.7	126.3	118.6	112.9	104.9	99.2	
Gross external financing need (in billions of US dollars) 4/	10.9	10.9	15.8	13.7	15.0			19.0	19.6	20.8	20.3	21.2	21.2	
in percent of GDP	11.5	8.7	10.7	8.0	7.1			9.2	8.8	8.8	8.0	7.7	7.1	
Key Macroeconomic Assumptions Underlying Baseline						10-Year Historical Average	10-Year Standard Deviation							
Real GDP growth (in percent)	4.6	4.7	5.7	6.8	7.7	3.5	3.3	3.5	2.0	4.0	4.8	5.0	5.0	
GDP deflator in US dollars (change in percent)	-5.6	18.5	20.2	5.1	18.0	-2.9	21.9	13.9	-11.6	5.4	0.6	4.6	1.8	
Nominal external interest rate (in percent)	6.3	6.7	7.0	7.2	7.3	6.9	0.5	6.9	5.9	6.2	5.7	6.0	6.4	
Growth of exports (US dollar terms, in percent)	10.9	23.8	25.2	17.1	19.8	9.9	11.5	20.5	-8.6	13.2	6.1	9.4	6.9	
Growth of imports (US dollar terms, in percent)	8.1	19.2	25.7	21.9	23.3	16.2	33.0	16.5	-4.2	9.2	3.9	8.5	5.4	
Current account balance, excluding interest payments	1.4	1.3	0.6	-0.1	-1.4	1.0	1.8	-2.2	-1.9	-1.5	-1.4	-1.1	-0.9	
Net non-debt creating capital inflows	0.9	2.4	3.8	3.3	3.8	2.3	1.1	4.2	3.4	3.1	3.0	2.8	2.6	
B. Bound Tests														
B1. Nominal interest rate is at historical average plus one standard deviation								**22.7**	**21.4**	**21.4**	**20.2**	**19.0**	**17.9**	**-2.7**
B2. Real GDP growth is at historical average minus one standard deviations								**22.7**	**18.8**	**19.0**	**18.0**	**17.0**	**16.0**	**-2.6**
B3. Non-interest current account is at historical average minus one standard deviations								**22.7**	**22.2**	**23.1**	**22.8**	**22.3**	**22.0**	**-2.8**
B4. Combination of B1-B3 using 1/2 standard deviation shocks								**22.7**	**22.0**	**22.7**	**22.1**	**21.4**	**20.9**	**-2.6**
B5. One time 30 percent real depreciation in 2009								**22.7**	**26.2**	**25.9**	**24.0**	**22.3**	**20.7**	**-3.3**

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

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

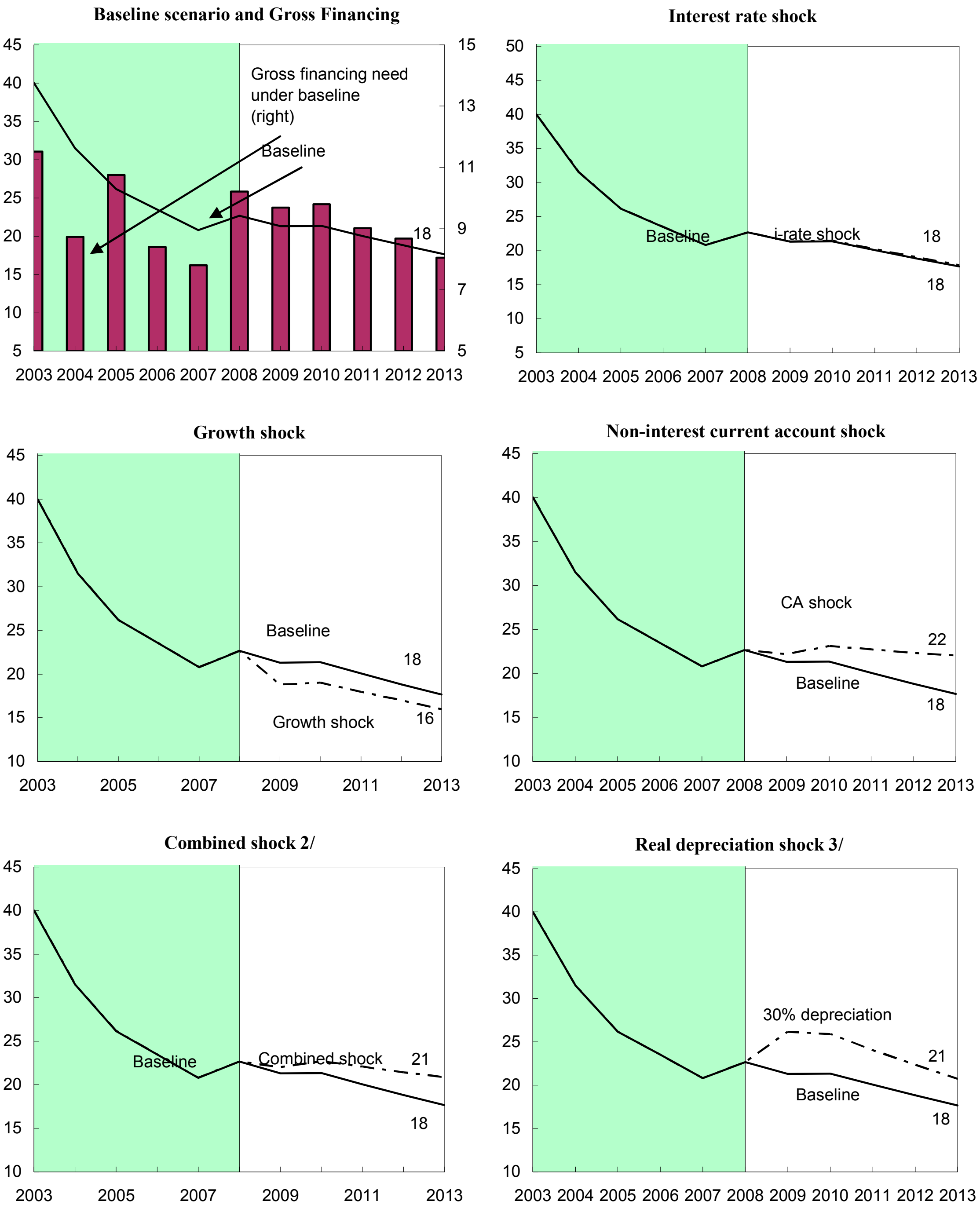
3/ For projection, line includes the impact of price and exchange rate changes.

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

5/ 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.

6/ 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 A1. Colombia: External Debt Sustainability: Bound Tests 1/
(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and alternative scenarios 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 2008.

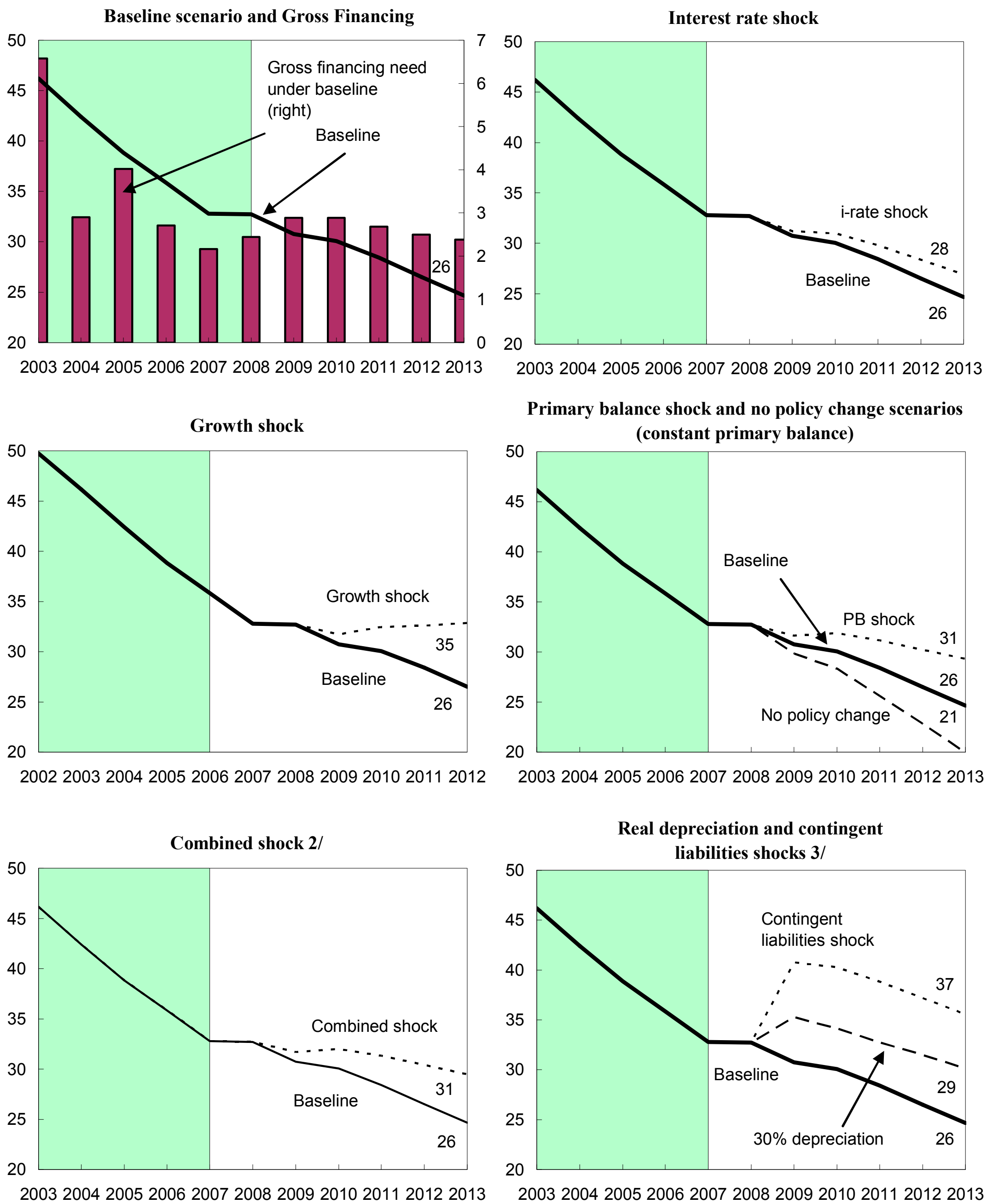
Table A2. Colombia: Public Sector Debt Sustainability Framework

(In percent of GDP, unless otherwise indicated)

	Actual													
	2003	2004	2005	2006	2007			2008	2009	2010	2011	2012	2013	
								I. Baseline Projections						**Debt-stabilizing primary balance 9/**
Public sector debt 1/	46.2	42.4	38.8	35.9	32.8			**31.7**	**29.7**	**28.7**	**27.9**	**26.9**	**26.0**	**1.8**
o/w foreign-currency denominated	25.8	20.6	16.4	15.3	13.5			14.6	14.1	14.6	13.6	12.5	11.5	
Change in public sector debt	-3.6	-3.8	-3.6	-3.0	-3.0			-1.1	-2.0	-1.0	-0.8	-0.9	-0.9	
Identified debt-creating flows (4+7+12)	-4.4	-7.8	-5.4	-4.1	-4.1			-0.8	-1.5	-0.6	-0.8	-0.9	-0.9	
Primary deficit	-1.9	-3.0	-3.2	-2.9	-2.9			-2.6	-1.7	-1.8	-1.6	-1.8	-1.7	
Revenue and grants	26.0	25.9	26.1	27.4	27.5			26.2	27.5	25.8	25.0	24.6	24.5	
Primary (noninterest) expenditure	24.0	22.9	22.8	24.5	24.6			23.6	25.8	24.0	23.4	22.7	22.8	
Automatic debt dynamics 2/	-2.5	-4.8	-2.1	-1.2	-1.2			1.9	1.0	1.2	0.8	0.9	0.8	
Contribution from interest rate/growth differential 3/	-1.7	-1.4	-1.2	-0.9	0.3			-0.1	1.2	0.8	0.7	0.9	0.6	
Of which contribution from real interest rate	0.3	0.5	0.9	1.4	2.7			0.9	1.8	1.9	2.0	2.2	1.7	
Of which contribution from real GDP growth	-2.0	-1.9	-2.2	-2.3	-2.5			-1.0	-0.6	-1.1	-1.3	-1.3	-1.1	
Contribution from exchange rate depreciation 4/	-0.8	-3.4	-0.9	-0.3	-1.5			2.0	-0.2	0.4	0.1	0.0	0.2	
Other identified debt-creating flows	0.1	0.0	0.0	0.0	0.0			-0.1	-0.8	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	0.1	0.0	0.0	0.0	0.0			-0.1	-0.8	0.0	0.0	0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes (2-3)	0.8	4.0	1.8	1.1	1.1			-0.3	-0.5	-0.4	0.0	0.0	0.0	
Public sector debt-to-revenue ratio 1/	177.9	163.8	149.1	131.0	119.2			121.0	108.1	111.2	111.3	109.6	106.3	
Gross financing need 5/	6.6	2.9	4.0	3.3	2.1			2.0	2.4	2.3	2.0	2.1	2.0	
in billions of U.S. dollars	6.0	3.3	5.8	5.3	4.3	10-Year Historical Average	10-Year Standard Deviation	4.9	5.2	5.5	5.1	5.7	6.1	Projected Average
Key Macroeconomic and Fiscal Assumptions														
Real GDP growth (in percent)	4.6	4.7	5.7	6.8	7.7	3.3	3.4	3.5	2.0	4.0	4.8	5.0	5.0	4.6
Average nominal interest rate on public debt (in percent) 6/	9.3	10.0	8.9	11.4	12.7	11.1	1.5	12.1	10.8	11.8	11.1	11.9	11.7	11.8
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	1.0	1.7	2.8	4.6	8.9	2.5	3.1	3.5	6.2	7.1	7.6	8.5	8.1	7.3
Nominal appreciation (increase in US dollar value of local currency, in percent)	3.1	16.3	4.6	2.0	11.1	-3.5	13.1	-13.5	1.3	-2.6	-0.8	-0.3	-0.8	-0.7
Inflation rate (GDP deflator, in percent)	8.3	8.3	6.1	6.8	3.9	8.6	3.5	8.7	4.6	4.6	3.5	3.4	3.6	4.4
Growth of real primary spending (deflated by GDP deflator, in percent)	-0.9	-0.4	5.6	13.7	8.3	2.9	5.8	-0.1	11.4	-3.3	2.5	1.7	5.4	3.5
Primary deficit	-1.9	-3.0	-3.2	-2.9	-2.9	-1.4	1.8	-2.6	-1.7	-1.8	-1.6	-1.8	-1.7	-2.0
A. Alternative Scenarios								**II. Stress Tests for Public Debt Ra**						**Debt-stabilizing primary balance 9/**
A1. Key variables are at their historical averages in 2009-13 7/								**31.7**	**27.6**	**24.8**	**22.2**	**19.6**	**16.5**	**-0.3**
A2. No policy change (constant primary balance) in 2009-13								**31.7**	**28.8**	**26.9**	**25.0**	**23.2**	**21.3**	**0.6**
B. Bound Tests														
B1. Real interest rate is at baseline plus one-half standard deviation								**31.7**	**30.2**	**29.6**	**29.2**	**28.8**	**28.3**	**1.3**
B2. Real GDP growth is at baseline minus one-half standard deviation								**31.7**	**30.7**	**31.0**	**32.0**	**33.4**	**35.2**	**1.6**
B3. Primary balance is at baseline minus one-half standard deviation								**31.7**	**30.6**	**30.5**	**30.7**	**30.7**	**30.8**	**0.9**
B4. Combination of B1-B3 using one-quarter standard deviation shocks								**31.7**	**30.7**	**30.6**	**30.8**	**30.9**	**31.0**	**1.4**
B5. One time 30 percent real depreciation in 2009 8/								**31.7**	**33.7**	**33.6**	**32.1**	**30.3**	**28.8**	**0.9**
B6. 10 percent of GDP increase in other debt-creating flows in 2009								**31.7**	**39.7**	**39.1**	**38.6**	**38.0**	**37.4**	**1.2**

1/ Covers the combined public sector (Non-financial public sector balance plus quasi-fiscal balance of the central bank and costs of financial reestructuring- FOGAFIN and FINAGRO). Debt is measured in gross terms.
2/ Derived as [(r - p(1+g) - g + ae(1+r)]/(1+g+p+gp)) times previous period debt ratio, with r = interest rate; p = 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).
3/ The real interest rate contribution is derived from the denominator in footnote 2/ as r - π (1+g) and the real growth contribution as -g.
4/ The exchange rate contribution is derived from the numerator in footnote 2/ as ae(1+r).
5/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.
6/ Derived as nominal interest expenditure divided by previous period debt stock.
7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.
8/ Real depreciation is defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).
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.

Figure A2. Colombia: Public Debt Sustainability: Bound Tests 1/
(Public debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and alternative scenarios being presented.
2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.
3/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2009, 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. Estimating the Underlying External Current Account Balance for Colombia

Under the 2007 Surveillance Decision, the underlying current balance is defined as the medium-term level of the current account, stripped of temporary factors influencing the trade and income balances. The adjustments to the projected current account balance, explained below, imply an estimated underlying current account deficit of 2.9 percent of GDP for 2008, compared to a projection of 3.2 percent of GDP. The adjustments are as follows:

- *Domestic output gap*. Domestic output is estimated to be below potential. Closing the output gap results in higher imports and has, therefore, a direct negative effect on the trade and current account balances.

- *Output gap in trading partners*. Foreign demand in Colombia's key trading partners is estimated to be below potential as a result of the global financial turmoil. Closing the gap will increase exports and therefore improve the trade and current account balances relative to the cyclically-unadjusted external balance.

- *Exports adjusted for commodity prices and the global economic slowdown*. Prices for oil and mineral products (Colombia's major export commodities) are estimated to be above their medium-term levels, implying a negative adjustment on the trade and current account balances. Non-traditional exports are also adjusted in the exercise, as they are assessed as being temporarily below their long-term level, in part on account of this year's temporary trade disruptions with Venezuela.

- *Exchange rate.* The average real effective exchange rate for 2008 is more appreciated than its long-term level.

- *Income account*. High oil prices and the appreciation of the peso in the first half of 2008 resulted in a high amount of repatriated profits from foreign investment.

Underlying Current Account Balance in 2008: Adjustment Factors

Current Account (as a share of GDP)	Adjustment Factor (as a share of GDP)	Concept	Explanation
-3.2		**2008 current account**	
	0.1	Output gap	Adjustment for effect of economic cycle on trade in Colombia and its partners
	0.9	Real exchange rate (REER)	REER more appreciated than its long-term average due to economic cycle; affects imports and exports
	-2.1	Export prices	Prices of commodities above 2013 price levels
	0.4	Profit transfers	Profit transfers above long-term average due to economic cycle and high oil prices
	1.1	Non-traditional exports	Well below projected levels, taking into account ER and growth projections.
-2.9		**Estimated underlying current account**	

Source: Staff estimates.

Appendix II. Background and Summary of Informational Annexes

Discussions

The 2008 Article IV consultation discussions were held in Bogotá during October 27–November 7, 2008. The mission met with the Minister of Finance and Public Credit, Mr. Óscar Iván Zuluaga; the Board of Directors of the Banco de la República; the Director of the National Planning Department, Ms. Carolina Rentería; senior staff of several government ministries and agencies; and representatives of the private sector and a major labor union. The staff team comprised B. Clements (Head), M. Piñón, L. Abrego, E. Flores, H. Kamil (all WHD), M. Souto (MCM), and M. Vera-Martin (SPR). Ms. Agudelo (OED) participated in most meetings.

Fund relations

The last Article IV consultation with Colombia was on January 16, 2008 (IMF Country Report No. 08/31). Colombia has no outstanding credit from the Fund. An FSAP update was carried out in September–October 2004 and the FSSA was discussed in April, 2005 (IMF Country Report No. 05/287). STA and MCM have provided technical assistance since 2005.

Exchange arrangements

Colombia has had a flexible exchange rate regime since September 1999, which is classified as a managed float. It maintains two exchange measures subject to Fund approval under Article VIII: (1) a multiple currency practice and an exchange restriction arising from a tax on outward remittances of nonresident profits earned before 2007 and that have been retained in the country for less than five years; and (2) an exchange restriction arising from the special regime for the hydrocarbon sector. Branches of foreign corporations are required to either surrender their export proceeds or agree to a government limitation on their access to the foreign exchange market. While Colombia is free under the Articles to impose surrender requirements and to exempt the application of those requirements, conditioning such exemptions to the acceptance of limitations on the availability of foreign exchange for the making of payments and transfers for current international transactions is inconsistent with Article VIII, section 2 (a) of the Fund's Articles.

Statistical issues

The quality of data in Colombia is generally adequate for surveillance. Colombia observes the Special Data Dissemination Standards (SDDS) and its metadata are posted on the Dissemination Standards Bulletin Board (DSBB). Colombia is availing itself of a flexibility option on the timeliness of certain production, monetary and external data. A data ROSC was completed in September 2006 and was subsequently published as IMF Country Report No. 06/356.

Relations with the World Bank Group

As of October 31, 2008, Colombia's outstanding debt to the IBRD was US$3.6 billion. The Bank's portfolio consisted of 19 active projects, with a total undisbursed balance of about US$0.8 billion. A new Country Partnership Strategy was approved in April 2008.

Appendix III. World Bank-Fund Country Level Work Program Under JMAP

	Products	Provisional timing of Title missions	Expected approval / delivery date
Bank work program in next 12 months	**A. CAS, CAS Progress Report**		
	None		
	B. Development Policy Lending		
	1. Catastrophes, US$150 millions		December 2008
	2. Sustainable Development III, US$450 million		December 2008
	C. Investment Lending		
	1. Bogotá Urban Services (additional Financing), US$30 million		Approved Oct. 08
	2. Monitoring and Evaluation of Public Systems, US$8.5 million		December 2008
	3. Social Safety Net, US$636 million		December 2008
	4. Solid Waste Management, US$20 million		March 2009
	5. Justice Sector Development, US$20 million		March 2009
	6. Peace and Development, US$20 million		February 2009
	D. Analytical Advisory Services		
	1. Alternative Energy		December 2008
	2. Peace Programmatic III		March 2009
	3. Public Finance		December 2008
	4. Financial Sector		January 2009
	5. Policy Options for Climate Change		May 2009
	6. Quality in Education		May 2009
IMF work program in next 12 months	***Technical Assistance***		
	1. Deposit insurance system	To be determined	To be determined
	Staff visit	Mid-2009	...
	Article IV Consultation	Late 2009	Late 2009/Early 2010

INTERNATIONAL MONETARY FUND

COLOMBIA

Staff Report for the 2008 Article IV Consultation—Informational Annex

Prepared by the Western Hemisphere Department

December 19, 2008

Annexes

Tables

ANNEX I. COLOMBIA: FUND RELATIONS

(As of October 31, 2008)

I. Membership Status: Joined: December 27, 1945; Article XIV

II. General Resources Account:	**SDR Million**	**% Quota**
Quota	774.00	100.00
Fund holdings of currency	488.20	63.08
Reserve Position	285.80	36.93
Holdings Exchange Rate		

III. SDR Department:	**SDR Million**	**% Allocation**
Net cumulative allocation	114.27	100.00
Holdings	136.41	119.37

IV. Outstanding Purchases and Loans: None

V. Latest Financial Arrangements:

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-By	May 02, 2005	Nov 02, 2006	405.00	0.00
Stand-By	Jan 15, 2003	May 02, 2005	1,548.00	0.00
EFF	Dec 20, 1999	Dec 19, 2002	1,957.00	0.00

VI. Projected Payments to Fund (in SDR Million)

			Forthcoming		
	2008	2009	2010	2011	2012
Principal					
Charges/Interest		0.01	0.01	0.01	0.01
Total		0.01	0.01	0.01	0.01

VII. Implementation of HIPC Initiative: Not applicable.

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

ANNEX II. COLOMBIA: WORLD BANK RELATIONS

The World Bank and Colombia's development strategy[1]

Colombia's National Development Plan is built on five pillars: (i) provide security to all Colombians; (ii) foster sustainable economic growth and employment generation under macroeconomic and price stability; (iii) build a more equitable society; and (iv) increase the transparency and efficiency of the State, and (v) promote environmental sustainability. On April 8 the new Colombia CPS was taken to the Board. FY08 IBRD lending to Colombia was US$940 million. In the last few months, the Colombian authorities have requested support for a large number of initiatives, taking full advantage of the Bank's array of services. Some of these are operational in nature, such as technical assistance for liability management, local finances, pensions and health sector reforms, safety net administration, among others.

IBRD is currently Colombia's largest single creditor

The World Bank Group and the Government of Colombia have built a productive and dynamic dialogue on a wide range of development issues and this has led to a strong lending program. Under each pillar it was agreed that the Bank would provide a flexible menu-based mix of financial and analytical services tailored to the country's evolving needs. New frontier products would also be offered, particularly in the area of financial and risk management.

Colombia's IBRD portfolio consists of 21 operations under implementation with 22 active grants ($46 million). Programmed lending for FY09 is over US$1 billion.

Good cooperation between IBRD and IFC on the growth and PSD agenda.

The central vehicle for IBRD support to the competitiveness agenda has been the Business Efficiency DPL series. Much of IFC's country program also revolves around strengthening the business environment and private sector competitiveness. IBRD reports on infrastructure, logistics and regional competitiveness, have been complemented by the recent regional *Doing Business* report.

Infrastructure. IBRD and IFC are supporting Government policies to improve utility management, particularly public-private models of service delivery in the water sector, where IFC is also a potential investor in small and medium sized private operators. IFC and IBRD are also helping to structure infrastructure concessions, with IFC focusing on private sector participation and IBRD providing technical assistance to the Government.

Urban Services. IBRD is financing the expansion of Bogotá's Transmilenio system to five additional cities, some of whom may be interested in borrowing from IFC or mobilizing market resources without a central Government guarantee.

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[1] Prepared by World Bank staff. Questions may be addressed to Mr. David Rosenblatt, Lead Economist, at (202) 473-7930 or drosenblatt@worldbank.org.

Financial Sector

IBRD has supported the Government's efforts to strengthen the financial sector in multiple ways, including support to issue and implement a new Capital Markets Law, consolidate supervision across all financial markets and develop a new financial sector law. To support country efforts to promote sustainable access to financial services, IBRD produced a study which investigates Colombia's relative performance (compared to other LAC countries) in banking sector finance to SMEs. IBRD is also exploring a potential contingent credit line for Disaster Risk Management and is collaborating with an inter-agency committee to carry out simulations of potential financial crises to ensure Government readiness to adequately manage risks. IFC is evaluating private equity players to identify strong business models that will generate efficiencies in industries with strong growth potential. IFC will also continue to focus on capital market development, as well as investment in firms at the pre-IPO stage.

Operations Portfolio (IBRD/IDA and Grants)

As of October 31, 2008

(In millions of U.S. dollars)

Closed Projects	**183**
Active Projects	**19**
IBRD/IDA *	
Total Disbursed (Active)	636.78
of which has been repaid	432
Total Disbursed (Closed)	12.881.69
of which has been repaid	9,448.45
Total Disbursed (Active + Closed)	13.519
of which has been repaid	9,448.45
Total Undisbursed (Active)	784.69
Total Undisbursed (Closed)	0.00
Total Undisbursed (Active + Closed)	784.69

Loan Information (IBRD)

As of October 31, 2008

(In millions of U.S. dollars)

Fiscal Year*	2003	2004	2005	2006	2007	2008
Total disbursements	948	491	567	692	830	638
Repayment amount	223	205	254	223	278	381
Net disbursements	725	286	313	469	477	257

*Fiscal Year: July 1–June 30.

Current IFC Portfolio				
Debt ($m)	Equity ($m)	Quasi Equity ($m)	Total ($m)	
755	209	163 (Loan+Equity Type)	1127	
Investment Business -- Top sectors and Clients			TA Business -- Top sectors	
Sector 1	Oil & Gas: Petrocol		Sector 1	Oil & Gas
Sector 2	Finance & Insurance: Davivienda-Protección		Sector 2	SME
Sector 3	Pulp & Paper: Carvajal S.A.			
Sector 4	Wholesale & Retail Trade: Sodimac Colombia			
Sector 5	Agriculture & Forestry: Procafecol			
Top client	DAVIVIENDA		Percentage of economy in the informal sector: 43	
Ranking in Doing Business Report: 66				

ANNEX III. COLOMBIA: STATISTICAL ISSUES

Data provision is adequate for surveillance. 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.

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. Estimates of GDP by the production and the expenditure approcahes both use 2000 as their base year. GDP compilation conforms to the methodological recommendations of the System of National Accounts 1993 (*1993 SNA*). The revision of the national accounts' base year (announced in December 2006) resulted in step increases in nominal GDP levels of about 12 percent with respect to the prior official estimates. Most of the revisions reflected improvements in source data, although methodological improvements regarding GDP calculations/estimates also affected nominal GDP levels.

Government finance statistics

The Ministry of Finance and Public Credit (MFPC) is responsible for the compilation of public revenue, expenditure, and financing data. While significant progress has been made, there is still a need to improve the timeliness and coverage of fiscal data, develop timely and reliable data on the finances of local governments, and improve monitoring of floating debts. Data cover the nonfinancial public sector (NFPS), but coverage of "above-the-line" operations of units outside the national administration is not exhaustive due to capacity constraints.

The General Accounting Office (GAO) has developed a single accounting database for the public sector. The GAO accounting classification is bridged to the *GFSM 2001* framework to compile GFS on accrual and cash bases. The information is sent to the Statistics Department of the IMF for publication in the *Government Finance Statistics Yearbook (GFS Yearbook)*.

Monthly data have been reported for publication in *IFS* and annual data for subsectors of general government on accrual and cash bases have been reported for publication in the *2007 GFS Yearbook*, with data up to 2006. Data for the consolidated general government have not been published yet because of shortcomings in the consolidation process.

Financial sector statistics

The BdR is in charge of compiling data on the financial sector, while the Superintendency of Banks and the Superintendency 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. The introduction of a new call report form in March 2005 significantly improved the quality of monetary statistics. In mid-2007, the authorities migrated to the new standardized forms for reporting to STA monetary data for the central bank (form 1SR) and other depository corporations (form 2SR). Currently, they are finalizing the migration to the standardized forms for other financial corporations (form 4SR).

Balance of payments and external debt

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 service 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. The BdR should reclassify FDI intercompany debt transactions from “other investment” to FDI and some FDI equity transactions to portfolio equity, and adjust the related investment income series accordingly. Also, it should continue efforts to identify government bonds issued abroad and purchased by residents as well as those purchased by residents on the secondary market.

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: Table of Common Indicators Required for Surveillance
As of December 3, 2008

	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	Oct. 2008	11/18/08	D	W	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[2]	Oct. 2008	11/18/08	M	M	M		
Reserve/Base Money	Aug. 2008	11/18/08	D	W	W	LO, O, LO, LO	O, O, O, O, O
Broad Money	Jul. 2008	11/18/08	D	W	W		
Central Bank Balance Sheet	Aug. 2008	11/18/08	M	M	M		
Consolidated Balance Sheet of the Banking System	Aug. 2008	11/18/08	M	M	M		
Interest Rates[3]	Oct. 2008	11/18/08	D	W	D		
Consumer Price Index	Oct. 2008	11/18/08	M	M	M		
Revenue, Expenditure, Balance and Financing Composition[4] – General Government (GG)[5]	Q2 2008	Oct. 2008	Q	Q	Q	O, O, LO, O	LO, O, O, O, NO
Revenue, Expenditure, Balance and Composition of Financing[4] – Central Government	Q2 2008	Oct. 2008	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[6]	June 2008	Oct. 2008	Q	Q	Q		
External Current Account Balance	Q2 2008	Oct. 2008	Q	Q	Q	O, LO, LO, LO	O, O, O, O, LO
Exports and Imports of Goods and Services	Q2 2008	Oct. 2008	Q	Q	Q		
GDP/GNP	Q2 2008	Oct. 2008	Q	Q	Q	O, LO, O, O	LO, O, LO, LO, NO
Gross External Debt	Aug. 2008	Oct. 08	M	M	M		
International Investment Position[7]	Q2 2008	Oct. 2008	Q	Q	Q		

[1] Daily (D); Weekly (W); Monthly (M); Bi-monthly (B); Quarterly (Q); Annually (A); Irregular (I); Not Available (NA).
[2] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[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.

INTERNATIONAL MONETARY FUND
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Public Information Notice (PIN) No. 09/08
FOR IMMEDIATE RELEASE
January 26, 2009

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2008 Article IV Consultation with Colombia

On January 14, 2009, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Colombia.[1]

Background

Colombia's economy has performed well in recent years**.** Economic growth in 2006-07 exceeded the regional average by a substantial margin. However, GDP growth slowed to about 4 percent (y/y) in January-September 2008, reflecting less buoyant domestic demand conditions and weaker global economic growth.

Colombian financial markets have been affected by the recent global turbulence, although debt and interbank markets have continued to function normally. Since mid-September 2008, spreads on credit default swaps (CDS) and equity prices have generally moved in line with the rest of the region, although EMBI and corporate bond spreads have risen more. External trade credit lines to domestic banks have been affected only modestly, although interest rates have risen.

[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. 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.

The authorities have acted swiftly to bolster confidence and ensure that the private sector retains access to credit. They have secured financing from multilateral institutions and private capital markets for 2009, which will *inter alia* permit Colombia to meet its public sector external financing requirements. The monitoring of liquidity has intensified, with frequent contacts with the banking sector to keep abreast of the latest developments. As a preventive measure, the Banco de la República (BdR) has also reduced reserve requirements and injected liquidity through open market operations.

As in other countries in the region, inflation has increased, driven mainly by higher food and fuel prices, although overheating pressures have also played a role. Nontraded goods inflation—a good indicator of underlying demand pressures—rose in the first half of the year. Inflation expectations remain outside the BdR's medium-term inflation target (2–4 percent).

The peso appreciated by about 15 percent in real effective terms between end-2007 and mid-June, but since then it has weakened, reflecting the decline of commodity prices and turbulence in international financial markets. Citing prudential considerations, the BdR stepped up its FX intervention in June, replacing the US$150 million monthly options-based auctions introduced in March with daily US$20 million purchases in the spot market. Against the backdrop of a weakening peso, the BdR suspended its daily purchases of foreign currency in early October. It also reinstated the automatic FX intervention rule, which had been suspended in June. Capital controls, which had been tightened at mid-year, were also eliminated in October.

Monetary policy was tightened in recent years to lower inflation and bring the growth of domestic demand to more sustainable levels. The BdR raised its policy interest rate by 400 basis points (to 10 percent) between April 2006 and July 2008 to rein in the growth of credit and domestic demand. Against this background, credit growth (y/y) slowed from about 35 percent in early 2007 to about 20 percent by September 2008. The policy rate was, however, lowered by 50 basis points in December 2008 against the backdrop of weakening global and domestic growth.

Fiscal policy has been expansionary, but public debt has continued to decline. Despite the mid-year decision to cut government outlays relative to the original budget, the fiscal stance in 2008 has remained expansionary. Nevertheless, strong economic growth over the past few years has led to a marked reduction of public debt ratios, which are now close to the average for emerging market economies at investment grade.

Financial soundness indicators remain solid. Although nonperforming loan ratios (NPLs) have risen—especially for consumer credit—banks are well provisioned and profitable, and expected default probabilities remain low. There is no evidence of extraordinary reductions of activity by subsidiaries of foreign banks. External credit lines account for a small share of banking system liabilities, and reliance on wholesale (nondeposit) financing is also moderate.

Executive Board Assessment

Executive Directors commended the Colombian authorities for implementing sound macroeconomic policies and wide-ranging structural reforms, which had contributed to rapid growth and reduced vulnerabilities. Directors considered that, with improved economic fundamentals and a healthy banking system, Colombia is well-placed to confront the challenges posed by the ongoing global downturn. They emphasized nonetheless the need for continued flexible and timely policy responses.

Directors considered that the authorities’ fiscal policy appropriately allows for some relaxation in the budget deficit in the near term, while keeping public debt ratios on a declining path. They underscored the importance of adhering to the fiscal targets incorporated in the medium-term fiscal plan, to reassure markets of the authorities’ commitment to reduce fiscal vulnerabilities further. At the same time, financing conditions would continue to be a key consideration in determining the scope for additional fiscal easing if economic growth turns out to be weaker than presently envisaged. Directors suggested that consideration be given to the adoption of a fiscal rule over the medium term to strengthen the policy framework. They also encouraged the authorities to further improve the efficiency of the tax system and reduce budget rigidities.

Directors agreed that the monetary policy stance should aim at steering the economy toward a soft landing. They welcomed the efforts to reduce inflation to its medium-term target. The recent reduction of interest rates was deemed appropriate in view of the weakening economy. Going forward, Directors stressed that continued close monitoring of forward-looking indicators of economic activity and inflation expectations will be necessary to guide the course of monetary policy.

Directors considered that Colombia’s flexible exchange rate regime has helped maintain external stability in the face of a rapidly changing external environment. Greater stability in exchange rate intervention practices would also strengthen the policy framework. In this regard, Directors welcomed the wider band for the automatic intervention rule, under which exchange rate intervention would take place less frequently. Directors welcomed the authorities’ elimination in October 2008 of the capital controls imposed in mid-2007. Noting the difference in views between the staff and the authorities on the effectiveness and impact of capital controls in the short run, some Directors considered that capital controls should remain in the authorities’ toolkit in case the need should arise in the future. A few Directors encouraged the authorities to remove the exchange restriction arising from the special regime for the hydrocarbons sector.

Directors noted that the financial sector has significant buffers and that, based on stress-testing undertaken by the authorities, it is expected to remain solvent under a number of extreme scenarios. They suggested extending stress-testing to a broader range of macroeconomic and global financial scenarios, and agreed that credit risk should be closely monitored given the rising nonperforming loan ratios. Directors welcomed recent efforts to strengthen the crisis prevention framework, improvements in financial sector monitoring and financial safety nets, and measures to help prevent liquidity problems. They saw scope for further strengthening the bank resolution process and the deposit insurance system, with technical assistance from the Fund. Greater clarity is also needed with respect to the circumstances under which emergency liquidity support would be provided.

Directors encouraged the authorities to move forward with their structural reform agenda. They welcomed progress in improving the regulatory framework for derivatives, and the proposed development of a multi-tier pension system. A strengthening of creditor rights and greater independence for financial sector supervisors remain important priorities.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Colombia: Selected Economic Indicators

	2004	2005	2006	2007	Proj. 2008
(Percentage changes, unless otherwise indicated)					
National income and prices					
Real GDP	4.7	5.7	6.8	7.7	3.5
Consumer prices (end of period) 1/	5.5	4.9	4.5	5.7	7.7
Nominal exchange rate (depreciation+, end-of-period) 1/	-14.0	-4.4	-2.0	-10.0	11.6
Real effective exchange rate (depreciation +)	-13.4	-11.6	1.9	-8.2	...
Money and credit					
Broad money	19.2	17.6	18.0	17.4	35.9
Credit to the private sector	29.8	11.3	38.5	23.5	17.5
Real interest rate (90-day time deposits; percent per year)	2.3	1.4	2.3	3.5	...
(In percent of GDP, unless otherwise indicated)					
External sector					
Current account (deficit -)	-0.8	-1.3	-1.8	-2.8	-3.6
External debt	31.5	26.2	23.4	20.9	22.7
Of which: public sector	20.6	16.4	15.3	13.5	14.6
Net official reserves (in months of imports of goods and services)	6.4	5.8	4.9	5.4	6.1
Savings and investment					
Gross domestic investment	20.1	21.6	24.3	24.9	24.3
Gross national savings	19.3	20.3	22.5	22.0	21.2
Public finances					
Combined public sector balance	-1.1	0.0	-0.7	-0.6	-0.8
Nonfinancial public sector balance	-1.3	0.0	-1.0	-0.8	-0.9
Central government balance	-4.7	-4.1	-3.4	-2.7	-2.6
Public debt 2/	42.4	38.8	35.9	32.8	31.7

Sources: Colombian authorities; and Fund staff estimates and projections.

1/ Actual figure for 2008.
2/ Includes bonds issued to recapitalize financial institutions.

Statement by the IMF Staff Representative on Colombia
January 14, 2009

1. This statement reports on developments since the issuance of the staff report for the 2008 Article IV Consultation. It does not change the thrust of the staff appraisal.

2. **Recent data releases point to a continued economic slowdown, consistent with staff projections**.

- Real GDP growth declined to 3.1 percent (y/y) in the third quarter, driven mainly by weaker domestic demand. Recent figures on industrial production and retail sales are also consistent with the further slowdown envisaged by staff for the fourth quarter. We are keeping our GDP growth estimates unchanged, both for 2008 and 2009.

- Headline inflation was 7.7 percent (y/y) in December, slightly above the staff forecast, owing largely to higher food prices.

3. **Declining oil prices are leading to a widening of the external current account deficit.** The current account deficit is now expected to be 3½ percent of GDP in 2008 and 3½–4 percent of GDP in 2009. Additional public sector external borrowing is expected to help finance the larger deficit in 2009.

4. **The authorities eased monetary policy in late December**. The Banco de la República reduced its policy rate by 50 basis points (to 9.5 percent), citing the continued weakening of economic activity and improved inflation expectations.

5. **The authorities have recently indicated that they will allow some further easing of fiscal policy in 2009**. The target for the overall deficit of the combined public sector will now be about ½ percent of GDP higher than envisaged in the budget. The authorities have reiterated their commitment to their medium-term fiscal targets, and staff continues to project that public debt will decline steadily as a ratio of GDP.

6. **Colombia has taken advantage of improved global financial conditions to tap international capital markets**. Following the recent decline in sovereign bond spreads, in early January the government placed US$1 billion (½ percent of GDP) in 10-year bonds, at a yield of 7½ percent. Financial conditions have also improved in the domestic markets, with long-term government bond rates having declined by about 250 basis points between early November 2008 and early January.

Statement by María Inés Agudelo on Colombia
January 14, 2009

I thank staff for the interesting and helpful discussions during the mission and for an accurate report. My authorities appreciate the advice provided, take serious consideration of the recommendations and value the in-depth analysis and conclusions of the selected issues paper.

Several years of strong economic performance, progress in structural reforms and improvement in the security situation give the country support to face the current international financial and economic crisis. Staff and the authorities coincide, in general, with the medium-term outlook and with the policy options to face a less favorable economic environment. Equally, they agree with the identified risks and the restrictions they inflict.

To understand the recent dynamics of the Colombian economy, it is essential to remember that the concerns, one year ago, were the risks posed by a dynamic economic activity that was considered above potential. Signs of overheating were pushing the authorities to take action to ensure a soft landing. In fact, during the first part of 2008, previous policy decisions on the monetary and fiscal fronts were already doing their job and economic growth was reduced to levels more consistent with potential, expecting that for the medium term economic growth will be more at the 5-5.5 percent range.

The international financial crisis and its effect on the global economic growth will put pressure on an already weak domestic demand. In addition to a tight monetary policy, a reduced disposable income, as a result of fuel and food prices increases, and low levels of public investment have induced a reduction on growth of domestic demand. In addition, exports of Colombian goods and services to Venezuela are lower now. On the supply side, nearly every economic activity has been affected, with industrial production now in the negative side and with weak commercial activity. As a result, after a record year of economic growth in 2007 of almost 8 percent, economic activity dropped to just 3 ½ percent in 2008 and it is expected to be below that this year.

Fiscal policy

The 2008 fiscal deficit is expected to remain at 0.8 percent of GDP, the initial target set by the government. Although income revenues were significantly lower than originally planned, the government announced, in mid-year, expenditure cuts, committing to the targets set in the Medium-Term Fiscal Framework and keeping public debt in a downward trend. Gross public debt was reduced to just above 30 percent of GDP from over 40 percent five years ago.

Budget discussions for this year were driven by the idea of reducing further public debt and keeping fiscal deficit at about 1.2 percent of GDP. However, the government is facing now a significant reduction of revenues due to lower economic activity and, recently, it announced a further cut in expenditures to partially compensate the revenue loss.

My authorities agree with staff that under a more adverse growth scenario, financing conditions would be determinant to allow for a larger fiscal deficit. In that sense, the government gives serious consideration to a well-functioning domestic public debt market, to the dynamics of interest rates and to the avoidance of any potential crowding out of the private sector. In particular, the authorities do not want to put pressure on scarce financial sector resources and wish to limit the willingness of banks to finance the public sector over the private sector. Fortunately, international markets are still open and Colombia successfully issued a new bond for one billion dollars during the first week of this year. As a result, the fiscal deficit will increase by ½ percentage point of GDP financed externally.

One final consideration on fiscal policy. Although Colombia has improved substantially its fundamentals and the country faces the global crisis with a strong foot, the possibility of having a "fiscal package" is limited. With a lower than expected economic growth, the government has to concentrate on finding resources to fill the gap left by revenue losses, leaving no room for being active on public expenditure. In other words, only automatic stabilizers can operate and only up to a point. In fact, box 3 of the staff report gives good support to the fact that only when financing is not an issue, fiscal policy can contribute to stabilize the economy. Under the current circumstances, liquidity restrictions and the lack of resources in global markets might be a real issue, limiting the possibility for a country like Colombia to have an active anti-cyclical fiscal policy.

Monetary and exchange rate policies

My monetary authorities agree with the assessment and recommendations made by staff with respect to monetary policy. I only want to add at this point that after a long period of monetary tightening during which the central bank increased its interest rate by 400 basis points, at the December meeting the rate was reduced by 50 basis points.

Since April 2006, monetary tightening was driven by the need to reduce pressures coming from domestic demand, to reduce credit growth and to limit second round effects of food and fuel prices. The current and expected external and domestic conditions give today room for a relaxation of monetary policy and for a change in the policy stance. Global inflation is coming down, domestic and external demand are weak and long-term interest rates and expectations are lower. In addition, for the last couple of years, the central bank has explicitly taken decisions to accumulate international reserves and, as a result, today the country has a comfortable level of international reserves at 10 percent of GDP.

At the Board discussion last year, we agreed with staff that capital controls should be temporary, given that in the long term they are ineffective and that financial markets and stock markets are negatively affected. During 2008, capital controls were removed.

My authorities are not completely satisfied with the main conclusions of the paper on capital controls, as support for "main drawbacks" are not warranted. I want to highlight the fact that although the evidence suggests that capital controls did not successfully affect capital flows (even if it reduced inflows of foreign borrowing) nor the level of the exchange rate, the association with an increase in volatility is not clear and the evidence to support this conclusion is weak. The fact is that exchange rate volatility is higher in Colombia than in any other country in Latin America, even during the very recent period of depreciation and appreciation of the exchange rate when capital controls where not in place. Staff points out that portfolio investment of Colombian pension funds might play a role, but further work in this area is needed.

In addition, measures taken to limit capital inflows into the country are part of a larger package with the aim of securing financial stability and reducing vulnerabilities to foreign exchange risks. We have to remember that at the same time other measures were taken (for example, limits on derivative positions). My authorities have made it clear that reducing balance sheet effects coming from exposure to foreign currencies was one of the objectives of the whole package of the measures taken. In fact, the observed reduction of external debt gave them comfort. Today the banking and the corporate sector are less vulnerable to the external markets lack of liquidity. The authorities response to the appreciation of the peso during the last years finds support in the deep believe that an economy, the size and characteristics of Colombia, is too vulnerable to the dynamics of external capital flows and to large swings of the exchange rate.

The complete package of policies in this front included, in addition, an increase in reserve requirements on bank deposits. Under large capital inflows, there was a real need to increase the effectiveness of monetary policy. The evidence of the staff paper might suggest this objective was also achieved.

Financial sector

My authorities share the assessment of staff on financial sector issues. The Colombian financial sector has sound indicators and stress tests show that they might remain adequate even under extreme circumstances. The liquidity at the inter-bank market has been working steadily without interruptions and deposits keep growing. My authorities concur with the main recommendations for further financial sector reforms and they are currently discussing with Congress some of these issues.

Risks

With strong financial markets and the correct macroeconomic policies, the Colombian economy should be well placed to weather the current global difficulties. However, risks in the external front are important and may challenge the current solidity of the economy. While my authorities are particularly concerned with expectations on economic growth of our main commercial partners (US, Venezuela and Ecuador) and the effect of reduced oil prices on our neighbors' economy, the baseline scenario is already introducing harder external conditions. In any case, they are ready to adjust economic policies according to evolving circumstances while remaining committed to long-term sustainability.