COLOMBIA

1. General trends

The Colombian economy grew by 4.3% in 2010, exceeding expectations; and there are clear indications that the upswing recorded in the final quarter of the year will continue throughout 2011. The economic strategy pursued by the government of President Santos, who took office in August 2010, focuses on five key sectors that have been identified as engines of economic growth: innovation, agriculture, transport infrastructure, mining and housing. The unusually heavy rainfall seen since the second half of 2010 has so far not affected the performance of trade and industry or the business and consumer confidence indices, which in early 2011 were up on the previous year. However, in dealing with the severe weather situation and rebuilding hard-hit economic and social infrastructure, care will need to be taken not to undermine efforts to maintain a healthy fiscal position. Against this backdrop, ECLAC forecasts growth of around 5.3% in 2011.

In 2011 the agencies Fitch Ratings, Standard & Poor's and Moody's all raised Colombia's credit rating to investment grade. The reasons cited were macroeconomic stability, a favourable medium-term growth outlook, effective public-debt management and a sounder legislative framework governing fiscal management.

2. Economic policy

(a) Fiscal policy

In 2010 the government cut spending by 2.8% with respect to 2009, aiming to boost the sustainability of public finances without jeopardizing social programmes. Interest payments on the external debt were reduced by 5.1% and a new system of fuel subsidies was implemented, thus expanding the fiscal space for poverty reduction programmes such as Families in Action, whose budget allocation increased by 33%. Although the heavy rains forced the government to redirect spending and created extra commitments during the emergency phase, the fiscal balances showed an improvement over 2009.

Economic uncertainty during 2009 brought predictions of lower tax receipts and capital resources for 2010, but those predictions were ultimately not borne out. Although a deficit of 4.4% of GDP was forecast, at year-end the central government was running a deficit of 3.8% of GDP (0.3 points below the 2009 level), even with the unexpected expenses arising from the extreme weather. This better fiscal balance resulted from a contraction in spending of 2.8% combined with higher tax receipts generated by the upturn in economic activity. Receipts from the value added tax (VAT) and customs duties grew sharply (12.5% and 16.3% respectively); customs duties in particular benefited from an import boom. The non-financial public sector deficit stood at 3.1% of GDP, which compared with 2.4% in 2009. This was attributable to a marked drop in the decentralized sector's surplus –from 1.7% to 0.7%– mainly because of higher expenditure by local governments, rising reimbursements for medicines and medical services not covered by the health plan and the gradual depletion of the Fuel Price Stabilization Fund (FEPC). Net central government debt stood at 37.4% of GDP (as against 36.8% in 2009), owing in the main to an increase in domestic debt of 11.6%.

With a view to safeguarding public finances and their countercyclical role, as well as boosting the economy and improving tax revenues, the government has proposed new measures to foster the country's competitiveness and set out clear rules to buttress fiscal responsibility. These include establishing a goal that the total central government structural balance should not exceed an annual deficit of 1.5% of GDP and a constitutional reform incorporating a summary review of fiscal capacity as a yardstick of State administration in upholding the economic, social and cultural rights of all citizens. A tax and competitiveness law was also passed, simplifying the tariff structure, eliminating tax distortions and abolishing excess non-salary company expenses, the most important being the electricity surcharge. In addition, a reform of the health-care system was passed that establishes the funding and uses of the system, thereby creating a framework for fiscal sustainability. The desired effect is to bring in an additional 1.5% of GDP in tax receipts over the next four years.

According to government estimates for 2011, the consolidated public sector deficit (excluding any weather-related expenditure) will be 3.0% and the central government deficit will be 3.6% of GDP, similar to the 2010 figures. This consistency is attributable to anticipated growth of 0.4 percentage points of GDP in tax receipts, thanks to robust economic performance and to the package of reforms advanced by the government. Increased oil production and high oil export prices will help boost government revenue from taxes on profits and dividends. Central government spending is also expected to rise, but not to quite the same extent as revenue. The equivalent of 0.3% of GDP will go towards strengthening the five key sectors.

The challenge for the fiscal authorities in 2011 will be to ensure fiscal sustainability despite additional spending related to the severe weather situation and reconstruction efforts. One solution pursued by the government was to strengthen the special fund that oversees the organization of reconstruction projects and transfers of resources. The fund’s initial budget will be around 260 billion Colombian pesos, made available through a reallocation of resources, chiefly special housing and royalty funds.

(b) Monetary policy

The expansionary monetary policy adopted in 2009 was maintained in 2010. It was supported by the fact that inflation remained within the target range and by the economic recovery, which, although significant, fell short of the potential growth rate.

The central bank’s policy rate stood at 3.5% in early 2010 and was cut by 50 basis points in April, to remain at 3.0% for the rest of the year. This policy translated into low nominal lending and borrowing rates, which fell by 60 and 115 basis points respectively between December 2009 and December 2010. Interest rates on household loans followed the same pattern: the consumer rate dropped from 20.2% to 16.8%; the credit card rate fell from 25.2% to 21.0%; and the mortgage rate edged down from 13.9% to 13.0%.

Falling interest rates generated growth in consumer, commercial and mortgage lending, which were up 16.4%, 19.1% and 6.8% respectively. This was reflected in the recovery of household consumption, private investment and home purchases. Demand for home loans was fuelled by the interest-rate subsidy, one of the pillars of the countercyclical policy.

Given the upturn in the domestic and world economy, and amid expectations that inflation would rise in the long term, the central bank’s board of directors announced a gradual shift in the monetary stimulus policy for 2011. Accordingly, during the first half of the year the policy rate rose by 25 basis points on five occasions, to stand at 4.25%.

With regard to monetary aggregates, the main source of primary liquidity in 2010 was foreign currency acquisition by the central bank through direct auctions. Between December 2009 and December 2010 the monetary base posted nominal annual growth of 13.5%, while M1, M2 and M3 increased by 17.7%, 10.2% and 11.4% respectively.

(c) Exchange-rate policy

Like other Latin American countries, Colombia is experiencing strong pressure towards currency appreciation, owing to capital inflows and higher commodity prices. In 2010, international risk aversion waned, and inflows from foreign direct investment and portfolio capital surged to US$ 11.834 billion. In effect, larger inflows of portfolio capital and the use of foreign credit to finance Colombian investment overseas led to an appreciation of 7.0% in the nominal exchange rate during the first few months of the year. By way of response, in March 2010 the central bank began buying reserves of US$ 20 million in daily auctions (which had been suspended in October 2008), accumulating US$ 3.06 billion over the course of the year. The auctions between March and June generated a depreciation of 0.9% in the exchange rate, while those carried out between September and December triggered a drop of 7.0%. Despite these efforts, the year closed with a nominal appreciation of the Colombian peso of 6.4%. The real effective exchange rate mirrored this process, recording a depreciation of 5.6% in 2009 and an appreciation of 13.1% in 2010.

In 2011 the central bank has continued to intervene in the currency market through daily auctions, but the trend towards appreciation is holding firm. Colombia's challenge this year is to contain currency appreciation in order to foster the country's competitiveness without driving up inflation in the process.

(d) Trade policy

The government has stated that one of the mainstays of growth is the country's positioning in the international arena, involving a comprehensive external policy that goes beyond economics and trade.

With a view to increasing Colombia's participation in the world economy and diversifying its markets, the National Development Plan contains a proposal to step up the negotiations on international trade agreements, such as the free trade agreements with Canada, the European Free Trade Association (EFTA), the United States and the European Union. It also proposes developing closer ties with the region and with Asia and the Pacific, and promoting the country's admission to the Organization for Economic Cooperation and Development (OECD) and the Asia-Pacific Economic Cooperation (APEC) forum.

From this new perspective, diplomatic relations with the Bolivarian Republic of Venezuela were re-established and trade links were reactivated; the first step in this new phase was the payment of the Venezuelan government's debt to Colombian business operators.

In June 2011 the free trade agreement with Canada was ratified; and it is expected that the United States Congress will ratify the free trade agreement with that country this year. In addition, the impact of the merger of the Chilean, Colombian and Peruvian stock exchanges will begin to become apparent during the year.

3. The main variables

(a) Economic activity

Based on preliminary official data, the Colombian economy grew by 4.3% in 2010.[1] All sectors performed well, with the exception of agriculture, which showed no growth. The economy's strong

[1] The National Administrative Department of Statistics (DANE) of Colombia took the unusual step of correcting its figure for GDP growth in 2009, revising it upwards from 0.8% to 1.5%.

performance was mainly attributable to mine and quarry exploitation (11.1%), trade (6.0%), industry (4.9%) and transport (4.8%). The remarkable buoyancy of the mining-energy sector was due to a leap of 16.9% in the value added of crude oil, natural gas and minerals. This testifies to the newly acquired importance of this sector to Colombia's economic growth, in view of international prices and the higher volume of production of crude oil (17.6%), natural gas (6.4%) and coal (2.0%).

The components of demand provide further evidence of good economic performance in 2010. The increase of 5.9% in domestic demand offset a net decline in external activity. A sustained expansion was seen throughout the year in both private and government consumption, which posted growth of 4.3% and 4.7% respectively at the end of 2010. The strengthening of the machinery and transport equipment sector, together with vigorous growth in public works, contributed to the 11% rise in investment. Imports expanded by 14.7% thanks to high volumes of investment and consumption, and to currency appreciation. Exports grew by 2.2% and overcame last year's slump.

The upturn witnessed towards the end of last year is continuing into 2011, with GDP growth of 5.1% recorded in the first quarter. The positive expectations regarding household spending were borne out by growth in industry, driven, among other factors, by a surge in car sales. Investment indicators are also performing well, as reflected in imports of machinery and equipment and construction licences; this early construction indicator saw a variation of 66.4%, an all-time high. Low interest rates and the wide availability of credit will continue to be conducive to consumption and investment. To 30 April 2011, consumption registered the strongest growth, followed by mortgages and trade, all with real annual increases. Moreover, this year Colombia must begin repairing the damage to housing and road infrastructure caused by the heavy rains, which will mean higher spending in these sectors.

(b) Prices, wages and employment

The pressure on food prices owing to heavy seasonal rainfall and to higher international prices for some agricultural commodities in 2010 has not prevented Colombia from achieving its inflation target. The inflation rate was 3.2% in 2010, which falls within the target range of 2%-4%. Food and housing contributed the most to this growth; together they accounted for over 70% of the total variation. The components showing the greatest price increase were health, food, education and housing. In contrast, communications and clothing experienced negative variations. End-of-year inflation, not including food, saw a variation of 2.8%, remaining stable with respect to 2009.

For 2011 the central bank has maintained an inflation target of between 2% and 4%. To May, year-on-year inflation stood at 3.0%, mainly owing to rising food prices in late 2010 and early 2011, a trend which has reversed since March, when the prices of perishable goods in particular began to fall. With core inflation below 3%, the bank considers the supply shocks seen in late 2010 to be temporary; nevertheless, to ease the pressure, the bank's board tightened monetary policy, seeking to keep inflationary expectations within the target range without affecting growth and employment in the short term.

The labour market responded favourably to greater economic activity in 2010. The unemployment rate dropped from 12.0% in 2009 to 11.8% in 2010, despite growth in the participation rate from 61.3% to 62.7%. The indicator for urban unemployment registered the best performance (a decrease from 13.0% to 12.4%); rural unemployment, however, climbed from 7.9% to 8.5%, a position which then took root as a consequence of the extreme weather conditions in the second half of the year. Despite some good results, employment quality is a concern, since most new jobs consist of self-employment and are generally described as informal. The rate of informal employment has not moved from the 51% recorded in 2008, and the unemployment rate among 14 to 26 year olds stood at around 20% for the whole year, remaining stubbornly higher than general unemployment. To tackle this problem, legislation on formalizing and creating employment was passed, granting tax breaks to companies formalizing their business and hiring people under the age of 28 by allowing them to offset payroll taxes against the income tax.

In the first quarter of 2011 the unemployment rate showed a downward trend consistent with economic recovery, edging down from 13.0% to 12.4% at a national level. This trend appears to be borne out when comparing data for April 2010 (12.2%) with that for the same month in 2011 (11.2%). The urban unemployment rate in the first quarter of 2011 decreased from 13.7% to 13.4% and rural areas also recovered (from 9.0% to 7.9%). The best recovery, however, was seen in the category of self-employment.

(c) The external sector

In 2010, the current account deficit widened by around 1 percentage point to 3.1% of GDP, mainly on the strength of buoyant imports, increased outflows due to higher profits among transnational companies in the mining sector and a 2.9% drop in worker remittances. The dollar value of imports rose by 23.7%, spurred by vehicles and vehicle parts and electrical sound and image recording equipment and appliances (35.3%). The dollar value of exports in 2010 meanwhile rose by 21.2% with respect to 2009, thanks to vigorous growth (41.2%) in traditional exports. Sales of oil and oil products expanded both in value terms (60.6%) and in volume terms (27.1%). Non-traditional exports, however, decreased by 2.9%, mainly because of lower sales of live animals and animal products (-75.6%) and textiles (-38.7%). Trade with the Bolivarian Republic of Venezuela continued to deteriorate, with a 64.9% fall in exports. This was partly due to a total block on meat exports, following which the sale of live animals and animal products plummeted by 99.5%. This situation was offset by an increase of 28.8% in non-traditional exports to the Andean Community.

Estimates indicate that the external sector will continue to expand this year. In April, the value of exports increased by 37.2%, owing to higher commodity prices; sales of oil and oil products grew by 60.9% in value and by 23.8% in volume. The value of imports rose by 36.7%, mainly as a consequence of the higher value of imports of vehicles and vehicle parts, boilers, machinery and parts, and fuels and mineral oils.

In 2010 the financial account posted a surplus of US$ 11.878 billion, which was US$ 4.744 billion up on 2009. This is attributable to capital inflows, thanks to higher net external debt, largely in the private sector. A total of US$ 6.504 billion left the country as outward foreign direct investment (FDI), taking the form of shares in mining and quarrying, financial intermediation and industry. FDI flows remained high, despite dipping slightly from US$ 7.137 billion in 2009 to US$ 6.760 billion in 2010 (2.4% of GDP). Inflows to the oil sector increased by 17.8% and oil and mining activity received 72.7% of registered net inflows. A bigger FDI drive is anticipated for 2011.