November 2006
IMF Country Report No. 06/408

Colombia: 2006 Article IV Consultation and the Third and Final Review Under Stand-By Arrangement—Staff Report; Public Information Notice and Press Release 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 a combined discussion of the 2006 Article IV consultation with Colombia and the third and final review under the Stand-By Arrangement, the following documents have been released and are included in this package:

- the staff report for the combined 2006 Article IV Consultation and the Third and Final Review Under Stand-By Arrangement, prepared by a staff team of the IMF, following discussions that ended on September 1, 2006, with the officials of Colombia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on October 16, 2006. 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 Public Information Notice (PIN) and Press Release, summarizing the views of the Executive Board as expressed during its October 30, 2006, discussion of the staff report on issues related to the Article IV consultation and the IMF arrangement, respectively; and

- a statement by the Executive Director for Colombia.

The documents listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Colombia*
Selected Issues Paper
*Also be included in Staff Report

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

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publicationpolicy@imf.org.

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International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

COLOMBIA

Staff Report for the 2006 Article IV Consultation and the Third and Final Review Under Stand-By Arrangement

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

Approved by Caroline Atkinson and Michael T. Hadjimichael

October 16, 2006

- **Article IV Consultation.** The mission took place soon after the second inauguration of President Uribe, who won re-election for another four-year term by a wide margin in May 2006. This timing offered a good opportunity to assess the government's economic policy strategy through 2010, drawing on lessons from the past four years. The Staff Report for the 2005 Article IV Consultation, together with the views of the Board and the authorities, was published on May 9, 2005 on the Fund's website.

- **Fund program.** The authorities will exit from formal Fund support when the current (precautionary) Stand-By Arrangement ends on November 2, 2006. This arrangement was approved in April 2005 in the amount of SDR 405 million (35 percent of quota on an annual basis). Colombia has no outstanding credit from the Fund and has accepted Article VIII, Sections 2, 3, and 4.

- **Third Review**. In their letter dated October 16, 2006 the authorities request completion of the third and final review. The staff supports this request. All quantitative performance criteria for end-June 2006 were met with substantial margins. The structural performance criterion for July 2006 (submission of a 2007 budget consistent with a CPS deficit of 1.7 percent of GDP) and the continuous performance criteria were observed. Key structural benchmarks were met, including submitting reforms of the tax system and intergovernmental revenue sharing.

- **Discussions**. A staff team visited Bogotá from August 21 to September 1, 2006. It met with the Minister of Finance, Mr. Alberto Carrasquilla; the General Manager, Mr. José Uribe, and the Board of Directors of the Banco de la República; the Director of the National Planning Department, Ms. Carolina Renteria; other senior government officials, members of Congress, and representatives of the private sector. The team comprised R. Rennhack (Head), R. García-Saltos, H. Kamil (all WHD), I. Adenauer (FAD), S. Reichold (PDR), and D. Gray (MCM). Mr. Steiner (OED) participated in all policy discussions.

- **Statistics**. Colombia has high-quality economic statistics and subscribes to the SDDS. A data ROSC was completed in September 2006.

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EXECUTIVE SUMMARY

The authorities will exit from formal Fund support when the current arrangement expires on November 2, 2006.

The economy continues to perform well, although there are some signs of possible overheating. In 2006, Real GDP is expected to grow by about 5 percent for the third year in a row, and the economy is probably operating near capacity. Inflation is targeted to fall to 4 ½ percent, the lowest level in decades. The external current account deficit is projected at 1.6 percent of GDP, while net international reserves would reach about 150 percent of short-term debt by end-2006. Financial indicators remain sound. The 2006 elections strengthened confidence, as President Uribe won re-election by a wide margin.

The authorities have begun to address the risk of overheating, although demand policies may need to be tightened further. The central bank is commited to achieve its inflation target and has raised its policy interest rate by 100 basis points since April 2006. However, staff recommends that fiscal policy play a more supportive role in containing the growth in demand to ease the burden on monetary policy. The staff sees clear benefits to limiting the combined public sector (CPS) deficit in 2006 to around 1 percent of GDP, below the target of 1.5 percent of GDP.

Over the next four years, the government's macroeconomic policies aim at continuity. The authorities' medium-term goals are as envisaged in the program. Fiscal policy is being framed with the goal of reducing public debt to 40 percent of GDP by 2010. Monetary policy will be aimed at lowering inflation further to 2-4 percent over the medium term.

The authorities plan to deepen structural reforms. They recently submitted to congress comprehensive reforms of the tax system and of intergovernmental transfers, and in the coming months intend to present for congressional approval financial sector reforms and a free trade agreement with the United States. The authorities have also introduced a plan to capitalize Ecopetrol to improve its efficiency. Staff supports these reforms, but notes there is scope to improve the tax system further, including by reducing the number of VAT rates further and phasing out the financial transactions tax.

Staff broadly supports this strategy, but with the following caveats. The authorities' medium-term fiscal plan will strengthen the economy and build resilience. However, staff pointed to the benefits of bringing public debt decisively below 40 percent of GDP to provide greater protection from shocks, such as a possible downturn in the global economy. The flexible exchange regime adopted in 1999 continues to serve Colombia well, but staff believes that less reliance on foreign exchange intervention would be helpful. The transition to risk-based supervision in line with Basel II will need to proceed with due caution.

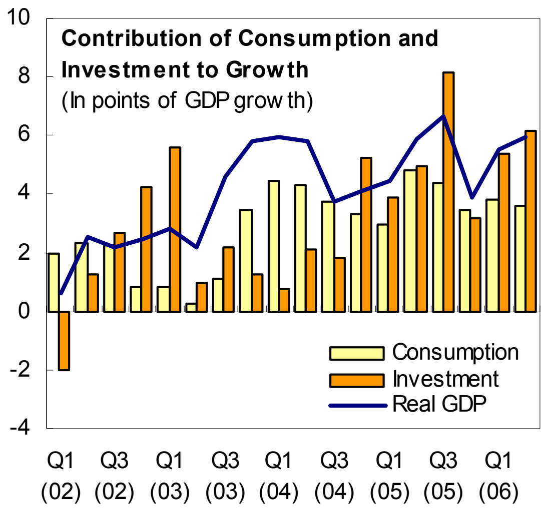
Staff recommends completion of the third and final review. All quantitative performance criteria for end-June 2006 and the structural performance criterion for July 2006 were observed and the indicative targets for end-September 2006 are expected to have been met.

I. Overview

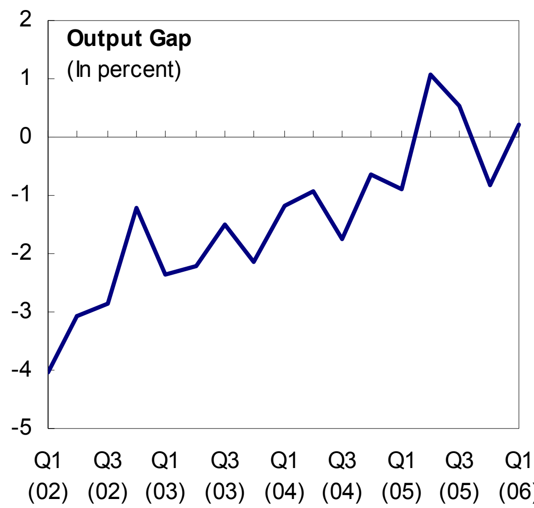
1. **Since 1999, economic policies have sought to place the country on a path of sustainable growth, which would help reduce unemployment and poverty.** The strategy focused on fiscal reforms and consolidation, policies to reduce inflation, and measures to strengthen the financial system. With the support of three successive Fund arrangements, numerous reforms were adopted that have reduced public debt, brought inflation to the lowest level in decades, and restored the health of the financial system after the 1999 crisis (Box 1).[1] As a result of these efforts and aided by a favorable global economy, real GDP rose by 5 percent a year in 2004–05, after having stagnated in 1999–2002.

II. Outlook for 2006

2. **The economy continues to perform well in 2006.** Real GDP is expected to rise by 5.2 percent (4.5 percent in the program), led by strong growth in private demand and continued robust export growth and closing the estimated output gap (Table 1). The surge in investment in recent years has supported gains in labor productivity. Urban unemployment fell to 13.1 percent in July, compared with 14.8 percent a year earlier. Inflation has remained under 5 percent, although it rose from 3.9 percent in June to 4.6 percent in September, and the Banco de la República intends to keep inflation at 4.5 percent by end–2006, as targeted.



Source: Central Bank of Colombia.



Source: Central Bank of Colombia.

[1] The Staff Report for the 2005 Article IV Consultation covered this period in more detail.

Box 1. Colombia. Major Reforms Adopted 1999–2006

Fiscal Policy

- *Taxes*. Several reforms and improved tax administration boosted public tax revenues from 17 percent of GDP in 2000 to about 21 percent of GDP in 2006.
- *Fiscal decentralization*. Laws approved in 2001–02 delinked intergovernmental transfers from current revenues and set spending and borrowing limits on territorial governments. Starting in 2004, these entities began to run an overall surplus.
- *Pension reform*. Three reforms were approved in 2002–05 that raised contributions and trimmed benefits for all pensions, and eliminated special regimes, including for teachers and the military. This reduced the actuarial deficit of the pension system from 200 percent of GDP in 2000 to 148 percent of GDP in 2005.
- *Fiscal responsibility law*. Since 2004, all levels of government must justify their fiscal targets in the context of a 10–year analysis of the sustainability of public debt.
- *Public sector administration*. Numerous steps were taken to streamline staffing levels and improve the efficiency of the public health system and of public enterprises, including by making Ecopetrol compete on a level playing field with private oil companies and establishing strong corporate governance for ISA.
- *Budget framework*. After congress declined to approve the revised budget code, a budget decree was issued in 2005 that implemented many elements of this code.

Monetary policy

- *Inflation targeting*. In 2000, an inflation targeting framework was adopted.

Financial sector

- *Privatization*. Divested all but one of the banks held by the public sector.
- *Financial supervision*. In 2006, a new financial superintendency was formed out of the merger of the superintendencies of financial institutions and of securities. Provisioning levels brought up to international standards.
- *Capital Markets*. A securities market law was approved in 2005 that strengthened clearing and settlement procedures, market integrity and corporate governance.

Exchange system

- *Exchange rate policy*. In September 1999, a flexible regime was adopted.
- *Article VIII.* In 2004, Colombia accepted the obligations of Article VIII. Only two exchange restrictions in effect as of September 2006.

3. **The 2006 elections have strengthened confidence.** President Uribe won re-election by a wide margin in May 2006, with widespread support for his handling of the economy and the security situation. His 6–party coalition won a majority in both houses of congress in March 2006 and the 2003 political reform is expected to strengthen party discipline. Elections for mayors and regional governors will take place in October 2007.

4. **The authorities expect the combined public sector (CPS) deficit to reach 1.5 percent of GDP in 2006, as targeted, with a primary surplus of 3.2 percent of GDP (Tables 2–5).** This would reduce public debt to around 45 percent of GDP, and with public sector deposits estimated at 13 percent of GDP, net public debt would fall to about 32 percent of GDP. The central administration deficit would be contained to just under 5 percent of GDP, benefiting from rapid growth in tax revenues as well as restraint of non-interest spending that offsets higher interest payments.[2] High world oil prices and real increases in regulated domestic fuel prices are strengthening the operating surplus of Ecopetrol (the state petroleum enterprise) to 4.0 percent of GDP.[3] However, the surplus of local and regional governments is likely to amount to 0.9 percent of GDP, somewhat less than expected, as these governments may raise spending ahead of the 2007 local elections. In July 2006, the government submitted a 2007 budget consistent with a CPS deficit of 1.7 percent of GDP (structural performance criterion).

Key Fiscal Trends
(In percent of GDP)

					2006		Proj.
	2002	2003	2004	2005	Prog.	Proj.	2007
CPS balance	-3.6	-2.7	-1.3	0.0	-1.5	-1.5	-1.7
Of which:							
Central government	-5.6	-3.7	-3.7	-2.7	-3.4	-3.4	-3.6
Ecopetrol operating surplus	2.3	3.0	3.4	3.6	3.7	4.0	4.4
Local and regional overall balance	0.9	0.6	1.7	1.2	1.1	0.9	0.8
Public debt	57.0	53.3	49.5	45.8	45.9	44.5	43.8

Sources: Colombian authorities; and Fund staff estimates.

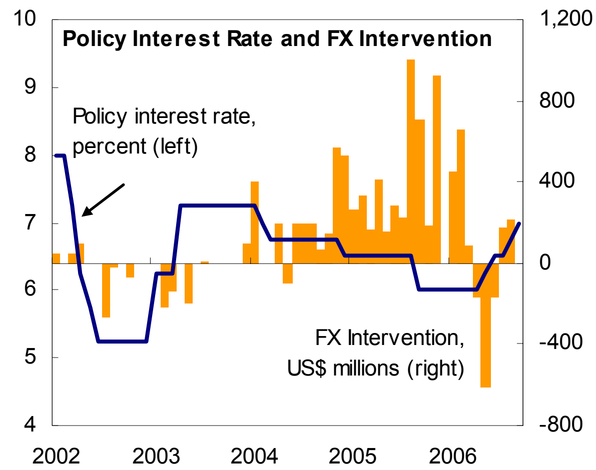
5. **After the elections, the government has imparted new momentum to key structural reforms.** It submitted in July a comprehensive tax reform and, in September, a

[2] In 2006, interest payments are expected to rise by 0.7 percent of GDP, because of higher domestic interest rates as well as a change in the accounting of interest payments adopted at the time of the second review.

[3] Ecopetrol has a monopoly on local production and sales of petroleum products, and sells diesel and regular gasoline at well below international wholesale prices. For the past few years, the government has been raising the retail and wholesale prices of these products in real terms, although more slowly than the rise in world oil prices. In August 2006, it sold regular gasoline at 70 percent and diesel at 50 percent of the international wholesale price. In 2005, these subsidies cost Ecopetrol 1.7 percent of GDP in foregone revenues.

constitutional amendment to modify the system of intergovernmental transfers (both structural benchmarks for August 2006). In August, the government sold a majority stake in the Cartagena refinery that had been fully owned by Ecopetrol (structural benchmark for June 2006). Negotiations on a free-trade agreement with the United States were completed.

6. **Since April 2006, the Banco de la República (BR) has been tightening monetary policy.** The BR raised its policy interest rate by a total of 100 basis points in April–September, to 7.0 percent, to ensure inflation remains under control. Between April and June it sold almost US$1 billion under an intervention rule to limit excess volatility, with an activation threshold of +/- 2 percent.[4] In July–August it reversed direction and purchased about US$400 million using the same rule, as the peso appreciated.



Source: Central Bank of Colombia.

7. **Financial indicators remain sound**. Through end-June, bank liquidity and loan portfolio quality were adequate, and bank solvency exceeded the minimum regulatory requirement of 9 percent. The growth in bank credit to the private sector picked up from 15 percent year-on-year at end-2005 to 27 percent year on year by June, as the real lending interest rate fell to 7.6 percent (Table 6). In May, the government announced that it would sell Granbanco—a bank created by the restructuring of Bancafe—and issued regulations for the securities market law by June and for computation of market risk in August.

Colombia: Financial Soundness Indicators
(In percent, unless otherwise indicated)

	2002	2003	2004	2005	2006 (Jun)
Regulatory Tier I capital to risk-weighted assets	9.7	10.5	10.8	10.4	10.3
Capital adequacy ratios	11.0	11.6	12.1	12.3	11.0
Nonperforming loans to total loans	8.7	6.8	3.3	2.7	2.8
Provisions to nonperforming loans	86.7	98.1	149.7	166.9	145.1
Operating margin to assets	2.7	3.5	4.1	4.0	3.3
Return on average equity	9.6	17.1	23.0	22.1	18.1
Liquid assets to assets	19.7	18.7	20.6	20.8	15.6

Sources: Superintendencia Bancaria; and Fund staff estimates.

[4] Under this rule, the BR writes options to sell (buy) foreign exchange of up to US$180 million when the peso depreciates (appreciates) by more than 2 percent from its 20-day moving average.

8. **The external current account deficit is expected to remain at 1.6 percent of GDP in 2006 (Table 7)**. The trade balance is projected to deteriorate, as imports, especially of investment goods, continue to grow faster than exports even though commodity prices remain favorable. However, this trend is being offset by lower external interest payments and continued growth in family remittances. Net capital inflows are projected to amount to 1.6 percent of GDP, led by strong net foreign direct investment. The overall balance of payments is likely to register a small deficit.

Selected Vulnerability Indicators

	Colombia		2006			
	2002	2006	Brazil	Hungary	Mexico	Turkey
External sector						
Current account balance (percent of GDP)	-1.7	-1.6	0.4	-8.6	-0.1	-7.4
Net FDI inflows (percent of GDP)	1.6	2.9	1.5	2.2	1.6	5.4
GIR in percent of ST debt at remaining maturity 1/	103.3	153.3	120.4	114.6	159.0	79.2
Public sector (PS)						
Public sector gross debt (PSGD, in percent of GDP)	57.0	44.5	71.1	70.1	43.1	71.2
Of which: Exposed to rollover risk (in percent of total PSGD)	12.0	9.7	36.1	22.5	22.0	34.6
Exposed to exchange rate risk (in percent of total PSGD)	56.3	44.4	10.4	31.5	30.8	36.5
Financial sector (FS)						
Nonperforming loans to total loans 2/	8.7	2.8	4.4	2.5	1.7	3.9
FX deposits held by residents (in percent of total deposits) 3/	1.3	1.7	0.5	12.7	6.4	36.1
Government debt held by FS (percent of total FS assets) 4/	15.3	16.7	38.7	26.6	5.1	36.0

Source: Fund staff estimates and projections.

1/ Net international reserves in percent of ST debt at remaining maturity provided for Colombia. Data for Hungary refers to end-June 2006.

2/ Data for Hungary refers to end-2005.

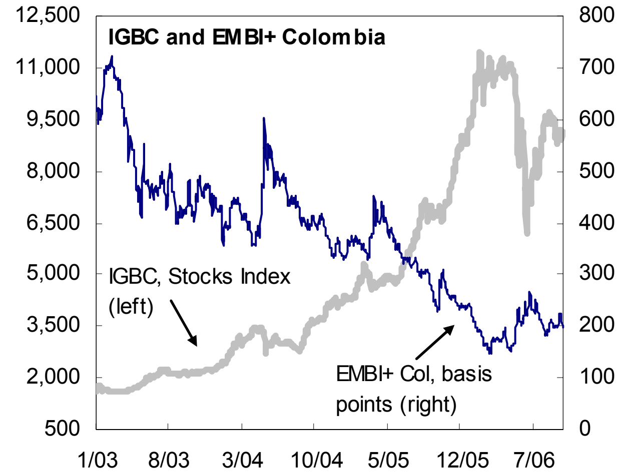
3/ Data for Hungary refers to end-June 2006.

4/ Brazil, Hungary, and Mexico data refer to 2005. Colombia refers to August 2006. Turkey refers to March 2006. For Mexico, includes federal government domestic securities held by pension funds, commerical, and development banks.

9. **Vulnerabilities have been reduced, as the economy has recovered from the effects of turbulence in international financial markets earlier this year.** Between February and June, domestic asset prices fell sharply and the peso depreciated in response to uncertainty about monetary policy in the United States. Colombia was one of the emerging markets hit hardest by the May–June turbulence, with prices of equity and government securities ripe for a correction.[5] Since June, equity prices have recovered to their level of

[5] By January 2006 equity prices had almost quadrupled since mid-2004 and yields on government securities had declined to about 6 percent. There was a growing presence of highly leveraged purchases of equity. The stock exchange recently took several steps to limit the degree of leverage.

December 2005, yields on government securities maturing in 2020 have stabilized at about 9.5 percent, and the peso has strengthened, bringing the cumulative depreciation since end–2005 to about 5 percent. As of early October 2006, the country risk premium was about 200 basis points. The economic effects of this financial market volatility were limited, as the turbulence was relatively short-lived, the wealth effects of equity holdings on consumption are small and the market did not question the direction of economic policy in Colombia. Bank profits declined, as the rise in interest rates lowered the value of their fixed income securities, but banks appeared to have provisioned for this risk.[6]



Sources: Central Bank of Colombia; and Datastream.

III. Discussions on Medium-Term Strategy

10. **The government's medium-term strategy will provide continuity of economic policies to enhance credibility and confidence.** Economic policies for 2006–07 will aim to preserve the main elements of the medium-term policy framework supported by the program.[7] The authorities noted the strong growth in investment in recent years might be raising the growth in potential output, but to be cautious they estimated that potential output was rising by 4-4 ½ percent a year. For this reason, real GDP is expected to grow by 4.5 percent in 2007 and then is projected to rise by 4 percent a year in 2007 and beyond. Inflation is targeted to decline from 4½ percent in 2006 to the range of 2–4 percent a year over the medium term. The external current account deficit would average a sustainable 2 percent of GDP over the medium term, financed by private capital inflows. Public debt would decline to 40 percent of GDP by 2010, as envisaged. This outlook does not incorporate any likely effects of the free trade agreement with the United States. (See para. 26)

[6] The BR estimates that a 200 basis point rise in the yield curve would produce losses equivalent to one-third of 2005 banks' profits.

[7] The government presents this framework to congress in June of each year, as required by the Fiscal Responsibility Law.

Authorities' Macroeconomic Framework: Main Elements 2003–11

	2003	2004	2005	Projections 1/ 2006	2007	2011
Real growth	3.9	4.9	5.2	4.8	4.5	4.0
Inflation	6.5	5.5	4.9	4.5	4.0	3.0
(In percent of GDP)						
External current account balance	-1.2	-1.0	-1.6	-1.3	-2.8	-2.5
NFPS primary balance	1.5	3.2	4.0	3.1	2.6	2.0
Combined public sector balance	-2.7	-1.3	0.0	-1.5	-1.7	-2.2
Total public gross debt 2/	53.3	49.5	45.8	43.2	40.8	38.6
Non Financial public sector Net debt 3/	44.7	39.0	33.5	32.8	31.7	31.4
(In billions of U.S. dollars)						
Net international reserves	10.5	13.2	14.7	15.1	15.6	18.6
(In U.S. dollars per barrel)						
Crude oil, spot price (WTI)	30.9	41.4	56.3	70.8	65.3	55.6
Crude oil, Ecopetrol's export price	28.3	35.9	46.4	56.8	44.5	41.4

Sources: Ministry of Finance; and Fund staff estimates and projections.

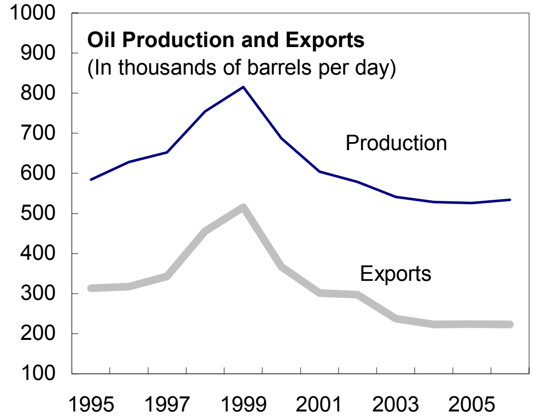
1/ Based on the medium term fiscal plan presented by the Ministry of Finance.
2/ Includes financial public sector debt, and nets out intra-government holdings only.
3/ Excludes financial public sector debt, and nets out intra-government holdings and financial assets.

11. **The authorities aim to deepen reforms to raise sustainable economic growth and improve social conditions**. For this reason, they are aiming to create a climate more conducive to growth and poverty reduction by:

- Continuing to improve the security situation;
- Preserving macroeconomic stability by keeping public debt on a sustainable downward path, while continuing to target low inflation in the context of a managed float for the exchange rate;
- Reducing distortions, especially those arising from the tax system;
- Broadening the coverage of health, education and other social programs;
- Improving infrastructure;
- Deepening capital markets through comprehensive financial sector reforms;
- Opening the economy further by securing congressional approval of a free trade agreement with the United States.

12. **The staff supported the main elements of this approach, and suggested some adjustments to limit the risks to the outlook.** The staff suggested that it may be necessary to tighten fiscal and monetary policy as the economy may be beginning to overheat. The output gap appears to have closed, inflation has increased in recent months and credit to the private sector is accelerating. It recommended that the government adopt a more ambitious fiscal policy over the medium term to bring public debt substantially below 40 percent of GDP, in light of the risks to the global economic outlook (Box 2). Staff also encouraged the authorities to limit the central bank's foreign exchange intervention and to proceed cautiously in adopting risk-based financial supervision in line with Basel II.

Box 2. Macroeconomic Effects of World Oil Prices



Sources: Central Bank of Colombia; EMED Database; and Fund staff estimates and projections.

Net Oil Exports
(In percent of GDP)

	2002	2003	2004	2005	Proj. 2006
Colombia	**3.8**	**4.0**	**4.1**	**4.1**	**4.5**
Ecuador	7.3	6.7	10.3	11.6	12.3
Mexico	2.3	2.9	3.5	4.2	5.0
Venezuela	23.2	26.4	29.0	36.2	36.7

Sources: Central Bank of Colombia; World Economic Outlook; and Fund staff estimates and projections.

Oil has been a declining sector since 1999. Over the past 10 years, proven reserves have fallen by 50 percent to 1.5 billion barrels by end-2004, as exploration has not led to the discovery of any new major oil fields. As a result, both production and exports have dropped significantly since 1999. Since 2002, Colombia's net oil exports have averaged 4 ½ percent of GDP, similar to Mexico and well below the oil export share in Ecuador and Venezuela. In recent years, the mix of Colombia's oil exports has shifted towards heavier crudes, selling at a wider discount with respect to the WTI. Colombia could become a net oil importer by around 2010, unless there are significant oil discoveries in the coming years.

Because of these trends, growth, inflation and the external sector have become less sensitive to movements in world oil prices. The authorities estimated that a 20 percent rise (fall) in the world oil price would raise (lower) real GDP by a moderately, 0.2–0.3 percent after one year. The regulation of domestic prices of gasoline and diesel at subsidized prices insulates inflation. The effect of changes in world oil prices on the external current account deficit would be partially offset by the flexibility of the peso and changes in economic growth.

Public oil revenues have also become less sensitive to the world price of oil. Since 2003, Ecopetrol's operating surplus has increased by 1 percent of GDP, even though world oil prices have risen sharply. The subsidies of diesel and regular gasoline lead to significant foregone revenues on Ecopetrol's refinery operations. Much of the operating surplus is distributed to other parts of the public sector as royalties, dividends, income taxes and automatic savings**.**

Allocation of Ecopetrol's Operating Surplus
(In percent of GDP)

	2003	2004	2005	Proj. 2006
Ecopetrol operating surplus	**3.0**	**3.4**	**3.6**	**4.0**
Central Administration	0.7	0.9	0.8	1.0
Local Governments (royalties)	1.0	1.1	1.1	1.2
FAEP	0.0	0.1	0.2	0.3
Other	0.1	0.4	0.4	0.4
Ecopetrol (Residual)	1.2	0.8	1.1	1.1
Fuel subsidies	**1.2**	**1.3**	**1.8**	**...**
Notional operating surplus	**4.2**	**4.7**	**5.4**	**...**

A. Fiscal Policy

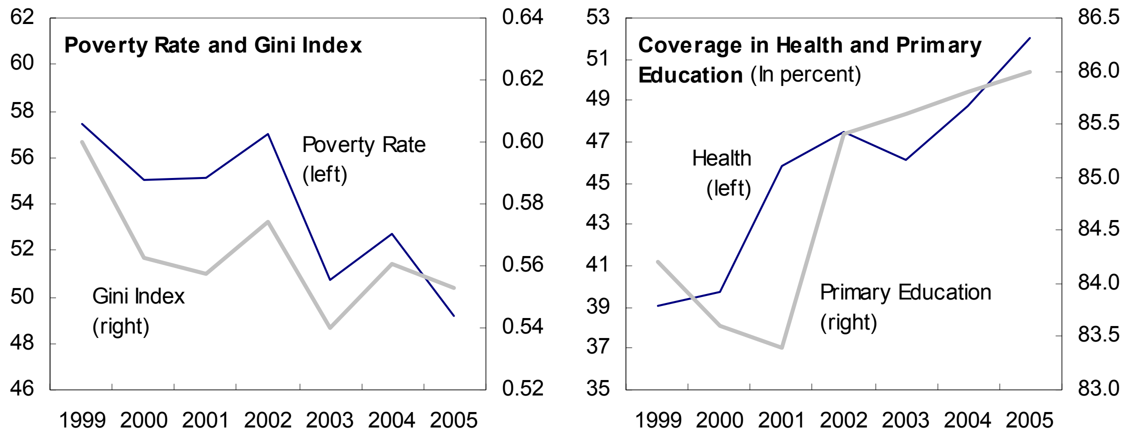
13. **The authorities commented that they have been taking advantage of exceptionally strong fiscal performance to reduce public debt.** In this context, their analysis indicated that—because of the stronger than expected fiscal performance in 2004–05—they could reduce public debt to 40 percent of GDP by 2010 with the primary surplus declining to 2.1 percent of GDP starting in 2008, below the range of 2½ to 3 percent of GDP contemplated in the program (Table 8).[8] Moreover, they noted that public debt net of deposits would fall to 32 percent of GDP in 2007.

14. **For 2007, the proposed CPS deficit of 1.7 percent of GDP is consistent with this debt objective.** Public revenues would remain stable at about 32 percent of GDP, while total spending would rise in relation to GDP to improve infrastructure and to broaden the coverage of health and education programs (Box 3). The primary surplus would decline to 2.4 percent of GDP, and public debt would decline slightly to 44 percent of GDP. The government recently issued a bond for US$1 billion to help pre-finance the deficit in 2007, as well as to reprofile existing maturities. The central administration deficit would remain slightly below 5 percent of GDP. The government continues to trim domestic fuel price subsidies, allowing Ecopetrol to raise its operating surplus to 4.4 percent of GDP and to invest more in oil exploration. The surplus of local and regional governments would fall to 0.8 percent of GDP 2010.

15. **The staff commented that—now that the economy is near capacity—fiscal policy may have to take a more prominent role in containing near-term demand pressures, as well as keeping public debt on a sustainable path.** For 2006, it urged the authorities to limit the CPS deficit to close to 1 percent of GDP, noting that the target of 1.5 percent of GDP would allow rapid growth in public consumption when private demand was already expanding rapidly. They noted that it would be feasible to contain the CPS deficit as the staff suggested, in view of the strong revenue performance, but left open the question of whether and how fiscal policy would respond to the prospect of overheating. They added that monetary policy would remain the primary tool to contain excess demand pressures.

[8] If world oil prices were to decline by US$10 per barrel relative to the authorities' projection, the operating surplus of Ecopetrol would fall by an estimated 0.1–0.2 percent of GDP.

Box 3. Social Programs in Colombia



Sources: Colombian authorities; and National Planning Department.

The authorities aim to reduce the poverty rate from 49 percent in 2005 to 39 percent by 2010, and to 15 percent by 2019, while improving income equality. Key policies include:

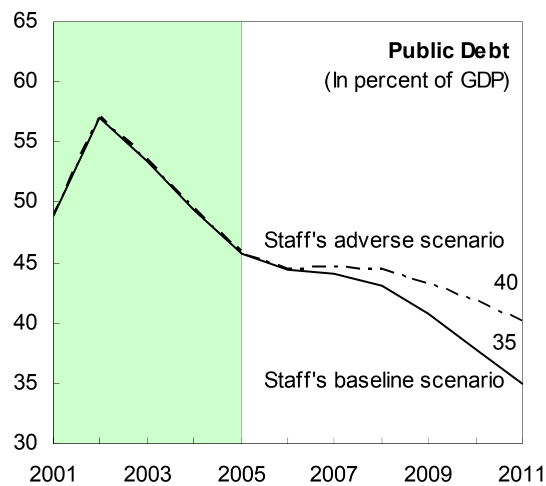
- Extend coverage of primary education and basic health care to the entire population by 2010. A national registration system has been developed to identify the most vulnerable groups of society and grant them access to social programs. The government would provide more schools and teachers to allow for 1.5 million more students. Lending for higher education would also be increased. Basic health service would be extended to 7 million more persons.

- Expand assistance to low-income families**.** The program *Familias en Acción* provides nutrition and education to families in extreme poverty. Mothers receive a cash benefit, provided their children attend 80 percent of their school classes. The program has been extremely successful, and the government will extend this program from over 620,000 families today to 1.5 million families

- Improve programs for the displaced population**.** Over 1.8 million people are registered as displaced, because of Colombia's security situation. Special assistance to them includes food aid and basic needs kits, subsidies for rents, and psychosocial care. The government also aims to ensure that all displaced persons have access to basic health care and primary education by 2010.

- Strengthen the alternative development program**.** Currently, about 50,000 families benefit from the program to provide alternative sources of income to coca-growing farmers through social and environmental training, as well as targeted subsidies.

16. **The staff suggested that the authorities' fiscal plan for 2007 and beyond—while sensible—could be more cautious.** Specifically, it recommended that the primary surplus remain at 2.7 percent of GDP starting in 2007. The lowering of the primary surplus envisaged for 2007 and beyond could provide too much stimulus to demand in the coming years. A stronger fiscal policy would also provide a larger cushion to weather shocks. The staff estimated that sustaining a primary surplus of 2.7 percent of GDP starting in 2007 would reduce public debt to 37.5 percent of GDP by 2010 and 34.6 percent of GDP by 2011 (Annex).[9] The staff discussed an adverse risk scenario with a disorderly unwinding of global imbalances that could drive up country risk premia and external interest rates, lower world commodity prices (including for oil) and slow global growth, which in turn would dampen growth in Colombia and raise the public sector's debt servicing costs. Under such an adverse scenario, staff estimated that public debt would remain manageable at 40 percent of GDP in 2011, if the primary surplus were to remain at 2.7 percent of GDP. In response, the authorities stressed that fiscal policy would remain directed at keeping public debt on a sustainable path, but believed their approach provided sufficient protection, while allowing for needed spending on social programs and infrastructure.



Sources: Fund staff estimates and projections.

[9] The scenario assumes a slower drawing down of deposits than assumed by the authorities, as these deposits offer only limited flexibility in financing the CPS deficit. Many of the deposits are held by Ecopetrol or local and regional governments or represent earmarked revenues.

Colombia: Medium-Term Outlook – Staff Scenarios

			BENIGN SCENARIO			ADVERSE SCENARIO		
	2005	2006	2007	2010	2011	2007	2010	2011
Assumptions								
US LIBOR (in %)	3.8	5.4	5.5	5.5	5.5	6.5	6.5	6.5
EMBI+ spread (basis points)	300	300	300	300	300	400	400	400
Trading partners' GDP growth (in %)	4.9	5.1	3.2	2.9	2.9	2.2	1.9	1.9
Petroleum, spot price 1/	53.4	69.2	75.5	70.5	69.3	68.0	63.5	62.3
Coffee, spot price	114.3	112.0	106.0	90.0	90.0	95.4	81.0	81.0
		(Annual percentage changes)						
Output and Prices								
Real GDP	5.2	5.2	4.5	4.0	4.0	4.0	3.0	3.0
Consumer prices (period average)	5.0	4.7	4.2	3.0	3.0	4.2	3.0	3.0
		(In percent of GDP)						
Nonfinancial and Consolidated Public Sector								
NFPS primary balance	4.0	3.5	2.7	2.7	2.7	2.7	2.7	2.7
Combined public sector balance	0.0	-1.1	-1.4	0.0	0.3	-1.4	-0.8	-0.7
Balance of Payments								
External current account balance	-1.6	-1.6	-2.0	-2.1	-1.9	-2.7	-2.6	-2.2
Debt								
Total public debt	45.8	44.5	44.1	37.9	34.9	44.6	41.7	40.1
Total public debt net of financial assets	33.5	31.7	31.7	26.8	24.4	32.2	30.3	29.1
Total external debt	30.8	30.3	29.6	27.1	25.9	29.2	29.9	28.9

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

B. Fiscal Structural Reforms

17. **Tax reform.** The reform submitted to congress in July is designed to promote investment and growth by simplifying tax administration, narrowing the differences in marginal effective tax rates across sectors, limiting the taxation of capital and lowering the cost of financial intermediation (Box 4). The authorities are working with congress to approve this reform by end-2006. The staff supported the reform, while noting a few areas for possible improvement. It pointed to the benefits of phasing out the FTT, which distorts financial intermediation and yields less revenue over time as evasion increases,[10] and beginning to eliminate the so-called *parafiscal* taxes, which discourage employment in the

[10] A recent OECD study finds that FTT's do not provide a reliable source of revenue over the medium term, as evasion grows over time and rises by more than increases in the tax rate. It also points to evidence of financial disintermediation caused by the FTT. See Baca-Campodonico, J., L. de Mello and A. Kirilenko (2006), "The Rates and Revenue of Bank Transaction Taxes," *OECD Economics Department Working Papers*, No. 494.

Box 4. The Case for Tax Reform

Several studies show that Colombia's tax system is inefficient and distortive. The income tax has a high top marginal rate that discourages investment and has encouraged special tax breaks that create significant horizontal inequities. The VAT has 10 different rates and many exemptions and deductions that cut the base and the productivity of the tax. The financial transactions tax rate of 0.4 percent and the stamp tax on medium- and long-term bank loans of 1.5 percent discourage financial intermediation. Indirect taxes on labor significantly add to the cost of employment in the formal sector. Local governments earn revenues through a cascading sales tax (ICA) that varies by jurisdiction. Also, Colombia has had 7 tax reforms since 1990, generating uncertainty about tax burdens that deters investment.

Indicators of Tax Efficiency

	Productivity 1/		No. of	Maximum	Indirect taxes
	VAT	Income Tax	VAT Rates	Income Tax Rate	on Labor 2/
Argentina	26.5	6.9	3	35	36.7
Brazil 3/	...	16.1	...	34	...
Chile	44.1	24.6	1	17	15
Colombia	38.8	15.6	10	38.5	49.8
El Salvador	54.5	…	1	25	...
Mexico	22.3	14.4	2	34	31.5
Peru	27.9	10	1	27	...

Source: National Planning Department, Vision Colombia 2019.

1/ Tax collected in percent of GDP divided by main VAT rate and top income tax rate.
2/ Taxes paid by employer or employee to finance social security, health and unemployment insurance, and contributions to social programs as percent of salary.
3/ In Brazil, the number of VAT rates varies by state and is very high in some states.

The key elements of the government's proposal include:

- Reducing the number of VAT rates to 5, while broadening the base to include almost every product; low-income households would be compensated for their higher VAT payments through direct government transfers.
- Lowering the top income tax in stages from 38.5 percent to 32 percent for corporations and individuals, while raising the minimum threshold of income subject to tax and removing most exemptions and deductions (including mortgage interest and voluntary pension contributions). These changes are expected to make the income tax more progressive.
- Limiting the taxation of capital, by allowing investment to be fully deductible in the first year.
- Eliminating the stamp tax on bank loans and the wealth and remittance taxes. The financial transactions tax (FTT) rate would stay at 0.4 percent, but with an exemption for accounts with monthly transactions below a certain threshold.

formal sector. The authorities replied that they had proposed to phase out the FTT over 4 years, but found no political support for an increase in the general VAT rate that would have been required to offset the loss in revenue. They added that the *parafiscal* taxes fund important social programs with strong political support. The staff also cautioned that the full-expensing provision was probably an excessive incentive for investment and could lead to a higher than expected revenue loss initially. The authorities noted that tax administration could effectively monitor the use of this provision and added that the additional investment and growth would help sustain tax revenues over the medium term.

18. **Intergovernmental transfers**. This reform proposes to limit the growth in transfers from the central government to local and regional governments to 3.5 percent in real terms in 2009 and 2010, and then to 2 percent in real terms from 2011 onwards.[11] Currently, the Constitution mandates that these transfers grow by 2.5 percent a year in real terms through 2008; in 2009 these transfers would rise by 1.5 percent of GDP and then grow in line with current revenues of the central administration. The staff agreed with the authorities that this reform was crucial to avoid a significant widening of the deficit of the central administration and preserve the credibility of fiscal policy.

19. **Ecopetrol capitalization**. The government aims to increase the commercial orientation of Ecopetrol to provide greater scope to invest in oil exploration; otherwise the enterprise will virtually disappear over the next 10–15 years, as it exhausts its reserves.[12] In September, the government submitted a law to congress that would allow Ecopetrol to sell shares for up to 20 percent of the enterprise's value and to strengthen its corporate governance to allow it to operate on a commercial basis and possibly be removed from the the government's fiscal indicators and targets. Domestic fuel price subsidies would be dismantled in the next two years. Starting in 2007, Ecopetrol will receive the international wholesale price for diesel and regular gasoline, and the government will record the subsidy as an explicit expenditure, financed through increased dividend payments from Ecopetrol. By mid–2008, these prices would be fully liberalized. The staff fully supported this approach and recommended several steps to strengthen Ecopetrol's commercial orientation, including by giving its board more independence from the government and completely removing the subsidies.[13] However, it urged the authorities to consider carefully the fiscal effects of increased spending by Ecopetrol, especially if the enterprise were removed from the government's fiscal indicators and targets.

20. **Other public enterprise reform.** In January, the government sold a majority stake in Telecom (the state communications enterprise), and it intends to sell Ecogas (the state gas

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[11] The proposal also allows for some faster real growth in transfers if real GDP rises by more than 4 percent.

[12] In 2004, ISA—an electricity distribution company where the government owns 60 percent of the shares—was deemed by the Fund to be commercially run and was removed from the program definition of the public sector. Thus its investment was not constrained to help achieve a target for the CPS deficit.

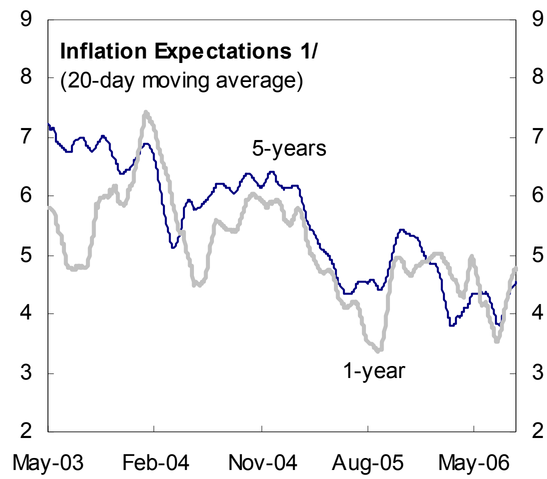
[13] These steps are fully explained in Chapter [–] of the Selected Issues Papers.

distribution company) in 2006. The authorities are continuing to strengthen the commercial orientation of other public enterprises. Staff found that Isagen (the state electricity generation and commercialization company) can be deemed commercially run, and presents a low fiscal risk according to FAD criteria, which would allow it to be excluded from the definition of the combined public sector starting in 2007.

21. **Revenue earmarking and budget rigidities**. Revenue earmarking and mandatory expenditure still amount to over 90 percent of all outlays. As mandated by the 2005 budget decree, the authorities have evaluated some earmarked revenues in the 2007 budget, and proposed to phase out several of these. The authorities pointed out that intergovernmental transfers—one of the most important rigidities—would decline in relation to GDP if congress approved the proposed reform. Pensions—another significant rigidity—would begin to decline in relation to GDP next decade, based on the three pension reforms approved under President Uribe's first government in 2002–2006, and the authorities felt there was virtually no political support for yet another pension reform, at least in the near term. Transfers to universities also had strong political support.

C. Monetary and Exchange Rate Policy

22. **The inflation targeting framework has been successful in reducing inflation and anchoring expectations.** The staff noted that inflation targeting appeared to have reduced the persistence of inflation and increased the importance of forward looking expectations in determining current inflation.[14] Near-term inflation expectations, however, have risen in recent months to above the inflation target for 2006. Long-term inflation expectations are about 4½ percent, slightly above the medium-term target range of 2–4 percent. The authorities reiterated that they would adjust monetary policy as necessary to meet the inflation targets in 2006 and beyond and expected long-term inflation expectations to decline over time, as the central bank reduced inflation to within this range.



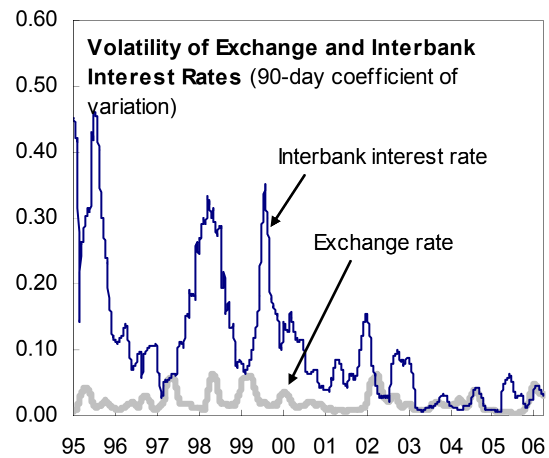
Source: Central Bank of Colombia.
1/ Corresponds to the 20-day moving average of the difference betw een the yield of fixed and inflation-indexed bonds (breakeven inflation expectations).

23. The central bank communicates its views on monetary policy transparently, but staff suggested that limiting foreign exchange intervention would send a clearer signal. The Executive Board of the Banco de la República explains its policies in several ways, including through quarterly inflation reports, semi-annual reports to congress and numerous seminar presentations. However, the staff suggested

[14] See Chapter 2 of the Selected Issues Papers.

that the central bank's foreign exchange intervention, which has been sizable since end-2003, could at times send a confusing signal about the intentions of monetary policy. It added that a narrow threshold for an automatic intervention rule could invite speculation, if the central bank were perceived to be obliged to intervene. For this reason, it recommended that the threshold for the excess volatility rule be widened to +/- 4 percent, its level prior to October 2005. The authorities responded that the foreign exchange purchases between December 2003 and early 2006 moderated the appreciation of the peso vis-à-vis the U.S. dollar without undermining the central bank's ability to meet its inflation target.[15] It noted that the excess volatility rule is transparent and has helped dampen undue exchange rate volatility without providing investors an incentive for one-way bets.

24. **The staff and the authorities agreed that the flexible exchange rate regime introduced in 1999 continues to serve Colombia well (Box 4)**. It has supported real economic growth by allowing relative prices to adjust to changing external conditions, such as terms of trade shocks and shifts in sentiment in international capital markets, and reducing the volatility of interest rates. Staff analysis suggests that the real effective appreciation of the peso since 2003 has been consistent with changes in fundamentals and could be explained by the recent strengthening in the terms of trade and the improved security situation, as well as a reversal of the excessive depreciation in 2002.[16] The staff and the authorities agreed that this analysis, while useful, should be interpreted with caution, as estimates of long-run determinants of the real exchange rate are subject to significant uncertainty.



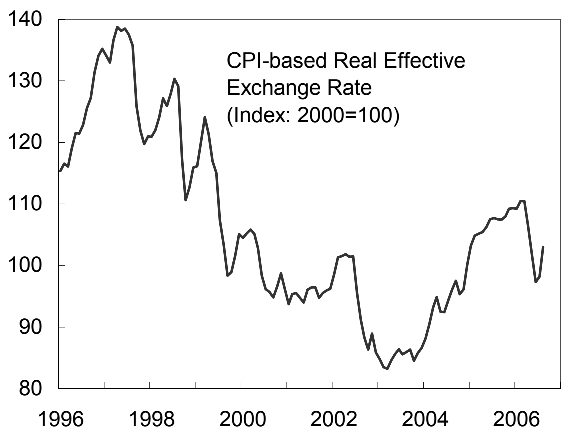
Sources: Bloomberg; and staff calculations.

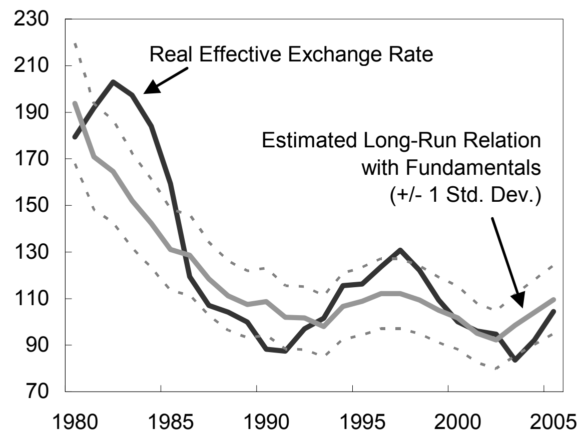
[15] A Banco de la República study found that the foreign exchange purchases slowed the appreciation of the peso. However, these purchases raised the volatility of the peso, most likely because the market believed the central bank would never subordinate its inflation objective to concerns about the exchange rate. See Toro, Jorge and Juan Manuel Julio, "*Efectividad de la Intervencion Discrecional del Banco de la República en el Mercado Cambiaro*," *Borradores de Economia*, No. 336, Banco de la República, 2005.

[16] See Chapter 3 of the Selected Issues Paper.

Box 5: Assessment of the Real Exchange Rate

Colombia's real effective exchange rate displayed significant fluctuations in recent years—including a sharp depreciation between March and June 2006. After reaching the most depreciated level in more than a decade in early 2003, the real exchange rate appreciated subsequently by more than 25 percent through March 2006, as growth recovered and the political and security situation stabilized. Since then, the peso depreciated in real effective terms by about 8 percent through early September.

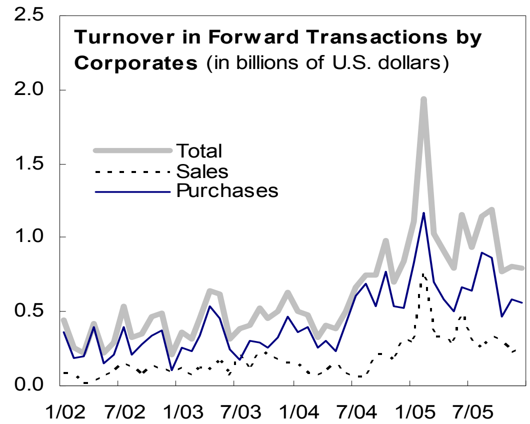




Based on an econometric model of the long-run determinants of the real exchange rate, the peso currently appears to be in line with fundamentals. Using annual data from 1961 to 2005, staff estimated the relation between the real exchange rate and commodity prices, net foreign assets, GDP per capita relative to trading partners, government consumption, and security conditions. The model suggests that about half of the observed appreciation since 2003 is explained by higher commodity export prices and improvements in the security situation. The rest represents primarily a reversal of the likely overshooting of the peso in 2002–03. As a result, in 2005, the REER was on average close to the projection of the model and the current REER remains only slightly more depreciated than the average in 2005.

Alternative approaches broadly confirm these results. The current account deficit reached 1½ percent of GDP in 2005 and is projected to widen to about 2–2½ percent of GDP over the medium term at the current level of the real exchange rate. Such a current account deficit would be sustainable and would broadly stabilize the net foreign asset position as a share of GDP. Recent trade performance also suggests the absence of competitiveness problems and major imbalances. Growth of non-traditional exports remained at about 15 to 20 percent in U.S. dollars through 2005 and early 2006. While imports have also been growing at similar rates, this has been driven mostly by buoyant investment activity—including foreign direct investment.

25. **The authorities agreed with staff on the importance of continuing to facilitate the development of market-based hedging mechanisms**.[17] While hedging has increased significantly since 1998, the market is mostly concentrated in forward exchange rate contracts, with very little hedging of interest rate risk. The authorities agree with the recommendations of a recent MCM technical assistance mission to promote wider use of hedging. The staff noted that the limit on banks' net foreign currency cash position has discouraged hedging activity by restricting banks' ability to take forward positions with offsetting spot transactions. The authorities commented that turnover in the forward foreign exchange market in the last two years increased significantly notwithstanding the limit on cash positions.



Sources: Central Bank of Colombia; and Fund staff estimates.

D. Trade Policy

26. **The government is continuing to liberalize trade.** The free trade agreement (FTA) with the United States will be submitted to both congresses later this year or in early 2007. It covers a broad range of issues including trade in goods and services, investment, intellectual property rights, government procurement, and labor and environmental standards. The preferential access to the U.S. market granted under ATPDEA would become permanent, and improve in certain areas, such as textiles and processed food. Several recent studies estimate that the agreement would lead to moderately higher real GDP in Colombia, significantly more trade, especially with the United States, and foreign direct investment, with a slight deterioration in the external current account deficit.[18] These studies highlight that the long-term economic effects could be more beneficial for Colombia, if the agreement sets off a process of restructuring that enhances the efficiency gains. The authorities estimate that the agreement would generate a small loss in tax revenues in the first four years, and after that the treaty's positive effects on growth would offset any loss in revenue. ATPDEA is set to expire at end-2006, and to cover any gap in preferential access, legislation has been submitted in the U.S. congress to extend ATPDEA for two more years. The authorities estimate that a temporary loss in trade preferences would have little effect, as exporters might be reimbursed for the temporary rise in their costs. The authorities commented that the withdrawal of Venezuela from the Andean Community would have little near term effect on

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[17] See Chapter 4 of the Selected Issues Paper.

[18] Toro, Jorge et. al. "*El Impacto del Tratado de Libre Comercio con Estados Unidos (TLC) en la Balanza de Pagos Hasta 2010*," *Borradores de Economia*, No. 362. Banco de la República, 2006. Schott, Jeffrey ed., Trade Relations between Colombia and the United States, *Policy Analyses for International Economics*, No. 79, Institute for International Economics, August, 2006.

trade, as the existing rules call for retaining preferential access for a five-year transition period. However, this situation did introduce some uncertainty into long-term trade relations.

E. Financial Sector

27. **The government is preparing reforms to deepen capital markets to encourage more non-bank financing and broaden access for small- and medium-sized enterprises**. Colombia's financial system faces several impediments—such as the stamp and financial transactions taxes, forced investment requirements, uncertain creditor rights and a somewhat outdated regulatory framework—that have raised the cost of capital and discouraged non-bank financing. The reforms, which are being developed in consultation with the World Bank, would seek to overhaul the financial sector legislation to make it consistent with universal banking, strengthen creditor rights, improve credit bureaus and help develop an annuities market to support the private pension system.

28. **The authorities intend to move forward to implement a risk-based supervisory framework consistent with Basle II**. Staff supported this approach but urged them to proceed at a cautious pace to ensure that banks and supervisors gained sufficient experience with the new system of analysis. MCM has provided technical assistance to improve the modeling of credit and market risk and has presented the framework of contingent claims analysis. The authorities remained committed to submitting, by no later than November 2006, a law that would strengthen the independence of the financial superintendency (structural benchmark for August 2006), but prefer to include this reform in the broader financial sector reforms that would most likely be introduced in October.

29. **Now only one bank is publicly owned.** On October 12, Granbanco was sold to a domestic bank for about US $900 million (0.3 percent in GDP). Banco Agrario is the only remaining public bank. The authorities are planning to issue by December 2006 regulations to strengthen its governance in line with the recommendations of MCM.

F. Article VIII

30. **Colombia maintains two exchange restrictions subject to Article VIII.**[19] The tax reform proposes to eliminate the tax on outward remittances. The central bank has partially relaxed the exchange restriction arising from the special regime for hydrocarbons exporters, but is still considering the steps necessary to completely remove the restriction.

IV. Third and Final Program Review

31. **Performance under the program remains strong.** All quantitative performance criteria for end-June 2006 and the structural performance criterion for July 2006 were observed and the indicative targets for end-September 2006 are expected to have been met. The continuous performance criterion barring the introduction of exchange restrictions and multiple currency practices was also observed. Almost all structural benchmarks have been met: (i) the tax reform was submitted in July 2006; (ii) the reform of intergovernmental

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[19] The restrictions are described in the Fund Relations Appendix.

transfers was submitted in September 2006; (iii) regulations to implement the securities market law were published by June; and (iv) a majority stake in the Cartagena refinery was sold to a private investor in August. The authorities intend to submit the draft law to strengthen the independence of the financial supervisor no later than November 2006. The remaining structural benchmark—the preparation of a draft law to reduce revenue earmarking not mandated by the constitution—will not be observed, although the authorities are taking other measures to scale back budget rigidities over time. Upon completion of the review, Colombia would be eligible to purchase up to SDR 405 million (52.5 percent of quota) until the arrangement expires on November 2, 2006 (Tables 9 and 10).

V. Staff Appraisal

32. **As the period of formal Fund support comes to end, Colombia's economic medium-term outlook is favorable.** The policy strategy of fiscal reform and consolidation, low inflation with exchange rate flexibility and strengthening financial supervision—aided by a favorable global economy—has enabled the economy to enter a virtuous cycle of strong investment-led growth and a sustainable external current account deficit. The recovery from the international financial market turbulence earlier this year shows that the economy has become more resilient in the face of shocks.

33. **The authorities have begun to address the risk that the economy may be beginning to overheat.** Monetary policy will continue to be the primary tool to manage excess demand pressures. The Banco de la República has already raised its policy interest rate by 100 basis points since April 2006, and is commited to maintain this tightening phase as needed to achieve the inflation target. However, now that the economy is probably operating near capacity, the staff recommends that fiscal policy play a more supportive role in containing the growth in demand to ease the burden on monetary policy. The staff sees clear benefits to limiting the CPS deficit in 2006 to around 1 percent of GDP—below the target of 1.5 percent of GDP—preferably by restraining the growth in public consumption. Moreover, the authorities' plan to lower the primary surplus in 2007 and beyond may add too much stimulus when the private sector is likely to provide a strong impetus for growth.

34. **Over the medium term, the authorities remain fully committed to keeping public debt on a sustainable downward path.** They intend to reduce public debt to 40 percent of GDP by 2010, as envisaged. Staff agrees this profile will strengthen the economy and build resilience. However, a larger primary surplus that would bring public debt decisively under 40 percent of GDP would provide greater protection from shocks, such as a possible downturn in the global economy.

35. **Key structural reforms are moving forward, now that the political transition is over.** The proposed constitutional amendment is crucial to preserve the credibility of fiscal policy by reforming the system of intergovernmental transfers. The government's proposed tax package is another key reform that will help make the economy more competitive by simplifying Colombia's complex and distortionary tax code. The reform correctly aims to be revenue-neutral, as total public revenues are almost a third of GDP. Scope remains to improve the tax system by reducing the number of VAT rates further, phasing out the financial transactions tax and beginning to eliminate at least some of the *parafiscal* taxes, which discourage formal sector employment. The proposed full-expensing provision for

investment appears overly generous. The staff notes that an unfinished task is to reduce revenue earmarking and budgetary rigidities. The authorities intend to scale back over time the two largest mandatory expenditures—intergovernmental transfers and pensions—but more action in this area would be useful. The authorities have introduced a sensible plan to capitalize Ecopetrol, which seeks to improve its efficiency, slow the depletion of Colombia's oil reserves and bring domestic fuel prices in line with world market conditions. However, several steps are required to improve the commercial orientation of Ecopetrol, including by making its board more independent of the government and removing the subsidies of diesel and regular gasoline.

36. **The flexible exchange rate regime introduced in 1999 continues to serve Colombia well**. It has supported real economic growth by allowing relative prices to adjust to external shocks and reducing the volatility of domestic interest rates, and the exchange rate appears to be broadly in line with the fundamentals. The staff believes that less reliance on foreign exchange intervention would allow the flexible regime to work more effectively and would send a clearer signal about the stance of monetary policy. In that context, it would urge the authorities to widen the threshold for the automatic intervention rule.

37. **The authorities are taking steps to strengthen the financial system.** The transition to risk-based supervision in line with Basel II will need to proceed with due caution to ensure that banks and the superintendency are fully ready to implement this complex system. The recently merged financial superintendency is designed to provide more effective oversight of financial intermediation. It will be crucial to submit to congress as early as possible the proposed legislation to enhance the independence of the superintendency. The likely sale of Granbanco is a welcome step that will leave only one bank in the public sector.

38. **The authorities are continuing to remove exchange restrictions subject to Article VIII.** The staff recommends approval of the retention of the multiple currency practice and exchange restriction arising from the tax on outward remittances through December 31, 2007 or the conclusion of the next Article IV consultation, whichever is earlier. Approval is recommended as the tax is maintained for nonbalance of payments reasons; the authorities are working towards eliminating it by end-2006 as part of the tax reform proposal currently before congress; and the tax does not materially impede Colombia's balance of payments adjustment nor discriminates among, or harm the interest of, other Fund members. The authorities have eased the exchange restriction arising from the special foreign exchange regime for hydrocarbons exporters. However, there is still no clear timetable for the full removal of the restrictive aspects of this regime and staff does not recommend approval of this restriction.

39. **Economic performance under the Stand By Arrangement continues to be favorable**. In 2006, the economy will continue to perform well. All performance criteria for June and July 2006 have been observed. On this basis, staff recommends completion of the third and final review.

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

Table 1. Colombia: Selected Economic and Financial Indicators

	2002	2003	2004	2005	2006 Prog.	2006 Proj.	Proj. 2007
	(Percentage changes, unless otherwise indicated)						
National income and prices							
Real GDP	1.9	3.9	4.8	5.2	4.5	5.2	4.5
GDP deflator	5.9	8.1	7.1	5.5	3.5	4.7	4.1
Consumer prices (average)	6.3	7.1	5.9	5.0	4.7	4.7	4.2
Consumer prices (end of period)	7.0	6.5	5.5	4.9	4.5	4.5	4.0
External sector (on the basis of US$)							
Exports (f.o.b.)	-4.1	12.1	24.7	26.2	13.4	14.6	10.6
Imports (f.o.b.)	-1.6	9.8	19.8	26.8	15.9	20.9	14.5
Export volume	-4.4	2.5	7.4	6.4	6.5	6.6	6.2
Import volume	-1.1	2.1	14.0	21.4	15.7	17.4	11.2
Terms of trade (deterioration -)	0.8	1.7	10.5	13.5	6.3	4.3	1.0
Real effective exchange rate (depreciation -)	-17.4	-5.2	11.4	10.9	…	…	…
Central administration							
Revenue	10.1	-0.5	31.2	14.8	16.7	17.0	677.0
Expenditure	12.6	-6.7	32.7	10.3	15.5	16.1	5.7
Money and credit							
Broad money	2.9	9.6	16.6	18.6	17.2	18.4	11.3
Credit to the private sector	4.0	9.2	12.0	15.7	15.5	23.6	17.0
Interest rate (90-day time deposits; percent per year)							
Nominal	7.7	7.9	7.7	…	…	…	…
Real	0.7	1.4	2.2	…	…	…	…
	(In percent of GDP)						
Central administration balance 1/	-6.4	-4.5	-5.4	-4.8	-4.9	-4.9	-4.9
Nonfinancial public sector balance 1/	-4.2	-3.2	-1.5	0.0	-1.5	-1.6	-2.0
Nonfinancial public sector savings 1/	4.1	5.7	4.4	5.7	5.0	4.9	5.1
NFPS primary balance1/	0.3	1.5	3.2	4.0	3.2	3.1	2.4
Public sector balance 1/	-3.6	-2.7	-1.3	0.0	-1.5	-1.5	-1.7
Foreign financing	0.6	1.0	0.5	-1.7	0.3	0.0	1.5
Domestic financing 2/	3.1	1.8	0.9	1.6	1.2	1.3	0.2
Privatization	-0.1	-0.1	0.0	0.1	0.0	0.3	0.0
Public debt 4/	57.0	53.3	49.5	45.8	45.9	44.5	43.8
Gross domestic investment 5/	15.3	17.2	18.3	19.3	19.8	19.5	21.0
Gross national savings	13.6	16.0	17.3	17.7	18.5	17.9	19.0
Current account (deficit -)	-1.7	-1.2	-1.0	-1.6	-1.3	-1.6	-2.0
External debt	52.6	46.2	36.8	30.8	30.7	30.2	29.5
Of which: public sector	32.1	29.8	24.0	19.4	19.5	19.8	19.9
NIR in percent of short-term debt	106.1	118.0	100.0	125.0	151.6	153.3	135.3
	(In percent of exports of goods, services, and income)						
External debt service	64.0	55.8	37.8	45.2	29.8	30.6	20.1
Of which: public sector	37.0	33.0	18.3	31.0	16.4	17.7	11.8
Interest payments	16.8	14.8	11.7	11.8	10.1	9.7	9.4
Of which: public sector	11.3	10.5	8.4	8.7	7.2	6.8	6.8
	(In millions of U.S. dollars)						
Overall balance of payments	138.2	-183.8	2,541.1	1,728.7	439.9	-32.4	568.1
Net official reserves 4/	10,506.9	10,524.2	13,196.6	14,721.2	15,161.1	14,855.2	15,423.2
Net official reserves (in months of imports of goods and services)	7.6	6.4	6.4	6.1	5.9	5.4	5.0

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

1/ In 2007 corresponds to authorities' projections
2/ Includes the quasi-fiscal balance of Banco de la República, sales of assets, phone licenses, and statistical discrepancy.
3/ Historical data was revised to exclude intra-public liabilites of the central administration.
4/ Program definition. Assumes no purchases under the current SBA arrangement. Includes valuation changes.
5/ Data on fixed capital formation were revised starting in 2003.

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

	2001	2002	2003	2004	2005	2006 Prog.	2006 Proj.	Proj. 2007
Total revenue	**29.5**	**29.5**	**30.0**	**30.3**	**30.8**	**31.2**	**31.7**	**31.9**
Current revenue	**29.5**	**29.5**	**30.0**	**30.3**	**30.8**	**31.2**	**31.7**	**31.9**
Tax revenue	19.2	19.1	19.5	19.6	20.1	20.9	20.9	20.8
Nontax revenue	10.3	10.4	10.5	10.7	10.7	10.2	10.9	11.1
Financial income	1.3	0.9	1.1	1.5	1.5	1.5	1.4	1.4
Operating surplus of public enterprises	4.2	4.0	4.6	3.4	3.9	3.8	4.1	4.6
Of which : Ecopetrol	2.5	2.3	2.9	3.4	3.6	3.7	4.0	4.4
Other	4.8	5.4	4.8	5.7	5.3	4.9	5.3	5.2
Total expenditure and net lending 2/	**33.2**	**33.5**	**32.5**	**31.5**	**31.0**	**32.7**	**33.3**	**33.9**
Current expenditure	**24.9**	**25.9**	**24.3**	**25.9**	**25.1**	**26.3**	**26.8**	**26.8**
Wages and salaries	7.5	8.0	7.3	7.0	6.7	7.0	7.2	7.2
Goods and services	3.5	3.4	3.3	4.4	4.3	4.4	4.6	4.6
Interest	5.0	4.5	4.7	4.8	4.0	4.8	4.7	4.4
External	2.3	2.1	2.1	1.9	1.6	1.5	1.4	1.4
Domestic	2.8	2.4	2.7	2.8	2.4	3.4	3.3	3.0
Transfers to private sector	9.8	9.8	9.1	7.8	7.9	7.9	8.1	8.5
Of which: from social security	6.5	6.7	6.9	6.9	6.8	6.9	7.0	7.4
Other 3/	-0.9	0.2	-0.1	1.9	2.1	2.1	2.2	2.0
Capital expenditure	**8.2**	**7.6**	**8.2**	**5.7**	**5.9**	**6.4**	**6.5**	**7.1**
Fixed capital formation (cash basis)	8.2	7.4	8.1	5.6	5.8	6.3	6.5	7.0
Other (including floating debt) 3/	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0
Transfers	0.1	0.2	0.1	0.1	0.0	0.0	0.0	0.0
Net lending	**0.1**	**0.1**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Statistical discrepancy	0.2	-0.1	0.7	-0.3	0.2	0.0	0.0	0.0
Nonfinancial public sector balance	**-3.5**	**-4.2**	**-3.2**	**-1.5**	**0.0**	**-1.5**	**-1.6**	**-2.0**
Quasi-fiscal balance (BR cash profits)	0.7	0.8	0.6	0.5	0.2	0.3	0.3	0.4
Fogafin balance	0.2	0.3	0.3	0.3	0.2	0.1	0.2	0.2
Net cost of financial restructuring 4/	-0.7	-0.6	-0.4	-0.5	-0.4	-0.4	-0.4	-0.3
Overall balance	**-3.2**	**-3.6**	**-2.7**	**-1.3**	**0.0**	**-1.5**	**-1.5**	**-1.7**
Overall financing	**3.2**	**3.6**	**2.7**	**1.3**	**0.0**	**1.5**	**1.5**	**1.7**
Foreign, net	2.3	0.6	1.0	0.5	-1.7	0.3	0.0	1.5
Of which								
Changes in assets held abroad (-increase)	-1.9	1.9	-0.7	-0.7	-0.7	-0.2	-1.4	-0.2
Domestic, net	0.9	3.1	1.8	0.9	1.6	1.2	1.3	0.2
Financial system	-1.1	-1.4	-0.6	-1.9	-1.2	0.8	0.6	-0.5
Bonds	2.8	3.9	2.5	2.1	2.8	0.6	0.6	0.7
Change in floating debt and accrual adjustments	-0.7	0.7	-0.2	0.7	-0.1	-0.2	0.2	0.1
Privatization (including concessions)	0.0	-0.1	-0.1	-0.1	0.1	0.0	0.2	0.0
Memorandum items:								
NFPS savings	4.7	4.1	5.7	4.4	5.7	5.0	4.9	5.1
NFPS primary balance	1.5	0.3	1.5	3.2	4.0	3.2	3.1	2.4
NFPS non-oil balance	-5.3	-5.9	-5.2	-3.9	-2.9	-4.1	-4.0	-5.2
NFPS non-oil primary balance	-2.1	-1.4	-0.3	0.8	1.1	0.7	0.7	-0.9

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

1/ The information on local governments has been significantly revised starting in 2004, leading to large changes in reported public investment and other nontax revenues and other current spending.
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)

	2002	2003	2004	2005	2006 Prog.	2006 Proj.	Proj. 2007
Total revenue	**19.7**	**20.8**	**22.0**	**21.9**	**23.2**	**22.6**	**22.4**
Current revenue	**19.7**	**20.7**	**21.6**	**21.6**	**23.2**	**22.6**	**22.4**
Tax revenue	16.4	16.9	17.7	17.3	18.5	18.3	18.0
Nontax revenue	2.6	3.2	3.4	3.1	3.3	3.0	2.7
Property income	0.7	0.9	0.9	1.2	1.2	1.1	1.1
Other	1.8	2.3	2.6	1.8	2.1	1.9	1.6
Current transfer receipts	0.8	0.6	0.5	1.2	1.4	1.3	1.8
Local government	0.0	0.0	0.0	0.7	0.7	0.7	0.7
Local enterprises	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Local nonfinancial public sector	0.0	0.0	0.0	0.0	0.0	0.0	0.0
National enterprises	0.8	0.6	0.5	0.5	0.7	0.7	1.1
Private sector	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital revenue	**0.0**	**0.1**	**0.4**	**0.3**	**0.0**	**0.0**	**0.0**
Sale of fixed assets	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital transfer receipts	0.0	0.1	0.4	0.3	0.0	0.0	0.0
Local government	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Local enterprises	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Local nonfinancial public sector	0.0	0.0	0.0	0.0	0.0	0.0	0.0
National enterprises	0.0	0.1	0.4	0.3	0.0	0.0	0.0
Private sector	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total expenditure and net lending	**25.3**	**24.5**	**25.7**	**24.5**	**26.7**	**26.0**	**26.0**
Current expenditure	**22.0**	**20.6**	**21.8**	**20.7**	**22.7**	**22.2**	**22.0**
Wages and salaries	3.4	3.2	3.0	2.7	2.9	2.8	2.8
Goods and services	2.2	2.3	2.3	2.1	2.4	2.3	2.1
Interest	3.5	3.9	3.8	3.5	4.6	4.4	4.2
External	1.7	1.8	1.6	1.5	1.3	1.3	1.3
Domestic	1.7	2.1	2.2	2.0	3.2	3.1	2.9
Transfers to	12.3	11.7	12.2	12.4	12.8	12.6	12.9
Local government	4.0	3.5	3.4	3.3	3.3	3.3	3.2
Local enterprises	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Local nonfinancial public sector	0.0	0.0	0.0	0.0	0.0	0.0	0.0
National enterprises	0.2	0.1	0.1	0.0	0.0	0.0	0.0
Private sector	8.0	8.1	8.8	9.1	9.5	9.4	9.7
Other current expenditure	0.6	-0.5	0.5	0.0	0.0	0.0	0.0
Capital expenditure	**3.0**	**3.5**	**3.8**	**3.9**	**4.2**	**4.0**	**4.2**
Fixed capital formation	1.9	1.8	2.1	2.4	2.7	2.5	2.7
Transfers to	1.1	1.8	1.7	1.6	1.5	1.5	1.5
Local government	1.0	1.6	1.5	1.5	1.5	1.4	1.4
Local enterprises	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Local nonfinancial public sector	0.0	0.0	0.0	0.0	0.0	0.0	0.0
National enterprises	0.0	0.1	0.1	0.0	0.0	0.0	0.0
Private sector	0.0	0.1	0.1	0.0	0.0	0.1	0.0
Net lending	**0.4**	**0.4**	**0.1**	**-0.1**	**-0.2**	**-0.2**	**-0.2**
Overall balance	**-5.6**	**-3.7**	**-3.7**	**-2.7**	**-3.4**	**-3.4**	**-3.6**

Sources: Colombian authorities; and Fund staff estimates.

1/ Includes the central administration, social security, and national decentralized agencies.

Table 4. Colombia: Public Debt and Deposits
(In percent of GDP)

	2002	2003	2004	Est. 2005	Proj. 2006
Total outstanding gross debt 1/	**57.0**	**53.3**	**49.5**	**45.8**	**44.5**
Domestic debt	24.9	23.5	25.4	26.4	24.8
External debt	32.1	29.8	24.0	19.4	19.7
Nonfinancial public sector gross debt	**53.9**	**51.0**	**47.5**	**43.9**	**41.3**
Domestic debt	23.5	22.1	24.2	25.2	22.3
External debt	30.5	28.8	23.3	18.7	19.0
Financial public sector gross debt	**3.0**	**2.4**	**2.0**	**1.9**	**3.3**
Domestic debt	1.4	1.4	1.3	1.3	2.5
External debt	1.6	1.0	0.7	0.6	0.7
Total public sector deposits	**8.2**	**8.7**	**10.4**	**12.3**	**12.8**
Domestic	4.8	4.9	6.6	7.8	7.4
Foreign	3.4	3.8	3.9	4.5	5.4
Nonfinancial public sector deposits	**8.2**	**8.7**	**10.1**	**11.6**	**12.5**
Domestic	4.8	4.9	6.6	7.8	7.4
Foreign	3.4	3.8	3.5	3.8	5.1
Financial public sector deposits	**0.0**	**0.0**	**0.3**	**0.8**	**0.3**
Domestic	...	...	0.0	0.0	0.0
Foreign	0.0	0.0	0.3	0.8	0.3
Total outstanding net debt 1/	**48.7**	**44.7**	**39.0**	**33.5**	**31.7**
Domestic debt	20.1	18.6	18.9	18.6	17.4
External debt	28.6	26.0	20.2	14.9	14.3
Nonfinancial public sector net debt	**45.7**	**42.3**	**37.4**	**32.3**	**28.7**
Domestic debt	18.7	17.3	17.6	17.3	9.7
External debt	27.0	25.1	19.8	15.0	19.0
Financial public sector net debt	**3.0**	**2.3**	**1.6**	**1.2**	**2.9**
Domestic debt	1.4	1.4	1.2	1.3	2.5
External debt	1.6	1.0	0.4	-0.1	0.4
Memorandum items:					
Floating Debt	2.0	1.6	2.1	1.7	0.0
GDP (Billions of COL Pesos)	203,451	228,517	256,368	284,548	313,451

Sources: Colombian authorities; and Fund staff estimates.

1/ Includes floating debt.

Table 5. Colombia: Operations of the Central Administration
(In percent of GDP)

	2002	2003	2004	2005	2006 Prog.	2006 Proj.	Proj. 2007
Total revenue	**15.0**	**13.3**	**15.5**	**16.1**	**17.4**	**17.1**	**17.2**
Current revenue	**15.0**	**13.3**	**15.5**	**16.1**	**17.4**	**17.1**	**17.2**
Tax revenue 1/	13.4	12.1	14.2	14.9	15.8	15.5	15.5
Net income tax and profits	5.3	4.5	6.1	6.1	6.9	6.6	6.6
Goods and services	5.8	5.5	6.2	6.5	6.6	6.6	6.7
Value-added tax	5.3	5.1	5.8	6.1	6.2	6.2	6.3
Gasoline tax	0.5	0.4	0.4	0.4	0.4	0.4	0.4
International trade	1.0	0.8	0.9	1.0	1.0	1.1	1.1
Financial transaction tax	0.7	0.6	0.9	0.8	0.8	0.8	0.8
Stamp and other taxes	0.7	0.7	0.2	0.4	0.5	0.4	0.2
Nontax revenue	1.6	1.2	1.2	1.2	1.6	1.6	1.7
Property income	0.3	0.2	0.2	0.2	0.2	0.2	0.2
Other	1.3	1.0	1.1	1.1	1.5	1.4	1.5
Total expenditure and net lending	**21.4**	**17.8**	**20.9**	**20.9**	**22.4**	**22.0**	**22.1**
Current expenditure	**18.2**	**14.7**	**17.5**	**17.8**	**19.0**	**18.4**	**18.3**
Wages and salaries	3.0	2.6	2.8	2.5	2.6	2.6	2.6
Goods and services	1.5	1.3	1.4	1.5	1.6	1.5	1.5
Interest	3.5	3.5	3.8	3.6	4.6	4.4	4.2
External	1.7	1.6	1.6	1.5	1.3	1.3	1.3
Domestic	1.7	1.8	2.2	2.1	3.2	3.1	2.9
Other expenditure 2/	0.7	-0.5	0.5	0.0	0.0	0.0	0.0
Current transfers 3/	9.5	7.8	9.1	10.2	10.2	9.9	10.0
Capital expenditure	**2.5**	**2.7**	**3.3**	**3.0**	**3.2**	**3.4**	**3.6**
Fixed capital formation 2/	1.3	1.0	1.4	1.1	1.8	1.7	2.0
Capital transfers	1.2	1.7	1.9	1.9	1.5	1.7	1.7
Net lending	**0.6**	**0.3**	**0.1**	**0.1**	**0.2**	**0.2**	**0.2**
Overall balance	**-6.4**	**-4.5**	**-5.4**	**-4.8**	**-4.9**	**-4.9**	**-4.9**
Memorandum item:							
Primary balance	-2.9	-1.0	-1.6	-1.2	-0.4	-0.5	-0.7

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

1/ Excludes proceeds of financial transaction tax in 1999 from revenue and expenditure.
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 6. Colombia: Monetary Indicators

	2002	2003	2004	2005	2006 Prog.	2006 Proj.	Proj. 2007
(In billions of Colombian pesos, unless otherwise indicated)							
Central bank							
Net international reserves 1/	29,576	29,544	31,537	33,627	36,465	35,653	36,873
billions of US$	10.5	10.5	13.2	14.7	15.2	14.9	15.4
Net domestic assets	-15,471	-12,929	-12,277	-10,823	-9,747	-8,480	-7,303
Net credit to public sector	2,101	2,866	-199	-1,595	-2,016	-1,384	687
TES	2,363	3,193	975	2,594	n.a	n.a	n.a
Other, including deposits and REPOs	-263	-327	-1,174	-4,189	n.a	n.a	n.a
Net credit to financial system	3,173	4,656	3,479	4,915	5,320	8,958	7,606
Other	-20,745	-20,451	-15,557	-14,143	-13,051	-16,054	-15,595
Monetary base	14,105	16,615	19,260	22,804	26,718	27,173	29,571
Currency in circulation	10,014	12,007	13,836	16,308	19,107	19,302	21,488
Banking system reserves	4,091	4,608	5,424	6,496	7,611	7,871	8,083
Banking system							
Net foreign assets	27,012	28,714	29,163	31,109	35,897	34,572	36,376
Billions of US$	9.6	10.2	12.2	13.6	14.9	14.4	15.2
Net domestic assets	33,594	37,731	48,317	60,769	69,205	74,171	84,682
Net credit to public sector	13,020	14,277	13,968	15,452	15,167	15,800	12,537
Credit to private sector	47,891	52,287	58,581	67,760	78,272	83,783	97,987
Other net	-27,317	-28,833	-24,231	-22,443	-24,234	-25,412	-25,842
Broad money 2/	60,606	66,445	77,480	91,878	105,102	108,743	121,058
(Annual percentage change)							
Credit to public sector, net	13.7	9.7	-2.2	10.6	-1.8	2.3	-20.7
Credit to private sector	4.0	9.2	12.0	15.7	15.5	23.6	17.0
Currency	19.9	19.9	15.2	17.9	17.2	18.4	11.3
Monetary base	21.1	17.8	15.9	18.4	17.2	19.2	8.8
Broad money 2/	2.9	9.6	16.6	18.6	17.2	18.4	11.3
(In percent of GDP)							
Credit to public sector, net	6.4	6.2	5.5	5.4	4.9	5.1	3.7
Credit to private sector	23.5	22.9	22.9	23.8	25.5	26.8	28.9
Currency	4.9	5.3	5.4	5.7	6.2	6.2	6.3
Monetary base	6.9	7.3	7.5	8.0	8.7	8.7	8.7
Broad money	29.8	29.1	30.3	32.3	34.2	34.8	35.7
(Annual percentage change)							
Central bank inflation target	6.0	5.9	5.5	4.5-5.5	3-5	3-5	...
Consumer price index	7.0	6.5	5.5	4.9	4.5	4.5	...
Exchange rate (+ depreciation)	20.0	-3.1	-16.3	-4.6	...	...	...

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

1/ Assets on and liabilities to nonresident entities.

2/ Currency in circulation plus deposit liabilities of the private sector.

Table 7. Colombia: Summary Balance of Payments

	2002	2003	2004	2005	2006 Prog.	2006 Proj.	Proj. 2007
	(In millions of U.S. dollars)						
Current account balance	**-1,358**	**-974**	**-938**	**-1,978**	**-1,694**	**-2,076**	**-2,911**
Trade balance	239	555	1,346	1,595	1,306	549	-360
Exports, f.o.b.	12,316	13,812	17,224	21,729	24,632	24,897	27,527
Coffee	772	809	949	1,471	1,407	1,453	1,310
Petroleum products	3,275	3,383	4,227	5,559	7,446	6,577	7,073
Non-traditional	6,287	6,234	8,149	9,863	10,590	11,305	13,276
Other	1,982	3,385	3,898	4,836	5,190	5,562	5,868
Imports, f.o.b.	12,077	13,258	15,878	20,134	23,327	24,348	27,887
Services (net)	-1,435	-1,439	-1,679	-2,100	-1,949	-1,882	-2,131
Income (net)	-2,867	-3,398	-4,332	-5,562	-5,032	-5,117	-5,049
Interest (net)	-1,898	-1,996	-1,998	-2,052	-1,384	-1,313	-1,220
Of which : public sector	-1,256	-1,447	-1,476	-1,591	-1,063	-991	-974
Other Income (net)	-969	-1,402	-2,334	-3,509	-3,648	-3,804	-3,829
Current transfers (net)	2,706	3,309	3,727	4,089	3,982	4,374	4,630
Financial account balance	**1,304**	**657**	**3,239**	**3,384**	**2,133**	**2,044**	**3,479**
Public sector (net)	349	378	-36	-2,732	223	-1,153	1,777
Nonfinancial public sector	490	619	472	-2,133	1,186	-65	2,060
Medium- and long-term (net)	-1,093	1,457	912	-1,189	659	1,860	2,446
Disbursements	2,469	4,915	2,890	4,312	2,837	4,603	3,911
Amortization	3,561	3,459	1,977	5,501	2,178	2,743	1,465
Other long-term flows	-29	-29	-50	-47	-29	-48	-48
Short term 1/	1,612	-809	-390	-897	556	-1,877	-338
Of which : change in public assets	1,567	-582	-727	-849	556	-1,823	-338
Financial public sector	-141	-241	-508	-599	-963	-1,088	-283
Private sector (net)	956	279	3,275	6,116	1,910	3,196	1,702
Nonfinancial private sector (net)	1,130	766	2,693	6,292	1,844	3,148	1,644
Direct investment	1,283	820	2,975	5,754	3,833	3,866	3,638
Leasing finance	-160	-319	-66	42	-165	-108	-22
Long-term loans	-970	-726	-1,162	-659	-382	-815	-435
Short term 2/	976	990	946	1,155	-1,442	205	-1,536
Financial private sector (net)	-174	-487	582	-176	66	48	58
Net errors and omissions	**192**	**133**	**241**	**322**	**0**	**0**	**0**
Changes in GIR 3/	**138**	**-184**	**2,541**	**1,729**	**440**	**-32**	**568**
Changes in NIR, program definition 3/	**525**	**17**	**2,672**	**1,525**	**440**	**134**	**568**
	(In percent of GDP)						
Current account balance	-1.7	-1.2	-1.0	-1.6	-1.3	-1.6	-2.0
	(In months of imports of goods and services)						
Gross international reserves 4/	7.8	6.6	6.5	6.1	6.0	5.5	5.1

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 8. Colombia: Medium-Term Outlook (Based on Authorities' Policies)

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
I. Output and Prices										
(Annual percentage changes)										
Real GDP	1.9	3.9	4.8	5.2	5.2	4.5	4.0	4.0	4.0	4.0
Consumer prices										
End of period	7.0	6.5	5.5	4.9	4.5	4.0	3.5	3.0	3.0	3.0
(In percent of GDP, unless indicated otherwise)										
II. Saving and Investment										
Gross national savings	13.6	16.0	17.3	17.7	17.9	19.0	19.0	19.7	20.8	21.6
Private sector	9.6	10.5	13.0	11.8	12.9	13.6	13.5	14.0	14.8	15.3
Public sector	4.0	5.4	4.4	5.9	5.0	5.4	5.6	5.7	6.0	6.3
Gross domestic investment	15.3	17.2	18.3	19.3	19.5	21.0	21.6	22.2	22.9	23.5
Private sector	7.7	9.0	12.6	13.4	13.0	13.9	14.6	15.4	16.1	16.7
Public sector capital expenditure	7.6	8.2	5.6	5.9	6.5	7.1	7.0	6.8	6.8	6.8
External current account balance	-1.7	-1.2	-1.0	-1.6	-1.6	-2.0	-2.6	-2.5	-2.1	-1.9
III. Nonfinancial and Consolidated Public Sector										
Nonfinancial public sector										
Revenue	29.5	30.0	30.2	30.7	31.7	31.9	31.5	31.1	31.2	30.9
Expenditure	33.5	32.5	31.4	30.9	33.3	33.9	33.2	32.5	32.5	32.0
Current expenditure	25.9	24.3	25.8	25.0	26.8	26.8	26.2	25.7	25.7	25.2
Capital expenditure	7.6	8.2	5.6	5.9	6.5	7.1	7.0	6.8	6.8	6.8
Primary balance	0.3	1.5	3.2	4.0	3.1	2.4	2.2	2.1	2.0	2.0
Overall balance	-4.1	-3.2	-1.5	0.0	-1.6	-2.0	-1.7	-1.4	-1.3	-1.0
Combined public sector balance	-3.6	-2.7	-1.3	0.0	-1.5	-1.7	-1.4	-1.1	-0.8	-0.5
External financing	0.6	1.0	0.5	-1.7	0.0	1.5	0.4	0.3	0.3	0.3
Domestic financing	3.1	1.8	0.8	1.6	1.3	0.2	1.1	0.8	0.5	0.2
Privatization	-0.1	-0.1	0.0	0.1	0.2	0.0	0.0	0.0	0.0	0.0
IV. Financial System										
Velocity (GDP/broad money)	3.4	3.4	3.3	3.1	2.9	2.8	3.0	3.0	3.0	3.0
Real growth in private sector credit	-2.2	1.9	5.8	10.1	18.1	12.2	-2.5	5.1	5.2	4.7
V. Balance of Payments										
External current account balance	-1.7	-1.2	-1.0	-1.6	-1.6	-2.0	-2.6	-2.5	-2.1	-1.9
Trade balance	0.3	0.7	1.4	1.3	0.4	-0.3	-0.9	-0.7	-0.4	-0.5
Exports	15.2	17.4	17.7	17.7	19.0	19.2	19.9	21.1	21.4	20.9
Imports	14.9	16.7	16.3	16.4	18.5	19.4	20.7	21.8	21.8	21.3
Capital and financial account balance	1.6	0.8	3.3	2.8	1.6	2.4	3.0	2.9	2.6	2.4
Public sector	0.4	0.5	0.0	-2.2	-0.9	1.2	0.4	0.4	0.3	0.2
Private sector	1.2	0.4	3.4	5.0	2.4	1.2	2.6	2.6	2.3	2.2
Overall balance	0.2	-0.2	2.6	1.4	0.0	0.4	0.4	0.4	0.5	0.5
VI. Debt										
Total external debt	52.6	46.2	36.8	30.8	30.2	29.5	29.5	28.5	27.1	25.9
Public debt	32.1	29.8	24.0	19.4	19.8	19.9	20.4	19.9	19.0	18.2
Private debt	20.5	16.4	12.7	11.4	10.5	9.6	9.1	8.6	8.1	7.7
Total public gross debt 1/	57.0	53.3	49.5	45.8	44.5	43.8	43.3	41.6	39.5	37.2
Domestic debt	24.9	23.5	25.4	26.4	24.8	23.9	23.0	21.7	20.5	19.1
External debt	32.1	29.8	24.0	19.4	19.8	19.9	20.4	19.9	19.0	18.2
Total public net debt 2/	48.7	44.7	39.0	33.5	31.7	31.4	31.1	30.1	28.4	26.7
Memorandum items:										
Nominal GDP (billions of Col$)	203,451	228,517	256,368	284,548	313,451	341,112	367,011	394,789	420,970	449,855
Risk Premium	645	430	400	300	300	300	300	300	300	300
US LIBOR	1.9	1.2	1.8	3.8	5.4	5.5	5.5	5.5	5.5	5.5
Crude oil, spot price	25.0	28.9	37.8	53.4	69.2	75.5	74.3	72.3	70.5	69.3

Sources: Colombian authorities; and Fund staff estimates.

1/ Includes debt of the Non Financial Public Sector plus FOGAFIN and FINAGRO.
2/ Defined as gross debt minus financial assets (deposits).

Table 9. Colombia: Schedule of Purchases Under the SBA, 2005–06

Date	Amount		Conditions
	(In millions of SDR)	(In percent of quota)	
May 2, 2005	193.50	25.0	Board approval.
September 15, 2005	42.30	5.5	Observance of end-June 2005 performance criteria and completion of first review.
December 15, 2005	42.30	5.5	Observance of end-September 2005 performance criteria.
March 15, 2006	42.30	5.5	Observance of end-December 2005 performance criteria and completion of second review.
October 30, 2006	84.60	10.9	Observance of end-June 2006 performance criteria and completion of third review.
Total	**405.00**	**52.3**	

Source: Fund staff estimates.

Table 10. Colombia: Indicators of Capacity to Repay the Fund, 2005–11 1/

	2005	2006	2007	2008	2009	2010	2011
Fund repurchases and charges							
In millions of SDRs	0.0	2.1	21.2	21.2	21.2	219.7	209.1
In millions of U.S. dollars	0.0	3.1	31.5	31.6	31.7	329.0	314.4
In percent of exports of goods and NFS	0.0	0.0	0.1	0.1	0.1	0.9	0.8
In percent of GDP	0.0	0.0	0.0	0.0	0.0	0.2	0.2
In percent of quota	0.0	0.3	2.7	2.7	2.7	28.4	27.0
In percent of overall debt service	0.0	0.0	0.2	0.2	0.2	1.9	1.8
In percent of gross foreign reserves	0.0	0.0	0.2	0.2	0.2	1.8	1.7
Fund credit outstanding							
In millions of SDRs	0.0	405.0	405.0	405.0	405.0	202.5	0.0
In millions of U.S. dollars	0.0	594.7	601.6	603.5	604.8	303.3	0.0
In percent of exports of goods and NFS	0.0	2.1	2.0	1.8	1.7	0.8	0.0
In percent of GDP	0.0	0.5	0.4	0.4	0.4	0.2	0.0
In percent of quota	0.0	52.3	52.3	52.3	52.3	26.2	0.0
In percent of overall debt service	0.0	4.2	4.3	3.9	3.8	1.7	0.0
In percent of gross foreign reserves	0.0	3.8	3.7	3.6	3.5	1.7	0.0
(In millions of U.S. dollars; unless otherwise stated)							
Memorandum items:							
Exports of goods and NFS	24,395	27,860	30,575	33,087	35,439	38,594	40,395
Quota (millions of SDRs)	774	774	774	774	774	774	775
GDP	122,571	131,339	143,525	150,738	152,895	165,269	177,377
U.S. dollar per SDR (WEO projection)	1.48	1.47	1.49	1.49	1.49	1.50	1.50
Public sector external debt	24,125	25,795	28,258	29,822	30,589	31,495	32,318
Overall external debt service	16,495	14,291	13,854	15,450	15,876	17,623	17,685
Overall external debt	38,343	39,484	41,878	43,170	43,866	44,925	46,015
Gross foreign reserves	14,927	15,656	16,231	16,847	17,530	18,009	18,521

Source: Fund staff estimates.

1/ Projections assume that scheduled purchases under the proposed Stand-By Arrangement are made.

Annex I. Colombia: Debt Sustainability Analysis

In the baseline scenario with authorities' policies, both public and external debt stay on a sustainable path through 2011. The baseline scenario is broadly consistent with the WEO, and assumes the government would generate a primary surplus of 2.1 percent of GDP on average for 2007–11, which would allow public debt to decline to 39.5 percent of GDP by 2010 and 37.2 percent of GDP by 2011. The external current account deficit for 2007–11 would increase slightly to 2.2 percent of GDP on average. This is consistent with a more moderate rate of growth of Colombian trading partners and small deterioration in Colombian terms of trade, as presented in the latest WEO. Provided policies remain strong, capital inflows are expected to continue —albeit at more moderate pace—, and total external debt would decline to 26 percent of GDP by 2011.

The major downside risk to the outlook is a possible worsening of the external environment. The elements of such scenario could include: a sharp slowdown in the growth of Colombian trading partners (growth lower by 1 percentage point compared with the baseline), tighter conditions in global financial markets out of concerns with inflationary pressures in the US (increase by 100 basis points in world interest rates relative to the baseline), and a worsening in the Colombian terms of trade (a fall by 10 percent in the price of commodities compared to the baseline). This shock could translate into lower real economic growth in Colombia. Under this more adverse scenario, and assuming the primary surplus remains at 2.1 percent of GDP over 2007–11, public debt would decline to 43 percent of GDP in 2010 and 42.1 percent of GDP in 2011. On the external side, the main effects would be a worsening of the trade balance by about 0.4 percent of GDP per year and the increase in the external debt by 3 percentage points of GDP to almost 29 percent of GDP by 2011.

Standardized bound tests

Public Debt. Even under the extreme cases of accelerated depreciation of the peso vis-à-vis the U.S. dollar or a significant slowdown in growth, public debt would remain on a sustainable path. Assuming a one time 30 percent depreciation of the peso vis-à-vis the U.S. dollar in 2007, or a slowdown of real GDP growth by 1.3 percent a year over 2007–11 (to 2.7 percent instead of 4 percent), the ratio of public debt to GDP would increase almost two percentage points in 2011 with respect to its 2006 levels, instead of following a declining trend as in the baseline projection with authorities' policies. This resilience reflects the baseline assumption that the primary fiscal balance would remain at 2.1 percent of GDP. If the primary surplus were to average 1.1 percent of GDP over this period, public debt would still decline to 42.4 percent of GDP by 2011.

External Debt. Colombia's external debt profile remains sustainable under all alternative scenarios. A higher external interest rate or slower economic growth would have little effect on the evolution of external debt, while a higher non-interest current account deficit would raise external debt to 32.5 percent of GDP by 2011. A one-time 30 percent depreciation of the peso vis-à-vis the U.S. dollar would raise external debt to 34.7 percent of GDP by 2011.

Table A1. Colombia: External Debt Sustainability Framework, 2001-2011
(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2001	2002	2003	2004	2005			2006	2007	2008	2009	2010	2011	Debt-stabilizing non-interest current account 6/
Baseline: External debt	47.5	52.6	46.2	36.8	30.8			**30.2**	**29.5**	**29.5**	**28.5**	**27.1**	**25.9**	**-2.2**
Change in external debt	1.5	5.1	-6.4	-9.4	-6.0			-0.5	-0.7	0.0	-1.0	-1.4	-1.2	
Identified external debt-creating flows (4+8+9)	-3.9	7.7	-7.0	-12.7	-8.1			-2.9	-1.8	-1.2	-1.2	-1.2	-1.2	
Current account deficit, excluding interest payments	-2.1	-1.6	-1.7	-1.5	-0.6			-0.4	0.1	0.6	0.5	0.2	0.1	
Deficit in balance of goods and services	1.0	1.7	1.1	0.3	0.4			1.0	1.8	2.5	2.3	2.1	-4.9	
Exports	18.3	20.0	19.1	18.2	19.6			21.3	21.6	22.6	23.0	23.3	22.7	
Imports	19.3	21.7	20.2	18.5	20.0			22.4	23.3	25.1	25.4	25.4	17.8	
Net non-debt creating capital inflows (negative)	-3.0	-1.8	-1.0	-2.8	-4.6			-3.0	-2.6	-2.6	-2.6	-2.3	-2.1	
Automatic debt dynamics 1/	1.2	11.1	-4.3	-8.4	-2.9			0.5	0.7	0.9	0.9	0.9	0.8	
Contribution from nominal interest rate	3.4	3.5	2.9	2.4	2.2			2.0	2.0	2.1	2.0	1.9	1.8	
Contribution from real GDP growth	-0.6	-1.1	-1.8	-1.7	-1.6			-1.5	-1.3	-1.1	-1.1	-1.1	-1.0	
Contribution from price and exchange rate changes 2/	-1.5	8.6	-5.4	-9.1	-3.5			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	5.3	-2.6	0.6	3.2	2.1			2.3	1.1	1.1	0.2	-0.1	0.0	
External debt-to-exports ratio (in percent)	260.0	263.2	241.6	202.5	157.2			141.7	137.0	130.5	123.8	116.4	113.9	
Gross external financing need (in billions of US dollars) 4/	8.9	11.5	10.9	11.0	16.1			14.1	14.3	16.7	17.0	18.3	18.3	
in percent of GDP	10.9	16.2	13.3	10.2	12.9			10.8	10.1	11.4	11.0	11.1	10.3	
Key Macroeconomic Assumptions Underlying Baseline						10-Year Historical Average	10-Year Standard Deviation							
Real GDP growth (in percent)	1.5	1.9	3.9	4.8	5.2	2.1	2.6	5.2	4.5	4.0	4.0	4.0	4.0	
GDP deflator in US dollars (change in percent)	3.4	-15.3	11.5	24.5	10.4	2.5	12.3	-0.3	3.9	-0.8	1.2	3.5	3.2	
Nominal external interest rate (in percent)	7.7	6.4	6.3	6.7	7.0	7.1	0.5	6.9	7.2	7.2	7.1	7.3	7.2	
Growth of exports (US dollar terms, in percent)	-4.6	-5.7	10.9	23.8	25.2	6.4	11.2	14.2	9.7	8.2	7.1	8.9	4.7	
Growth of imports (US dollar terms, in percent)	10.2	-3.1	8.1	19.2	25.7	10.0	36.8	17.2	13.3	11.2	6.2	7.6	-24.6	
Current account balance, excluding interest payments	2.1	1.6	1.7	1.5	0.6	0.8	2.6	0.4	-0.1	-0.6	-0.5	-0.2	-0.1	
Net non-debt creating capital inflows	3.0	1.8	1.0	2.8	4.6	2.8	1.2	3.0	2.6	2.6	2.6	2.3	2.1	
B. Bound Tests														
B1. Nominal interest rate is at baseline plus one-half standard deviation								**30.2**	**29.6**	**29.7**	**28.7**	**27.4**	**26.3**	**-2.1**
B2. Real GDP growth is at baseline minus one-half standard deviations								**30.2**	**29.9**	**30.2**	**29.5**	**28.5**	**27.5**	**-2.0**
B3. Non-interest current account is at baseline minus one-half standard deviations								**30.2**	**30.8**	**32.2**	**32.5**	**32.4**	**32.5**	**-2.2**
B4. Combination of B1-B3 using 1/4 standard deviation shocks								**30.2**	**30.4**	**31.3**	**31.1**	**30.6**	**30.2**	**-2.0**
B5. One time 30 percent real depreciation in 2007								**30.2**	**40.2**	**39.9**	**38.4**	**36.4**	**34.7**	**-3.0**

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.

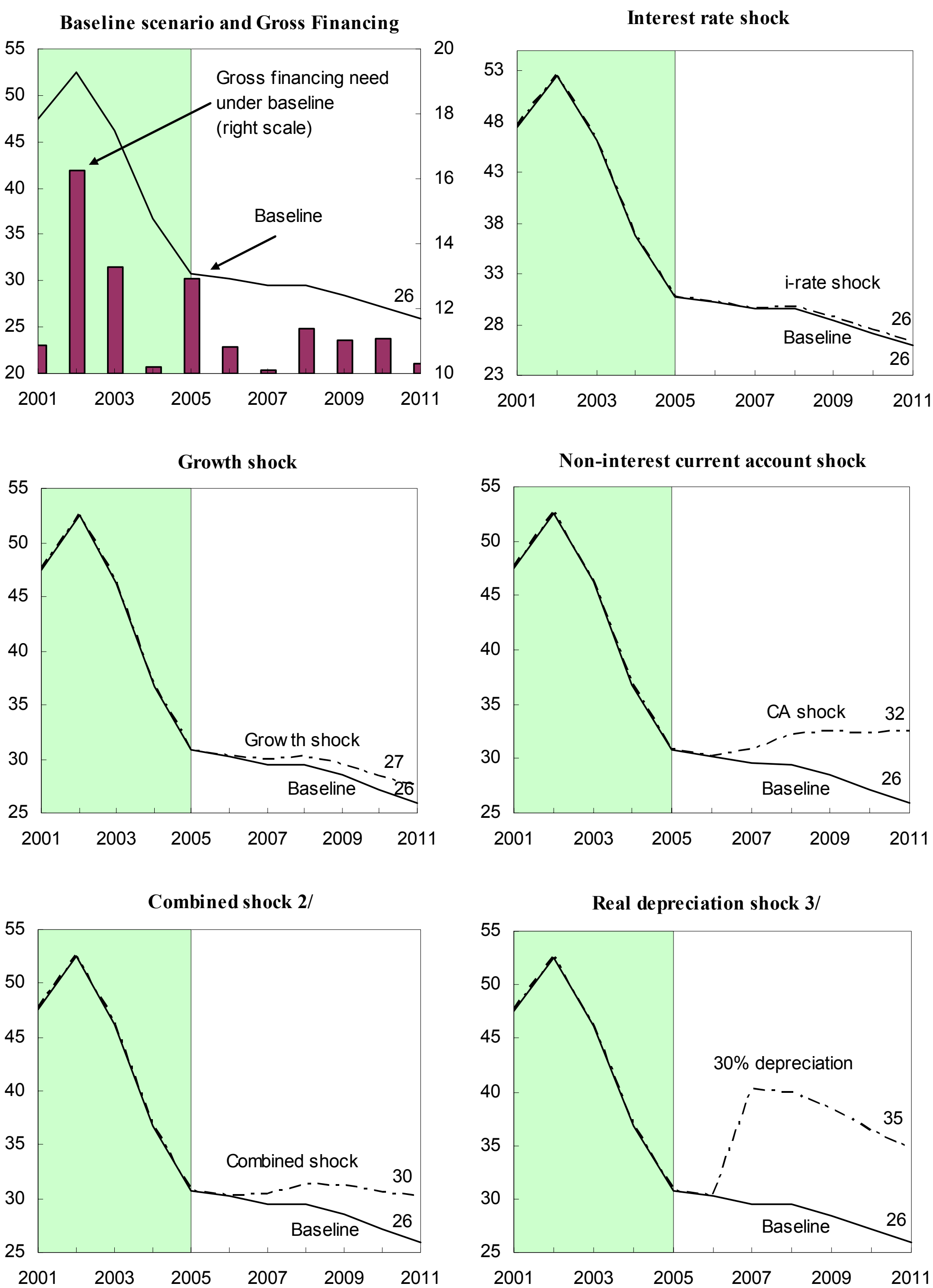
6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Table A2. Colombia: Public Sector Debt Sustainability Framework, 2001–11
(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2001	2002	2003	2004	2005			2006	2007	2008	2009	2010	2011	
								I. Baseline Projections						Debt-stabilizing primary balance 10/
Public sector debt 1/	48.9	57.0	53.3	49.5	45.8			**44.5**	**43.8**	**43.3**	**41.6**	**39.5**	**37.2**	**0.4**
o/w foreign-currency denominated	28.5	32.1	29.8	24.0	19.4			19.8	19.9	20.4	19.9	19.0	18.2	
Change in public sector debt	1.2	8.1	-3.6	-3.9	-3.7			-1.3	-0.7	-0.4	-1.7	-2.1	-2.3	
Identified debt-creating flows (4+7+12)	0.9	7.7	-4.6	-8.5	-5.8			-1.9	-1.6	-0.6	-1.2	-1.5	-1.6	
Primary deficit	-1.3	-0.5	-2.2	-3.5	-3.8			-3.1	-2.4	-2.2	-2.1	-2.0	-2.0	
Revenue and grants	29.5	29.5	30.0	30.2	30.7			31.7	31.9	31.5	31.1	31.2	30.9	
Primary (noninterest) expenditure	28.2	29.0	27.8	26.7	26.9			28.7	29.5	29.3	29.0	29.2	28.9	
Automatic debt dynamics 2/	2.3	8.0	-2.4	-5.0	-1.9			1.4	0.8	1.6	0.9	0.5	0.4	
Contribution from interest rate/growth differential 3/	1.6	0.9	-1.5	-1.1	-0.9			0.4	0.8	0.8	0.5	0.7	0.5	
Of which contribution from real interest rate	2.2	1.8	0.4	1.2	1.4			2.6	2.6	2.4	2.1	2.3	2.0	
Of which contribution from real GDP growth	-0.7	-0.9	-2.0	-2.3	-2.3			-2.2	-1.8	-1.6	-1.6	-1.6	-1.5	
Contribution from exchange rate depreciation 4/	0.7	7.1	-0.9	-4.0	-1.0			1.0	0.0	0.9	0.5	-0.2	-0.1	
Other identified debt-creating flows	0.0	0.1	0.1	0.0	0.0			-0.3	0.0	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	0.0	0.1	0.1	0.0	0.0			-0.3	0.0	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)	0.3	0.4	1.0	4.7	2.1			0.6	0.9	0.1	-0.5	-0.6	-0.7	
Public sector debt-to-revenue ratio 1/	165.7	193.1	177.9	163.8	149.1			140.3	137.3	137.6	133.8	126.8	120.5	
Gross financing need 5/	6.3	8.4	7.6	3.4	4.7			4.0	3.8	3.5	3.3	3.0	2.7	
in billions of U.S. dollars	5.1	6.8	6.0	3.3	5.8			5.2	5.4	5.3	5.0	5.0	4.8	
Key Macroeconomic and Fiscal Assumptions						10-Year Historical Average	10-Year Standard Deviation							Projected Average
Real GDP growth (in percent)	1.5	1.9	3.9	4.8	5.2	2.2	2.7	5.2	4.5	4.0	4.0	4.0	4.0	4.1
Average nominal interest rate on public debt (in percent) 6/	11.3	9.9	9.3	10.0	8.9	11.1	1.5	11.2	10.7	9.5	8.7	8.4	8.2	9.1
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	5.1	4.1	1.2	2.9	3.4	0.5	3.5	6.5	6.6	6.0	5.3	5.9	5.5	5.8
Nominal appreciation (increase in US dollar value of local currency, in percent)	-2.7	-20.0	3.1	16.3	4.6	-7.3	12.9	-4.8	-0.2	-4.1	-2.2	0.9	0.4	-1.0
Inflation rate (GDP deflator, in percent)	6.2	5.9	8.1	7.1	5.5	10.6	4.6	4.7	4.1	3.5	3.4	2.5	2.8	3.3
Growth of real primary spending (deflated by GDP deflator, in percent)	5.5	5.1	-0.7	0.7	6.2	3.4	6.0	11.9	7.6	3.4	2.9	4.7	3.0	4.3
Primary deficit	-1.3	-0.5	-2.2	-3.5	-3.8	-0.8	2.0	-3.1	-2.4	-2.2	-2.1	-2.0	-2.0	-2.14
A. Alternative Scenarios								II. Stress Tests for Public Debt Ratio						Debt-stabilizing primary balance 10/
A1. Key variables are at their historical averages in 2006-10 7/								**44.5**	**43.9**	**43.3**	**41.7**	**39.3**	**37.1**	**-0.7**
A2. No policy change (constant primary balance) in 2006-10								**44.5**	**42.6**	**40.9**	**38.9**	**35.6**	**32.2**	**0.3**
B. Bound Tests														
B1. Real interest rate is at baseline plus one-half standard deviation								**44.5**	**44.5**	**44.8**	**43.9**	**42.5**	**41.0**	**1.1**
B2. Real GDP growth is at baseline minus one-half standard deviation								**44.5**	**44.8**	**45.7**	**45.8**	**45.9**	**46.2**	**1.1**
B3. Primary balance is at baseline minus one-half standard deviation								**44.5**	**44.8**	**45.4**	**44.7**	**43.6**	**42.3**	**0.5**
B4. Combination of B1-B3 using one-quarter standard deviation shocks								**44.5**	**44.9**	**45.7**	**45.2**	**44.3**	**43.2**	**1.1**
B5. One time 30 percent real depreciation in 2007 9/								**44.5**	**51.0**	**50.8**	**49.2**	**47.2**	**45.0**	**0.5**
B6. 10 percent of GDP increase in other debt-creating flows in 2006								**44.5**	**53.8**	**53.7**	**52.2**	**50.2**	**48.1**	**0.5**

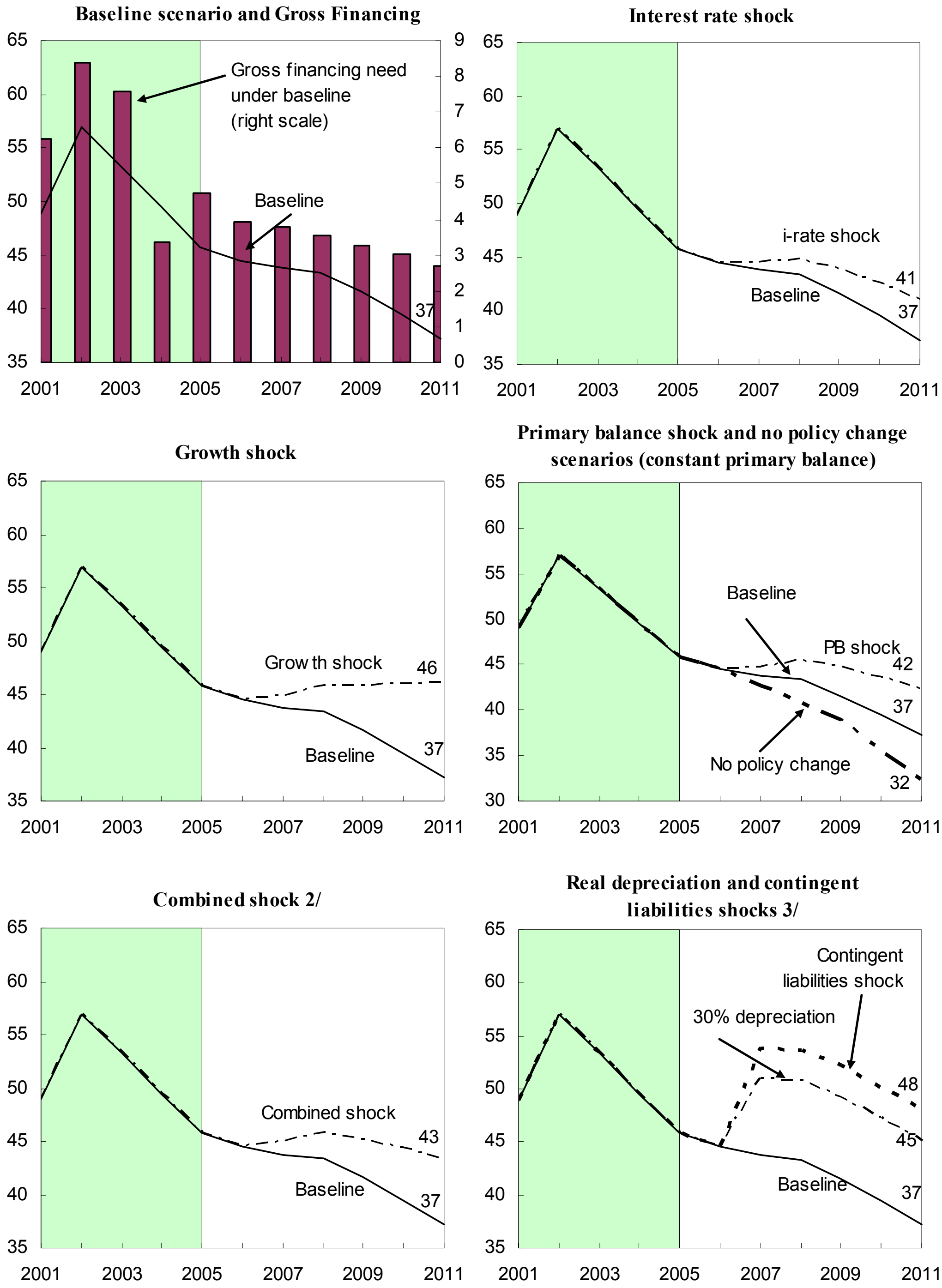
1/ Covers the combined public sector (Non-financial public sector balance plus quasi-fiscal balance of the central bank and costs of financial restructuring- FOGAFIN and FINAGRO). Debt is measured in gross terms.
2/ Derived as [(r - p(1+g) - g + ae(1+r)]/(1+g+p+gp)) times previous period debt ratio, 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/ The implied change in other key variables under this scenario is discussed in the text.
9/ Real depreciation is defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).
10/ 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 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 2007.

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 2006, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

APPENDIX I. COLOMBIA: FUND RELATIONS

(As of September 30, 2006)

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

II. General Resources Account:	**SDR Million**	**% Quota**
Quota	774.00	100.00
Fund holdings of currency	488.20	63.08
Reserve position in Fund	285.80	36.93

III. SDR Department:	**SDR Million**	**% Allocation**
Net cumulative allocation	114.27	100.00
Holdings	126.12	110.37

IV. Outstanding Purchases and Loans: None

V. Latest Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
SBA	May 2, 2005	Nov. 2, 2006	405.00	0.00
SBA	Jan. 15, 2003	May 2, 2005	1,548.00	0.00
EFF	Dec. 20, 1999	Dec. 19, 2002	1,957.00	0.00

VI. Projected Obligations to Fund (in SDR Million):

			Forthcoming		
Type	**2006**	**2007**	**2008**	**2009**	**2010**
Principal	0.00	0.00	0.00	0.00	0.00
Charges/Interest	0.00	0.01	0.01	0.01	0.01
Total	0.00	0.01	0.01	0.01	0.01

VII. Safeguards Assessments:

A safeguards assessment of the Banco de la República (BRC), completed on October 24, 2005, found that the recommendations from the 2003 assessment had been implemented. The assessment report concluded that there continue to be no major vulnerabilities in the BRC's safeguards framework, and consistent with the 2003 assessment, it recommended that the BRC continue progress toward the full adoption of IFRS.

VIII. Exchange Rate Arrangement:

In September 1999 the Banco de la República floated the peso. At end-August 2006, the exchange rate was Col$2,396 per U.S. dollar. The authorities accepted the obligations of Article VIII in August 2004. Colombia maintains the following two exchange measures, subject to Fund approval under Article VIII: a) an exchange restriction arising from a special foreign exchange regime for the hydrocarbon sector that limits the availability of foreign exchange for branches of foreign corporations that choose to participate in the regime and b) a multiple currency practice and an exchange restriction arising from a tax on remittances abroad of nonresident income which is withheld when the foreign exchange is purchased.

IX. Last Article IV Consultation:

The 2005 Article IV consultation was concluded on April 29, 2005.

X. FSAP Participation:

The Financial Sector Stability Assessment update (FSSA) was discussed in April, 2005.

XI. Statistics: Colombia subscribes to the SDDS. ROSC completed in September 2006.

XII. Recent Technical Assistance:

Dept.	**Purpose**	**Time of Delivery**
STA	National Income Accounts	June 2005
MFD	Governance of Public Banks	October 2005
ICM	Developing Hedging Instruments	October 2005
MCM	Risk Measurement for Financial Supervision	July 2006
MCM	Developing Hedging Instruments	August 2006

XIII. Resident Representative: None.

XIV. Fourth Amendment: Colombia has accepted this amendment.

APPENDIX II. COLOMBIA: WORLD BANK RELATIONS[1]

The World Bank and Colombia's Development Strategy

Colombia's National Development Plan is built on four 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. The World Bank Group's (WBG's) strategy seeks to support Colombia's quest for development and peace. The Country Assistance Strategy (CAS) for Colombia was discussed by the Bank's Board in January 2003 and since then Colombia has received about US$2 billion in loans, of which nearly 60 percent consists of fast-disbursing operations. A CAS Progress Report was prepared in September 2005. It follows along the same pillars of the original CAS with an additional "peace pillar" that envisions activities to support social policies for populations affected by conflict.

The World Bank Program for FY 2005–06

In line with the CAS, since June 2004, the IBRD has prepared development policy loans to support fiscal reform, financial sector reform, the labor and social sector reform, and environmental management. Labor and social sector reforms have been supported by a series of development policy loans and a technical assistance loan that aims to improve knowledge, develop effective instruments, and strengthen the ability to carry out such reforms. The environment development policy loan series is being complemented by a technical assistance loan to support the inclusion of environmental and social policies in government programs and to strengthen the capacity of the major relevant institutions.

The WBG's International Bank for Reconstruction and Development (IBRD) will also support a program to increase business productivity and efficiency, and a program in monitoring and evaluation. The Bank's support for the Government of Colombia's program for promoting greater business productivity consists of a three-phased series of programmatic development policy loans. The second phase extends the support to other areas of microeconomic reform, including upgrading the quality and certification standards necessary to allow enterprises to take advantages of an even more open economy, and further supports reforms to foster the supply of credit and increased transparency and access to financial services. The Bank will continue its support in strengthening Colombia's Monitoring and Evaluation system through an investment loan. The WBG's International Finance Corporation (IFC) focuses on supporting new forms of public-private partnerships, while the Multilateral Investment Guarantee Agency (MIGA) focuses on the provision of political risk guarantees for private sector investments; hands-on technical assistance for investment promotion intermediaries; and the dissemination of information on investment opportunities in Colombia.

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

Bank-Fund Collaboration in Specific Areas

The WBG is helping Colombia implement its reform agenda in the following areas of Bank-Fund collaboration:

- Assisting fiscal reforms, notably reforming the tax system, strengthening tax administration, implementing a fiscal responsibility law, and reforming the public sector.
- Reforming the transfers from the central government to subnational governments.
- Reforming the pension and social security systems.
- Fostering financial sector and capital market developments.
- Broadening and deepening the scope of Colombia's anticorruption program.
- Combating money laundering.

Operations Portfolio (IBRD/IDA and grants)
As of September 12, 2006
(In millions of U.S. dollars)

Closed Projects	**171**
Active Projects	**21**
IBRD/IDA *	
Total Disbursed (Active)	503.25
of which has been repaid	12.08
Total Disbursed (Closed)	10,726.87
of which has been repaid	8,738.10
Total Disbursed (Active + Closed)	11,230.11
of which has been repaid	8,750.19
Total Undisbursed (Active)	1,011.19
Total Undisbursed (Closed)	0.00
Total Undisbursed (Active + Closed)	1,011.19

Loan Information (IBRD)
As of August 17, 2006
(In millions of U.S. dollars)

Fiscal Year*	2002	2003	2004	2005	2006
Total disbursements	369	948	491	567	692
Repayment amount	243	223	205	254	223
Net disbursements	126	725	286	313	469

*Fiscal Year: July 1 – June 30.

IFC Operations
As of July 31, 2006
(In millions of U.S. dollars)

	Loans	Equity (+Quasi)	Participation	Total
Total commitments	288.4	221.0	2.6	512.0
Total undisbursed	168.0	107.1	0.0	275.1

APPENDIX III. COLOMBIA: RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK[20]

(As of September 15, 2006)

I. Background and Objectives

In September 2003, the IADB Board of Directors approved the Bank's strategy for Colombia for the period 2003–2006. The strategy identifies three overarching objectives: (i) lay the foundations for economic revival and jump-starting growth; (ii) foster social progress and make sure society's most vulnerable are protected; and (iii) strengthen governance and further modernization of the State. These objectives constitute the framework for the Bank activities in Colombia.

To help reinvigorate the economy the Bank is working to foster competitiveness and will support agricultural development and natural resources management. To foster social progress and ensure that society's most vulnerable are protected, Bank's actions will improve social protection systems and will promote the coverage, quality, and efficiency of essential social services. In the governance and modernization of the State area the Bank will support national public sector reforms and local governments management capacity building, moreover, the Bank will promote initiatives to foster transparency and combat corruption, and will support judicial branch reforms.

From the Bank's standpoint, the implementation of the strategy is constrained by the country's fiscal deficit and security issues. Both constraints have implications for the size of the lending program, the mix of lending and non-lending products, and the prospects for achieving the strategy objectives. The Bank is in the process of preparation of a new country Strategy for Colombia that will cover the period 2007–2010.

II. LENDING

Under the current strategy, the Bank has approved 20 new loans amount US$3.584 million. 74% of these resources were approved through rapid disbursement operations. As of September 15, 2006 the country's portfolio consists of 29 loans an amount equivalent to US$2,159 million. These resources are distributed among 26 investment loans (US$1,159 million) and three policy-based loans (US$1,000 million). In addition, the country portfolio with Colombia includes 32 non-reimbursable technical cooperation operations (US$20.8 million). Through the Multilateral Investment Fund (MIF), which finances private sector investment projects, Colombia has 37 non-reimbursable operations (US$19.3 million) and 2 loans (US$2.2 million). The IIC has 16 active projects totaling US$154.3 millions, and the Private Sector has active three operations totaling US$108.6 million.

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[20] Prepared by IADB staff. Questions may be addressed to Mr. Kim B. Staking, Country Economist, at (202) 623-3003 or kims@iadb.org.

So far in 2006 the Bank has approved two programmatic loans supporting competitiveness (US$200 million) and social development (US$200 million), and two investment loans to support hospital reorganization (US$60 million) and citizen services in Bogota (US$10 million). For the remainder of 2006, the Bank projects approving three additional operations totaling US$130 million to support Colombian sub-national governments in the areas of education, urban development and infrastructure.

COLOMBIA: FINANCIAL RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK
(As of Sept 15, 2006)

I. IDB OPERATIONS
(In millions of U.S. dollars)

	Commitments	Disbursements	Undisbursed amounts
Agricultural and rural development	20.5	13.9	6.6
Modernization of State	727.3	485.6	241.8
Social Investment	231.3	26.8	204.5
Education	26.0	20.9	5.1
Health	267.0	117.9	149.1
Sanitation	25.1	10.7	14.4
Natural resource management	55.4	35.3	20.0
Urban development and household	180.0	119.1	60.9
Energy	200.0	36.7	163.3
Competitiveness and Business Environment	205.0	0.6	204.4
Transportation	221.7	16.4	205.3
Grand total	**2,159.3**	**884.0**	**1,275.3**

II. IDB LOAN TRANSACTIONS
(In millions of U.S. dollars)

	1999	2000	2001	2002	2003	2004	2005	2006*
Gross disbursemen	952.4	241.2	785.3	151.8	2,011.7	329.6	361.6	899.6
Amortization, interest and contributions	445.8	473.2	408.2	819.4	1,017.5	661.3	1,757.8	459.8
Net cash flow	506.6	-232.0	377.1	-667.6	994.2	-331.7	-1,396.2	439.8

(*) Projections. Note: 2005 included prepayment of Emergency Loan (US$1,250 million) issued in 2003.

Source: IADB.

Bogotá, Colombia
October 16, 2006

Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. de Rato:

In 2006, Colombia's economy is likely to prolong its good performance, as the continuity of strong policies has improved confidence and promoted vigorous growth in investment. Real GDP is expected to grow by 5.2 percent, while inflation is targeted to decline to 4.5 percent—the lowest level in decades. The external current account deficit is likely to remain low at 1.6 percent of GDP, owing to the strength of world commodity prices as well as robust growth in non-traditional exports. The economy handled with little difficulty the volatility in international financial markets earlier this year, providing a clear indication that it has become more resilient.

The Fund's support through the Stand-By Arrangement that expires in November 2006 has helped provide a transparent policy framework and fortify confidence. We are requesting the completion of the third and final review under this arrangement. The performance criteria at end-June 2006 and end-July 2006 and the continuous performance criteria have been observed and the program agenda has been completed (Tables 1 and 2). With regard to the structural benchmarks, in July 2006 we submitted a revenue-neutral tax reform designed to cut distortions and in September 2006 the draft constitutional amendment to reform intergovernmental transfers was presented. We plan to submit a draft law to strengthen the independence of the financial supervisor no later than November 2006. The 2007 budget presented to congress in July includes some provisions to trim earmarked revenues over time.

Over the medium term, we remain fully committed to strengthening policies further to sustain economic growth and to make the economy more resilient. We intend to keep fiscal policy on a sustainable path with a view to reducing public debt to 40 percent of GDP by 2010, limit annual inflation to the range of 2–4 percent in the medium term and to continue to deepen structural reforms. We look forward to maintaining a strong policy dialogue with the Fund in the context of annual Article IV consultations.

Sincerely yours,

/s/	/s/
Alberto Carrasquilla Minister of Finance and Public Credit	José Dario Uribe General Manager Banco de la República

Table 1. Colombia: Performance Criteria for 2006 1/

		2006			
		Indicative	Performance	Indicative	
	Outturn	Targets	Criteria	Targets	
	Dec. 31, 2005	Mar. 31	Jun. 30	Sept. 30	Dec. 31
I. Performance Criteria					
Cumulative flows from beginning of calendar year (In billions of Colombian pesos)					
Overall balance of the combined public sector					
Ceiling	-4,557	-1,657	-1,383	-1,995	-4,711
Outturn	-24	-2,199	659	…	…
Margin (+) or shortfall (-)	4,533	-542	2,042	…	…
Inflation rate 3/ (12-month inflation rate)					
Inflation - Consultation band					
Upper limit	6.0	5.8	**5.1**	**5.1**	…
Target	5.0	4.8	4.1	4.1	4.5
Lower limit	4.0	3.8	3.1	3.1	…
Outturn	4.9	4.1	3.9	…	…
(In millions of U.S. dollars)					
Net international reserves of the Banco de la Republica					
Floor	12,215	12,215	12,215	12,215	12,215
Outturn	14,721	15,011	14,120	...	...
Margin (+) or shortfall (-)	2,506	2,796	1,905	…	…
Change in the outstanding stock of short-term external debt of the public sector					
Ceiling	200	100	100	100	100
Outturn	-92	18	-69	…	…
Margin (+) or shortfall (-)	292	82	169	…	…
II. Indicative Targets					
Cumulative net disbursement from beginning of calendar year (In millions of U.S. dollars)					
Net disbursement of foreign currency debt to the public sector					
Ceiling	-750	-400	-100	100	200
Outturn	-2,835	-986	-716	…	…
Margin (+) or shortfall (-)	2,085	586	616	…	…

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

1/ Definitions of concepts and adjustments to the performance criteria are explained in the technical memoranda of understanding (TMU) attached to IMF Country Reports Nos. 05/154, 05/392, and 06/71.

2/ Deviations from the quarterly path for inflation will trigger consultations with the Fund, as set out in the TMU.

Table 2. Colombia: Structural Conditionality Under the 2005–2006 Program SBA

	Prior Action	Status
	Issue circular that requires banks to treat the annexes pertaining to their operations with the nonfinancial public sector as part of their reports on their balance sheets.	Done.
	Structural Performance Criteria	
June 30, 2005	Congressional approval of the changes to the Budget Code. The revision will (a) adopt a budget classification according to international standards that fits into the context of Colombia's legal framework; (b) require that the annual budget law include information on tax expenditures, quasifiscal activities, subsidies, contingent fiscal liabilities, medium-term fiscal projections, and a fiscal sustainability analysis; (c) establish a mid-year budget report to Congress; (d) gradually phase out most revenue earmarking not mandated by the constitution by subjecting these earmarking provisions to explicit sunset provisions; (e) limit the budget carry over by eliminating the "reserva presupuestal"; and (f) limit the power of the government to make spending commitments for future years on projects not authorized under the Development Plan.	Not observed. Several of these issues have been addressed in the context of the Fiscal Responsibility Law approved in 2003. The authorities are have reducinged the budget carry over, and will begin to limit revenue earmarking in the context of a decree and draft legislationissued a decree in December 2005.
July, 31 2005	Submission to Congress of 2006 budget consistent with combined public sector deficit of 2.0 percent of GDP in 2006.	Done.
July 31, 2006	Submission to Congress of 2007 budget consistent with CPS deficit of 1.7 percent of GDP.	Done.
	Structural Benchmarks	
June 30, 2005	Congressional approval of a constitutional amendment to eliminate special pension regimes, end 14th monthly pension and cap maximum pension at no more than 25 minimum salaries. Congressional approval of new securities law.	Done. Done.
September 30, 2005	Issue the regulations needed to improve the quality of information reported for the operations of local and regional governments.	Revised information without having to issue regulations.
October 31, 2005	Issue decree that adopts as many elements of the revised budget code as possible, including a requirement to present expenditure according to an international classification system.	Done in December 2005.
December 31, 2005	Publish a report evaluating the current system of sharing revenue among the different levels of government. Bring Granahorrar to the point of sale.	Not done. Prepared in February 2006 but not published. Done in October 2005.
March 30, 2006	Prepare draft law on revenue earmarking not mandated by the constitution.	To be done by June 2006. Not observed.
June 30, 2006	Complete issuance of all regulations needed to fully implement the securities market law approved in June 2005. Complete process of finding private investor for joint venture to modernize the Cartagena refinery.	Done Done August 2006.
August 31, 2006	Submit tax reform to Congress. Submit revenue sharing reform to Congress. Submit law that grants independence to financial superintendency.	Done July 2006 Done September 2006 Pending

APPENDIX V. COLOMBIA: STATISTICAL ISSUES

The data provided by the authorities are generally adequate for surveillance. Colombia is in observance of the Special Data Dissemination Standard (SDDS) and metadata are posted on the Fund's Dissemination Standards Bulletin Board (DSBB). Colombia is availing itself of a flexibility option on the timeliness of certain production, monetary and external data. A mission visited Bogotá during September 5–16, 2005 to prepare a data ROSC, which will be published shortly.

Real sector

The National Department of Statistics (DANE) is responsible for the compilation of the national accounts, although the Banco de la República (BR) compiles the financial accounts. Estimates of GDP and expenditures are based on an outdated base year (1994). However, the DANE is in the process of compiling new series with 2000 as the new base year. Compilation has conformed to the recommendations of the 1993 SNA since 1995. However, there are shortcomings in estimates of gross fixed capital formation as some agencies use different source data and sampling techniques. Estimates of illicit activities focus on agricultural output and do not include downstream value added.

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 GFS compiled are sent to the Statistics Department in the IMF for publication in the *Government Finance Statistics Yearbook (GFS Yearbook)*.

Monthly data have been reported for publication in IFS and annual data on the consolidated general government on accrual and cash bases have been reported for publication in the *2006 GFS Yearbook*. The last year for which data were reported was 2005.

Financial sector statistics

The BR 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 of data quality, including interagency cooperation and procedures to ensure data consistency. The introduction of a new call report form in March 2005 will significantly improve the quality of monetary statistics. The authorities are in the process of migrating to the new standardized forms for reporting monetary data to STA.

Balance of payments and external debt

The BR is in charge of compiling and disseminating balance of payments data. Quarterly data have been produced since 1994, and the BR 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. Financial account data are now based on actual disbursement rather than registers.

The 2005 data ROSC mission recommended that the BR, in consultation with the DANE, develop a methodology to include unrecorded trade in the balance of payments on a timely basis. The BR should reclassify 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 BR 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 September 26, 2005

	Date of latest observation	Date received	Frequency of Data[1]	Frequency of Reporting[1]	Frequency of publication[1]
Exchange Rates	9/22/05	9/25/05	D	W	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[2]	8/31/06	9/08/06	M	M	M
Reserve/Base Money	9/20/05	9/25/05	D	W	W
Broad Money	9/8/05	9/25/05	D	W	W
Central Bank Balance Sheet	8/31/05	9/14/05	M	M	M
Consolidated Balance Sheet of the Banking System	7/31/05	9/14/05	M	M	M
Interest Rates[3]	9/20/05	9/25/05	D	W	D
Consumer Price Index	Aug. 2006	Sep. 2006	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[4] – General Government[5]	Dec. 2004	Feb. 2005	Q	Q	Q
Revenue, Expenditure, Balance and Composition of Financing[4] – Central Government	Dec. 2004	Feb. 2005	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[6]	Dec. 2004	Feb. 2005	Q	Q	Q
External Current Account Balance	3/31/06	6/30/06	Q	Q	Q
Exports and Imports of Goods and Services	Apr. 2005	Jul. 2005	Q	Q	Q
GDP/GNP	Q1 2006	Jul. 2006	Q	Q	Q
Gross External Debt	3/31/06		M	M	M

[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 general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[6] Including currency and maturity compositio

Public Information Notice (PIN) No. 06/130
FOR IMMEDIATE RELEASE
November 7, 2006

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

IMF Executive Board Concludes 2006 Article IV Consultation with Colombia

On October 30, 2006, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Colombia.[1]

Background

In early November 2006, Colombia exited from a period for Fund support that began in 1999. Since then, numerous reforms were adopted that have reduced public debt, brought inflation to the lowest level in decades, and restored the health of the financial system after the 1999 crisis. As a result of these efforts and aided by a favorable global economy, real GDP rose by 5 percent a year in 2004–05, after having stagnated in 1999–2002.

The economy continues to perform well in 2006. Real GDP is expected to rise by 5.2 percent, led by strong growth in private demand and continued robust export growth. Urban unemployment fell to 13.1 percent in July, compared with 14.8 percent a year earlier. The Banco de la República intends to keep inflation within a range of 4–5 percent by end–2006, as targeted. The economy has recovered swiftly from the effects of turbulence in international financial markets earlier this year, indicating that vulnerabilities have been reduced.

The authorities expect the combined public sector deficit to reach 1.5 percent of GDP in 2006, as targeted, which would reduce public debt to around 45 percent of GDP and allow deposits held by the public sector to reach 13 percent of GDP.

[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 government has imparted new momentum to key structural reforms. In July it submitted to congress a comprehensive tax reform and, in September, a constitutional amendment to modify the system of intergovernmental transfers. The authorities are also seeking congressional approval of a plan to enhance the commercial orientation of Ecopetrol. In the coming months, they intend to present to congress several financial sector reforms and a free trade agreement with the United States.

Since April 2006, the Banco de la República (BR) has been tightening monetary policy. The Banco de la Republica raised its policy interest rate by a total of 125 basis points in April–September, to 7.25 percent, and is prepared to adjust monetary policy as needed to ensure inflation remains under control.

The external current account deficit is expected to remain at 1.6 percent of GDP in 2006, fully financed by net capital inflows, led by strong net foreign direct investment. By end-2006, net international reserves are expected to reach about US$15 billion (150 percent of short-term debt on a remaining maturity basis).

Financial indicators remain sound. Through end-June, bank liquidity and loan portfolio quality were adequate, and bank solvency exceeded the minimum regulatory requirement of 9 percent.

Over the next four years, the government's macroeconomic policies aim at continuity. The authorities' medium term goals are as envisaged in the program. Fiscal policy is being framed with the goal of reducing public debt to 40 percent of GDP by 2010. Monetary policy will be aimed at lowering inflation to 2-4 percent a year over the medium term. The authorities have proposed structural reforms in the areas of taxes, intergovernmental transfers, and the commercial orientation of public enterprises, and in the coming months will present legislation to broaden domestic financial deepening and establish free trade with the United States.

Executive Board Assessment

Executive Directors congratulated Colombia for the successful completion of the Fund-supported program and exiting from the use of Fund resources. Directors commended the authorities' policy strategy of fiscal reform and consolidation, low inflation with exchange rate flexibility, and strengthening of the financial system, which has enabled the economy to enter a virtuous cycle of strong investment–led growth and a sustainable external current account position. They noted that the recovery from the international financial market turbulence earlier this year underscores the economy's increased resilience in the face of shocks.

Directors welcomed the tightening of monetary policy since April 2006 to help address the risk of overheating. At the same time, Directors underscored the benefits of limiting the combined public sector deficit in 2006 to below the budgeted level to contain the growth in demand and ease the burden on monetary policy.

Directors welcomed the authorities' intention to keep public debt on a sustained downward path to strengthen the economy and build resilience. A number of Directors agreed that the authorities' medium-term fiscal consolidation program provides sufficient protection against exogenous shocks, while providing fiscal space to meet important infrastructure and social investment needs. However, many Directors considered that a larger primary surplus that would bring public debt decisively below 40 percent of GDP would provide a greater protection from shocks. These Directors cautioned that the authorities' plan to lower the primary surplus in 2007 and beyond may add too much stimulus when the private sector is likely to provide a strong impetus for growth.

Directors welcomed the renewed momentum for structural reforms. They remarked that the reform of intergovernmental transfers was crucial to preserve the credibility of fiscal policy, while the tax reform would help make the economy more competitive by simplifying Colombia's complex and distortionary tax code. Directors called on the authorities to phase out the financial transactions tax and eliminate the parafiscal taxes, which encourage informality in the financial and the labor markets. They noted that an unfinished task was to reduce the widespread revenue earmarking to allow for greater expenditure flexibility. Directors also welcomed the decision to increase the commercial orientation of Ecopetrol and supported the authorities' plan to deregulate the domestic prices of gasoline and diesel by mid-2008.

Directors considered that the flexible exchange rate regime has served Colombia well. They judged external competitiveness to be adequate, in view of the broad-based growth in exports and the sustainable level of the external current account deficit. In this context, many Directors considered that less reliance on foreign exchange market intervention would provide a clearer signal about the stance of monetary policy, while a number of other Directors agreed with the general foreign exchange policy stance of the authorities. Directors agreed that the development of market-based hedging mechanisms would reduce the need for foreign exchange intervention during periods of high volatility.

Directors welcomed the continuing efforts to strengthen financial supervision. They agreed with the authorities that the transition to risk-based supervision in line with Basel II should proceed with due caution to ensure that banks and the financial superintendency are well prepared to implement this complex system. Directors urged the authorities to submit to congress the proposed legislation to strengthen the independence of the financial superintendency. They welcomed the recent privatization of Granbanco and the authorities' plans to issue regulations to strengthen the governance of Banco Agrario, the only remaining public sector bank.

Directors commended Colombia for accepting the obligations under Article VIII, Sections 2, 3, and 4, and welcomed the authorities' intention to remove one of the remaining exchange restrictions that is subject to Fund approval.

Colombia: Selected Economic Indicators

	2002	2003	2004	2005	Proj. 2006
(Annual percentage change, unless otherwise indicated)					
National income and prices					
Real GDP	1.9	3.9	4.8	5.2	5.2
Consumer prices (end-of-period)	7.0	6.5	5.5	4.9	4.5
Nominal exchange rate (depreciation+, end-of-period)	20.0	-3.1	-16.3	-4.6	...
Real effective exchange rate (depreciation-)	-17.4	-5.2	11.4	10.9	...
Money and credit					
Broad money	2.9	9.6	16.6	18.6	18.4
Credit to the private sector	4.0	9.2	12.0	15.7	23.6
Real interest rate (90-day time deposits; percent per year)	0.7	1.4	2.2	...	...
(In percent of GDP, unless otherwise indicated)					
External sector					
Current account (deficit-)	-1.7	-1.2	-1.0	-1.6	-1.6
External debt	52.6	46.2	36.8	30.8	30.2
Of which: public sector	32.1	29.8	24.0	19.4	19.8
Net official reserves (in months of imports of goods and services)	7.6	6.4	6.4	6.1	5.4
Savings and investment					
Gross domestic investment 1/	15.3	17.2	18.3	19.3	19.5
Gross national savings	13.6	16.0	17.3	17.7	17.9
Public finances					
Combined public sector balance 2/	-3.6	-2.7	-1.3	0.0	-1.5
Nonfinancial public sector balance 2/	-4.2	-3.2	-1.5	0.0	-1.6
Central administration balance 2/	-6.4	-4.5	-5.4	-4.8	-4.9
Public sector debt 3/	57.0	53.3	49.5	45.8	44.5

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

1/ Data on fixed capital formation were revised starting in 2003.
2/ In 2007 corresponds to authorities’ projections.
3/ Program definition. Assumes no purchases under the current SBA. Includes valuation changes.

INTERNATIONAL MONETARY FUND EXTERNAL RELATIONS DEPARTMENT

Press Release No. 06/235
FOR IMMEDIATE RELEASE
October 31, 2006

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Final Review Under Colombia's Stand-By Arrangement

The Executive Board of the International Monetary Fund (IMF) has completed the third and final review of Colombia's performance under an 18-month SDR 405 million (about US$597.6 million) Stand-By Arrangement approved on April 29, 2005 (see Press Release No. 05/95). Colombia has not drawn under the arrangement, and the authorities have indicated that they will not make any drawings before the arrangement expires on November 2, 2006.

Following the Executive Board's discussion of Colombia on Monday, October 30, 2006 Mr. Takatoshi Kato, Deputy Managing Director and Acting Chair made the following statement

“Colombia’s economy continues to perform well in 2006. Strong economic growth is helping to lower unemployment and poverty, while inflation is declining in line with the authorities’ targets. The external position remains robust, supported by favorable terms of trade and sizable net capital inflows, while the continued moderation in the combined public sector balance will reduce public debt further. The economy has recovered swiftly from the turbulences in international financial markets earlier this year, underscoring the increased resilience of the Colombian economy in the face of shocks.

“While demand policies will need to guard against the risk of overheating in the short-term, the government’s macroeconomic policies aim at continuity over the next four years, consistent with the medium-term goals envisaged by the authorities in the Fund-supported programs. In this respect, the authorities are framing fiscal policy with the goal of reducing public debt to 40 percent of GDP by 2010, while monetary policy will aim at lowering inflation to international levels over the medium term in the context of a flexible exchange rate policy. The authorities are proposing structural reforms to raise sustainable economic growth and improve social conditions, with specific reforms steps proposed in the areas of taxes, intergovernmental transfers, and the commercial orientation of public enterprises. In the coming months, the authorities will present legislation to deepen domestic financial markets and to conclude a free trade agreement with the United States.

“Over the medium-term, the authorities’ strategy of continued reforms within a supporting framework of macroeconomic stability will enable the economy to continue to enjoy strong investment-led growth and support a sustained reduction in poverty,” Mr. Kato said.

Statement by Roberto Steiner, Alternate Executive Director for Colombia
October 30, 2006

On behalf of my authorities, I would like to thank management and staff for the support and advice they have provided Colombia. After three precautionary arrangements dating back to 1999, Colombia is now in a position to return to the standard Article IV relationship with the Fund. My authorities look forward to continuing with the constructive policy dialogue that has always characterized the relationship between Colombia and the Fund.

Main Developments Under the Fund-Supported Arrangements

My authorities appreciate the well-written set of papers that attest to the progress achieved by Colombia over the last few years, particularly since 2002. A strong policy framework, an enhanced security situation and a favorable external environment have delivered major improvements in all economic indicators. GDP growth is likely to average 5.2 percent in 2004-2006, more than twice the rate observed in 2000-2003. Inflation is now close to 4.5 percent, a remarkable feat for a country not long ago labeled as the *moderate inflation country par excellence* – inflation having averaged 21 percent during 1983-1999. Progress has also been impressive on the fiscal front, with the CPS deficit averaging 0.6 percent of GDP in 2004-2005. The primary surplus increased from 0.3 percent of GDP in 2002 to 4 percent in 2005, while public debt declined from 57 to 46 percent of GDP. NIR have been replenished and now cover more than 150 percent of short term debt.

These results have been underpinned by a wide range of structural reforms. There is hardly any topic in which the government has not strived to introduce far-reaching changes, although in some instances either Congress or the Courts failed to support or to uphold those efforts. All levels of government are now constrained by a fiscal responsibility law, tax revenues have been enhanced, the fiscal position of local governments has been strengthened, the actuarial deficit of the public pension system has been trimmed by one quarter and there has been a notable improvement in the administration of SOE's. The government has divested itself from all banks except the agricultural bank, which has always been a public entity. The recent privatization of Granbanco was a success, with the auction clearing at more than twice the base price. Private banks are profitable and well-capitalized and their loan portfolio is sound. A new supervisory authority was formed to facilitate consolidated supervision and a securities market law has strengthened clearing and settlement procedures, market integrity and corporate governance. In September 1999 a flexible exchange rate regime was adopted and in 2000 inflation targeting was formally introduced.

The program was implemented in full, with all reviews undertaken in a timely manner. All quantitative PCs were met and, except for congressional approval of a reform of the budget code, all structural PCs were complied with. Other than revenue-earmarking, the rest of the features of that reform were incorporated through executive decrees. Likewise, most structural benchmarks were completed. Congress recently approved the 2007 budget, which is consistent with a CPS deficit of 1.7 percent of GDP. It is now discussing a revenue-neutral tax reform and has voted positively at the committee level the constitutional amendment that makes permanent, with minor alterations, the transitional arrangement governing transfers to local governments. Next year Congress will consider the FTA with the U.S. and a financial sector reform that improves creditor rights and enhances the independence of the supervisor.

The 2006 Article IV Consultation

In staff's opinion there are signs of overheating, which call for a further tightening of policies. Noting that monetary policy has been tightened and that the policy interest rate has been increased by 100 bps since April 2006, staff calls for the 2006 fiscal target to be tightened by 0.5 percent of GDP. My authorities certainly remain vigilant to the possibility that the economy might be growing beyond potential, though it should be borne in mind that the private investment to GDP ratio has doubled since 2002 and, consequently, it is likely that potential output itself has been expanding quite rapidly.

The government believes that due to revenue over-performance, the 2006 fiscal deficit could turn out to be some 0.5 percent of GDP smaller than originally envisioned. Willingness to refrain from spending this revenue over-performance should not, however, be interpreted as an agreement to target a lower than originally envisioned debt to GDP ratio for 2010. **Since 2002 my authorities have made it clear that their medium term fiscal target is to reduce the debt burden to 40 percent of GDP by 2010**. While under the conditions prevailing a few years ago this implied a primary surplus of 2.7 percent of GDP, fiscal over-performance since 2004 and current conditions indicate that the same debt target can now be reached with a slightly lower primary surplus. In the 2002 and 2005 IMF programs as well as in the 2006 Medium-Term Fiscal Framework the authorities have consistently stated that the main goals for macroeconomic policy are to reduce the debt ratio to 40 percent by 2010 and inflation to the 2-4 percent range in the medium term. These goals are well in line to being met.

As has been the case throughout the IT regime period, the central bank is willing to further tighten monetary policy if needed to meet its inflation target. The Selected Issues paper attests to the effectiveness of Colombia's IT regime, with inflation on a declining trend and with expected inflation now playing a larger role as a determinant of current inflation, a clear signal of enhanced central bank credibility. These results have occurred within a flexible exchange rate regime in which the central bank occasionally intervenes – in a discretionary manner or through pre-announced rules – and in which a most welcome replenishment of international reserves has taken place. The central bank has always made it a point to ensure that its intervention in the F/X market does not jeopardize the attainment of the inflation target. Net intervention in 2005 was, in any event, much smaller than in 2004.

Since 2003 staff has questioned central bank intervention in the F/X market, alleging that this could compromise the inflation target if not sterilized, that quasi-fiscal costs would ensue if sterilized, and that, by offering what staff understood to be one-sided bets to markets, speculative capital inflows could become a problem. None of these concerns has materialized, to a great extent due to the fact there has been a significant increase in money demand, which the central bank has accommodated without placing at risk the inflation target. The central bank has never had a target for the exchange rate, and my authorities fully agree with staff that it would be a major mistake to offer markets one-sided bets. Colombia's recent experience is indicative of the fact that an IT regime can be credible and effective even though the exchange rate is not on an entirely clean float.

Staff correctly points out that long-term inflation expectations are about 4 ½ percent, slightly above the medium term target. While this can be ascribed to less than full credibility in a context of disinflation, it is important to bear in mind that in other successful IT countries such as the U.K. and Chile expectations only converged to the medium term target once observed inflation actually met that target. My authorities believe that expected inflation should decline over time, as inflation is reduced towards the medium term target.

My authorities welcome staff's work on the determinants of the equilibrium real exchange rate, a valuable contribution to a burgeoning literature on the subject. There being many different specifications offering widely different results, my authorities believe that all estimates should be interpreted with caution. Staff's assessment that Colombia's real exchange rate is currently in line with fundamentals seems consistent with the fact that the current account deficit has been and is expected to remain moderate and sustainable.

Staff supports ongoing efforts to deepen structural reforms, but calls for further improvements in the tax code. My authorities wanted to phase out the FTT. To maintain revenue neutrality, this could only have been done by increasing the VAT. When the idea was floated in Congress, it became evident that enough support could not be obtained for such a move. Staff welcomes the initiative to reduce the top income tax rate, but believes it is overly generous to allow investment to be fully deductible in the first year. While acknowledging a slight adverse fiscal impact in the short term, my authorities feel that over the long term the scheme is fiscally sound and not very different from the rather complex and arbitrary depreciation scheme now in place. My authorities are committed to broadening the VAT base and reducing the number of rates. It is worth noting that most of the differentiated rates apply only to automobiles, depending on engine size. It is unlikely that this generates major distortions or compliance costs. Box 4 shows that the productivity of Colombia's VAT is acceptable by regional standards and higher than in countries with fewer tax rates.

The government is more sanguine than staff and believes that under current trends Colombia would become a net oil importer in 2015, not in 2010. As a result of higher prices, enhanced security and a new contractual framework more favorable to private investment, new explorations have gone up from 14 in 2002 to 59 in 2005. Higher prices have also rendered profitable investments in fields that had been taken out of production. On subsidies, the government has consistently increased fuel prices – albeit at a time when international prices increased faster. Subsidies are now explicit in the budget, and this should assist the policy of further reducing them. The government is keen on improving governance and efficiency at Ecopetrol. In order to expand the Cartagena refinery, Ecopetrol recently associated itself, as minority stakeholder, with the Swiss firm Glencore. The government has proposed legislation allowing Ecopetrol to receive a 20 percent private sector capital injection. Actions are being taken in order for the company to be run on a commercial basis, not for the sake of removing it from the public sector, but rather to enhance the value of a key state asset. While staff rightly calls for continued monitoring of the enterprise in order to minimize fiscal risks, my authorities believe that Colombia's largest fiscal risk is running out of oil. Curtailing Ecopetrol's investment would only enhance such a risk.

My authorities agree with staff's call for caution in the transition to risk-based bank supervision. A strategy has been designed taking into account the technical resources available at the Financial Superintendency. After a judicious analysis, the Superintendency feels it is prepared to transition towards risk-based supervision of market risk, but is taking a more cautious approach with regard to credit and operational risk. In the process, it has received valuable TA from the Fund. My authorities are also appreciative of ICM support in the area of hedging instruments. While noting that hedging for currency risk has increased significantly in the recent past, staff correctly points out that there are several areas for improvement of the hedging of foreign exchange risk as well as interest rate risk.

The tax reform proposal being considered by Congress eliminates the tax on outward remittances, a restriction under Article VIII. The central bank does not have a schedule for amending the regime for hydrocarbon exports because, following changes introduced as a result of Fund advice, it is not persuaded that the regime entails any restriction under Art. VIII. It is quite telling that in p. 44 of the report it is stated that there is "an exchange restriction arising from a special foreign exchange regime for the hydrocarbon sector that limits the availability of foreign exchange for branches of foreign corporations *that choose to participate in the regime*" (our emphasis). My authorities cannot accept that a regime in which participation is *voluntary* and whose existence is supported by those eligible to participate could be meaningfully considered an exchange restriction.