INTERNATIONAL MONETARY FUND

IMF Country Report No. 11/224

Colombia

2011 ARTICLE IV CONSULTATION COVER

July 2011

2011 Article IV Consultation—Staff Report; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Colombia

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2011 Article IV consultation with Colombia, the following documents have been released and are included in this package:

- The staff report for the 2011 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on June 23, 2011, 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 July 7, 2011. 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) summarizing the views of the Executive Board as expressed during its July 20, 2011 discussion of the staff report that concluded the Article IV consultation.

- A statement by the Executive Director for Colombia.

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

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International Monetary Fund
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INTERNATIONAL MONETARY FUND

COLOMBIA

STAFF REPORT FOR THE 2011 ARTICLE IV CONSULTATION

July 7, 2011

KEY ISSUES

Near term policy stance. The economic recovery is well-entrenched, with growth projected for this year at somewhat above potential. Inflation pressurges are contained, the financial system is solid, international reserves are strong, the sovereign debt rating has been raised this year to investment grade by all three ratings agencies, and the FCL appears to have bolstered market confidence. Monetary policy is moving toward a more neutral position, but staff is of the view that fiscal policy remains stimulative. With the output gap projected to close in early 2012 and the balance of risks tilted toward overheating, staff cautioned that the burden of dampening potential demand pressures in the near term would fall too much on monetary policy.

Strengthening of the fiscal framework. Colombia's fiscal institutions are very strong and will be further strengthened by recently approved fiscal reforms, including a fiscal rule to support existing fiscal responsibility legislation, inclusion of fiscal sustainability as a constitutional criterion, and a revamping of the allocation and use of royalty payments that will generate important savings. Still, staff underscored that revenue collections are relatively low compared with regional peers and welcomed the authorities' plans (presently under discussion) to reduce distortions in the tax system and promote formal sector activity that, in turn, would increase revenue and, in staff's view, facilitate compliance with the fiscal rule.

Financial sector oversight. Financial system supervision is very strong and is being strengthened further through initiatives to bolster cross-border and consolidated supervision. Assessing capital adequacy under Basel III terms is just beginning, and staff urged that the timetable for assessing the impact of its requirements be accelerated. An FSAP update is scheduled for early 2013.

Labor markets. High rates of structural unemployment and poverty and widespread labor informality constitute longstanding policy challenges.

Approved By
Miguel A. Savastano and Lorenzo Giorgianni

Discussions took place in Bogotá during June 13–23. Staff representatives comprised A. Wolfe (Chief), V. Cerra, M. García-Escribano, and C. Faircloth (all WHD), D. Mendoza (MCM), and T. Miyoshi (SPR). Ms. Arbeláez (OED) attended the meetings.

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BOXES

BACKGROUND

1. **The Colombian economy exhibited resilience during the global financial crisis and is undergoing a solid recovery.** Colombia's strong policy frameworks, including its inflation-targeting regime and medium-term fiscal framework, provided the authorities with policy space to undertake timely and effective countercyclical measures in response to the 2008-09 global crisis. Following a short-lived contraction, economic activity started to recover in the second half of 2009, supported by fiscal and monetary stimulus, which helped keep real GDP growth in positive territory. The central bank lowered the policy rate by 600 basis points (to 3.5 percent) over the course of 2009, and the combined public sector deficit widened to 2.7 percent of GDP (compared with near balance in 2008).

2. **The presidential elections of 2010 had little effect on macroeconomic policies or investors' risk perceptions.** Elections took place in May and June 2010, and a new administration (of President Santos) took office in early August. The central bank governor remained in his position (as stipulated by the central bank law), and the new Minister of Finance launched initiatives that supported his predecessor's efforts to strengthen the fiscal framework (e.g., by adopting a fiscal package that included rationalizing tax incentives and submitting to congress important structural fiscal reforms). In addition, the new government completed the negotiation of a free-trade agreement with the United States that had started in 2006.[1]

3. **In concluding the 2010 Article IV consultation, Executive Directors commended the Colombian authorities for their sound macroeconomic management and strong institutional framework.** Directors advised that, with inflation expectations within the target range, the monetary stance could be kept accommodative until there was clear evidence of a sustained recovery. They also noted that the deterioration of the fiscal position in 2009, including through a modest fiscal stimulus, had not compromised medium-term sustainability. Directors welcomed the authorities' strategy of using the exchange rate as the first line of defense to large capital inflows, but pointed out that other instruments may have to be considered if those inflows were to persist. Directors also advised the authorities to develop a strategy to minimize medium-term fiscal risks, including those resulting from tax incentives, special tax regimes, and pension spending, and noted that higher oil-related revenues over the medium term would provide the opportunity to build up international reserves and continue lowering external vulnerabilities.

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

4. Exchange system and data. Colombia's exchange rate (both de jure and de facto) is a floating rate. There have been no changes in Colombia's exchange restrictions since the last Article IV consultation. Colombia maintains: (i) a multiple currency practice and an exchange restriction arising from a tax on outward remittances of nonresident profits earned before 2007 and that have been retained in the country for less than five years; and (ii) an exchange restriction arising from the special regime for the hydrocarbon sector, in which branches of foreign corporations are required to either surrender their export proceeds to the authorities or agree to a government limitation on their access to the foreign exchange market. Data provision is adequate for surveillance.

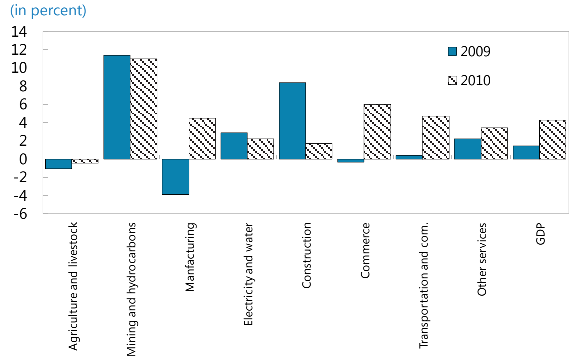
5. On May 6, 2011, the Executive Board approved a two-year FCL arrangement for 500 percent of quota, which the authorities are treating as precautionary. In approving Colombia's request (the third FCL since 2009), Directors agreed that Colombia continued to meet the qualification criteria for access to FCL resources, noting especially the country's very strong policy frameworks and economic fundamentals and the excellent track record of policy implementation. Directors also agreed that, despite the very favorable outlook, uncertainties about the world recovery and global liquidity conditions were key risks to the medium-term outlook.

RECENT DEVELOPMENTS

6. In 2010 macroeconomic policies remained supportive of the economic recovery.

- Activity gained further momentum during the year, and real GDP grew by 4.3 percent (despite output disruptions associated with Venezuela's decision to suspend bilateral trade with Colombia and severe floods in the latter part of the year). Growth was led by domestic demand, which increased by 6¾ percent, reflecting robust consumption and investment, including significant inventory restocking. The broad-based recovery of domestic demand was linked to strong growth in most sectors (except the labor-intensive sectors of agriculture, construction, and light manufactures linked to trade with Venezuela).

Colombia: Sectoral GDP growth
(in percent)

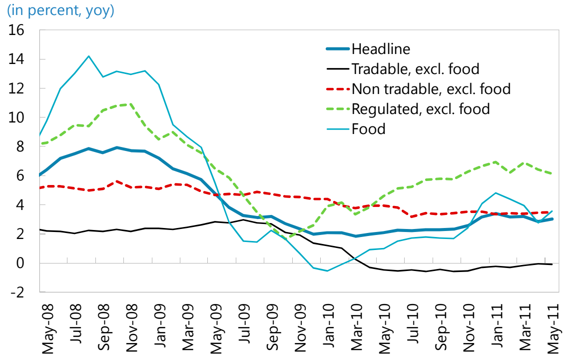


Sources: Staff estimates.

- CPI inflation rose to 3.2 percent by year end (close to the midpoint of the official target range). Severe flooding late in the year and high international fuel prices pushed up the prices of food and regulated items such as gasoline to 4.1 percent and 6.6 percent, respectively. Despite these shocks, the strength of the peso and the credibility of the monetary policy framework helped anchor core inflation below the midpoint of the official target range of 2–4 percent.

Colombia: Inflation

(in percent, yoy)



Sources: Staff estimates.

- The external current account deficit increased by almost 1 percentage point of GDP (to 3.1 percent), reflecting a sharp rebound in imports and the loss of the Venezuelan market for nontraditional products. Strong private capital inflows, mainly FDI in the oil and energy sector, but also other investment flows and borrowing by the private sector toward the end of the year, more than offset a decline in official borrowing, resulting in an overall balance of payments surplus of more than US$3 billion. Gross reserves ended the year at over US$28 billion (just under 6 months of imports of goods and services).

7. **Fiscal policy in 2010 continued to support domestic demand.** The combined public sector deficit rose to 3.2 percent of GDP, mainly on account of lower oil-related revenues.[2] The outturn for the central government was better than budgeted, however, largely as a result of lower-than-expected capital expenditures (which more than offset emergency expenditures of 0.2 percent of GDP for flood-related relief).[3]

8. **An important tax reform was enacted.** President Santos used flood-related state of emergency powers to adopt reforms that broadened the tax base (by eliminating the fixed asset tax credit in 2012 and closing loopholes in the financial transactions tax) and increased the net wealth tax: the combined yield of these measures is estimated at an average of 0.4 percent of GDP per annum during 2011–14.[4]

9. **Monetary policy also remained supportive of the recovery during 2010.** The

[2] A large fraction of oil-related government revenues lag oil price developments by one year, reflecting the lag of dividend payments to the government from Ecopetrol, the large majority state-owned oil company.

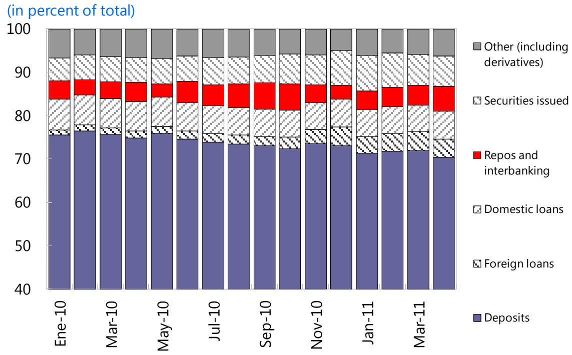
[3] This estimate excludes the deficit of the Fuel Price Stabilization Fund (FEPC), which increased to 0.15 percent of GDP and represents a contingent government liability.

[4] This estimate is net of revenue losses from the reduction of import tariffs and electricity surcharges. Also, after 2014, the net wealth tax is to expire and the FTT will begin to be phased out.

policy rate was kept at an historic low of 3 percent (from April 2010 to February 2011), helping to reduce lending spreads and facilitating a recovery in bank credit. Commercial and consumer credit, which had been broadly stable in 2009, began to rebound strongly around mid-year.

10. Financial soundness indicators remained strong. Banks' capital adequacy and profitability levels remained solid in 2010, and nonperforming loans (NPLs) were broadly stable and at relatively low levels. Higher demand for foreign currency credit by corporates, in the context of very low interest rates, tilted banks' liquidity slightly toward foreign sources, though most of the borrowing was fully hedged.

Colombia: Bank Liabilities
(in percent of total)

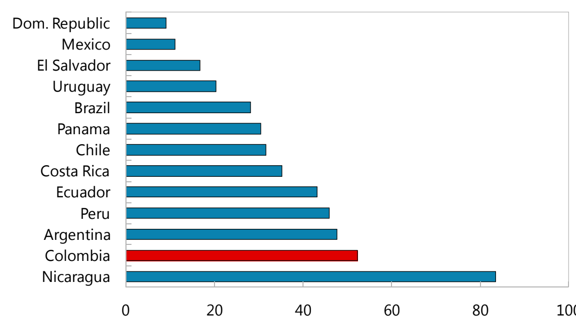


Sources: Staff estimates.

11. A flexible exchange rate combined with limited intervention in the foreign exchange market was the main tools to absorb large capital inflows (Boxes 1 and 2). In response to strong appreciating pressures, in March 2010 the central bank adopted a program of pre-announced daily purchases of US$20 million from the interbank market (a similar program, without pre-announced amounts, had been used before).[5] In spite of these measures, the peso appreciated by 6.4 percent in nominal terms against the U.S. dollar during the year.

12. High minimum wages and labor taxes hinder a recovery in employment and continue to foster labor informality (Box 3). Unemployment has not declined despite the pickup in activity and remains at around 11 percent, while labor informality is estimated at about 60 percent. A high minimum wage and high rates of labor taxation are seen as the key factors behind the high levels of unemployment and informality.[6]

Minimum wage in Latin America
(in percent of per capita GDP)



Source: International Labor Organization (2006); IMF, World Economic Outlook database (2009)

[5] Other measures aimed at easing pressures on the exchange rate consisted of postponing government-related foreign exchange inflows, such as the repatriation of dividends from Ecopetrol.

[6] Eighty-five percent of workers in the formal sector earn between 1 and 2 minimum wages, which recently have been adjusted in line with productivity gains in the more dynamic sectors of the economy.

Non-Wage Labor Costs in Colombia	
Earmarked Programs	**Percent of Wage**
Pensions	16.0
Contributory Health Regime	12.5
Severance Fund	8.3
Paid Vacation	4.2
Mandatory Bonuses	8.3
Severance payment for Unjust Dismissals 1/	4.2
Special Funds	
SENA (Training)	2.0
ICBF (Family and Child Welfare)	3.0
CCF (Family Compensation)	4.0
Total	**62.5**

1/ Varies according to the type of contract and time employed with a minimum value of around 4.23 percent in the case of defined contract (after labor reform of 2002).

OUTLOOK

Colombia: Medium-Term Outlook

(in percent of GDP, unless otherwise indicated)

	Prel.	Projections					
	2010	2011	2012	2013	2014	2015	2016
Real GDP growth (in percent)	4.3	4.9	4.5	4.5	4.5	4.5	4.5
Inflation, end of period (in percent)	3.2	3.1	3.1	3.0	3.0	3.0	3.0
External current account balance	-3.1	-2.6	-2.5	-2.1	-2.3	-2.2	-2.0
Central government overall balance	-3.8	-3.8	-3.0	-2.6	-2.3	-2.3	-2.1
Nonfinancial public sector overall balance	-3.3	-3.0	-1.5	-1.2	-1.0	-0.9	-0.9
Total public gross debt (excluding Ecopetrol)	35.2	34.5	33.2	32.3	31.6	31.0	30.2
Total public net debt	28.5	29.2	28.4	27.5	27.0	26.6	26.1

13. The outlook for 2011 and the medium term is generally positive.

- **The output gap is expected to close in early 2012**. Real GDP growth in 2011 is expected to be somewhat below 5 percent and broadly balanced (with solid growth in both private consumption and investment). The contained consumption growth outlook reflects slower projected growth in labor-intensive sectors such as agriculture (where adverse weather conditions remain), construction, and industries linked to nontraditional exports to Venezuela. Starting in 2012, real GDP growth is to stabilize at around the potential rate of growth (estimated at 4½ percent per year).

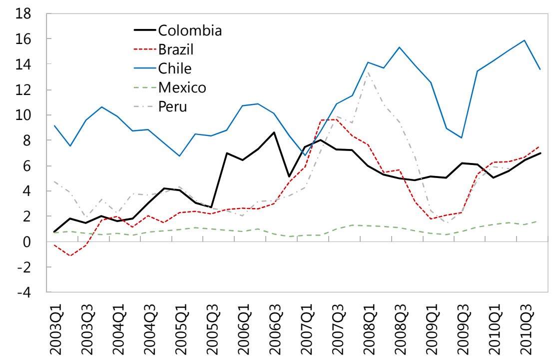
Box 1. Capital Inflows to Colombia

Colombia has received large capital inflows in the range of 5–7 percent of GDP and mainly in the form of FDI since 2005. Despite the global crisis, total inflows and FDI to Colombia remained buoyant during 2009–10. Other countries in the region showed more volatile inflows, reflecting the larger share of portfolio and other short-term flows. The smaller share of these flows in Colombia is related, to some extent, to its relatively smaller financial market. Net FDI inflows to the oil and mineral sectors were relatively stable over 2005–10, but FDI flows to other sectors have shown greater volatility.

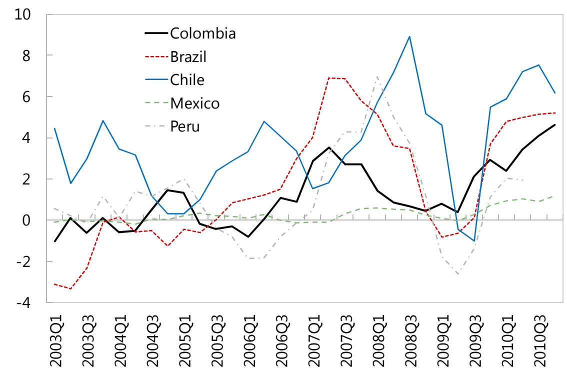
Starting in 2009, the share of portfolio and other short-term capital inflows began to increase. The share of net FDI in total inflows fell below 50 percent by mid-2010 for the first time since 2001. This is in line with developments in other emerging markets, and reflects Colombia's strong fundamentals and growth prospects, as well as global liquidity conditions.

Colombia's investment climate seems to be a factor in attracting FDI. Colombia is ranked 39 of 183 economies in World Bank indicators on ease of doing business, an improvement over the past five years. Colombia is ranked higher than some regional peers and is particularly strong in investor protection.

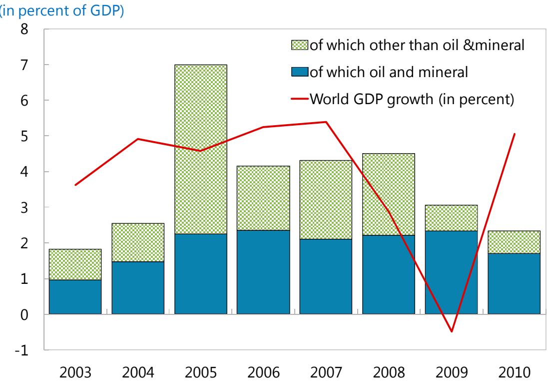
Colombia: Gross capital inflows
(four-quarter cumulative, in percent of GDP)



Colombia: Gross non-FDI capital inflows
(four-quarter cumulative, in percent of GDP)



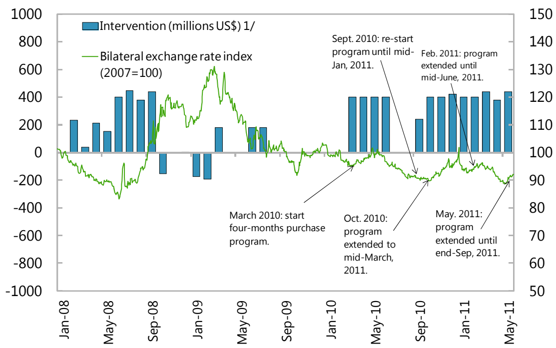
Colombia: Inward FDI
(in percent of GDP)



Box 2. Colombia's Foreign Exchange (FX) Intervention in the Latin American Context

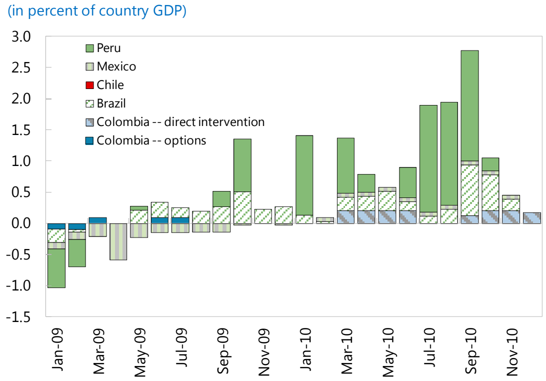
Amid a surge in capital inflows, starting in 2010, Colombia has relied on FX purchases to mitigate appreciation pressures. Easy global liquidity and favorable terms of trade increased appreciation pressures and led the central bank to adopt a program of preannounced daily purchases. Under this program the central bank purchased just over US$3 billion in 2010 (about 11 percent of the end-2010 stock of gross international reserves) and US$2.5 billion in the first half of 2011.

Colombia: Intervention and Exchange Rate



1/ Direct intervention and put and call options.

Intervention
(in percent of country GDP)



A comparison with foreign exchange intervention strategies in other countries of the region reveals the following:

- *Magnitude*. The amounts of intervention in Colombia have been much smaller than those in Brazil and Peru (and more comparable to those in Chile and Mexico).
- *Modality*. Colombia has conducted FX purchases in the spot market of US$20 million per day over a pre-announced time horizon (extended now until September 30, 2011).[1] Previously, Colombia had auctioned options (granting holders the right to sell dollars to the central bank). Chile directly purchased US$12 billion in 2011. Intervention in Peru (spot market only) and Brazil (spot, forward and swap markets) has been discretionary.
- *Motivation*. Colombia's FX purchases aim to slow the speed of appreciation. Chile has justified its intervention on the grounds of reserve accumulation, and Peru's intervention is geared to reduce excessive exchange rate volatility.

Has Colombia's intervention been effective? The Colombian peso appreciated by 6.4 percent against the U.S. dollar during 2010 and by 6.6 percent so far during 2011, but in the absence of a counterfactual, it is difficult to assess the overall effectiveness of intervention on the pace of appreciation. Cross-country studies on the effectiveness of intervention detect such an effect (though not on the degree of appreciation). The effectiveness is larger when the market perception is that the currency is overvalued.[2] Also, announcements of FX purchases have an impact on the exchange rate, but such effects fade away when announcements become frequent.

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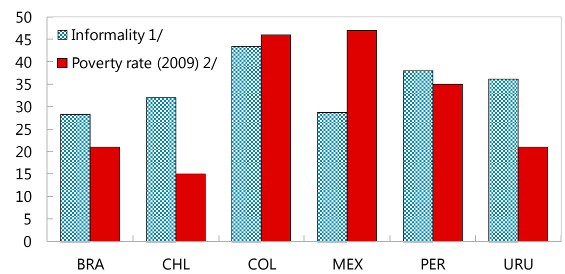
[1] Colombia's intervention was fully sterilized in 2010 through the sale of Treasury debt instruments held by the central bank (first half of 2010) and higher government issuance of short-term bills (second half of 2010 and so far in 2011).

[2] G. Adler and C. Tovar, "Foreign Exchange Market Intervention: How Good a Defense Against Appreciation Winds" in *Regional Economic Outlook, Watching Out for Overheating: Western Hemisphere, IMF* (Washington, April 2011).

Box 3. Labor Market Issues and Challenges

High levels of unemployment and labor informality are longstanding policy challenges in Colombia. In the last decade, marked by sustained output growth and substantial policy reform, unemployment fell only modestly from 17 percent in 1999 to about 12 percent in 2010. Unemployment remains high by regional standards; in addition, Colombia's labor informality is estimated at 58 percent, also relatively high for Latin American countries. Colombia's labor market segmentation complicates poverty reduction by creating a poverty trap—where informal laborers, who are predominantly poor, tend to be employed in lower-quality jobs and face barriers to access higher productivity formal-sector job opportunities.[1]

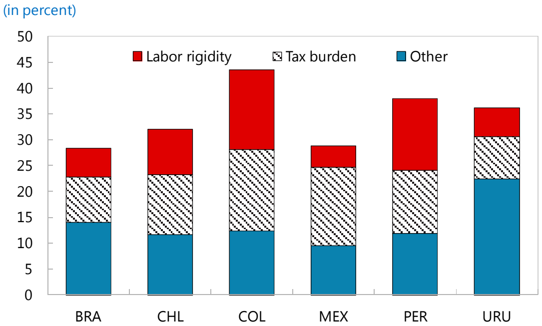
Informality and poverty in major Latin American countries
(in percent)



1/ Vuletin, Guillermo, Measuring the Informal Economy in Latin America and the Caribbean, IMF Working Paper, Washington DC, 2008.
2/ Reports national poverty statistics which are not comparable across countries. 2008 poverty data is reported for Mexico and Uruguay.

Labor market distortions are a key factor behind Colombia's elevated levels of unemployment and informality. Findings across a broad set of empirical studies suggest that labor market regulations and laws have impeded the creation of employment and created incentives towards greater informality. Key among these is Colombia's high-nonwage costs, which rose sharply in the 1990's, partly to help finance the health and pension systems mandated by the 1991 constitution. Colombia's high and constitutionally protected minimum wage (which as of end-2010 was equivalent to 52 percent of GDP per capita, the second highest in the region) is another factor. Non-wage costs in the formal sector (in addition to payroll tax contributions to fund health and pension schemes) include taxes to fund training and set asides for severance payments, paid vacations, and mandatory bonuses. Colombia's labor taxes and other mandatory contributions amount to over 60 percent of profits—the highest among large Latin American countries. In addition, some studies have linked the expansion of publicly provided health services in the early 1990's to higher informality, as it has given workers the opportunity to enjoy health services without having to participate in a contributory regime. This has raised concerns about the potential for further informality pressures from health reforms now under consideration to equalize benefits across the subsidized and contributory schemes.

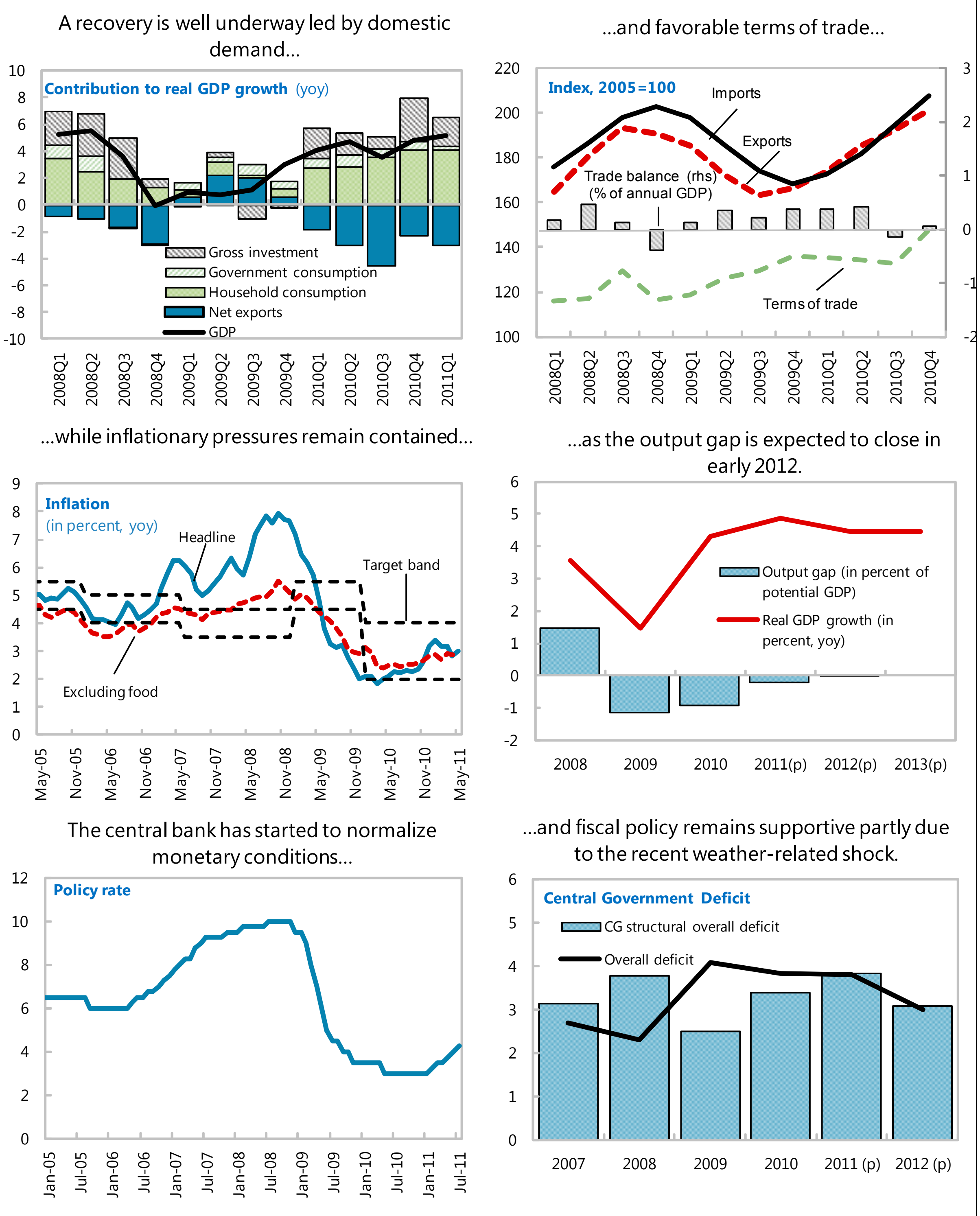
Size and causes of the informal economy in Latin America 1/
(in percent)



1/ Vuletin, Guillermo, Measuring the Informal Economy in Latin America and the Caribbean, IMF Working Paper, Washington DC, 2008.

[1] World Bank (2009), *Non-Lending Technical Assistance: Colombia Poverty and Jobs*, Washington, D.C.

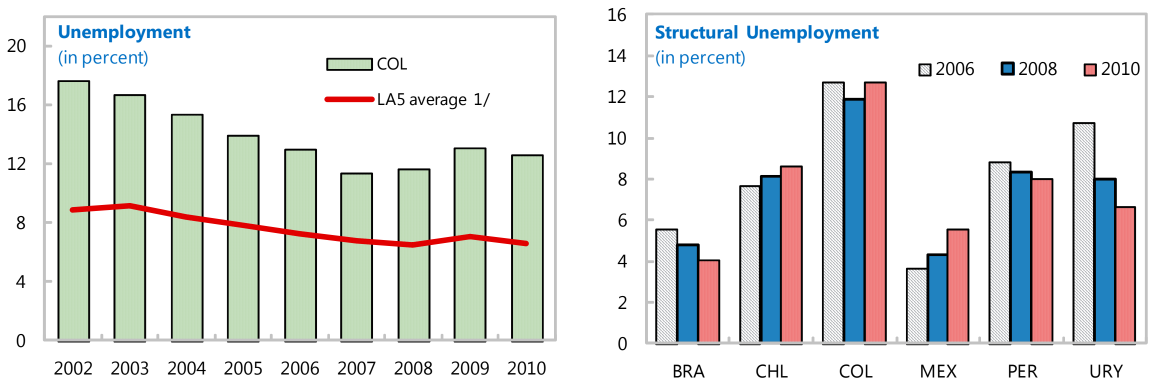
Figure 1. Colombia: Recent Economic Developments



Sources: Haver, Datastream, and Fund staff estimates.

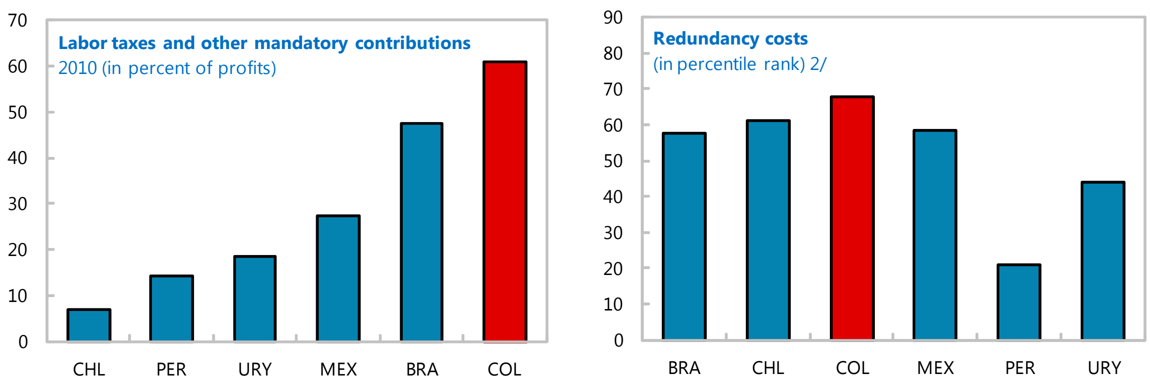
Figure 2. Colombia: Labor Market Developments and Challenges

Despite progress over the past decade to improve labor market conditions, overall unemployment and structural unemployment in Colombia remain high by regional standards.



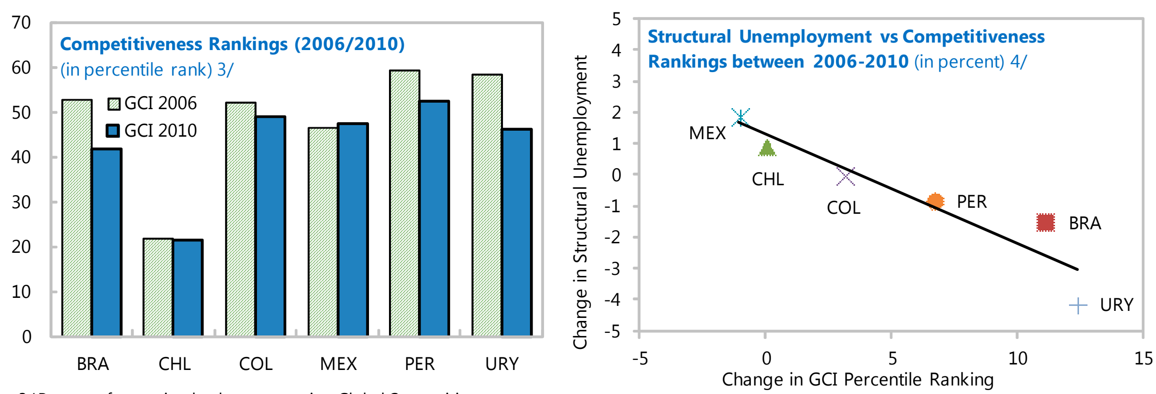
1/ LA5 is comprised of Brazil, Chile, Mexico, Peru, and Uruguay

Reducing labor market distortions, such as high non-wage costs and rigidities...



2/ Percent of countries that have a superior Global Competitiveness Index (GCI) according to the Global Competitiveness Survey.

... that impair competitiveness may help improve labor market outcomes.

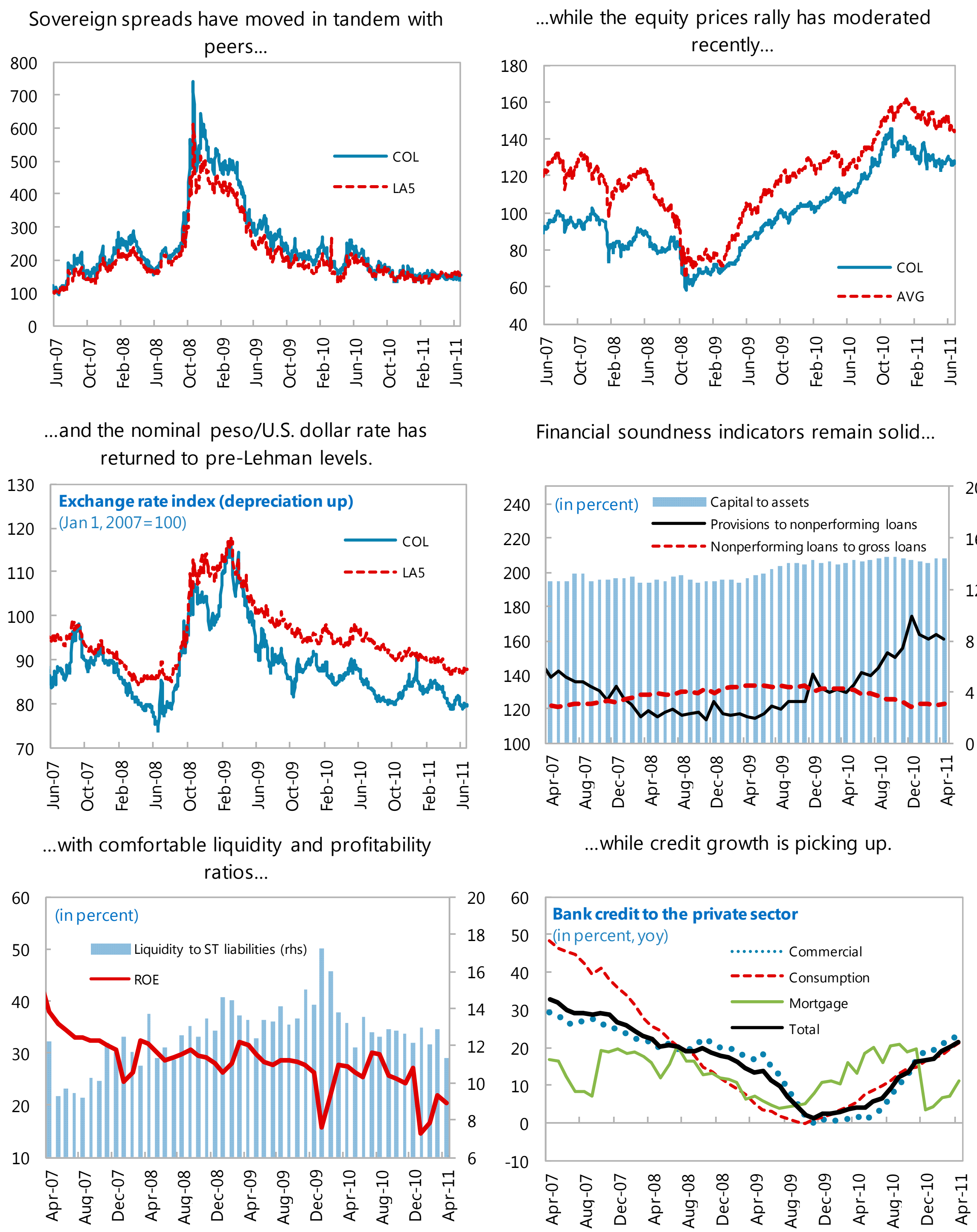


3/ Percent of countries that have a superior Global Competitiveness Index (GCI) according to the Global Competitiveness Survey.

4/ A positive change in GCI constitutes an improvement in ranking.

Sources: Haver, Central Banks, National Statistics Offices, the Global Competitiveness Survey, World Bank's Doing Business Indicators, and Fund staff estimates.

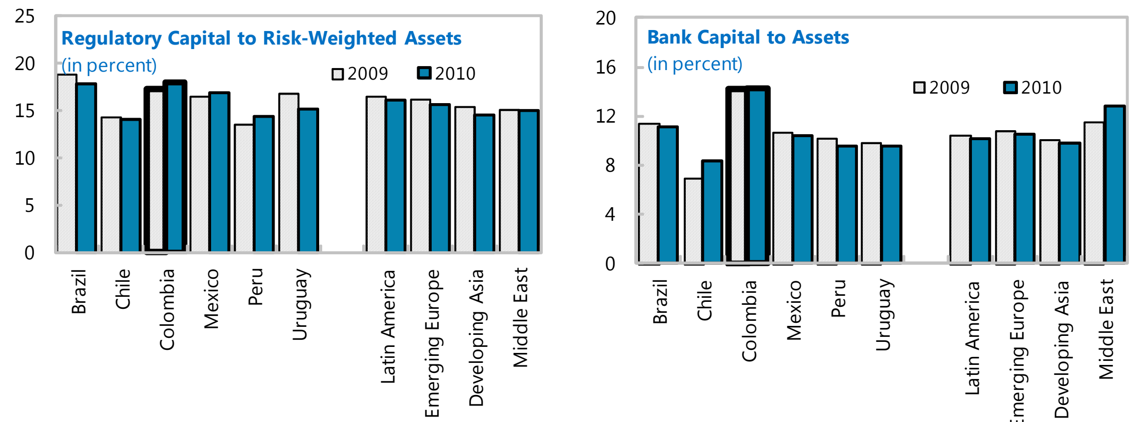
Figure 3. Colombia: Financial Markets Developments



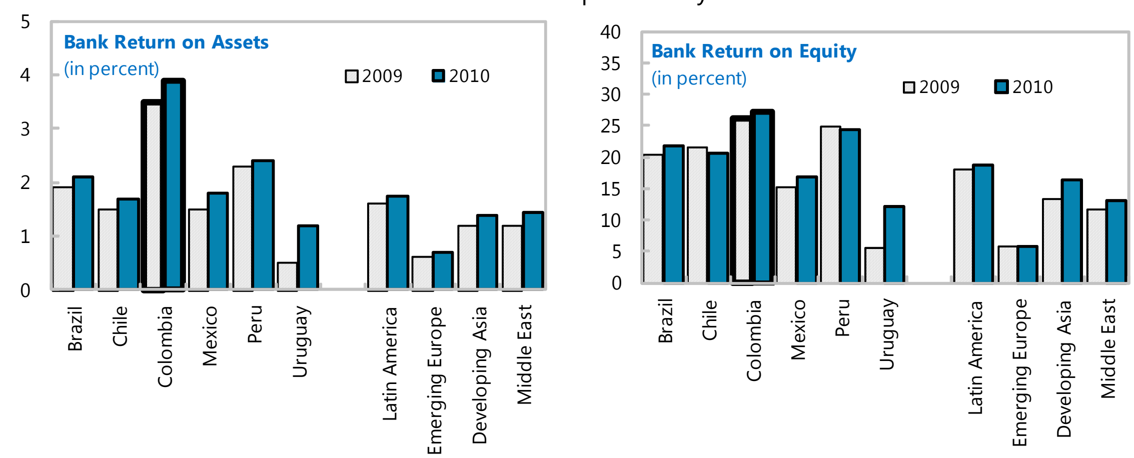
Sources: IFS, Haver, Datastream, and Fund staff estimates.
Note: LA5 represents the average of Chile, Colombia, Brazil, Mexico, and Peru.

Figure 4. Financial Soundness Indicators: Colombia and Other Emerging Markets

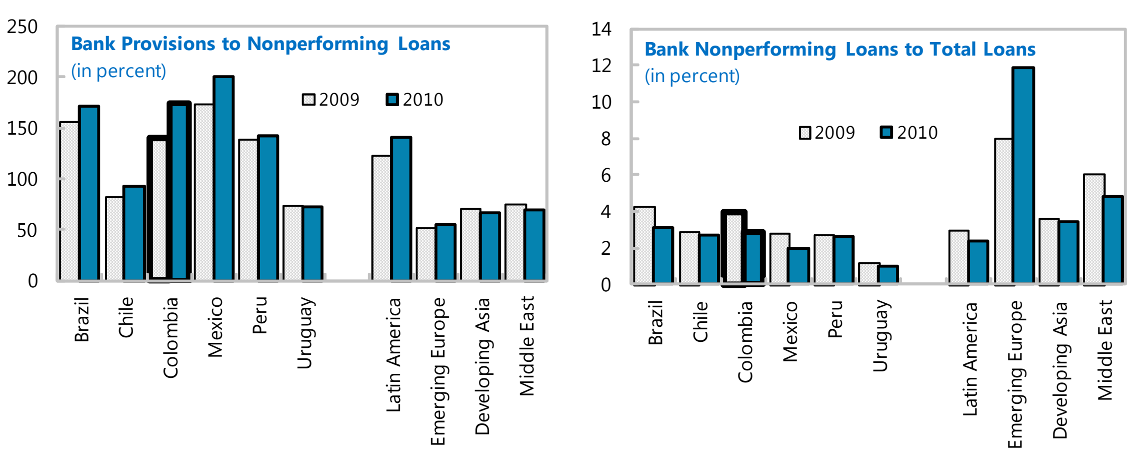
Colombian banks weathered the crisis with strengthened capitalization…



and robust profitability.

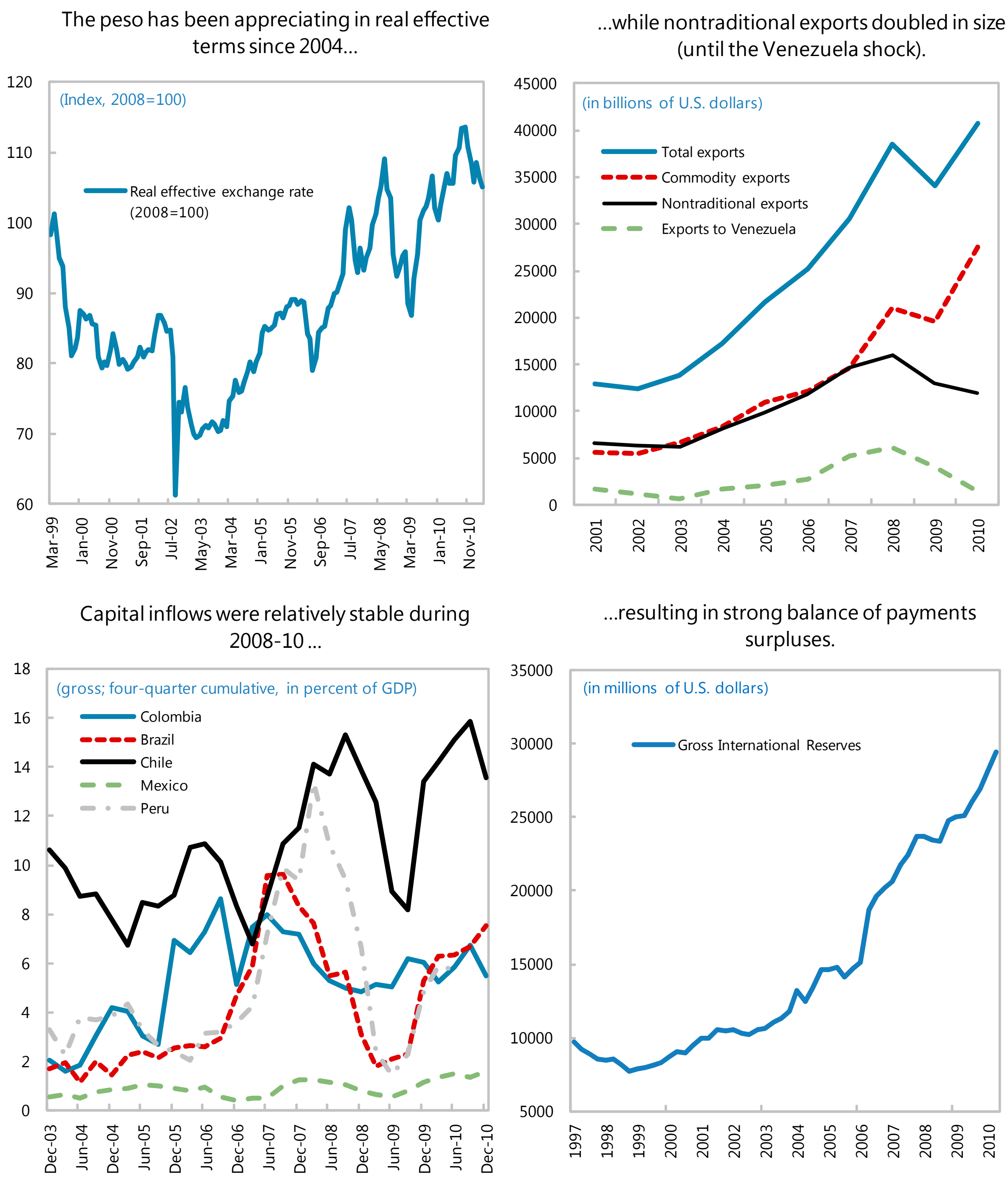


Nonperforming loans have remained moderate and are well covered by provisions.



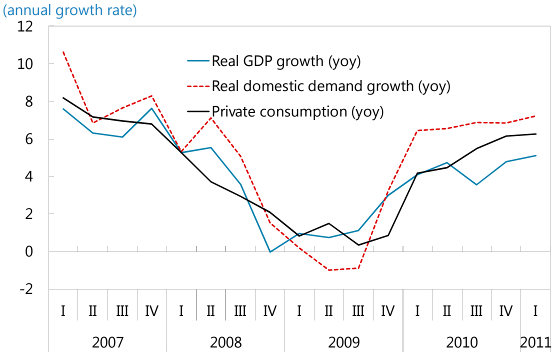
Source: April 2011 GFSR Statistical Appendix.

Figure 5. Colombia: External Sector Developments



Sources: Banco de la República; Haver; IFS and INS databases; and Fund staff estimates.

Colombia: Real Domestic Demand
(annual growth rate)



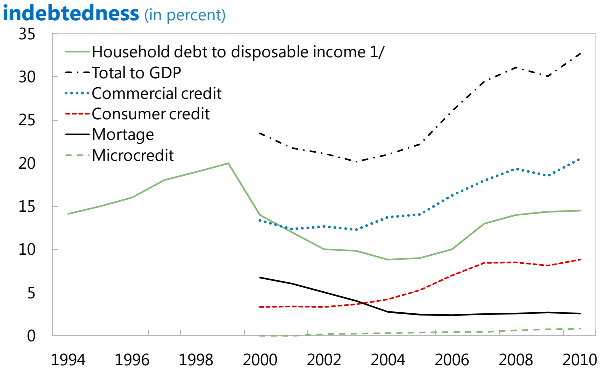
Sources: Staff estimates.

- **Notwithstanding the shock to commodity prices, inflation is expected to stay within the (2–4 percent) official target range**. Inflation expectations are well anchored by the strong credibility of the central bank and the expectation of continued peso appreciation. Over the medium term, inflation is expected to remain well within the target range.

- **The external current account deficit is expected to decline, and the overall balance of payments is expected to remain in surplus.** Exports of oil and other mineral products, as well as manufacturing, are expected to result in sizeable trade surpluses, although they will be more than offset by large profit repatriation flows. The resulting current account deficits, however, will be more than financed by large capital flows (especially FDI).

14. **Despite the pickup in bank credit, there is no clear evidence of asset market bubbles**. Amidst low lending rates and easy global financial conditions, credit to the private sector has recovered strongly since mid-2010 (growing by 23 percent (y/y) in April 2011), but the stock of credit remains below 35 percent of GDP. Asset bubbles do not seem to have appeared. Other than fast growth in prices of high-end housing in Bogotá and Medellín, there is no sign of risk in the housing market. The stock market has been flat thus far in 2011, as foreigners' purchases of stocks replaced withdrawals from local pension funds. Moreover, indicators of household and corporate balance sheets do not reveal worrisome levels of indebtedness.

Colombia: Credit by sector to GDP and household indebtedness (in percent)



Source: Staff estimates.
1/ Household debt includes mortage and consumer loans.

POLICY DISCUSSIONS

15. **Discussions centered on the pace of normalization of the macroeconomic policy stance and on strengthening the policy framework.** Specifically, the discussions covered: (i) the appropriate near-term fiscal and monetary policies in a context of a narrowing output gap and easy external financing conditions; (ii) the medium-term fiscal outlook and measures to strengthen the fiscal framework; (iii) monetary, exchange rate, and reserve management policies; (iv) the scope to further bolster Colombia's strong supervisory and regulatory frameworks; and (v) policy plans to address labor market rigidities and the high rate of unemployment.

A. Near-Term Policy Stance

16. **There was agreement that the economy was not facing overheating pressures, although the near-term risks were tilted to the upside**. While persistently high commodity prices and easy global financial conditions will remain strong tailwinds, their effect on domestic demand growth is likely to continue to be mitigated by several factors, including the weak U.S. recovery (Colombia's main trading partner) and continuing adverse weather conditions. The authorities also noted that the latest surveys of consumer confidence and indicators of activity in the industrial and construction sectors supported the view of moderation in growth in the second half of 2011.

17. **The authorities considered that their macropolicy stance for 2011 would keep domestic demand pressures in check.** They envisage to continue raising the policy rate until it reaches a neutral level (the market consensus estimate of which is between 4.75 and 5.25 percent),[7] and broadly adhering to the fiscal targets announced recently in their medium-term fiscal framework (i.e., a central government deficit of 4.0 percent of GDP and a combined public sector deficit of 3.4 percent of GDP). The authorities noted that the planned government spending contained one-off outlays of an emergency nature for relief and reconstruction of about 0.5 percent of GDP, and that measures of the fiscal stance excluding these items did not suggest that fiscal policy would be expansionary in 2011. They also noted that the monetary tightening underway had already maintained indicators of inflation expectations for end-2012 within the official inflation target range.

[7] Since February, the central bank has raised the policy rate five times, as of mid-June the rate stood at 4.25 percent.

18. Staff argued that a more ambitious fiscal target for 2011 would be advisable to rebalance the policy mix and guard against possible overheating pressures in the latter part of the year. Staff noted that normal lags in the operation of fiscal policy implied that government spending would continue to support domestic demand until the first part of 2012, and thus would put undue pressure on monetary policy if private demand growth were to exceed expectations or if capital inflows were to intensify in the coming months. The authorities did not think that the lags in fiscal policy would have a material effect in light of the balance of risks facing Colombia, but they noted that investment spending so far in 2011 was below budgeted levels and saw a possibility that the year-end deficit for the central government would be below 3.8 percent of GDP. They also saw scope for saving any overperformance in central government revenues that may arise in the remainder of the year.

19. The authorities indicated that their policy response to a possible surge in capital inflows would be geared at mitigating risks to financial stability. They emphasized that the bulk of the inflows in the current episode had been related to large FDI projects and noted that their program of pre-announced daily purchases of foreign exchange had helped contain appreciating pressures and massive portfolio inflows without creating balance sheet vulnerabilities. They also underscored, however, that if capital inflows were to endanger financial stability through, for example, excessive leveraging, they would consider tightening macroprudential measures (Box 4) and reintroducing capital flow management (CFMs) tools used in previous episodes of large capital inflows.[8] Staff noted that the current coverage of macroprudential measures was broad and adequate and that CFMs could be useful as part of a transitory response to an unexpected surge in inflows. Staff emphasized, however, that a tighter fiscal stance would have to be the main element of the policy response in that scenario.

20. The authorities agreed on the need to remain vigilant of credit market developments to keep balance sheet risks under control. They noted that they were supervising closely the financial system, particularly individual banks' loan portfolios and liquidity and asset markets, to detect and prevent large exposures. Staff underscored the need to monitor corporate and household balance sheets, especially for any currency mismatches stemming from the pickup in

[8] In 2007, in the context of large capital inflows and rapid credit growth, the central bank introduced marginal reserve requirements on domestic deposits and increased loan provisioning requirements. In addition, it placed unremunerated reserve requirements (URR) on foreign borrowing and portfolio inflows of all maturities. The URRs were successful in altering the composition of capital inflows (reducing foreign borrowing and non-resident portfolio inflows), though they did not appear to have had a significant impact on the volume of total inflows.

Box 4. Macroprudential Policies

Colombia has in place a broad set of macroprudential tools that is more extensive than in their regional peers. For the most part, the authorities have used micro-prudential tools to control macroprudential risks. These include those aimed at limiting the exposure of financial intermediaries to specific risks (e.g., loan-to-value ratio limits) to increase resilience to shocks and those geared towards reducing the overall amplitude of financial cycles (e.g., dynamic provisioning) that would provide for a more stable credit supply.

A legal mandate for macroprudential policy has not been established, which is the current practice in many countries in the region. Four institutions constitute the financial stability committee—the central bank, the Superintendencia Financiera (SF), the Ministry of Finance and the Deposit Insurance Agency. The Ministry of Finance is the regulator for the entire financial system, and the SF is the primary supervisor for the financial system. The central bank adheres to a financial stability mandate (although this is not codified in the law); regulates the foreign exchange system and is the lender of last resort. The deposit insurance agency implements decisions taken by the SF on intervened deposit-taking institutions. This committee has recently redoubled efforts to coordinate and facilitate information exchange. Each of the four institutions retains its micro-prudential responsibility to: identify risk, implement and enforce policies, and report to Congress.

Macroprudential Tools in Latin America

Tool / Country	Brazil	Chile	Colombia	Mexico	Peru
Cap on loan to value ratio	✓	✓	✓		
Debt to income limit			✓		
Ceiling on credit growth			✓		
Limit on FX net open position	✓		✓	✓	✓
Limit on maturity mismatch			✓	✓	
Countercyclical capital requirement	✓			✓	
Dynamic provisioning	✓		✓		✓
Restriction on banks' profit distribution			✓		

Macroprudential Tools in Colombia

Tool	Introduced	Details
Loan-to-value ratio limits	1999	Applies to mortgage borrowers; set at 70 percent.
Debt-to-income limits	1999	Applies to mortgage borrowers; monthly debt service limited to 30 percent of disposable income.
Real credit growth caps	1992	Applies to banks; limited to 20 percent; usage limited to 120 days per year.
Foreign-currency position limits in cash	1999	Limit is 50 percent of capital plus reserves and cannot be negative.
Foreign-currency position limits	1999	Long (short) limit is 20 percent (-5 percent) of capital plus reserves.
Dynamic Provisioning	2007	Introduced for commercial (2007) and consumption (2008) loans. Application to mortgage and micro-credit loans is pending.
Restriction on banks' profit distribution	2008	At end-2008, banks reached agreement with the SF to retain a portion of their 2008 profits as an additional capital buffer. Amounts determined for each institution were based on systemic importance.
Limit on off balance sheet positions	2007	Applies to banks. Gross open positions in derivative products is 550 percent of capital plus reserves.

capital inflows to these sectors. There was agreement that changes observed in banks' funding sources and liquidity composition in recent months deserved special attention.

B. Strengthening the Medium-Term Fiscal Framework

21. Discussions focused on the key elements of the government's strategy to strengthen further Colombia's sound fiscal framework and on the medium-term fiscal path. The centerpiece of the authorities' strategy is a fiscal rule for the central government that was approved by Congress in June 2011. The rule aims at enhancing fiscal discipline to reduce the nation's debt burden and facilitate countercyclical fiscal policy, mainly through improved management of windfall commodity revenues.[9] The main features of the rule are:

- Set a path for fiscal consolidation that lowers the structural deficit to 2.3 percent of GDP in 2014, and keeps it below 1 percent of GDP from 2022 onwards.
- Allow fiscal expansion when the expected output growth rate is at least two percentage points lower than the long-term growth rate.[10]
- Create a national sovereign wealth fund (SWF) to save windfall revenue from natural resources.

22. The fiscal framework was further strengthened by constitutional amendments approved in June. These included: (i) adding fiscal sustainability as a "constitutional criterion" (to limit the impact of fiscally costly rulings of the constitutional court); and (ii) reforming the system of royalties to achieve a more equitable distribution of royalty payments across regions and to save a portion of such royalties in a sub-national savings and stabilization fund.

23. The authorities noted their commitment to undertake significant fiscal consolidation during the next three years to lower the central government deficit below 2½ percent of GDP. The bulk of the consolidation is expected to come from expenditure restraint mainly through: (i) control over goods and services

[9] The plan to adopt a fiscal rule was formulated by the previous government and discussed during the 2010 Article IV Consultation. At that time, staff recommended that the fiscal rule cover the consolidated public sector to better anchor the overall debt target, and that the government set an ambitious fiscal target to create fiscal space quickly. The authorities opted for a fiscal rule focused on the central government on the grounds that it was preferable to define the targets on variables that were under the direct control of the government.

[10] The rule also allows for countercyclical fiscal policy in cases of emergencies and/or large shocks to macroeconomic stability.

expenditures;[11] (ii) adoption of a rule to keep the growth in transfers to regions below the projected medium-term rate of growth of real GDP;[12] and (iii) lower interest payments stemming from the implementation of a single treasury account (that will lower the reliance on costly short-term debt).

Colombia: Combined Public Sector Balances
(in percent of GDP)

	Prelim.	Projections					
	2010	2011	2012	2013	2014	2015	2016
Combined public sector (CPS) overall balance 1/	**-3.2**	**-2.9**	**-1.5**	**-1.2**	**-1.0**	**-0.9**	**-0.8**
Oil revenues	2.1	2.9	3.4	3.3	3.2	3.2	3.2
Non-oil revenues	22.2	22.3	22.5	22.9	22.8	23.0	23.0
Primary expenditure	24.5	25.1	24.4	24.5	24.3	24.6	24.7
Central government (CG) overall balance	**-3.8**	**-3.8**	**-3.0**	**-2.6**	**-2.3**	**-2.3**	**-2.1**
Memorandum items:							
CPS structural overall balance 2/	-2.4	-3.1	-1.7	-1.3	-1.0	-0.9	-0.8
CG structural overall balance 2/	-3.4	-3.8	-3.1	-2.7	-2.3	-2.3	-2.1

1/ Includes statistical discrepancies.
2/ Includes adjustments for the output gap, oil price expectations, and fuel subsidies.

24. **Staff encouraged the authorities to also undertake revenue-raising reforms.** Staff underscored that Colombia's fiscal revenue-to-GDP ratio is low compared with regional peers, and that sustained improvements in tax collections would be necessary to meet the targets under the fiscal rule, especially considering planned increases in infrastructure spending and compensation for victims of the internal conflict, as well as the contingent liabilities from the healthcare system and the fuel stabilization fund. The authorities stressed that additional tax measures were not needed to comply with the fiscal rule, which would be met through expenditure restraint, but noted the importance of reducing distortions in the tax system to combat informality. In this regard, they are considering recent FAD recommendations on tax policy and administration to simplify the tax system to create an environment supportive of formal sector activity. They noted that such a revamping of the tax system would spur economic growth and boost revenue collections.

25. **Staff also encouraged the authorities to give priority to enact the supporting legislation for the fiscal rule and to make it conform to international best practice**. Staff emphasized that the

[11] This includes reforms in the healthcare system, such as a peer-review mechanism for the approval of health services and ceilings on prescription benefits.

[12] The rule caps the growth of transfers in real terms at 3 percent over 2011–2016; thereafter, it will be set at the rolling 4-year average growth of income.

oversight committees responsible for developing and monitoring the methodologies to be used in the computation of the fiscal rule (e.g., the structural fiscal balance and potential output) had to be independent of the political process and subject to strict requirements of transparency. Staff also stressed that reforms to public financial management and the budgetary process were necessary to make the rule operational (including integrating a medium-term expenditure framework into the budget process). The authorities underscored that the supporting legislation will be ready in time for the 2012 budget, and said that they were confident that the decisions on key parameters of the rule would be shielded from political influences (noting that the inclusion of congressional representatives on the oversight committees was important for consensus building on fiscal consolidation). They also noted that they are seeking assistance from the IMF to improve budgetary processes.

26. Staff supported the royalty reform recently passed in Congress and welcomed plans to establish a national sovereign wealth fund (SWF) to save windfall fiscal revenues. Staff noted, however, that the revenue projections underlying the fiscal targets under the rule did not seem to leave much room for windfalls. Staff underscored that in order to accumulate resources in the SWF in the next few years, the fiscal strategy had to contemplate higher revenues and/or stricter expenditure restraint than those assumed in the government's fiscal consolidation path. The authorities considered that a more ambitious fiscal consolidation was not politically feasible and would delay the investments necessary to reduce the country's infrastructure deficit.

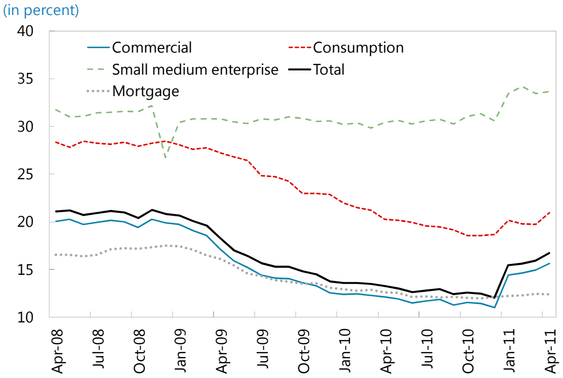
27. Staff expressed concern about the continued delays in developing a strategy to address significant contingent liabilities of the healthcare and pension systems.[13] The authorities shared staff's concern about the long-run viability of the healthcare and pension systems, but noted that reforming those systems required time to build a social consensus, and that more time was needed to prepare Colombian society to concentrate on this matter.

[13] Unfunded liabilities from these systems are estimated to be in the order of 200 percent of GDP (in present value terms).

C. Monetary, Exchange Rate, and Reserve Management Policies

28. It was agreed that the inflation targeting framework had served the country well and did not require modification. Staff supported the authorities' plans to maintain the official target range at 2–4 percent over the medium term. Staff also welcomed the recent increase of "usury" caps on interest rates that had improved the transmission of monetary policy to lending rates across all types of borrowers, especially for consumers and micro-enterprises.

Colombia: Lending rates by type of credit
(in percent)

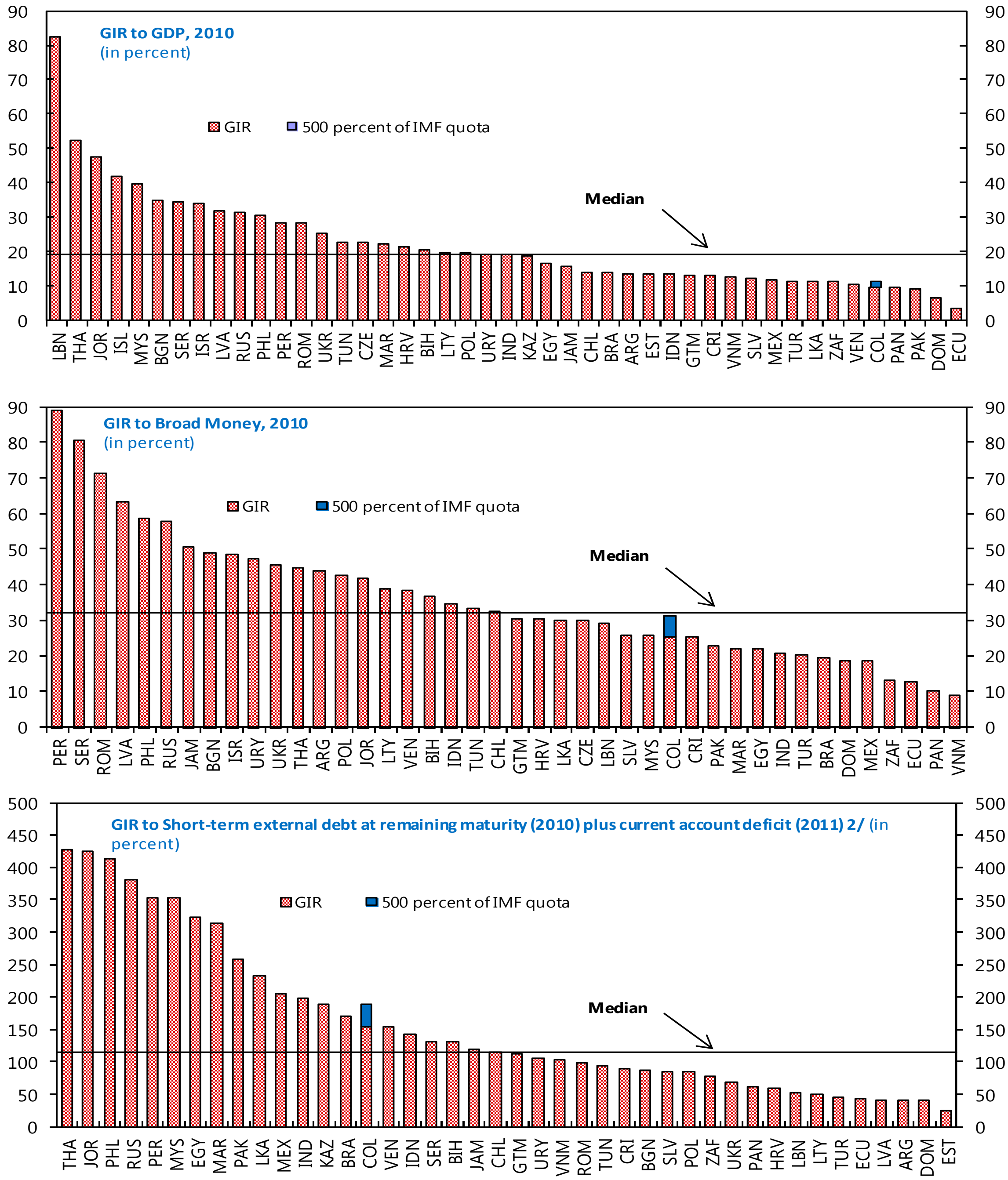


29. The authorities restated their commitment to exchange rate flexibility, but saw scope for a further buildup of reserves to strengthen the external position. Staff argued that there was no intrinsic inconsistency between a flexible exchange rate system and a target on international reserves, and it was agreed that key metrics of reserve coverage in Colombia fall below the median coverage level in other emerging market economies (Figure 6). Staff welcomed the authorities cautious cost-benefit approach to reserve accumulation, but noted that the challenge was to inform the public of the various central bank objectives and to leave no doubt that the inflation target had priority over all other goals. The authorities and staff also agreed that at current reserve levels the FCL added an important layer of protection in continued uncertain times.[14]

30. The authorities concurred with staff's assessment of the real exchange rate. Staff explained that results from CGER-type assessments suggest that the nominal appreciation of the Colombian peso has been kept broadly in line with fundamentals (Box 5). The authorities agreed and saw the prospects for higher commodity exports, especially petroleum, continued large FDI flows, as well as the favorable prospects for private sector demand growth over the medium term as consistent with a further strengthening of the peso.

[14] As discussed in "Arrangement under the Flexible Credit Line and Cancellation of the current arrangement." a tail event of a negative shock to commodity prices and curtailed access to capital markets that is less severe than that experienced in 2008–09 could generate a net external financing gap for Colombia of some US$5.5 billion.

Figure 6. Colombia: Reserve Coverage in International Perspective 1/



Sources: World Economic Outlook and IMF staff estimates.

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

The new reserve metric in "Assessing Reserve Adequacy" for Colombia stands at 181 percent, compared with a suggested adequacy range of 100-150 percent.

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

Box 5. Exchange Rate Assessment

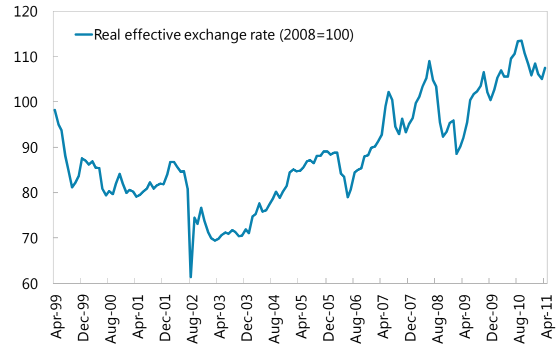
The Colombian peso has strengthened steadily in real effective terms since 2004. Following a sharp fall in the wake of the global crisis, the peso resumed its appreciation trend and reached an historic high in September 2010.

Estimates from the standard CGER-type methodologies suggest that, as of end-April 2011, the peso is broadly in line with its long-term fundamentals. Results from the macroeconomic balance approach suggest that the real effective exchange rate is about 10 percent above its medium-term equilibrium, mainly reflecting current account deficits somewhat larger than the current account norm. Results from the equilibrium real exchange rate approach suggest that the observed appreciation is in line with the equilibrium response to improved terms of trade. The external stability approach, which focuses on the relationship between the sustainability of the external position and current account flows, also suggests that the peso is broadly in line with fundamentals.

A gradual strengthening of the current account, mainly resulting from a higher oil balance surplus, is consistent with continued appreciation of the equilibrium real exchange rate. The current account deficit, which was 3.1 percent of GDP in 2010, is projected to decline to 2 percent in 2016, owing to higher production and exports of commodities, especially oil, which will keep the trade balance in surplus. Nontraditional exports, which declined in 2009 and 2010 because of disruptions of trade with Venezuela, are not expected to be adversely effected by the appreciation of the peso over the medium term due to expected improvements in the business climate and labor markets.

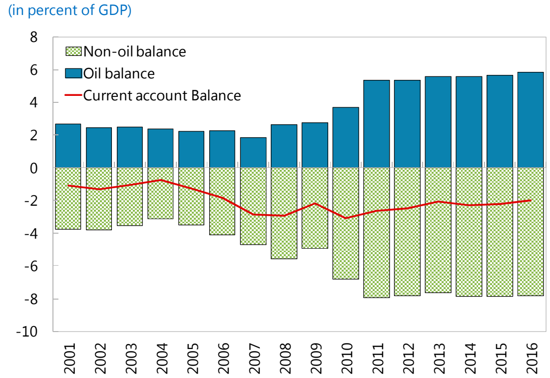
Real effective exchange rate

(2008=100)



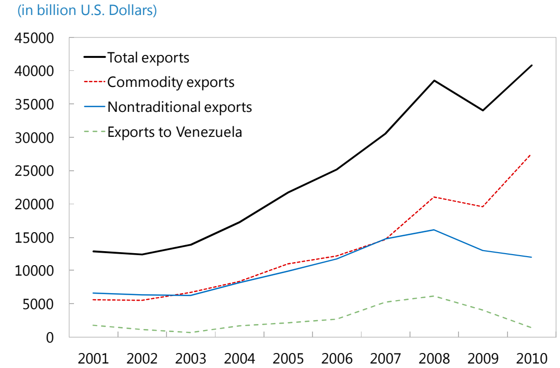
Colombia: current account developments

(in percent of GDP)



Colombia: Export developments

(in billion U.S. Dollars)



Colombian Peso: Equilibrium Assessments	
Reference period	Apr-11 (deviations from equilibrium, in percent)
Methodology	
Macrobalance	10
External stability	-1
Equilibrium exchange rate	2
Average	4
Change in exchange rate	
Ref period to proj date	2.4
2010 average to ref period	-0.6
2010 average to proj date	1.8

Source: Fund staff estimates

31. Staff confirmed that there have been no changes in Colombia's exchange restrictions since the last Article IV consultation. The retention of the multiple currency practice and exchange restriction arising from a tax on outward remittances of nonresident profits earned before 2007 has been approved until December 31, 2011 and the measure will be fully phased out on January 1, 2012. Staff encouraged the authorities to set a timetable for the removal of the exchange restriction arising from the special regime for the hydrocarbon sector. The authorities said they will reassess this restriction.

D. Financial Sector Oversight

Financial Soundness Indicators, 2010 (in percent)

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

Source: GFSR Statistical Appendix. December 2010 data.
1/ Bank regulatory capital to risk-weighted assets.
2/ NPL definition for Colombia is 30 days delinquent.

32. Financial sector supervision is solid, and will be strengthened by the recently released Financial Superintendency Roadmap. The roadmap (released in April) covers the period 2011–14 and strengthens the coordination for information exchange, bank resolution, the design of financial and macroprudential regulation among the different entities with regulatory and supervisory responsibilities, upgrades the supervisory process, and improves consolidated supervision (for example, by increasing cross-border collaboration with other supervisors).

The roadmap also proposes to enhance the independence and legal protection of financial regulators, but progress on this front will require legislative approval. An FSAP update is planned for early 2013.[16]

33. Assessing financial soundness and other steps needed for implementing Basel III terms is in its early stages. The authorities noted that Colombian banks' solvency is strong and the quality of their capital is good (as shown during the recent global crisis), and that they are just beginning to assess the quality of banks' capital and liquidity according to Basel III standards. Staff urged the authorities to move ahead quickly with their analysis to expedite a decision on adopting Basel III. The authorities expressed some concern that full adoption of Basel III requirements could negatively affect financial deepening in the country.

34. Colombia's financial sector has taken important steps in the area of AML/CFT. Colombia is member of the Financial Action Task Force of South America (GAFISUD) and is characterized as having strict AML/CFT practices in the financial sector. The superintendency implements a risk-based approach to AML/CFT supervision and provides advice and assistance to the *Superintendencia de Economia Solidaria* so that cooperatives enhance compliance with AML directives. A recently issued Circular aims to increase the compliance of cooperatives with regard to AML/CFT customer due diligence.

E. Improving Labor Market Performance

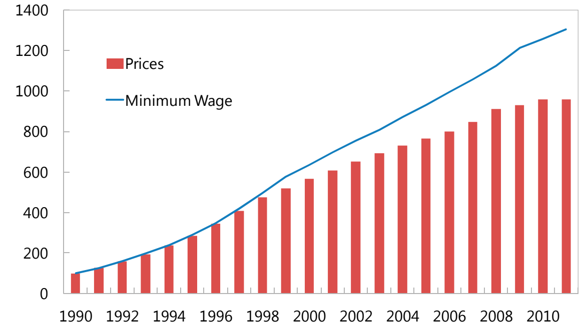
35. Labor market conditions have been improving, but significant challenges remain. The government has set a target of reducing unemployment to 8.5 percent by 2014. To help attain this goal, legislation was passed in December 2010 establishing a temporary payroll tax break for small and medium-term enterprises to promote formalization and encourage youth employment. Staff welcomed this initiative to improve labor market flexibility, but underscored that the main hindrances to formal employment are the relatively high minimum wage and burdensome taxes and charges levied on firms.

36. Staff recommended a sweeping reform of labor tax legislation as part of the broader reform of the tax system and adopting mechanisms to ensure that minimum wage adjustments do not exceed target inflation. Staff argued that the additional revenue from a tax reform should be designed to be sufficient to cover the special funds and programs (e.g., for retraining) that are presently funded by specific labor taxes. Staff also noted that the

[15] The last FSAP update was carried out in September–October 2004 and the FSSA was discussed by the Board in April, 2005 ("Colombia—Financial System Stability Assessment").

current tax system and sharp rise of minimum wages was hurting competitiveness. The authorities agreed that reducing labor taxes would be beneficial, but argued that larger gains in competitiveness would stem from improvements in infrastructure, policies to develop the agriculture sector, free trade agreements, and simplifying the tax burden for firms.

Colombia: Minimum Wage and Inflation
(Index 1990=100)



Sources: Staff estimates.

STAFF APPRAISAL

37. The Colombian economy proved resilient to the global financial crisis and a solid recovery is underway. The recovery was appropriately supported by expansionary monetary and fiscal policies. However, the output gap is expected to close in a matter of months and, with the balance of risks tilted to the upside, the normalization of macropolicies has to become a priority.

38. The fiscal policy stance envisaged for 2011 carries the risk of yielding excessive stimulus in 2012. Staff recognizes that budget rigidities and infrastructure needs, in part related to flooding damage, limit the scope to tighten the fiscal stance in the second half of the year. Notwithstanding this, domestic demand momentum in a context of limited slack in the economy is a serious concern, and the authorities are encouraged to exercise the maximum expenditure restraint feasible in the remainder of the year. The authorities' intention to save any revenue overperformance is welcome, but may not be sufficient to slow down demand in time.

39. The pace of monetary tightening envisaged for 2011 strikes the right balance between restraining credit growth and mitigating incentives for further capital inflows. Inflation expectations remain within the official target range, and markets expect that the policy rate will rise a few more basis points to its neutral level before end 2011. Staff welcomes the authorities' unwavering commitment to attaining the inflation target and preserving financial stability.

40. Nonetheless there is a risk that a sudden acceleration of domestic demand places an additional burden on monetary policy in the coming months. The strategy of supplementing the flexible exchange rate with an intervention program of pre-announced purchases has worked reasonably well, but has limitations. Staff welcomes the authorities' plans to consider other policies (including strengthened macroprudential regulations and capital flow management policies) if capital inflows are seen as likely to endanger financial stability. Staff also underscores that a tightening of the fiscal stance would have to be part of the policy response to a possible surge in capital inflows.

41. Colombia's reserve position appears adequate, but it could be somewhat larger. Staff welcomes that the recent buildup in reserves has been carried out in a transparent fashion without compromising exchange rate flexibility and monetary policy objectives. Indicators of reserve adequacy suggest that Colombia's current level is comfortable, but a larger reserve buffer could help mitigate costs of unexpected financial or capital account shocks.

42. Colombia's fiscal framework will be strengthened by the reforms taken in the last year. The fiscal rule for the central government, the incorporation of fiscal sustainability as a constitutional criterion, and the reform of the royalties system are all positive steps for ensuring a sound fiscal position going forward. In staff's view the necessary next step should consist of a revenue reform focused on broadening the tax base, including by eliminating exemptions and lowering the number of rates of the VAT. Such a reform will encourage formalization in the economy and allow for more ambitious medium-term fiscal targets and a faster build up of resources in the new national sovereign wealth fund. Staff encourages the authorities to start developing a strategy to address contingent liabilities stemming from Colombia's pension and healthcare systems.

43. Colombia's financial sector oversight is solid, and plans to strengthen cross-border and consolidated supervision are welcome. Staff recommends adopting a more ambitious timetable for completing the analysis of the composition of bank capital and liquidity under Basel III. Close monitoring of foreign borrowing activities by banks and corporates is also necessary.

44. Steep taxation of labor and a relatively high minimum wage are significant hindrances to Colombia's competitiveness. Staff urges that the authorities build on the recent labor market reform for first-time employees to lower the costs of formal employment and help to begin reducing the high rate of informality. Staff also supports the authorities' plans to expand business opportunities as a cornerstone of its efforts to reduce informality. In addition, staff recommends reducing the tax burden on labor earmarked for special funds and to support them through general budget allocations, as well as establishing prudent limits to minimum wage increases.

45. There have been no changes in Colombia's exchange restrictions since the last Article IV consultation. Staff does not recommend approval of the retention of the restriction arising from the special regime for the hydrocarbon sector, since there is no timetable for its removal.

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

Table 1. Colombia: Selected Economic and Financial Indicators

I. Social and Demographic Indicators

Population (millions), 2009	45.0	Physicians (per 100,000 people), 2008	143.0
GDP, 2010		Adult illiteracy rate (ages 15 and older), 2007	6.9
per capita (US$)	4,943	Gross primary school enrollment rate, 2008	119.9
in billions of Col$	546,951	Sustainable access to safe water, 2006	
in billions of US$	289.4	(percent of population)	93.0
Unemployment rate, March 2011 (percent)	10.8	Gini index, 2009	57.8
Life expectancy at birth (years), 2008	73.0	Poverty rate ($2 a day (PPP)), 2009	18.0
Under 5 mortality rate (per 1,000 live births), 2008	20.6	Extreme poverty rate ($1 a day (PPP)), 2009	8.0

II. Economic Indicators

				Prelim.	Projections	
	2007	2008	2009	2010	2011	2012
(Percentage changes, unless otherwise indicated)						
National income and prices						
Real GDP	6.9	3.5	1.5	4.3	4.9	4.5
GDP deflator	5.0	7.8	4.2	3.1	5.7	2.9
Consumer prices (average)	5.5	7.0	4.2	2.3	3.3	2.9
Consumer prices (end of period)	5.7	7.7	2.0	3.2	3.1	3.1
External sector (on the basis of US$)						
Exports (f.o.b.)	21.4	26.0	-11.7	19.8	34.5	5.5
Imports (f.o.b.)	25.4	20.5	-16.2	22.7	25.8	5.9
Terms of trade (deterioration -)	3.0	11.0	-30.7	14.7	17.1	-2.2
Real effective exchange rate (depreciation -)	7.7	0.4	5.2	5.5	...	...
Central government						
Revenue	14.8	16.0	2.8	-2.8	16.7	13.0
Expenditure	9.9	12.9	13.6	-1.9	15.2	7.1
Money and credit						
Broad money	17.4	18.5	8.1	11.5	17.6	13.3
Credit to the private sector	25.6	14.0	0.9	16.8	20.9	13.5
Interest rate (90-day time deposits; percent per year)						
Nominal	9.0	10.1	4.1	3.5	...	...
Real	3.3	2.4	2.1	0.3	...	...
(In percent of GDP)						
Central government balance	-2.7	-2.3	-4.1	-3.8	-3.8	-3.0
Combined public sector balance 1/	-0.7	-0.1	-2.7	-3.2	-2.9	-1.5
Public debt 2/	32.7	30.8	36.3	36.4	35.9	34.7
Public debt, excluding Ecopetrol	32.7	30.8	35.3	35.2	34.5	33.2
Gross domestic investment	23.0	23.4	22.7	22.5	22.9	23.0
Gross national savings	20.2	20.5	20.5	19.4	20.3	20.6
Current account (deficit -)	-2.9	-2.9	-2.2	-3.1	-2.6	-2.5
External debt	21.2	19.7	22.9	22.4	22.9	23.3
Of which: public sector	13.7	12.5	15.9	13.6	14.0	14.6
GIR in percent of short-term debt	198.7	207.3	244.4	183.7	174.0	181.2
(In percent of exports of goods and services)						
External debt service	39.2	32.0	37.9	30.2	32.7	35.2
Of which: public sector	15.6	12.7	11.7	11.0	8.9	9.5
Of which: Interest payments	9.2	7.7	8.1	7.6	7.4	6.5
Of which: public sector	6.4	5.5	5.7	5.4	4.8	4.2
(In millions of U.S. dollars)						
Changes in GIR	5,498	3,065	1,321	3,086	3,725	1,948
Exports (f.o.b.)	30,577	38,534	34,026	40,777	54,861	57,870
Of which: Petroleum products	7,318	12,204	10,254	16,483	25,679	27,319
Coffee	1,714	1,883	1,543	1,884	3,300	3,457
Gross official reserves (US millions)	20,607	23,672	24,992	28,078	31,803	33,751
Share of ST debt at remaining maturity + CA deficit	119	143	130	119	119	129
In months of imports of goods and services	5.5	7.4	6.4	5.8	6.2	6.2

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

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

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

Table 2. Colombia: Summary Balance of Payments

				Prelim.	Projections					
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
	(In millions of U.S. dollars)									
Current account balance	**-6,018**	**-6,923**	**-5,141**	**-8,944**	**-8,409**	**-8,377**	**-7,470**	**-8,737**	**-8,954**	**-8,499**
Trade balance	-584	971	2,546	2,136	6,256	6,421	7,375	6,446	6,267	7,132
Exports, f.o.b.	30,577	38,534	34,026	40,777	54,861	57,870	62,315	65,063	68,300	73,438
Coffee	1,714	1,883	1,543	1,884	3,300	3,457	3,354	2,602	1,859	1,611
Petroleum products	7,318	12,204	10,254	16,483	25,679	27,319	29,922	31,454	33,397	36,317
Non-traditional	15,174	17,101	14,624	14,197	15,987	17,458	19,210	20,904	22,786	24,966
Other	6,370	7,346	7,605	8,214	9,895	9,636	9,829	10,103	10,258	10,544
Imports, f.o.b.	31,161	37,563	31,479	38,641	48,605	51,450	54,941	58,617	62,033	66,305
Services (net)	-2,647	-3,072	-2,809	-3,465	-4,026	-4,259	-4,506	-4,815	-5,123	-5,434
Income (net)	-8,002	-10,333	-9,492	-12,096	-14,718	-14,913	-15,043	-15,427	-15,534	-16,038
Interest (net)	-1,737	-2,067	-2,515	-2,991	-3,739	-3,206	-2,612	-2,286	-1,816	-1,324
Of which: public sector	-1,284	-1,502	-1,779	-2,263	-2,500	-2,132	-1,848	-1,697	-1,452	-1,213
Other Income (net)	-6,265	-8,266	-6,978	-9,105	-10,979	-11,708	-12,431	-13,140	-13,718	-14,714
Current transfers (net)	5,216	5,512	4,614	4,481	4,079	4,374	4,704	5,058	5,437	5,841
Financial account balance	**10,347**	**9,492**	**6,254**	**11,879**	**12,134**	**10,325**	**9,355**	**10,495**	**10,649**	**10,433**
Public sector (net)	2,198	-309	7,287	5,168	5,137	4,746	2,351	2,045	1,281	1,195
Nonfinancial public sector	1,578	-45	6,512	5,039	4,745	4,740	2,097	1,948	1,313	1,274
Medium- and long-term (net)	1,298	998	6,383	1,338	5,305	4,749	2,105	1,957	1,321	1,282
Disbursements	4,096	3,246	7,942	3,357	6,964	7,305	4,584	5,699	4,817	3,276
Amortization	2,798	2,248	1,559	2,019	1,659	2,556	2,479	3,742	3,495	1,994
Other long-term flows	-20	-1	-8	-8	-8	-8	-8	-8	-8	-8
Short term 1/	300	-1,042	138	3,709	-551	0	0	0	0	0
Financial public sector	620	-264	774	129	392	6	254	97	-32	-79
Private sector (net)	8,149	9,801	-1,033	6,711	6,997	5,579	7,004	8,450	9,368	9,238
Nonfinancial private sector (net)	7,862	8,797	161	4,292	6,944	5,631	7,054	8,487	9,398	9,259
Direct investment	8,136	8,342	4,049	256	4,612	5,910	6,451	6,888	7,396	7,974
Direct investment abroad	913	2,254	3,088	6,504	3,166	2,314	2,342	2,371	2,404	2,441
Direct investment in Colombia	9,049	10,596	7,137	6,760	7,778	8,224	8,793	9,258	9,800	10,415
o/w Gross inward direct investment	...	17,798	16,324	18,133	20,863	22,060	23,587	24,835	26,286	27,937
Leasing finance	116	277	733	78	86	198	314	250	118	78
Disbursements	656	1,004	1,797	1,025	810	853	913	974	1,021	1,089
Amortization	540	726	1,064	946	725	655	599	725	904	1,011
Long-term loans	951	408	642	3,367	1,858	482	1,006	1,377	2,164	1,635
Disbursements	3,031	2,263	3,365	6,433	5,574	5,307	6,036	8,262	12,987	9,808
Amortization	2,080	1,854	2,724	3,065	3,716	4,825	5,030	6,885	10,822	8,173
Short term 2/	-1,342	-231	-5,263	590	388	-960	-717	-28	-281	-428
Financial private sector (net)	287	1,005	-1,194	2,419	53	-52	-50	-37	-29	-20
Valuation changes/Contribution to FLAR 3/	800	442	-27	-50	0	0	0	0	0	0
Net errors and omissions	**368**	**53**	**234**	**201**	**0**	**0**	**0**	**0**	**0**	**0**
Changes in GIR 4/ 5/	**5,498**	**3,065**	**1,321**	**3,086**	**3,725**	**1,948**	**1,884**	**1,758**	**1,696**	**1,934**
Memorandum Items:										
Current account balance (in percent of GDP)	-2.9	-2.9	-2.2	-3.1	-2.6	-2.5	-2.1	-2.3	-2.2	-2.0
Oil Price (Colombian mix)	66.2	90.2	56.6	73.1	98.4	97.4	94.2	92.1	91.4	91.1
Gross international reserves (in US$ billion)	20.6	23.7	25.0	28.1	31.8	33.8	35.6	37.4	39.1	41.0
Gross international reserves / (st debt at remaining maturity + ca deficit)	119.2	142.9	130.4	118.5	119.3	129.3	114.9	105.4	124.9	118.7
Gross international reserves (months of imports of G&S)	5.5	7.4	6.4	5.8	6.2	6.2	6.1	6.1	6.0	6.3
Nominal GDP (US$ billion)	210.6	235.7	234.2	289.4	321.5	339.9	363.4	382.9	405.3	430.7

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

1/ Mainly deposit flows of public sector entities abroad.
2/ Includes net portfolio investment.
3/ FLAR is Fondo Latinoamericano de Reservas.
4/ IMF definition.
5/ Figures for 2009 include SDR allocation to Colombia amounting to US$972 million.

Table 3a. Colombia: Operations of the Central Government 1/

(In percent of GDP)

	2006	2007	2008	2009	Prel. 2010	Proj. 2011	2012	2013	2014	2015	2016
Total revenue	**14.7**	**15.0**	**15.6**	**15.2**	**13.7**	**14.4**	**15.2**	**15.2**	**15.1**	**15.3**	**15.3**
Current revenue	**14.7**	**15.0**	**15.6**	**15.2**	**13.7**	**14.4**	**15.2**	**15.2**	**15.1**	**15.3**	**15.3**
Tax revenue	13.4	13.4	13.4	12.8	12.2	12.7	13.4	13.4	13.4	13.6	13.6
Net income tax and profits 2/	5.5	5.6	5.1	5.5	4.9	5.1	5.7	5.7	5.7	5.5	5.5
Goods and services	5.9	5.7	5.9	5.3	5.5	5.6	5.6	5.9	6.0	6.6	6.7
Value-added tax	5.6	5.4	5.6	5.1	5.2	5.4	5.3	5.7	5.8	6.4	6.4
Gasoline tax	0.3	0.3	0.3	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.2
International trade	0.9	1.0	0.9	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8
Financial transaction tax	0.7	0.7	0.7	0.6	0.6	0.7	0.7	0.7	0.4	0.4	0.2
Stamp and other taxes	0.3	0.5	0.8	0.5	0.4	0.4	0.6	0.3	0.5	0.2	0.4
Nontax revenue	1.3	1.6	2.2	2.4	1.5	1.7	1.7	1.7	1.7	1.7	1.7
Property income	0.3	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Other	1.1	1.4	2.0	2.2	1.4	1.7	1.6	1.6	1.6	1.6	1.6
Total expenditure and net lending	**18.1**	**17.7**	**17.9**	**19.2**	**17.5**	**18.2**	**18.2**	**17.8**	**17.4**	**17.5**	**17.4**
Current expenditure	**15.2**	**14.5**	**14.4**	**15.5**	**14.7**	**14.8**	**14.9**	**14.6**	**14.6**	**14.9**	**14.7**
Wages and salaries	2.1	2.0	2.0	2.1	2.1	2.1	2.1	2.0	1.9	1.9	1.8
Goods and services	1.3	1.2	1.2	1.0	0.7	0.8	0.8	0.7	0.7	0.7	0.7
Interest	3.6	3.7	3.2	3.0	2.7	2.9	2.7	2.6	2.4	2.2	2.1
External	1.0	0.9	0.8	0.8	0.7	0.8	0.6	0.5	0.5	0.4	0.4
Domestic	2.6	2.8	2.4	2.2	2.0	2.1	2.1	2.1	1.9	1.8	1.7
Current transfers	8.2	7.6	8.0	9.4	9.2	9.0	9.2	9.3	9.5	10.1	10.1
Of which: fuel subsidies 3/	0.0	0.1	0.1	1.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital expenditure	**2.8**	**3.1**	**3.5**	**3.7**	**2.8**	**3.4**	**3.3**	**3.2**	**2.9**	**2.7**	**2.7**
Fixed capital formation	1.5	1.9	2.2	2.3	1.9	2.5	2.4	2.3	2.0	1.8	1.8
Capital transfers	1.2	1.3	1.2	1.4	0.9	0.9	0.9	0.9	0.9	0.9	0.9
Net lending	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	**-3.4**	**-2.7**	**-2.3**	**-4.1**	**-3.8**	**-3.8**	**-3.0**	**-2.6**	**-2.3**	**-2.3**	**-2.1**
Memorandum item:											
Oil-related revenues 4/	0.9	1.1	1.2	2.3	0.7	1.0	1.5	1.6	1.5	1.5	1.5
Overall structural balance 5/	-3.5	-3.1	-3.8	-2.5	-3.4	-3.8	-3.1	-2.7	-2.3	-2.3	-2.1
Primary balance	0.2	1.0	0.9	-1.1	-1.1	-0.9	-0.3	0.0	0.1	0.0	0.1
Nominal GDP (in COP billions)	383,898	431,072	481,037	508,532	546,951	606,418	652,062	710,157	759,410	814,051	875,075

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

1/ Includes central administration only.

2/ The increase in revenue of 0.8 percent of GDP in 2012 reflects almost entirely the elimination of the fixed asset tax credit, which was part of the end-2010 tax reform

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

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

5/ Adjusts for the output gap, oil price projections, fuel subsidies, and one-off relief expenditures.

Table 3b. Colombia: Operations of the Central Government 1/

(In COP Billions)

	2006	2007	2008	2009	Prel. 2010	Proj. 2011	2012	2013	2014	2015	2016
Total revenue	**56,350**	**64,705**	**75,059**	**77,156**	**74,957**	**87,467**	**98,839**	**107,800**	**114,659**	**124,236**	**134,065**
Current revenue	**56,350**	**64,705**	**75,059**	**77,156**	**74,957**	**87,467**	**98,839**	**107,800**	**114,659**	**124,236**	**134,065**
Tax revenue	51,278	57,866	64,349	65,196	66,781	76,873	87,582	95,411	101,640	110,495	119,180
Net income tax and profits 2/	21,062	24,010	24,448	28,117	26,863	30,990	36,986	40,331	42,943	44,891	48,351
Goods and services	22,750	24,589	28,352	27,202	30,039	33,955	36,460	41,823	45,655	54,067	58,210
Value-added tax	21,563	23,378	27,064	25,910	28,353	32,474	34,868	40,799	43,802	52,079	56,074
Gasoline tax	1,187	1,212	1,288	1,291	1,335	1,480	1,592	1,734	1,854	1,987	2,136
International trade	3,493	4,260	4,292	4,001	4,265	5,016	5,399	5,873	6,360	6,816	7,369
Financial transaction tax	2,672	2,990	3,200	3,121	3,390	4,487	4,824	5,254	2,885	3,092	1,749
Stamp and other taxes	1,301	2,017	4,057	2,755	2,224	2,426	3,912	2,130	3,797	1,628	3,500
Nontax revenue	5,072	6,839	10,710	11,960	8,176	10,594	11,256	12,389	13,019	13,741	14,885
Property income	977	766	986	758	527	584	628	684	731	784	842
Other	4,095	6,074	9,724	11,201	7,649	10,010	10,628	11,705	12,288	12,957	14,043
Total expenditure and net lending	**69,419**	**76,319**	**86,126**	**97,871**	**95,976**	**110,561**	**118,444**	**126,539**	**132,301**	**142,766**	**152,072**
Current expenditure	**58,366**	**62,501**	**69,360**	**78,899**	**80,186**	**89,600**	**96,842**	**103,954**	**110,562**	**121,100**	**128,782**
Wages and salaries	8,046	8,650	9,687	10,862	11,240	12,880	13,849	14,373	14,610	15,254	15,960
Goods and services	5,026	5,304	5,723	5,296	3,775	4,559	4,903	5,162	5,520	5,714	5,923
Interest	13,964	15,908	15,366	15,149	14,847	17,627	17,855	18,595	18,561	18,246	18,656
External	3,875	3,859	3,662	3,846	3,913	4,715	4,089	3,612	3,861	3,346	3,521
Domestic	10,089	12,050	11,704	11,303	10,934	12,911	13,766	14,983	14,699	14,901	15,135
Current transfers	31,330	32,639	38,584	47,592	50,324	54,535	60,235	65,824	71,871	81,886	88,243
Of which: fuel subsidies 3/	0	220	660	4,906	0	0	0	0	0	0	0
Capital expenditure	**10,640**	**13,560**	**16,601**	**18,796**	**15,576**	**20,659**	**21,439**	**22,585**	**21,739**	**21,666**	**23,290**
Fixed capital formation	5,917	7,991	10,734	11,536	10,473	15,214	15,583	16,207	14,920	14,356	15,432
Capital transfers	4,723	5,570	5,867	7,260	5,103	5,446	5,856	6,377	6,820	7,310	7,858
Net lending	412	257	166	176	214	301	164	0	0	0	0
Overall balance	**-13,069**	**-11,614**	**-11,067**	**-20,715**	**-21,019**	**-23,094**	**-19,606**	**-18,739**	**-17,642**	**-18,531**	**-18,007**
Memorandum item:											
Oil-related revenues 4/	3,368	4,871	5,992	11,783	3,998	5,945	9,920	11,039	11,388	11,818	12,911
Overall structural balance 5/	-13,555	-13,571	-18,268	-12,733	-18,651	-23,244	-20,177	-19,130	-17,842	-18,655	-18,105
Primary balance	896	4,295	4,298	-5,566	-6,172	-5,467	-1,751	-144	919	-284	649

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

1/ Includes central administration only.

2/ The increase in revenue of 0.8 percent of GDP in 2012 reflects almost entirely the elimination of the fixed asset tax credit, which was part of the end-2010 tax reform

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

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

5/ Adjusts for the output gap, oil price projections, fuel subsidies, and one-off relief expenditures.

Table 4a. Colombia: Operations of the Combined Public Sector 1/

(In percent of GDP)

	2006	2007	2008	2009	Prel. 2010	Proj. 2011	2012	2013	2014	2015	2016
Total revenue	**27.3**	**27.2**	**26.3**	**26.5**	**24.4**	**25.3**	**25.9**	**26.2**	**26.0**	**26.2**	**26.2**
Tax revenue	19.2	19.4	19.2	18.3	17.5	18.0	18.7	18.7	18.7	18.9	18.9
Nontax revenue	8.1	7.8	7.1	8.3	6.9	7.3	7.2	7.4	7.3	7.4	7.3
Financial income	1.2	1.4	1.3	1.7	1.2	1.2	1.2	1.2	1.2	1.2	1.1
Operating surplus of public enterprises	3.6	3.2	0.3	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Other	3.3	3.2	5.4	6.4	5.5	5.9	5.8	6.1	6.0	6.0	6.1
Total expenditure and net lending 2/	**28.1**	**28.2**	**26.3**	**29.1**	**27.5**	**28.3**	**27.4**	**27.4**	**27.1**	**27.2**	**27.1**
Current expenditure	22.6	21.8	21.3	22.9	22.1	22.3	21.8	21.8	21.7	22.0	21.9
Wages and salaries	5.8	5.6	5.5	5.7	5.7	5.7	5.7	5.6	5.5	5.5	5.4
Goods and services	3.6	3.6	3.4	3.2	2.9	3.0	2.7	2.8	2.9	2.9	2.8
Interest	3.9	4.1	3.5	3.3	3.0	3.2	3.0	2.9	2.7	2.5	2.4
External	1.1	1.0	0.8	0.8	0.8	0.8	0.7	0.6	0.6	0.5	0.5
Domestic	2.7	3.1	2.6	2.5	2.2	2.3	2.3	2.3	2.2	2.0	1.9
Transfers to private sector	7.3	7.2	7.4	8.7	8.6	8.4	8.6	8.7	8.9	9.4	9.5
Of which: fuel subsidies 3/	0.0	0.1	0.1	1.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other 4/	2.0	1.3	1.5	1.9	1.9	2.0	1.7	1.8	1.8	1.7	1.8
Capital expenditure	5.5	6.4	5.0	6.2	5.4	6.0	5.6	5.6	5.3	5.1	5.1
Statistical discrepancy	-0.2	0.2	-0.3	-0.2	-0.2	0.0	0.0	0.0	0.0	0.0	0.0
Nonfinancial public sector balance	**-1.0**	**-0.8**	**-0.3**	**-2.8**	**-3.3**	**-3.0**	**-1.5**	**-1.2**	**-1.0**	**-0.9**	**-0.9**
Quasi-fiscal balance (BR cash profits)	0.4	0.4	0.3	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Fogafin balance	0.2	0.1	0.1	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Net cost of financial restructuring 5/	-0.3	-0.3	-0.3	-0.2	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Combined public sector balance	**-0.7**	**-0.7**	**-0.1**	**-2.7**	**-3.2**	**-2.9**	**-1.5**	**-1.2**	**-1.0**	**-0.9**	**-0.8**
Overall financing	0.7	0.7	0.1	2.7	3.2	2.9	1.5	1.2	1.0	0.9	0.8
Foreign, net	0.5	-0.1	-0.6	1.8	1.5	0.7	0.9	0.2	0.2	0.0	-0.1
Domestic, net	0.2	0.7	0.6	0.7	1.7	1.9	-0.4	0.4	0.6	0.9	0.9
Privatization (including concessions)	0.0	0.0	0.1	0.2	0.1	0.4	0.9	0.5	0.2	0.0	0.0
Memorandum items:											
CPS overall structural balance 6/	-0.8	-1.3	-1.9	-0.6	-2.4	-3.1	-1.7	-1.3	-1.0	-0.9	-0.8
Primary Balance	3.2	3.4	3.3	0.6	-0.2	0.2	1.6	1.7	1.8	1.6	1.6
Oil-related revenues 7/	3.4	3.0	2.7	3.5	2.1	2.9	3.4	3.3	3.2	3.2	3.2
Total public debt 8/	36.8	32.7	30.8	36.3	36.4	35.9	34.7	33.7	32.8	32.1	31.2
Nominal GDP (in COP billions)	383,898	431,072	481,037	508,532	546,951	606,418	652,062	710,157	759,410	814,051	875,075

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

1/ Combined public sector includes the central, regional and local governments, social security, and public sector enterprises. Figures for 2008 and projections reflect exclusion of Ecopetrol operations and privatization of health care, which reduced revenue and spending by about 2 percent of GDP and 1.5 percent of GDP, respectively, in 2008.

2/ Expenditure reported on commitments basis.

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

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

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

6/ Adjusts for the output gap, oil price projections, fuel subsidies, and one-off relief expenditures.

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

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

Table 4b. Colombia: Operations of the Combined Public Sector 1/

(In COP Billions)

	2006	2007	2008	2009	Prel. 2010	Proj. 2011	2012	2013	2014	2015	2016
Total revenue	**104,745**	**117,164**	**126,674**	**134,879**	**133,300**	**153,165**	**168,787**	**185,778**	**197,652**	**213,466**	**229,316**
Tax revenue	73,800	83,550	92,581	92,874	95,757	109,000	122,127	133,034	141,872	153,621	165,539
Nontax revenue	30,944	33,614	34,092	42,006	37,543	44,165	46,660	52,744	55,780	59,845	63,776
Financial income	4,614	6,068	6,332	8,524	6,730	7,435	7,994	8,706	9,310	9,980	9,853
Operating surplus of public enterprises	13,641	13,731	1,654	689	790	660	709	773	826	886	952
Other	12,689	13,815	26,107	32,792	30,023	36,071	37,957	43,265	45,644	48,979	52,971
Total expenditure and net lending 2/	**107,974**	**121,618**	**126,485**	**147,744**	**150,234**	**171,461**	**178,571**	**194,380**	**205,472**	**221,114**	**236,903**
Current expenditure	86,774	94,070	102,389	116,379	120,777	135,311	142,155	154,632	165,025	179,298	191,923
Wages and salaries	22,299	24,334	26,571	29,238	31,272	34,666	37,275	39,886	41,893	44,500	47,398
Goods and services	13,757	15,621	16,314	16,066	16,016	18,106	17,790	20,050	21,794	23,254	24,808
Interest	14,861	17,489	16,668	16,986	16,369	19,314	19,670	20,572	20,674	20,512	21,091
External	4,412	4,294	3,962	4,134	4,244	5,082	4,483	4,041	4,320	3,838	4,050
Domestic	10,449	13,195	12,705	12,852	12,126	14,233	15,186	16,531	16,354	16,674	17,042
Transfers to private sector	28,109	30,905	35,750	44,183	46,988	50,836	56,258	61,493	67,240	76,921	82,906
Of which: fuel subsidies 3/	0	220	660	4,906	0	0	0	0	0	0	0
Other 4/	7,748	5,721	7,086	9,907	10,132	12,389	11,162	12,631	13,424	14,111	15,720
Capital expenditure	21,200	27,547	24,096	31,365	29,457	36,150	36,416	39,749	40,447	41,816	44,980
Statistical discrepancy	-578	802	-1,402	-1,236	-1,037	0	0	0	0	0	0
Nonfinancial public sector balance	**-3,808**	**-3,652**	**-1,214**	**-14,101**	**-17,971**	**-18,296**	**-9,784**	**-8,602**	**-7,820**	**-7,648**	**-7,587**
Quasi-fiscal balance (BR cash profits)	1,440	1,641	1,306	599	223	163	-254	-251	-212	-191	-210
Fogafin balance	773	343	502	926	426	597	665	665	665	665	715
Net cost of financial restructuring 5/	-1,113	-1,161	-1,270	-1,117	-392	-281	-98	-39	-10	-31	-33
Combined public sector balance	**-2,708**	**-2,829**	**-677**	**-13,693**	**-17,714**	**-17,817**	**-9,471**	**-8,227**	**-7,377**	**-7,205**	**-7,115**
Overall financing	2,708	2,829	677	13,693	17,714	17,817	9,471	8,227	7,377	7,205	7,115
Foreign, net	2,068	-217	-2,840	9,298	8,111	3,961	5,812	1,407	1,511	101	-680
Domestic, net	623	3,046	2,985	3,502	9,072	11,596	-2,455	3,136	4,339	7,104	7,794
Privatization (including concessions)	16	0	532	893	531	2,260	6,114	3,684	1,527	0	0
Memorandum items:											
CPS overall structural balance 6/	-3,013	-5,683	-9,212	-2,865	-12,854	-18,663	-10,779	-9,034	-7,750	-7,413	-7,263
Primary Balance	12,153	14,660	15,991	3,292	-1,345	1,497	10,199	12,344	13,298	13,306	13,976
Oil-related revenues 7/	13,165	13,062	13,022	17,772	11,629	17,786	21,958	23,458	24,276	25,898	28,253
Total public debt	141,394	141,085	148,358	184,783	199,243	217,814	226,171	238,993	249,393	260,925	272,956

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

1/ Combined public sector includes the central, regional and local governments, social security, and public sector enterprises. Figures for 2008 and projections reflect exclusion of Ecopetrol operations and privatization of health care, which reduced revenue and spending by about 2 percent of GDP and 1.5 percent of GDP, respectively, in 2008.

2/ Expenditure reported on commitments basis.

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

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

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

6/ Adjusts for the output gap, oil price projections, fuel subsidies, and one-off relief expenditures.

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

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

Table 5. Colombia: Monetary Indicators

	2006	2007	2008	2009	2010	April 2011
	(In billions of Colombian pesos, unless otherwise indicated)					
Central Bank						
Net Foreign Assets	35,265	42,876	54,661	50,526	53,265	52,814
Gross official reserve assets	34,878	42,343	53,720	51,650	54,583	54,738
in billions of US$	15.7	21.0	23.9	25.3	28.5	31.0
Short-term foreign liabilities	326	136	613	562	844	1,379
Other net foreign assets	1,257	1,161	2,106	1,955	1,865	1,724
Net domestic assets	-8,215	-9,964	-18,403	-10,958	-8,373	-12,393
Net credit to the public sector	-284	-4,038	-1,792	622	-2,098	-17,769
Net credit to the financial system	6,598	5,039	-143	-419	1,516	9,404
Other	-14,529	-10,965	-16,468	-11,160	-7,792	-4,028
Monetary base	27,032	32,415	36,195	39,547	44,878	40,409
Currency in circulation	20,120	22,417	24,352	25,671	29,674	26,385
Deposit money banks reserves	6,896	9,970	11,832	13,865	15,157	13,973
Other deposits	16	29	12	10	47	52
Financial system						
Net foreign assets	34,751	37,886	49,670	48,267	44,392	43,124
in billions of US$	15.0	18.4	21.4	24.2	23.0	23.1
Net domestic assets	88,469	106,762	121,706	136,915	162,008	163,313
Net credit to public sector	20,401	11,926	16,150	32,352	33,782	20,912
Credit to private sector	104,290	130,986	149,366	150,766	176,020	188,076
Other net	-36,222	-36,150	-43,809	-46,203	-47,794	-45,674
Broad money	123,219	144,648	171,376	185,182	206,399	206,437
	(Annual percentage change)					
y-o-y						
Credit to private sector	35.6	25.6	14.0	0.9	16.8	22.6
Currency	22.9	11.4	8.6	5.4	15.6	16.0
Monetary base	18.5	19.9	11.7	9.3	13.5	16.2
Broad money	18.0	17.4	18.5	8.1	11.5	12.2
	(In percent of GDP)					
in percent of annual GDP						
Credit to private sector	27.2	30.4	31.1	29.6	32.2	31.0
Currency	5.2	5.2	5.1	5.0	5.4	4.4
Monetary base	7.0	7.5	7.5	7.8	8.2	6.7
Broad money	32.1	33.6	35.6	36.4	37.7	34.0
Memorandum items:						
Central bank inflation target	4.0-5.0	3.5-4.5	3.5-4.5	4.5-5.5	2.0-4.0	2.0-4.0
CPI inflation, eop	4.5	5.7	7.7	2.0	3.2	3.1
Nominal GDP (COP billions)	383,898	431,072	481,037	508,532	546,951	606,418

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

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

	2006	2007	2008	2009	2010	April 2011
Capital Adequacy						
Regulatory capital to risk-weighted assets	15.4	16.0	15.4	17.2	17.3	17.9
Regulatory Tier 1 capital to risk-weighted assets	11.8	12.5	12.0	13.4	13.0	14.1
Capital (net worth) to assets	13.3	12.9	12.6	14.2	14.3	14.4
Asset Quality and Distribution						
Nonperforming loans to gross loans	2.7	3.2	3.9	4.0	2.9	3.0
Provisions to nonperforming loans	154.4	133.8	124.3	140.1	174.0	161.3
Gross loans to assets	65.0	70.3	71.2	64.3	67.9	64.3
Earnings and Profitability						
ROAA	4.0	4.0	3.6	3.5	3.9	2.9
ROAE	29.9	30.8	28.1	26.2	27.2	20.5
Interest margin to gross income	45.8	52.1	54.0	54.0	55.5	49.1
Noninterest expenses to gross income	53.3	45.1	46.1	43.2	47.0	52.9
Liquidity						
Liquid assets to total assets	6.0	7.5	8.2	9.2	7.5	7.0
Liquid assets to short-term liabilities	9.2	11.6	12.8	14.2	12.1	11.3
Deposit to loan ratio	101.4	94.7	94.9	98.8	93.5	91.0
Other						
Foreign-currency-denominated loans to total loans	4.4	6.3	6.6	4.2	6.9	7.0
Foreign-currency-denominated liabilities to total liabilities	4.5	8.5	8.9	6.6	11.2	...
Net open position in foreign exchange to capital	21.4	1.9	-0.1	1.7	-2.0	-3.1

Sources: Superintendencia Financiera; and Creditedge (Moody's-KMV).
1/ All deposit taking institutions.

Table 7. Colombia: Medium-Term Outlook

	2007	2008	2009	Prelim. 2010	Projections 2011	2012	2013	2014	2015	2016
I. Output and Prices										
(Annual percentage changes)										
Real GDP	6.9	3.5	1.5	4.3	4.9	4.5	4.5	4.5	4.5	4.5
Consumer prices										
End of period	5.7	7.7	2.0	3.2	3.1	3.1	3.0	3.0	3.0	3.0
(In percent of GDP, unless indicated otherwise)										
II. Saving and Investment										
Gross national savings	20.2	20.5	20.5	19.4	20.3	20.6	21.0	20.8	20.8	21.0
Private sector	15.5	15.7	17.2	17.3	17.4	16.6	16.7	16.5	16.6	16.8
Public sector 1/	4.7	4.8	3.3	2.1	2.9	4.0	4.3	4.2	4.1	4.2
Gross domestic investment	23.0	23.4	22.7	22.5	22.9	23.0	23.1	23.0	23.0	23.0
Private sector	17.7	18.5	16.9	17.2	17.2	17.7	17.7	18.0	18.1	18.1
Public sector 1/	5.4	4.9	5.8	5.2	5.7	5.3	5.3	5.1	4.9	4.9
External current account balance	-2.9	-2.9	-2.2	-3.1	-2.6	-2.5	-2.1	-2.3	-2.2	-2.0
III. Nonfinancial and Consolidated Public Sector										
Nonfinancial public sector 2/										
Revenue	27.2	26.3	26.5	24.4	25.3	25.9	26.2	26.0	26.2	26.2
Expenditure	28.2	26.3	29.1	27.5	28.3	27.4	27.4	27.1	27.2	27.1
Current expenditure	21.8	21.3	22.9	22.1	22.3	21.8	21.8	21.7	22.0	21.9
Capital expenditure	6.4	5.0	6.2	5.4	6.0	5.6	5.6	5.3	5.1	5.1
Primary balance 3/	3.2	3.2	0.6	-0.3	0.2	1.5	1.7	1.7	1.6	1.5
Overall balance 3/	-0.8	-0.3	-2.8	-3.3	-3.0	-1.5	-1.2	-1.0	-0.9	-0.9
IV. Balance of Payments										
External current account balance	-2.9	-2.9	-2.2	-3.1	-2.6	-2.5	-2.1	-2.3	-2.2	-2.0
Trade balance	-0.3	0.4	1.1	0.7	1.9	1.9	2.0	1.7	1.5	1.7
Exports	14.5	16.3	14.5	14.1	17.1	17.0	17.1	17.0	16.9	17.1
Imports	14.8	15.9	13.4	13.4	15.1	15.1	15.1	15.3	15.3	15.4
Capital and financial account balance	4.9	4.0	2.7	4.1	3.8	3.0	2.6	2.7	2.6	2.4
Public sector	1.0	-0.1	3.1	1.8	1.6	1.4	0.6	0.5	0.3	0.3
Private sector	3.9	4.2	-0.4	2.3	2.2	1.6	1.9	2.2	2.3	2.1
Net errors and omissions	0.2	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	2.2	1.1	0.6	1.1	1.2	0.6	0.5	0.5	0.4	0.4
V. Public Debt										
Total public gross debt 4/	32.7	30.8	36.3	36.4	35.9	34.7	33.7	32.8	32.1	31.2
Domestic debt	19.0	18.3	20.5	22.8	21.9	20.0	19.3	18.7	18.4	18.0
External debt	13.7	12.5	15.9	13.6	14.0	14.6	14.3	14.2	13.7	13.2
Total public gross debt, excluding Ecopetrol	32.7	30.8	35.3	35.2	34.5	33.2	32.3	31.6	31.0	30.2
Total public net debt 5/	22.7	21.0	27.4	28.5	29.2	28.4	27.5	27.0	26.6	26.1
Memorandum items:										
Nominal GDP (billions of COP)	431,072	481,037	508,532	546,951	606,418	652,062	710,157	759,410	814,051	875,075
Crude oil, spot price	71.1	97.0	61.8	79.0	106.3	105.3	101.8	99.5	98.8	98.5
Crude oil, spot price (Colombian mix)	66.2	90.2	56.6	73.1	98.4	97.4	94.2	92.1	91.4	91.1

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

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

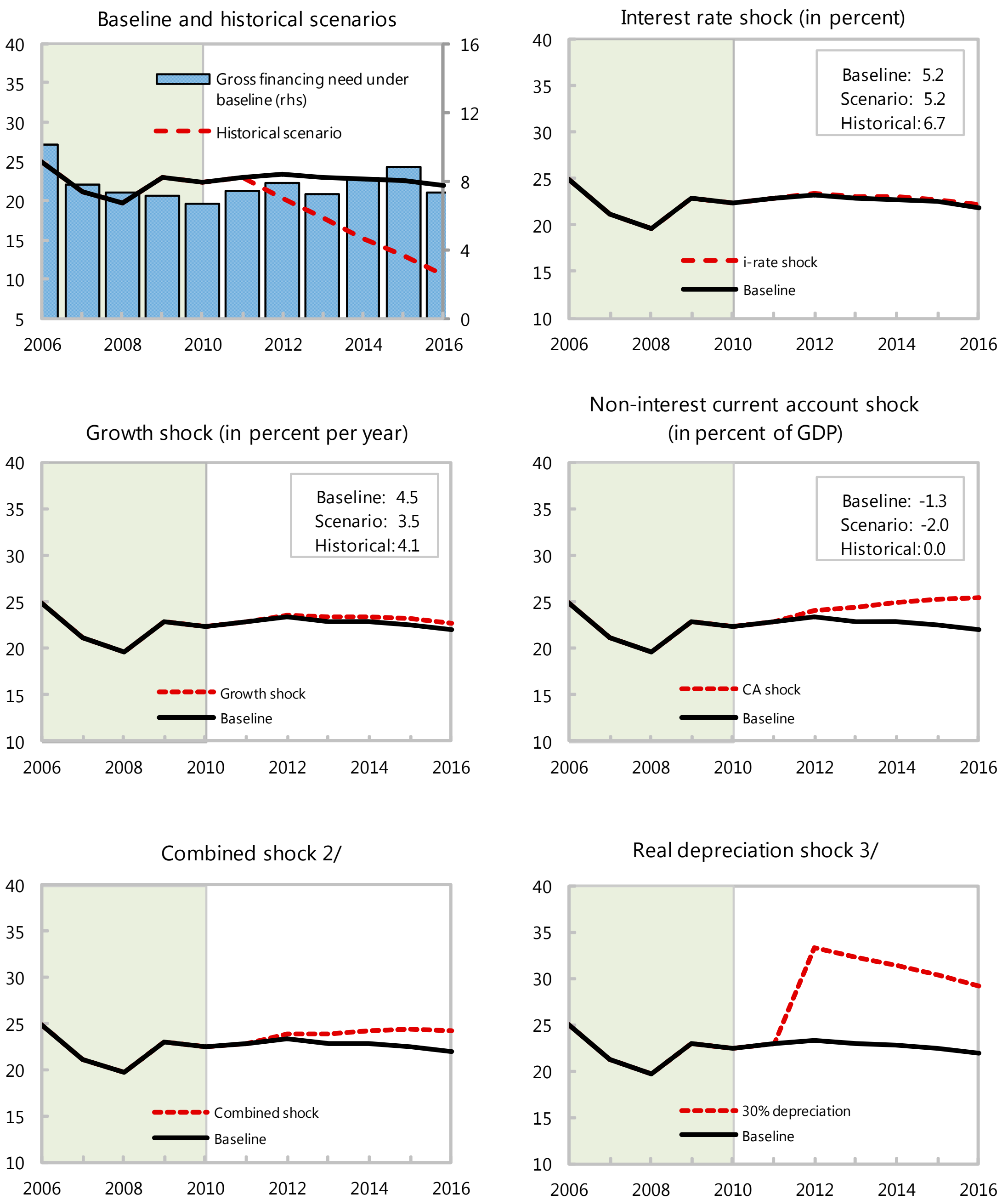
Table 8. Colombia: External Debt Sustainability Framework, 2006-2016
(In percent of GDP, unless otherwise indicated)

	Actual					Staff Projections 1/							
	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016		**Debt-stabilizing non-interest current account 7/**
Baseline: External debt	25.0	21.2	19.7	22.9	22.4	**22.9**	**23.3**	**22.9**	**22.8**	**22.5**	**21.9**		**-2.6**
Change in external debt	-1.3	-3.8	-1.5	3.3	-0.5	0.5	0.4	-0.4	-0.1	-0.3	-0.6	0.0	
Identified external debt-creating flows (4+8+9)	-3.9	-6.9	-2.9	0.6	-1.4	0.2	-0.2	-0.7	-0.8	-0.8	-1.1	0.0	
Current account deficit, excluding interest payments	0.2	1.4	1.7	1.0	2.0	1.3	1.4	1.1	1.3	1.4	1.2	2.6	
Deficit in balance of goods and services	1.1	1.5	0.9	0.1	0.5	-0.7	-0.6	-0.8	-0.4	-0.3	-0.4		
Exports	17.8	16.2	18.1	16.3	15.6	18.8	18.7	18.8	18.6	18.5	18.6		
Imports	18.9	17.8	19.0	16.4	16.1	18.1	18.1	18.0	18.2	18.2	18.2		
Net non-debt creating capital inflows (negative)	-3.5	-3.9	-3.5	-1.7	-0.1	-1.4	-1.7	-1.8	-2.1	-2.1	-2.1	-2.1	
Automatic debt dynamics 2/	-0.6	-4.5	-1.0	1.3	-3.2	0.3	0.1	0.0	0.0	-0.1	-0.1	-0.5	
Contribution from nominal interest rate	1.7	1.5	1.2	1.2	1.1	1.3	1.1	0.9	0.9	0.8	0.8	0.8	
Contribution from real GDP growth	-1.6	-1.3	-0.7	-0.3	-0.8	-1.0	-1.0	-1.0	-1.0	-1.0	-0.9	-0.9	
Contribution from price and exchange rate changes 3/	-0.7	-4.6	-1.6	0.4	-3.6	...	...	...	...	...	...	-0.4	
Residual, incl. change in gross foreign assets (2-3) 4/	2.6	3.1	1.4	2.7	0.8	0.3	0.7	0.3	0.6	0.5	0.5	0.0	
External debt-to-exports ratio (in percent)	140.4	130.2	108.7	140.5	143.3	122.0	124.7	121.9	122.4	121.8	117.6		
Gross external financing need (in billions of US dollars) 5/	16.2	16.3	17.3	16.6	19.2	23.7	26.7	26.1	31.0	35.5	31.3		
in percent of GDP	10.1	7.7	7.3	7.1	6.6	7.4	7.8	7.2	8.1	8.8	7.3		
Scenario with key variables at their historical averages 6/						**22.9**	**20.4**	**17.8**	**15.3**	**12.9**	**10.6**		**-2.8**
Key Macroeconomic Assumptions Underlying Baseline												For debt stabilization	
Real GDP growth (in percent)	6.7	6.9	3.5	1.5	4.3	4.9	4.5	4.5	4.5	4.5	4.5	4.5	
GDP deflator in US dollars (change in percent)	2.7	22.6	8.1	-2.1	18.5	5.9	1.2	2.4	0.8	1.3	1.7	1.7	
Nominal external interest rate (in percent)	7.1	7.7	6.5	6.0	6.0	6.6	5.1	4.3	4.4	3.9	3.8	3.8	
Growth of exports (US dollar terms, in percent)	17.1	19.8	24.7	-10.4	18.3	33.3	5.4	7.4	4.4	4.9	7.3		
Growth of imports (US dollar terms, in percent)	21.9	23.4	19.6	-14.0	21.0	24.7	5.7	6.6	6.5	5.7	6.7		
Current account balance, excluding interest payments	-0.2	-1.4	-1.7	-1.0	-2.0	-1.3	-1.4	-1.1	-1.3	-1.4	-1.2		
Net non-debt creating capital inflows	3.5	3.9	3.5	1.7	0.1	1.4	1.7	1.8	2.1	2.1	2.1		

Source: IMF staff estimates.

1/ Does not assume any drawings under the Flexible Credit Line arrangement.
2/ Derived as [r - g - p(1+g) + ea(1+r)]/(1+g+p+gp) times previous period debt stock, with r = nominal effective interest rate on external debt; p = change in domestic GDP deflator in US dollar terms, g= real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.
3/ The contribution from price and exchange rate changes is defined as [-p(1+g) + ea(1+r)]/(1+g+p+gp) times previous period debt stock. p increases with an appreciating domestic currency (e > 0) and rising inflation (based
4/ For projection, line includes the impact of price and exchange rate changes.
5/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.
6/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.
7/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

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



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
3/ One-time real depreciation of 30 percent occurs in 2012, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

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

	Actual					Staff Projections						
	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Debt-stabilizing primary balance 9/
Baseline: Public sector debt 1/	36.8	32.7	30.8	36.3	36.4	**35.9**	**34.7**	**33.7**	**32.8**	**32.1**	**31.2**	**0.3**
o/w foreign-currency denominated	16.4	13.7	12.5	15.9	13.6	14.0	14.6	14.3	14.2	13.7	13.2	
Change in public sector debt	-1.8	-4.1	-1.9	5.5	0.1	-0.5	-1.2	-1.0	-0.8	-0.8	-0.9	
Identified debt-creating flows (4+7+12)	-3.9	-4.6	-2.1	-0.4	-0.5	-0.9	-2.0	-2.1	-1.4	-1.3	-1.4	
Primary deficit	-3.0	-3.0	-3.5	-0.8	0.1	-0.2	-1.5	-1.7	-1.7	-1.6	-1.5	
Revenue and grants	27.3	27.2	26.3	26.5	24.4	25.3	25.9	26.2	26.0	26.2	26.2	
Primary (noninterest) expenditure	24.3	24.2	22.8	25.7	24.5	25.1	24.4	24.5	24.3	24.6	24.7	
Automatic debt dynamics 2/	-0.8	-1.5	1.6	0.6	-0.5	-0.4	0.5	0.1	0.5	0.3	0.2	
Contribution from interest rate/growth differential 3/	-0.5	0.0	0.1	1.7	0.4	-0.4	0.5	0.1	0.5	0.3	0.2	
Of which contribution from real interest rate	1.8	2.3	1.1	2.1	1.9	1.2	2.0	1.5	1.9	1.7	1.5	
Of which contribution from real GDP growth	-2.3	-2.3	-1.0	-0.4	-1.4	-1.6	-1.5	-1.4	-1.4	-1.4	-1.3	
Contribution from exchange rate depreciation 4/	-0.3	-1.6	1.5	-1.1	-1.0	...	...	...	...	...	...	
Other identified debt-creating flows	0.0	0.0	-0.1	-0.2	-0.1	-0.4	-0.9	-0.5	-0.2	0.0	0.0	
Privatization receipts (negative)	0.0	0.0	-0.1	-0.2	-0.1	-0.4	-0.9	-0.5	-0.2	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) 5/	2.1	0.5	0.2	5.9	0.6	0.4	0.7	1.1	0.5	0.5	0.5	
Public sector debt-to-revenue ratio 1/	135.0	120.4	117.1	137.0	149.5	142.2	134.0	128.6	126.2	122.2	119.0	
Gross financing need 6/	10.9	9.1	7.1	7.8	7.3	7.1	5.1	5.7	5.0	4.7	3.9	
in billions of U.S. dollars	17.6	19.2	16.7	18.4	21.2	23.0	17.5	20.8	19.2	18.9	16.7	
Scenario with key variables at their historical averages 7/						**35.9**	**33.9**	**32.7**	**31.3**	**30.0**	**28.7**	**0.3**
Scenario with no policy change (constant primary balance) in 2011-2016						**35.9**	**36.0**	**36.5**	**37.3**	**38.0**	**38.6**	**0.4**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (in percent)	6.7	6.9	3.5	1.5	4.3	4.9	4.5	4.5	4.5	4.5	4.5	
Average nominal interest rate on public debt (in percent) 8/	11.3	12.4	11.8	11.4	8.9	9.7	9.0	9.1	8.7	8.2	8.1	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	5.5	7.3	4.0	7.2	5.7	4.0	6.1	4.8	6.3	5.6	5.2	
Nominal appreciation (increase in US dollar value of local currency, in percent)	2.0	11.1	-10.2	9.8	6.8	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	5.8	5.0	7.8	4.2	3.1	5.7	2.9	4.3	2.4	2.6	2.9	
Growth of real primary spending (deflated by GDP deflator, in percent)	14.9	6.5	-2.1	14.3	-0.7	7.5	1.5	4.9	3.9	5.8	4.6	
Primary deficit	-3.0	-3.0	-3.5	-0.8	0.1	-0.2	-1.5	-1.7	-1.7	-1.6	-1.5	

Source: IMF staff estimates.

1/ Gross debt of the combined public sector, including Ecopetrol and Banco de la República's outstanding external debt. Does not assume any drawings under the Flexible Credit Line arrangement.

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/ For projections, this line includes exchange rate changes.

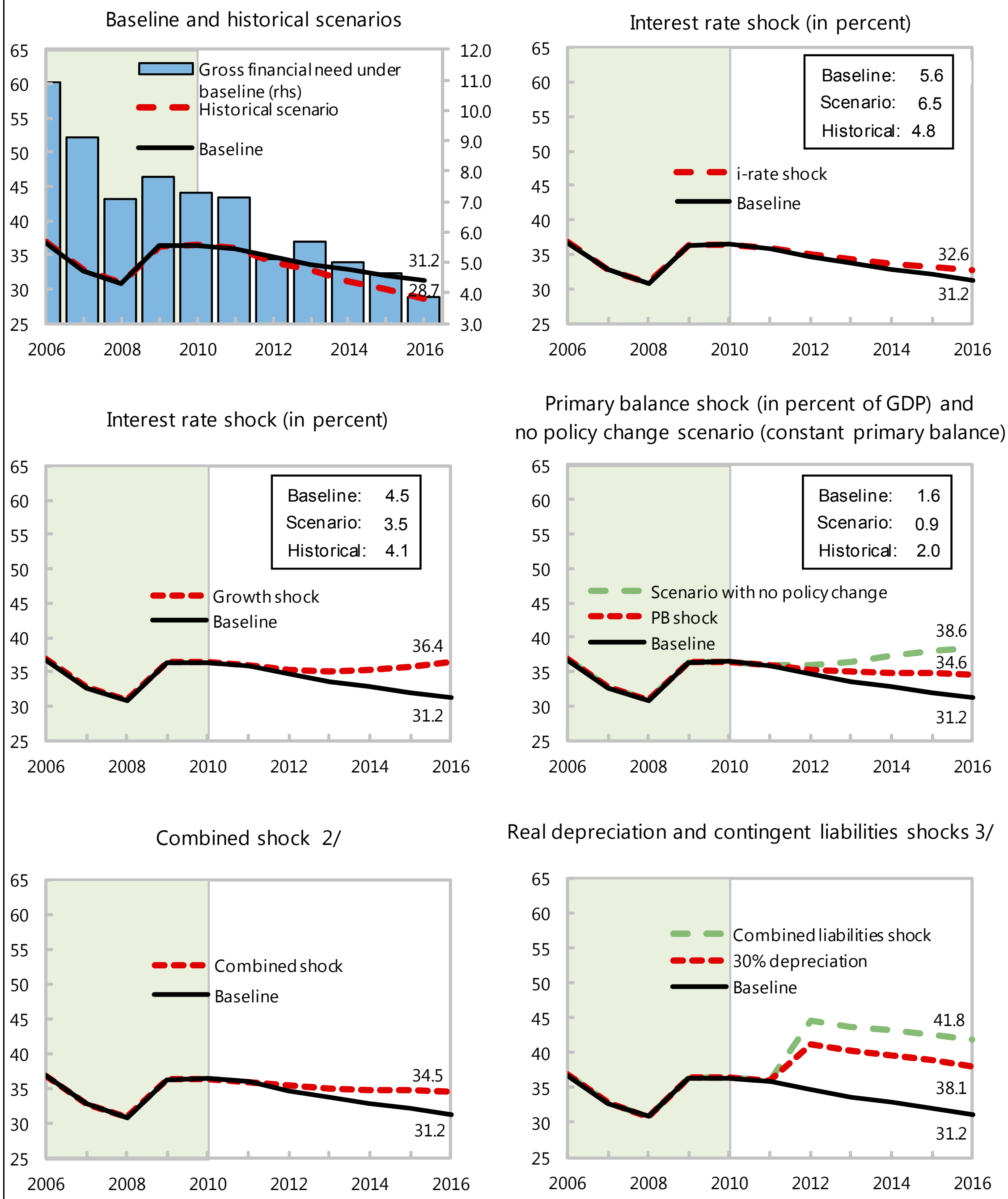
6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.

8/ Derived as nominal interest expenditure divided by previous period debt stock.

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

Figure 8. Colombia: Public Debt Sustainability: Bound Tests 1/
(Public debt in percent of GDP)



Sources: International Monetary Fund, country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.
3/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2012, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

INTERNATIONAL MONETARY FUND

COLOMBIA

July 07, 2011

STAFF REPORT FOR THE 2011 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

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

CONTENTS

ANNEX I. COLOMBIA: FUND RELATIONS

(As of May 31, 2011)

Membership Status:

Joined: December 27, 1945; Article VIII.

General Resources Account:

	SDR Million	Percent Quota
Quota	774.00	100.00
Fund holdings of currency	565.30	73.04
Reserve position	208.70	26.96
Holdings Exchange Rate		

SDR Department:

	SDR Million	Percent Allocation
Net cumulative allocation	738.32	100.00
Holdings	742.43	100.56

Outstanding Purchases and Loans:

None.

Latest Financial Arrangements:

In millions of SDR				
Type	Arrangement	Date	Amount Approved	Amount Drawn
FCL	May 6, 2011	May 5, 2013	3,970.00	0.00
FCL	May 7, 2010	May 5, 2011	2,322.00	0.00
FCL	May 11, 2009	May 6, 2010	6,966.00	0.00
Stand-by	May 2, 2005	Nov 2, 2006	405.00	0.00
Stand-by	Jan 15, 2003	May 2, 2005	1,548.00	0.00

Projected Payments to Fund (in SDR Million):

	Forthcoming				
	2011	2012	2013	2014	2015
Principal					
Charges/interest		0.01	0.01	0.01	0.01
Total		**0.01**	**0.01**	**0.01**	**0.01**

Implementation of HIPC Initiative:

Not applicable.

Implementation of Multilateral Debt Relief Initiative (MDRI):

Not applicable.

ANNEX II. COLOMBIA: WORLD BANK RELATIONS[1]

The IBRD lending program to Colombia expanded faster than anticipated over the past four years, partly as a result of the global financial crisis. During the previous Country Partnership Strategy (CPS) period (FY 08–FY 11, i.e. July 2008 to June 2011), the Executive Board approved 20 loans to Colombia totaling US$3.7 billion. Moreover, the Bank delivered an average of six analytical and advisory activities per fiscal year, in topics as diverse as climate change, education quality, decentralization, financial sector access, poverty measurement, social protection, health system modernization and extractive industries. Disbursements over the four year-period reached around US$3.9 billion (US$975 million per fiscal year, on average), while overall exposure to Colombia rose to approximately US$7.5 billion. As of May 31, 2011, the IBRD had 22 active projects in Colombia, while the IFC had a total portfolio of US$1.1 billion. Colombia is the 7th largest client of the World Bank Group (the 3rd largest in the Region).

A new Country Partnership Strategy (FY 12 –16) will be presented to the World Bank Executive Board on July 21, 2011.[2]

The CPS is designed to support the National Development Plan, entitled Prosperity for All (Prosperidad para Todos) 2011–14. The overarching goals of this Plan are to increase employment, reduce poverty, and improve security. The World Bank Group will carry out activities either through financial, knowledge, or convening services for which the government or the private sector has expressed explicit need. These activities are combined as a results-focused package of support grouped in the CPS under three strategic themes: (1) Expanding Opportunities for Social Prosperity; (2) Sustainable Growth with Enhanced Climate Change Resilience; and (3) Inclusive Growth with Enhanced Productivity.

The indicative lending program is expected to reach US$1.1 billion in FY 12 and range between US$800 and 1.1 billion per year in FY 13–16. In FY 12, the Bank is expected to present six new projects to the Board, including: a First Programmatic Fiscal Sustainability and Growth Resilience Development Policy Loan (US$300 million), a Second Catastrophic Deferred Draw Down Option Development Policy Loan (US$150 million), an Urban Transport investment loan (US$350 million), a Subnational Institutional Strengthening investment loan (US$150 million), a Smallholder Agriculture Competitiveness

[1] Prepared by World Bank staff.

[2] For a comprehensive description of World Bank activities, please refer to the Country Partnership Strategy Board Document (FY 12-16), Report No. 60620-CO, published July 21, 2011.

investment loan (US$150 million), and a Sustainable Development technical assistance loan (US$10 million).

Aside from financial support, the Bank will also be providing an array of knowledge and convening services to Colombia in FY 12. Theme 1 activities cover areas such as social promotion, education opportunities, and improved social services. Theme 2 services include urbanization reviews, support to the infrastructure concession agency, low carbon development, and strengthening environmental institutions. Finally, within Theme 3, there is planned and ongoing work on financial sector development, poverty, labor markets, monitoring and evaluation, public sector strengthening, institutional and mineral rights, productivity, competitiveness, and entrepreneurship. One important aspect of this work is its multi-year programmatic approach, where the Bank is actively engaged in a consistent manner over time, defining its work program in each area, according to client demand.

Operations Portfolio (IBRD/IDA and Grants)
As of May 31, 2011
(In millions of U.S. dollars)

Closed Projects	191
Active Projects	22
IBRD/IDA	
Total Disbursed (Active)	1,294.00
of which has been repaid	34.12
Total Disbursed (Closed)	6,175.92
of which has been repaid	2,260.08
Total Disbursed (Active + Closed)	7,469.92
of which has been repaid	2,294.20
Total Undisbursed (Active)	741.38

Loan Information (IBRD)
As of May 31, 2011
(In millions of U.S. dollars)

Fiscal Year*	2005	2006	2007	2008	2009	2010
Total disbursements	567	692	830	638	1,240	1,592
Repayment amount	254	223	278	381	170	258
Net disbursements	313	469	477	257	1,070	1,334

*Fiscal Year: July 1–June 30.

International Finance Corporation (IFC) Portfolio
(as of May 31, 2011)

Debt ($m)	Equity ($m)	Quasi Equity ($m)	Total ($m)	Guarantee
548	347	185 (Loan+Equity)	1,121	41

Investment Business -- Top sectors and Clients

Sector 1	Financial Markets
Sector 2	Infrastructure
Sector 3	Telecomunications
Sector 4	Agribusiness
Sector 5	Microfinance
Top client	DAVIVIENDA

ANNEX III. COLOMBIA: INTER-AMERICAN DEVELOPMENT BANK RELATIONS[1]

The Bank's ongoing country strategy with Colombia for 2007–2010 identifies the main targets of engagement in the areas of competitiveness, social development, and governance and strengthening of the State.[2] These three areas are part of a comprehensive vision for the development process, aimed at creating a "virtuous circle" between the objectives of increased growth, and reduced poverty and inequality, by contributing to the generation of mechanisms that strengthen the bonds between these objectives while having a direct effect on both. There are cross-cutting requirements associated with these areas, in order to overcome conditions of poverty and inequity, which are: (i) targeting actions and resources to a balanced, multidimensional approach to regional development in relation to public management and competitiveness, and (ii) recognizing both infrastructure development, and human and social capital development, as necessary factors for greater competitiveness, stronger institutions and better governance.

Between 2007 and 2010, the Bank approved US$3.5 billion to the sovereign sector, with average annual disbursements of US$833 million. The Bank portfolio is currently composed of 23 operations totaling US$2.1 billion, with a disbursed amount of US$1.2 billion (58.2 percent). In relationship to the three strategic areas, 15 of the 23 sovereign operations were in competitiveness for US$240 million (66 of the portfolio), 5 were in social development (32 percent) and 3 were in governance (2 percent). The non-reimbursable technical cooperation portfolio includes 95 operations with an approved value of US$48.7 million.

The current portfolio of private sector initiatives (non-sovereign guarantee) in Colombia consists of 3 loans, totaling US$250.0 million. This portfolio supports interventions in the transportation sector, infrastructure financing, expanding low-income families' access to commercial credit and the promotion of international trade. In addition, the Multilateral Investment Fund has a portfolio of 53 operations valued at US$52.8 million that supports microfinance institutions in underserved areas, provides seed capital and helps to improve management practices of small and medium enterprises.

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

[2] The strategy for 2011–14 is currently under preparation and expected to be approved in August 2011.

Colombia: Sovereign Loan Portfolio

As of June 10, 2011

	Number of operation	Current Approved US$ x 000	Disbursement (in percent)
Competitiveness	15	1,395,065	53
Social Development	5	688,519	46.2
Governance	3	41,382	0.8
Total	23	2,124,966	58.2

ANNEX IV. COLOMBIA: STATISTICAL ISSUES

(as of June 15, 2011)

I. Assessment of Data Adequacy for Surveillance

Data provision is adequate for surveillance.

Real sector

The National Department of Statistics (DANE) is responsible for the compilation of the national accounts, although the Banco de la República (BdR) compiles the financial accounts. Estimates of GDP by the production and the expenditure approaches both use 2005 as their base year. GDP compilation conforms to the methodological recommendations of the System of National Accounts 1993 (*1993 SNA*). The rebasing of the national accounts' base year included a change in the index formulae (historically it was a Laspeyres fixed-base index, but it is a Laspeyres chain index with the 2005 base year). The main implications of the rebasing are that the 2000 and 2005 are not comparable and the chain index is associated with non-additivity of the components. The rebasing also resulted in a revision of the nominal GDP reflecting improvements in source data.

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.

Financial sector statistics

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

Balance of payments and external debt

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

<table>
<tr><td colspan="2">The 2005 data ROSC mission recommended that the BdR, in consultation with the DANE, develop a methodology to include unrecorded trade in the balance of payments on a timely basis. The BdR should reclassify some FDI equity transactions to portfolio equity, and adjust the related investment income series accordingly. Also, it should continue efforts to identify government bonds issued abroad and purchased by residents as well as those purchased by residents on the secondary market.

The BdR also compiles and disseminates data on International Investment Position statistics, External Debt statistics, and the Data Template on International Reserves and Foreign Currency Liquidity.</td></tr>
<tr><td colspan="2">II. Data Standards and Quality</td></tr>
<tr><td>Colombia subscribes to the Special Data Dissemination Standard (SDDS) and metadata are posted on the Fund's Dissemination Standards Bulletin Board (DSBB).</td><td>A data ROSC was published in October2006.</td></tr>
<tr><td colspan="2">III. Reporting to STA (optional)</td></tr>
<tr><td colspan="2">Colombia reports annual GFS to STA for general government and its subsectors on accrual and cash bases for publication in the Government Finance Statistics Yearbook (GFS Yearbook). Data for the consolidated general government are only available from 2008 onward because of shortcomings in the consolidation process of past data. Currently, no high frequency data are reported for publication in IFS. The authorities use the standardized report forms for reporting monetary data for the central bank (Form 1SR), other depository corporations (Form 2SR), and other financial corporations (Form 4SR) to STA.</td></tr>
</table>

Colombia: Table of Common Indicators Required for Surveillance

As of June 15, 2011

	Date of latest observation	Date received	Frequency of Data[1]	Frequency of Reporting[1]	Frequency of publication[1]	Memo Items: Data Quality – Methodological soundness[8]	Memo Items: Data Quality – Accuracy and reliability[9]
Exchange Rates	May 2011	Jun. 1, 2011	D	W	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[2]	Apr. 2011	May 23 2011	M	M	M		
Reserve/Base Money	Apr. 2011	May 17, 2011	D	W	W	LO, O, LO, LO	O, O, O, O, O
Broad Money	Mar. 2011	May 17, 2011	D	W	W		
Central Bank Balance Sheet	Apr. 2011	May 17, 2011	M	M	M		
Consolidated Balance Sheet of the Banking System	Mar. 2011	May 17, 2011	M	M	M		
Interest Rates[3]	May 2011	Jun. 7, 2011	D	W	D		
Consumer Price Index	Apr. 2011	May 17, 2011	M	M	M		
Revenue, Expenditure, Balance and Financing Composition[4] – General Government (GG)[5]	Q2 2009	Feb. 2010	Q	Q	Q	O, O, LO, O	LO, O, O, O, NO
Revenue, Expenditure, Balance and Composition of Financing[4] – Central Government	2009	Apr. 2011	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[6]	Q3 2009	Jan. 2010	Q	Q	Q		
External Current Account Balance	Q4 2010	Apr. 14, 2011	Q	Q	Q	O, LO, LO, LO	O, O, O, O, LO
Exports and Imports of Goods and Services	Q4 2010	Apr. 14, 2011	Q	Q	Q		
GDP/GNP	Q4 2010	Apr. 20, 2011	Q	Q	Q	O, LO, O, O	LO, O, LO, LO, NO
Gross External Debt	Sep. 2009	Jan. 2010	M	M	M		
International Investment Position[7]	Q4 2011	Apr. 14, 2011	Q	Q	Q		

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

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL
RELATIONS
DEPARTMENT

Public Information Notice (PIN) No. 11/96
FOR IMMEDIATE RELEASE
July 22, 2011

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

IMF Executive Board Concludes 2011 Article IV Consultation with Colombia

On July 20, 2011, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Colombia.[1]

Background

With strong policy and institutional frameworks, Colombia's economy exhibited resilience during the global crisis, and the output recovery is well entrenched. Following a short-lived contraction, economic activity began to recover in the second half of 2009 supported by appropriate countercyclical fiscal and monetary policies, and a Flexible Credit Line arrangement, which helped keep real growth in positive territory (1.5 percent for the year as a whole). Activity gained further momentum in 2010 when real GDP grew by 4.3 percent (despite the adverse impact of severe flooding), inflation was near the mid-point of the official target range of 2−4 percent, commercial and consumer credit began to rebound strongly around mid-year, and the external currency account deficit widened to 3.1 percent of GDP, reflecting a sharp pick up in imports.

[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. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm

Countercyclical macroeconomic policies in support of this performance included: the central bank lowering its policy rate by 650 basis points to a historic low of 3 percent between early 2009 and early 2011, an expansionary fiscal policy stance, with the combined public sector deficit widening to around 3 percent of GDP in 2009 and 2010 (compared with near balance in 2008). The financial system was little impacted by the global shocks and the downturn in activity as capital adequacy and profitability remained strong and non-performing loans increased only slightly.

In 2010, global liquidity conditions and favorable prospects for the Colombia economy resulted in renewed appreciation pressures on the peso. The bulk of the inflows were related to foreign direct investment, but portfolio and other investment inflows began accelerating toward the end of the year. In response to these pressures, the central bank purchased just over US$3 billion in the foreign exchange market through its pre-announced intervention program of purchasing at least US$20 million per day over a specified time horizon (most recently extended until September 30, 2011), and the peso appreciated by just 1 percent against the U.S. dollar through the remainder of the year since the program was initiated.

The outlook for 2011 is generally positive. Real GDP growth in 2011 is projected at about 5 percent, led by domestic demand and favorable terms of trade. Inflation is expected to remain within the central bank target range as the economy still operates with some slack (the output gap is projected to close in early 2012) and the impact of further anticipated peso appreciation. Inflation expectations are well anchored supported by the strong credibility of the central bank. In response to the cyclical recovery, the central bank has started to normalize monetary conditions (with the policy rate increased by 125 basis points so far during 2011). The external current account deficit is expected to narrow to 2.6 percent of GDP as a result of higher oil and other commodity prices. Strong private capital inflows (mainly foreign direct investment) are expected to result in an overall balance of payments surplus and continued appreciation pressures.

The government is taking important steps to strengthen the fiscal framework. The strategy comprises a structural fiscal rule for the central government, constitutional amendments that establish fiscal sustainability as a constitutional criterion and a more equitable distribution of royalties, and the creation of a national sovereign wealth fund.

Executive Board Assessment

Executive Directors commended the Colombian authorities for their sound macroeconomic policies and strong institutional frameworks. Economic recovery is well entrenched and the outlook is positive. Inflation pressures are contained, the financial sector is solid, and market sentiment is favorable. The main challenges ahead are to normalize the macropolicy mix to stave off overheating pressures, strengthen revenue collection, and reduce unemployment and labor market informality.

Directors generally agreed that a speedier exit from fiscal stimulus would be desirable in light of the closing output gap. A tighter fiscal stance would also help mitigate an unexpected surge in capital inflows and avoid overburdening monetary policy. Directors encouraged the authorities to save any overperformance in government revenues this year and restrain expenditure where feasible.

Directors welcomed the recent legislative reforms to strengthen further the medium-term fiscal framework, including the adoption of a fiscal rule for the central government. They noted that these reforms will bolster Colombia's commitment to fiscal sustainability, and encouraged the authorities to make them operational in a timely manner. Directors supported the authorities' plans to broaden the tax base and reduce distortions to spur formal sector activity. They welcomed the creation of a national Sovereign Wealth Fund to manage windfall fiscal gains. Directors stressed the importance of developing a strategy to address the large contingent liabilities in the pension and healthcare systems.

Directors noted that the inflation targeting framework has served Colombia well. They supported the gradual normalization of the monetary stance to mitigate inflation pressures without exacerbating capital inflows. Directors underscored that exchange rate flexibility, alongside limited intervention in the foreign exchange market, should remain the primary tool for absorbing capital inflows. Additional tools, including strengthened macroprudential regulation and capital flow management policies, can play a role in the event that capital inflows threaten financial stability. Most Directors supported the policy intention to further improve reserve coverage.

Directors noted that the financial system is sound. Credit and asset market developments however should be closely monitored for overheating risks. Directors welcomed improvements in financial supervision, particularly recent measures to improve the coordination of information exchange, bank resolution, and the design of macroprudential regulation. Directors encouraged the authorities to complete their analysis of the composition of bank capital and liquidity under Basel III.

Directors urged the authorities to build on recent labor market reforms to lower unemployment and labor market informality. They welcomed the authorities' measures to improve incentives for firms to operate in the formal sector, but stressed the need to tackle remaining structural impediments including by broadening cuts in the still high labor taxation and addressing the binding minimum wage.

Colombia: Selected Economic Indicators

	2006	2007	2008	2009	Prel. 2010
(Annual percentage change, unless otherwise indicated)					
National income and prices					
Real GDP	6.7	6.9	3.5	1.5	4.3
Consumer prices (average)	4.3	5.5	7.0	4.2	2.3
Consumer prices (end-of-period)	4.5	5.7	7.7	2.0	3.2
Real effective exchange rate (depreciation -)	-1.0	7.7	0.4	5.2	5.5
Money and credit					
Broad money	18.0	17.4	18.5	8.1	11.5
Credit to the private sector	35.6	25.6	14.0	0.9	16.8
Interest rate (90-day time deposits; percent per year)					
Nominal	6.8	9.0	10.1	4.1	3.5
Real	2.3	3.3	2.4	2.1	0.3
(In percent of GDP, unless otherwise indicated)					
External sector					
Current account (deficit-)	-1.9	-2.9	-2.9	-2.2	-3.1
External debt	25.0	21.2	19.7	22.9	22.4
Of which: Public sector	16.4	13.7	12.5	15.9	13.6
GIR in percent of short-term debt	147.6	198.7	207.3	244.4	183.7
Savings and investment					
Gross domestic investment	22.4	23.0	23.4	22.7	22.5
Gross national savings	20.5	20.2	20.5	20.5	19.4
Public finances					
Combined public sector balance	-0.7	-0.7	-0.1	-2.7	-3.2
Central government balance	-3.4	-2.7	-2.3	-4.1	-3.8
Public debt 1/	36.8	32.7	30.8	36.3	36.4

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

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

Statement by María Angélica Arbeláez, Alternate Executive Director for Colombia July 20, 2011

On behalf of the Colombian authorities, I would like to thank staff for the constructive meetings held in Bogota. My authorities broadly agree with staff's assessment and policy recommendations and appreciate that marginal differences in perceptions with regard to some specific aspects were addressed in the staff report.

Economic outlook

The economic recovery began in 2010 and remains strong in 2011. After the solid performance of the economy in the first quarter of this year (5.1 percent year-on-year), the government and the central bank (Banco de la República, BR) recently raised their forecast from 4.5 percent to between 5 and 6 percent for 2011, and they expect the current negative output gap to close before the end of this year. As pointed out by staff, there are no clear signs of overheating, as no price bubbles have been observed in asset markets (e.g. housing, equity) and credit growth remains manageable. Nonetheless, macroeconomic policy strategy has shifted towards tighter monetary policy and a gradual exit from fiscal stimulus policy.

Fundamentals in the economy remain strong. In 2011, inflation is expected to be low (3.1 percent in December year-on-year according to the central bank's projections). The fiscal deficit will be close to 3 percent of GDP and the public gross debt around 36 percent of GDP. The current account deficit will narrow to 2.6 percent of GDP, financed mostly by FDI inflows, and the level of international reserves remains adequate. In addition, the credit rating on the sovereign debt was raised to investment grade, and the FCL has played a major role in providing protection against tail risks.

Looking ahead, Colombia's strong institutions coupled with a solid framework that has been put in place (e.g. inflation targeting, flexible exchange regime and an ambitious set of fiscal tools) will allow the government to maintain sound macroeconomic fundamentals. Nonetheless, many challenges remain, such as improving road infrastructure, bringing down unemployment and informality, and improving living conditions for a non-negligible part of the population. The government is taking concrete actions to address these issues and enhance competitiveness, with the medium-term objective of raising the potential growth rate, which today is around 4.5 percent.

Fiscal policy

Colombia has put in place a solid and comprehensive institutional framework in order to ensure discipline and debt sustainability, both at central and regional levels. In 1997 and 2000, three laws were enacted aiming to regulate the regions' indebtedness and to force fiscal discipline and transparency. With regard to the Central Government, The Fiscal

Responsibility and Transparency Law adopted in 2003—which includes a Medium-Term Fiscal Framework and a Medium-Term Expenditure Plan—set specific ceilings of fiscal deficit and financing, and establishes maximum levels of spending. In addition to that, and with the purpose of creating mechanisms for additional savings during boom periods, three ambitious reforms were recently approved by Congress: a) The Fiscal Rule, which limits the structural deficit of the Central Government, creates mechanisms to increase savings from the expected large growth in hydrocarbon export related revenues, and develops rules to manage countercyclical fiscal policies; b) The Fiscal Sustainability Legislative Act, which incorporates fiscal sustainability as a general principle in the Constitution; and c) The Royalties Reform, an amendment to the Constitution that mandates that both regional and central governments save a large amount of hydrocarbon royalties (30 percent). It also directs ways to distribute royalties more fairly among the regions, and seeks to enhance the spending efficiency of such royalties.

As staff has mentioned, the authorities are preparing the supporting legislation and are committed to passing it before 2012. In particular, concerning the Fiscal Rule, it is the highest priority for the Colombian government that the process of developing and monitoring key parameters for the rule is technically robust, transparent and independent, and is committed to acting accordingly. Moreover, the Fiscal Rule is perceived as an essential tool for fiscal discipline and the authorities will gradually reduce the Central Government's deficit until reaching the target of below 1 percent of GDP from 2022 onwards—as established by the Rule, which will be met through significant spending cuts independent of new tax reforms.

With respect to revenues, the authorities have acknowledged the need to improve the tax structure. Indeed, as mentioned in the staff report the new government enacted a tax reform in 2010, which eliminated some exemptions, broadened the tax base, and gradually dismounted distortionary taxes such as the financial transactions tax. Looking ahead, they see further room to improve the tax structure although through measures that stimulate private activity and reduce the informal economy. Tax adjustments could include broadening the tax base and reducing tariffs (the income tariff of 33 percent is extremely high compared to peers and competitors), and eliminating some VAT rebates. They expect significant results from such measures, as they will generate higher economic dynamism. The Colombian Ministry of Finance valued the recent Fund's TA mission on tax reform and shares some of the recommendations, and is designing a tax package that will be presented to Congress when they consider conditions are appropriate.

Over the short term, the fiscal adjustment in 2011 was delayed due to severe flooding in the country. The floods cost around 0.5 percent of GDP in 2011, and the total reconstruction costs are estimated to be between 2 and 3 percent of GDP. It must be noted that the authorities have tackled this negative shock by increasing taxes and reducing spending to ensure an unchanged fiscal stance, highlighting their commitment to fiscal stability.

Moreover, the budget for 2011 that was approved before the tax reform of 2010 was not modified according to the expected additional revenues. Therefore, the revenues driven by the reform—which have been higher than expected—combined with the spending lower than envisaged, will likely result in a lower deficit by around 0.4 percent of GDP than the one projected by the authorities (3.4 percent of GDP for the combined public sector). Should these circumstances materialized, and considering that the target for 2012 is a further significant reduction, the authorities perceive that the fiscal policy would not be pro-cyclical.

Monetary policy

The inflation targeting regime adopted in the late 1990s, has served the economy well, as it has brought down inflation significantly, has increased monetary policy credibility and has anchored inflation expectations, giving the authorities the flexibility and opportunity to react to the rapidly changing macroeconomic environment.

After two years of an accommodative monetary stance, that helped the country to cope with the global financial crisis, the BR started tightening monetary policy in 2011. Since February, it has raised its benchmark interest rate by 25 basis points every month, with the double objective of keeping inflation low/stable and smoothing the business cycle. The path toward a neutral monetary stance remains a precautionary and medium-term policy: in circumstances of high commodity prices and higher hydrocarbons' production, close vigilance is warranted in order to avoid overheating and potential financial imbalances. In the short run, despite contained inflation (3.2 percent year-on-year in June) and inflation expectations, the BR is carefully monitoring the evolution of asset prices and credit, and is prepared to act promptly should signs of overheating appear.

Capital inflows

Colombia is also fully committed to exchange rate flexibility. The authorities see the exchange rate as the most important shock absorber to mitigate the effects of the surge in capital inflows. As staff pointed out, capital inflows have continued to increase, mostly under the form of FDI, although recently portfolio flows have risen as well. The Colombian authorities believe this is a positive trend, but they recognize some potential effects associated with a surge in these inflows, such as financial instability and excess exchange rate appreciation. The main policy response that the central bank has used to contain excess appreciation in the currency has been the program of pre-announced daily purchases of foreign exchange (US$20 million per day). However, it is worth mentioning that besides correcting exchange rate misalignments, the main objective of interventions has been to build up international reserves. The central bank has found that this transparent, small and predictable intervention is more effective than a large-scale and unpredictable accumulation of international reserves. According to BR's analyses, interventions have been effective, especially when the amounts were fixed and when the exchange rate was excessively low (misaligned). There are two reasons for that, first because the likelihood of misalignment is higher and second because interventions with fixed amounts are not a signal of defending a specific level that the markets could subsequently attack.

Looking ahead, and should inflows keep rising, the policy response will depend on the nature of these inflows (private sector external indebtedness is being closely monitored) and whether the impact is mainly on the exchange rate or on the broader stability of the financial system. Given the complexity of this situation, the BR's purpose is to clearly identify the problem and adopt the adequate solution.

Unemployment, informality and poverty

High structural unemployment rate is one of the major challenges for the Colombian government. The economic downturn of 2008 entailed an increase in unemployment, after several years of reduction. However, improvements have been observed in 2011: the unemployment rate in May was 11.1 percent compared to 12 percent in May of 2010, and the decline was especially strong in rural unemployment which went down from 8.6 percent to 7.5 percent. In addition, the quality of labor has enhanced, as salaried employment has grown while non-salaried has declined.

The authorities recognize that labor costs are high in Colombia, but several studies show that their reduction may have a limited impact on employment creation, aside from being politically difficult. Under these circumstances, the strategy to tackle unemployment—and bringing it down to one digit—gives weight to the promotion of larger-scale economic activity (focused on labor intensive sectors such as road infrastructure and agriculture). Nonetheless, the authorities have also taken steps to reduce labor costs and incentive formalization. The Formalization and First Employment Law was recently enacted, which dictates the reduction of labor taxes with the view to promote formalization of small businesses and to stimulate employment for youth, where unemployment is concentrated. Although the law is still new, its impact has been remarkable: it is estimated that around 400,000 small and medium businesses were formalized.

Finally, successive Colombian governments have been doing strong efforts to reduce poverty and have put in place several programs, including subsidies and targeted assistance schemes. Indeed, although still high, it has substantially decreased over the past years. Using the standard and comparable index of poverty based on income used by the World Bank—defined as the percentage of the population living with less than USD 2.5—we observe that poverty has declined from around 20 percent in 2000 to 16.4 percent in 2009 (close to Latin American average) and the goal of the government is to reach 9.0 percent in 2014. Other calculations of poverty using different methodologies show different figures. In the chart presented by staff in Box 3, the poverty index of each country is defined domestically therefore they are not comparable. Indeed, the poverty line defined as the value of the basic market basket in Colombia (as well as in Mexico) almost double the value used in other Latin

American countries; therefore the rate of poverty appears to be much higher. Nonetheless the government acknowledges that poverty is still high and all efforts are focused on attaining a more balanced and pro-poor growth.