INTERNATIONAL MONETARY FUND

IMF Country Report No. 13/35

COLOMBIA

2012 ARTICLE IV CONSULTATION

February 1, 2013

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 2012 Article IV consultation with Colombia, the following documents have been released and are included in this package:

- **Staff Report** for the 2012 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on November 16, 2012, 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 January 8, 2013. 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.
- **Staff Statement** of January 23, 2013.
- **Informational Annex** prepared by the IMF.
- **Public Information Notice** (PIN) summarizing the views of the Executive Board as expressed during its January 23, 2013 discussion of the staff report that concluded the Article IV consultation.
- **Statement by the Executive Director** for Colombia.

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

Financial System Stability Assessment (FSSA)

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

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STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION

January 8, 2013

KEY ISSUES

Context. Following buoyant economy activity in 2011, growth is moderating to potential, largely reflecting the lagged impact of countercyclical policies and weak external demand. Inflation remains subdued. A cabinet reshuffling in early September and ongoing peace negotiations have provided a renewed momentum to structural reform initiatives**.**

Policy stance is broadly appropriate. The 2013 budget is in line with medium-term fiscal consolidation plans. Monetary policy remains broadly neutral, with ample room for easing if growth surprises on the downside. The central bank continues to strengthen its international reserves position gradually, and strong FDI inflows continue to exert pressure on the exchange rate.

Risks. Direct linkages to foreign banks (including from Europe) are limited, but Colombia is vulnerable to a sharp growth slowdown in trading partners, a steep drop in oil prices, or a sharp rise in global risk aversion. The flexible exchange rate, the comfortable level of international reserves reinforced by the FCL arrangement, and low ratios of external and public debt provide adequate buffers.

Medium-term. Key medium-term challenges are to sustain stable and inclusive growth with macroeconomic stability, while avoiding overdependence on the volatile commodity sector. Addressing these challenges would require reforms to boost competitiveness and productivity and increase national saving. Reforms should focus on (i) reducing the high rates of informality and structural unemployment, including through the envisaged tax and pension reforms; (ii) adhering to fiscal consolidation (while closing the infrastructure gap); and (iii) preserving financial stability and promoting financial deepening.

Approved By
Miguel A. Savastano and Lorenzo Giorgianni

Discussions took place in Bogotá during November 6–16. The team comprised Valerie Cerra (Head), Teresa Daban Sanchez, and Mercedes García-Escribano (all WHD), and Toshiyuki Miyoshi (SPR). Maria Angelica Arbeláez (OED) attended some of the meetings. Robert Rennhack (MCM) joined the end of the mission. The team met with senior government and central bank officials, and representatives from the business community.

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BACKGROUND

A. Context

1. **Colombia's economy has been resilient to the adverse global shocks of recent years.** A very strong policy framework—anchored by an inflation-targeting regime, flexible exchange rate, effective financial supervision and regulation, and a medium-term fiscal framework—and skillful policy management provided the authorities with policy space to undertake timely and effective countercyclical measures following the global crisis of late 2008. Growth slowed significantly in 2009, but output rebounded strongly in 2010 supported by sound macroeconomic policies. Reflecting these achievements and a marked improvement in security and confidence, Colombia's sovereign debt regained investment grade status in 2011. Financial stability has been underpinned by a resilient banking system and sound framework for regulation and supervision.

2. **The authorities' macroeconomic policies over the past year have been broadly in line with Fund advice.** As recommended by Directors at the conclusion of the 2011 Article IV Consultation, fiscal and monetary policy stimulus was gradually unwound to stave off overheating pressures. The authorities also advanced reforms to bolster the fiscal policy framework, strengthened financial sector regulation and supervision, and maintained a rules-based system of foreign exchange intervention.

3. **On May 4, 2012, the Executive Board completed its review and reaffirmed Colombia's continued qualification to access resources under the Flexible Credit Line (FCL) arrangement.** Directors agreed that the two-year FCL arrangement for 500 percent of quota, approved on May 6, 2011 in the context of heightened external risks, has supported the authorities' macroeconomic strategy, providing insurance against global tail risks. Directors also noted that despite the downside risks stemming from lingering global uncertainty, Colombia had maintained ample policy space to mitigate the potential fallout from adverse shocks, and the authorities remained committed to adjust policies as needed within their rules-based framework.

4. **Exchange system and data.** Colombia has a floating exchange regime (de jure and de facto). Colombia maintains an exchange restriction subject to Fund approval under Article VIII arising from the special regime for the hydrocarbon sector. Data provision is adequate for surveillance.

B. Recent Developments

5. **Growth moderated in 2012, reflecting countercyclical policies adopted the previous year, tepid external demand, and supply shocks.** As real GDP growth surged to nearly 6 percent in 2011 and the output gap closed, the central bank raised the policy rate from 3 percent to 5.25 percent between end-2010 and February 2012. Ripple effects from a weak external environment and unexpected supply shocks (e.g., disruptions in oil production related to the guerrilla attacks) also dampened economic activity. Manufacturing and retail sales slowed, and

consumer and business confidence declined. Output growth in 2012 is projected at 4.3 percent, supported by the acceleration in budget execution during the second half of the year.

6. **Inflation has been subdued, but unemployment remains high**. After peaking at 4 percent in late 2011, headline inflation fell to 2.8 percent (y-o-y) in November 2012, reflecting the unwinding of transitory supply factors (e.g. adverse weather conditions), the normalization in policies, and lower increases of administered prices. Inflation expectations have remained anchored at 3 percent (the midpoint of the official inflation target band). Strong economic growth in recent years has led to an increase in labor participation rates and a decline in unemployment (from more than 17 percent in 2002), but the unemployment rate remains high (nearly 10 percent).

7. **Credit growth has eased.** Banking credit to the private sector expanded at about 19 percent in real terms in 2011, among the highest in the region (Annex II). Strong aggregate demand and the entry of retail-lending-oriented foreign banks may have played a role in fueling strong growth in consumer credit. In response, in May 2012, the authorities increased provisioning requirements on consumer loans. As a result of this measure and the monetary tightening in 2011, credit growth slowed from 23.5 percent y/y in September 2011 to 16.1 percent y/y in September 2012.

8. **Financial soundness indicators are relatively strong.** The banking system is well-capitalized and profitable, and nonperforming loans remain low (2.9 percent at end-October 2012) and well-provisioned (Figure 4), although concentration risk remains a source of fragility. In November 2012, the authorities intervened and liquidated assets of the largest brokerage firm, Interbolsa, after it failed to meet a loan repayment; the authorities indicated that losses were small and did not pose systemic risk. Nonetheless, to prevent contagion, the central bank created a temporary liquidity facility for other brokerage firms.

9. **The strong balance of payments, particularly FDI inflows, continues to put upward pressure on the peso.** Despite high export prices and the moderation in growth, the external current account deficit remained broadly unchanged at 3 percent of GDP during 2012, reflecting the strong demand for investment-related imports, and large profit repatriations by foreign firms. That said, the current account deficit continues to be more than offset by a sizable surplus in the financial account largely driven by net FDI inflows. Reflecting this, the surplus in the balance of payments is likely to be close to US$5.2 billion (US$3.8 billion in 2011) and the nominal exchange rate appreciated by about almost 7 percent through November 2012.

10. **The macroeconomic policy stance during 2012 was broadly neutral.** Amidst a slightly more pronounced economic slowdown than anticipated, the central bank lowered the policy rate by 75 bps in the second half of the year. In addition, it extended its program of daily purchases of foreign exchange (of at least US$20 million) until March 2013. Fiscal consolidation, as measured by the structural balance, is estimated to have been somewhat stronger than envisaged in the medium-term fiscal framework, reflecting higher tax revenues (linked to windfall gains in the oil-sector in 2011) and lower-than-expected expenditures. Measured in terms of the non-oil balance (a metric

that captures better the effects of fiscal policy in commodity-producing countries), the fiscal stance is estimated to have been broadly unchanged.

C. Outlook and Risks

11. In 2013, growth is expected to rise to potential and inflation to remain on target. Higher public investment spending, favorable export prices and continued large FDI inflows are expected to sustain a moderate expansion in domestic demand, with growth envisaged to settle at about staff's estimate of Colombia's potential growth rate (4½ percent). Staff projects that inflation will remain close to the mid-point of the central bank's 2−4 percent inflation target range. The external current account deficit is expected to remain at about 3 percent of GDP.

12. Short-term risks to the outlook continue to be tilted to the downside owing to global uncertainties. Colombia has not been significantly affected by the financial turmoil in Europe, as direct financial linkages are limited (Annex I). However, it remains vulnerable to a sharp intensification of the global downturn (e.g., through a worsening of the euro area crisis, an unsatisfactory resolution of the U.S. fiscal cliff, or a hard landing in China) and to a steep drop in oil prices (which could adversely affect Colombia's commodity exports, remittances, and FDI). In addition, a sharp rise in global risk aversion could increase Colombia's risk premium, dent confidence, and slow economic growth. Domestic credit growth, albeit still at a high level, has declined significantly during 2012, dissipating concerns of overheating pressures. Mitigating factors of high credit growth include the low level of financial deepening and household debt, resilient corporate balance sheets, and low risks of currency mismatches in banks (Annex II).

13. The authorities broadly agreed with the outlook and characterization of key risks. Staff forecasts of actual and potential growth are in line with those of the central bank and the consensus of market analysts. However, the government expects the economy to grow by 4.8 percent in 2012−13, buoyed by strong public investment. The government also considers that Colombia's potential growth rate has risen to about 5 percent as a result of high investment rates in recent years.

Colombia: Risk Assessment Matrix 1/

	Up/Down Side	*Risks*	*Impact*	*Policy Advice*
U.S. fiscal cliff (political gridlock in early 2013 leading to a compromise involving excessive austerity)	↓	L	M	Consider lowering interest rates to support domestic demand and use exchange rate flexibility
Strong intensification of the euro area crisis (incomplete delivery of policy commitments leading to yield reversal)	↓	M	M	Intervention in forex market to smooth volatility and provision of liquidity through central bank facilities
Further slowdown in Emerging Markets (including a further growth shock in China permeating through commodity prices)	↓	L	H	Use the exchange rate and international reserves as shock absorbers, and consider lowering interest rates to support domestic demand
Continued high credit growth rates and upward trend in house prices	↑	L	M	Adopt prudential measures tailored to the risk profile of financial institutions

1/ This matrix reflects staff's views on the source of risks and overall level of concerns as of the time of discussions with the authorities.

POLICY DISCUSSIONS

Discussions focused on the macroeconomic policy mix for 2013 and on policies and reforms to sustain strong and inclusive growth, while preserving macroeconomic stability. These include pending fiscal reforms, including to the tax and pension systems, measures to strengthen financial supervision and regulation, and policies aimed at reducing structural unemployment and labor market informality.

A. Near-Term Policy Mix

14. The broadly neutral macroeconomic policy stance expected for 2013 seems adequate. Staff noted that the 2013 budget is in line with the government's medium-term fiscal consolidation plans and includes a welcome increase in public investment on infrastructure. Combined with a policy interest rate that is near or below the neutral rate, the policy stance is conducive to output expanding at its potential rate and inflation remaining within the 2−4 percent target range. The authorities agreed, but considered that the economy had slowed more than expected in 2012. Weak global conditions depressed external demand for Colombia's exports, especially in the manufacturing and agricultural sectors, underscoring the central bank's decisions to cut policy interest rates in the second half of the year. The authorities stressed that inflation expectations remain well anchored at 3 percent.

15. There was agreement that Colombia is well-positioned to cope with downside risks. The authorities agreed that there are ample buffers to absorb adverse shocks. Monetary policy and the flexible exchange rate would remain key shock absorbers. International reserves are at relatively comfortable levels, reinforced by the FCL arrangement, and the ratios of external and public debt are low. With inflation projected close to the target, staff advised that further monetary easing could be considered if downside risks materialize, but noted that discretionary fiscal expansion should be considered only if the growth slowdown is too large.

B. Enhancing External Stability

16. The authorities agreed that Colombia's overall external position was relatively strong. The government has accessed international capital markets at increasingly favorable terms and the current account deficit is predominantly financed by stable FDI inflows (Annex III). The external debt ratio remains low and is expected to decline over the medium term (Figure 8), reflecting low borrowing from corporations, banks and the public sector. Colombia's international investment position has improved over the decade, and the share of FDI is high compared to peer countries. The level of international reserves is relatively comfortable, according to several metrics (Figure 6).

17. The real exchange rate appreciation and persistent current account deficits in recent years mainly reflect underlying fundamentals. The results of the Fund's pilot External Balance Assessment (EBA) exercise indicate that an improvement in terms of trade and other fundamentals have driven much of the appreciation in the real exchange rate since 2004 (Annex III). EBA results nonetheless suggest that the current account deficit is larger, and the real exchange rate is more appreciated (by 1−8 percent), than levels that can be explained by fundamentals and desirable policies. Staff considers that taking into account key country-specific factors (such as the large profit repatriations by multinationals investing in Colombia and the strong import demand associated with the recent expansion in exploration and development of the oil and mining sectors), the current account and the real exchange rate are broadly in line with fundamentals.

18. The authorities also are of the view that the exchange rate is broadly in line with fundamentals. They noted that the results of the EBA exercise for Colombia yield large unexplained residuals and the central bank's models indicate that exchange rate overvaluation is at most 10 percent. They emphasized that the current account deficit has been stable, and comfortably financed by FDI inflows, limiting vulnerabilities.

19. There was agreement that domestic policies can play a role in containing appreciation pressures and improving the current account. The authorities plan to improve the fiscal balance over time and lower the structural balance to 2.3 percent by 2014, but staff argued that a faster pace of consolidation could help further mitigate appreciation pressures. The authorities noted that the recent reform of the royalty system would also contribute to increasing national savings. They also emphasized that factors different from the exchange rate were critical for competitiveness. In this regard, they viewed reforms to reduce labor market informality and an improvement in the country's infrastructure as key to raising productivity and export potential. Agricultural reforms and measures to enhance the business environment and security also would be important. The authorities also highlighted their recent efforts to diversify export markets and products by negotiating free trade agreements with several trading partners.

20. The central bank's intervention policy is geared at containing exchange rate volatility and strengthening external buffers. Staff supported the goals of reducing volatility and gradually building international reserves in line with the growth of trade and economic activity, and noted that those objectives were consistent with the inflation targeting framework.[1] Staff argued, and the authorities concurred, that although intervention in the foreign exchange market may slow the pace of nominal appreciation, it would not be effective in altering the path of the equilibrium real exchange rate. Staff advised the government to communicate clearly that its recent foreign asset purchases were part of the asset management strategy associated with the royalty reform (¶23), and not an attempt to influence the level of the exchange rate.

21. Colombia's exchange restrictions have changed since the last Article IV consultation. The multiple currency practice and exchange restriction arising from a tax on outward remittances of nonresident profits earned before 2007 and retained in the country for less than five years phased out on January 1, 2012. However, the authorities have no plans to remove the exchange restriction

[1] The issuance of Treasury bills to sterilize the foreign exchange intervention operations made by the government as part of its asset management strategy have been coordinated with the central bank. Proceeds from the issuance of Treasury bills for this purpose will be deposited in a government account at the central bank.

arising from the special regime for the hydrocarbon sector, in which branches of foreign corporations are required to either surrender their export proceeds or agree to a government limitation on their access to foreign exchange. The authorities noted that the special regime serves to minimize foreign exchange volatility and that participation in the special regime is voluntary, and bestows advantages such as the simplification in reporting requirements of the offshore foreign exchange operations of those branches. While Colombia is free under the Articles to impose surrender requirements and to exempt the application of these requirements, conditioning such exemptions to the acceptance of limitations on the availability of foreign exchange for the making of current payments and transfers for current international transactions is inconsistent with a member's obligation under Article VIII, Section 2(a) of the Fund's Articles. This obligation cannot be modified or contracted away by members in agreement with third parties.

C. Strengthening the Fiscal Policy Framework

22. The authorities are committed to continue strengthening Colombia's fiscal framework. Constraints on sub-national fiscal balance were introduced during the late 1990s, and a fiscal responsibility law (underpinning the formulation of a medium-term fiscal framework) was approved in 2003. In 2011, the government adopted reforms to strengthen the management and distribution of oil and mining royalties, added a fiscal sustainability principle as a constitutional criterion, and enacted a fiscal rule on the central government balance that would lower the structural deficit to 2.3 percent of GDP by 2014 and keep it below 1 percent from 2022 onwards.[2] In 2012, the government outlined its debt management strategy, focused on minimizing risks and costs, with a composition tilted towards domestic debt. The momentum for structural fiscal reform initiatives has gathered further steam, following the cabinet reshuffling in early September and the peace negotiations with the insurgence group launched in October.

23. The implementation of recent fiscal reforms is on track. As mandated by the new oil and mining royalty regime, in 2012 the government formulated a bi-annual royalty-funded capital budget and created investment committees to approve viable projects. In addition, the government made the initial contribution to a savings fund to smooth regions' royalty-related spending, through the purchase of US$500 million in the foreign exchange market. In mid-2012, the government created two technical committees that will provide inputs on the output gap and structural oil prices to the Consultative Committee charged with devising the methodology and other operational aspects of the structural fiscal balance rule for the central government (Annex IV) to ensure the full implementation of the rule in 2013. Staff recommended prudence in the choice of structural oil prices to make those calculations, arguing that a sharp and persistent decline in oil prices was a key risk to the fiscal position.

[2] The authorities have received technical assistance from the IMF to further improve their framework in a number of areas, including fiscal rule, the fiscal regime for oil and mining, revenue administration, and pension reform.

24. Staff advised adopting more ambitious targets for medium-term fiscal consolidation. The authorities considered that the pace of fiscal consolidation implied by the structural balance targets is sufficient to continuing reducing the public debt ratio and preserve fiscal sustainability. Staff agreed, but argued that a more ambitious medium-term target could help ease pressures on the currency, as well as build buffers against adverse commodity price shocks and potential exhaustibility of commodity resources.

25. Staff recommended that fiscal consolidation focuses on revenue mobilization. The government's medium-term fiscal framework projects a decline in revenue ratios over time, largely as a result of the scheduled phasing out of the financial transactions tax and the wealth tax starting in 2014. This decline in the revenue ratio is to be offset by lower capital spending, despite the existing infrastructure gap, high inequality and the need to raise productivity in the medium-term. Staff stressed the importance of more than offsetting this decline in order to increase the non-commodity revenue ratio (which is among the lowest in the region). It noted that higher non-commodity revenues would help create fiscal space for the much-needed increase in public infrastructure and help reduce the budget's exposure to oil price swings.

26. Congress recently approved a comprehensive tax reform. The authorities are confident that the replacement of payroll taxes (*parafiscales*) with a component of the corporate income tax contained in the proposal will reduce non-wage labor costs and spur employment creation. In addition, the tax reform proposal would simplify and improve fairness in personal income taxes and reduce the number of VAT rates. More generally, the proposal aims at improving the income distribution, curbing incentives to remain in the informal sector, facilitating tax administration and enhancing compliance. The authorities emphasized that reforms to the structure of the tax system were more pressing than increasing the revenue intake, because reducing labor informality and unemployment were key planks of the government's strategy (Annex V). They also noted that by raising employment and long-term growth, the tax reform would eventually increase revenues.

27. Staff agreed with the authorities' intention to reform the public pension system to improve coverage and fairness. Current parameters of the public pension system and constitutional restrictions on minimum contributions and benefits significantly limit coverage and skew pension access to the high income pensioners. The government is considering options for reform, as well as other initiatives to support elderly low-income workers. Staff noted that the new government-subsidized savings program (BEPS) for informal workers was useful, but would not be a sufficient solution. Staff also advised reviewing the health care system to ensure that costs are contained and to encourage participation in the contributory regime.

D. Preserving Financial Stability

28. As discussed in the companion Financial System Stability Assessment, the financial health of Colombia's credit institutions appears sound. Credit quality is strong and banks are quite profitable, largely because borrowers have strong balance sheets. Funding is stable, relying mostly on domestic deposits and only minimally on short-term wholesale funding. The stress tests show that Colombian banks appear resilient to a variety of shocks, although some vulnerabilities do arise from the high concentration of the commercial loan portfolio to large corporate borrowers. The FSAP noted that fostering capital and money market deepening and promoting financial inclusion would help reduce concentration risk. Nonbank financial intermediaries generally have been performing well.

29. All financial institutions are effectively supervised by the Financial Superintendency of Colombia (SFC). The broad authority of the SFC offers several critical benefits, including the ability to develop a common supervisory framework for the financial sector, secure information on financial groups, and contain regulatory arbitrage. Because of the broad regulatory perimeter, there are several critical supervisory issues that apply to all financial institutions. In particular, the SFC has considerable de facto independence to undertake operations required by its mandates, and the supervisor carries out his functions with no political interference. However, its de jure independence could be strengthened. Also, the SFC would benefit from the adoption of a law extending its full regulatory and supervisory powers to holding companies of financial institutions and the extension of legal protection for good faith actions taken in discharging official duties. The adoption of a Basel II, Pillar II supervisory review process would give the SFC a clearer mandate to tailor prudential norms to the risks of each bank. In addition, the financial safety net could be strengthened by shortening and clarifying the resolution process and developing an action plan to deal with systemic events.

STAFF APPRAISAL

30. Colombia's economic performance in recent years has been very strong. The economy has been resilient to adverse shocks, growth rates have been relatively high and stable, and inflation has been low. The cornerstone of these achievements has been a strong policy framework, prudent macroeconomic management, and a sound and well-supervised financial system.

31. Macroeconomic performance remained favorable in 2012. The moderation of growth is largely a result of the prudent countercyclical policies adopted to tame high credit growth and overheating pressures in 2011 and weak external demand.

32. The broadly neutral policy stance planned for 2013 is appropriate. The output gap is closed and output growth is expected to converge toward its potential rate of 4½ percent in 2013. Moreover, inflation remains subdued and expectations well anchored at the midpoint of the inflation target band.

33. There is ample space to adjust policies if downside risks materialize. Spillovers from the global turmoil have been limited so far, but Colombia is vulnerable to a sharp worsening in the external environment. Monetary policy retains room for easing if growth surprises on the downside, and the flexible exchange rate should continue to serve as a shock absorber. A comfortable level of international reserves reinforced by the FCL arrangement, and low ratios of external and public debt provide additional buffers.

34. Despite strong recent economic performance, medium-term challenges remain. The economy and public finances are becoming increasingly dependent on the volatile oil and mining sectors. Moreover, despite strong growth, unemployment and income inequality remain high and labor productivity low. Addressing these challenges will require decisive actions to boost competitiveness, reduce the high rates of informality and structural unemployment, increase national saving, and diversify exports.

35. The external position has been stable. The current account and the real exchange rate are broadly in line with fundamentals. The current account deficit is expected to remain comfortably financed by large FDI inflows to the hydrocarbon sector. These inflows and related imports, rather than flows driven by short-term factors, are the principal source of exchange rate appreciation. In view of this, medium-term reforms and fiscal consolidation would be key for boosting competitiveness and productivity, raising national saving, and easing appreciation pressures. The central bank's strategy of gradual preannounced purchases of foreign exchange is appropriate for continuing to strengthen the external position. The government should communicate clearly that its recent foreign asset purchases were part of an asset management strategy and not an attempt to influence the level of the exchange rate.

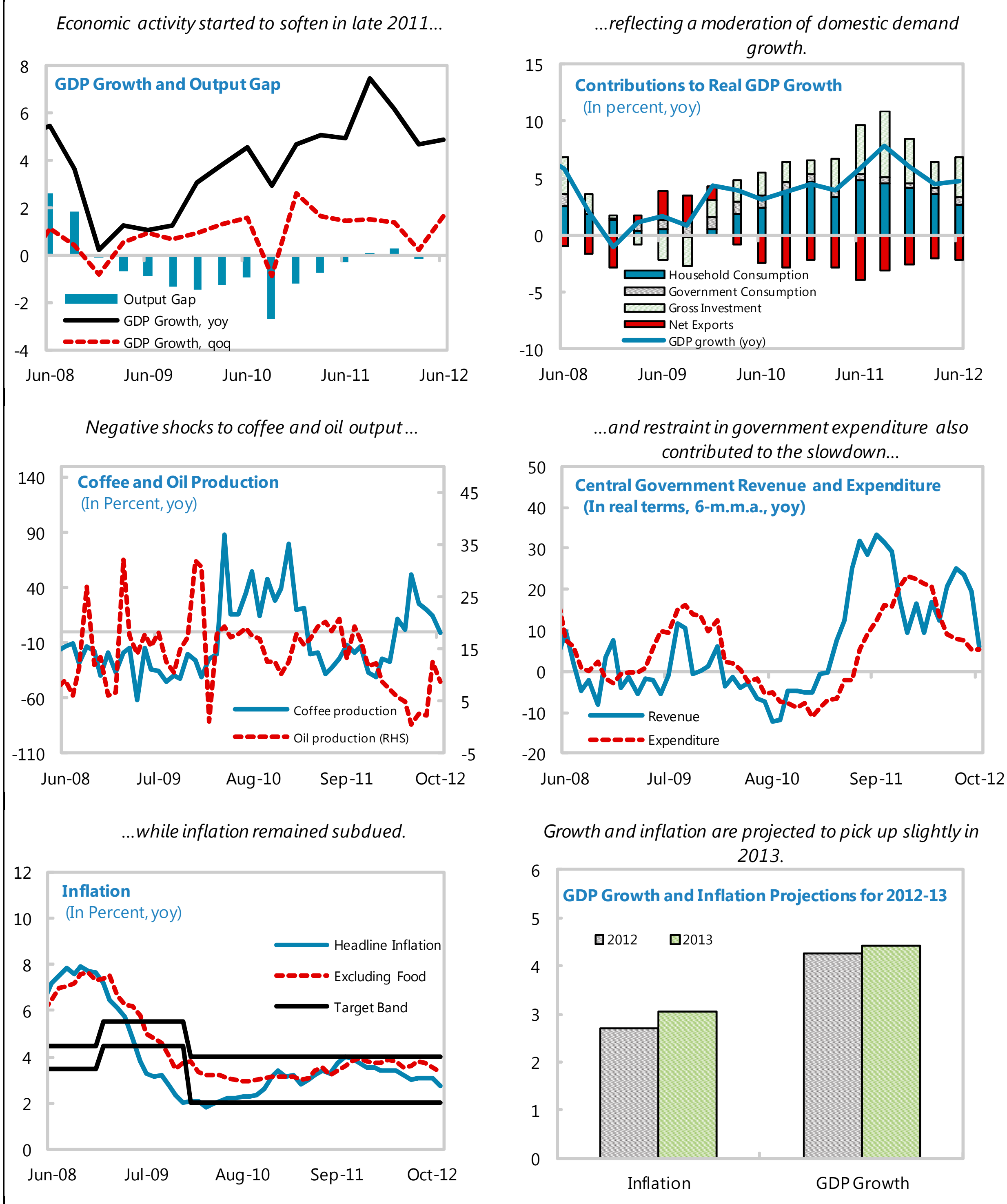
36. Fiscal consolidation over the medium term could be more ambitious, and focused on revenue mobilization. A faster pace of fiscal consolidation or more ambitious fiscal target could help mitigate pressure on the currency, and further build buffers against adverse shocks. An increase in non-commodity revenues would ensure fiscal space for public investment in infrastructure, and help reduce the budget's exposure to oil prices swings.

37. Staff welcomes the tax reform recently approved by Congress and the plans for pension reform. The measures to reduce non-wage labor costs, lower the regressivity of the tax system, and facilitate compliance go in the right direction. Staff also supports the plans to increase coverage and fairness in the pension system, further reducing incentives for informality.

38. The financial system appears resilient to a wide range of shocks and is effectively supervised, although there is scope for further improvements. In particular, further efforts would be useful to improve the risk-based approach to supervision in line with Pillar 2 of the Basel II framework, promote the independence and legal protection of supervisors, strengthen the financial safety net, guard against concentration risks, and extend supervisory and regulatory powers to holding companies of financial institutions.

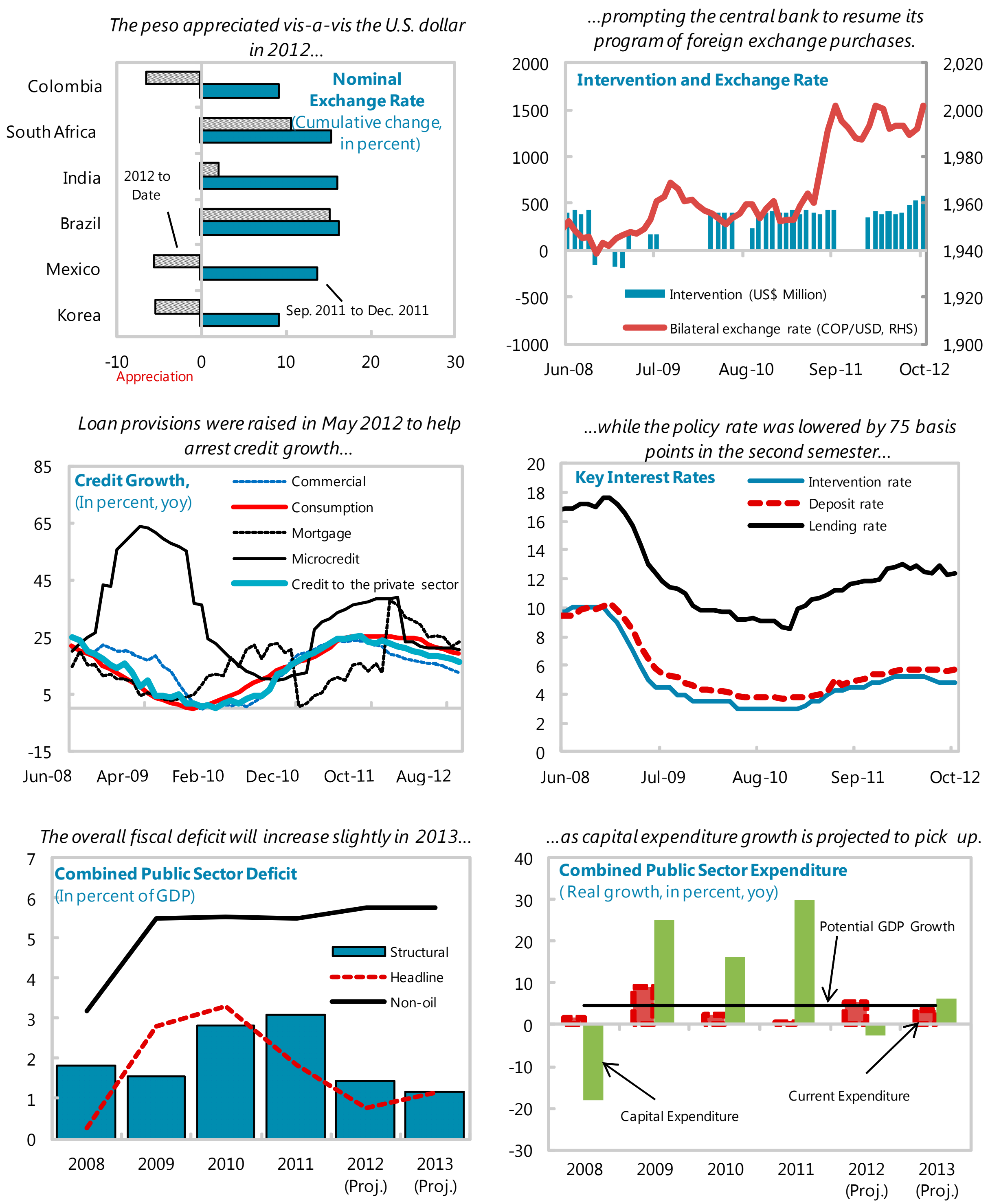
39. Staff recommends that the next Article IV consultation takes place on the standard 12-month cycle.

Figure 1. Colombia: Recent Economic Developments and Outlook



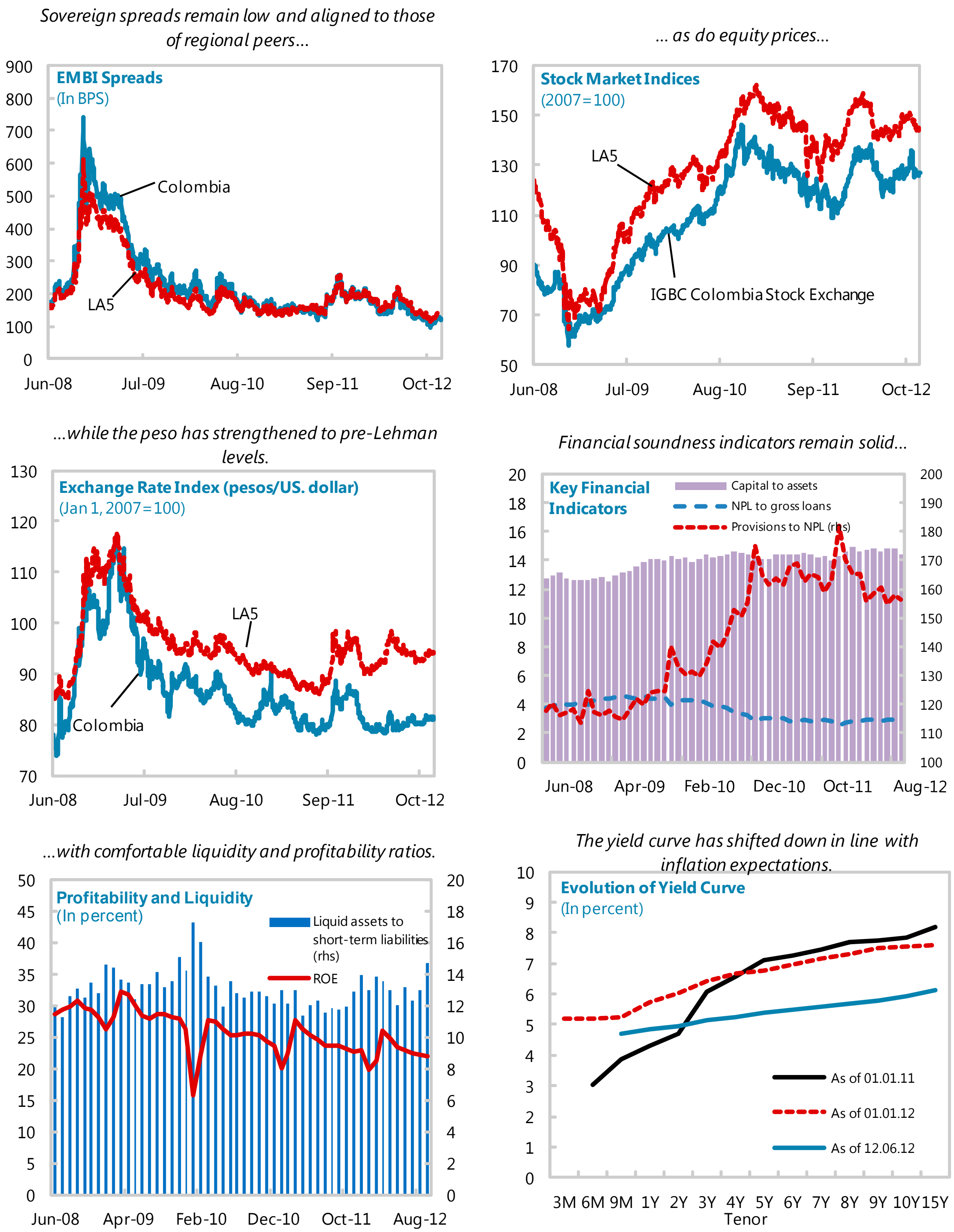
Sources: DANE; Central Bank of Colombia via Bloomberg and Haver.

Figure 2. Colombia: Macroeconomic Policies



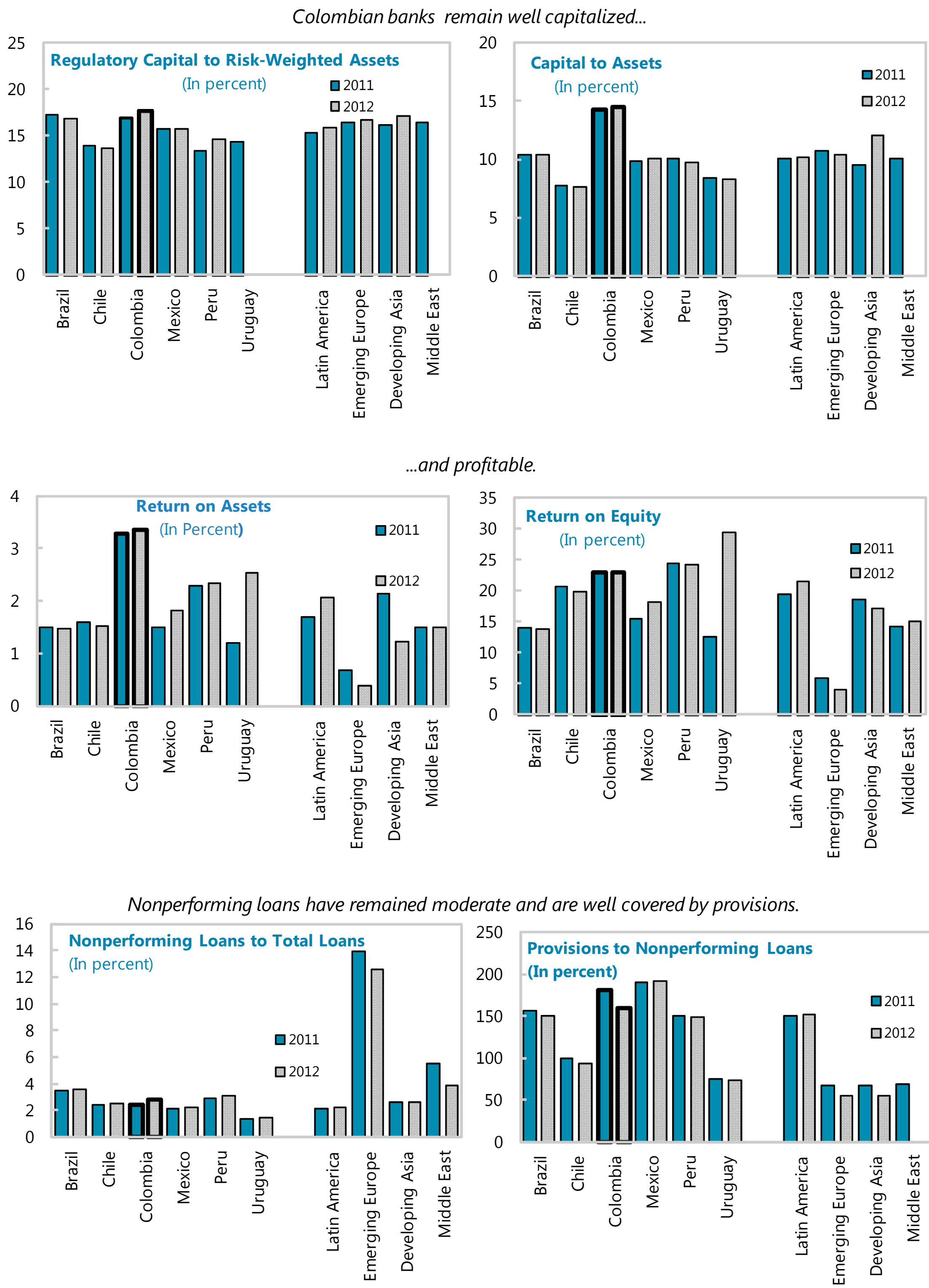
Sources: Superintendencia Financiera de Colombia, Central Bank of Colombia; DANE; Haver; and Bloomberg.

Figure 3. Colombia: Financial Market Developments 1/



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

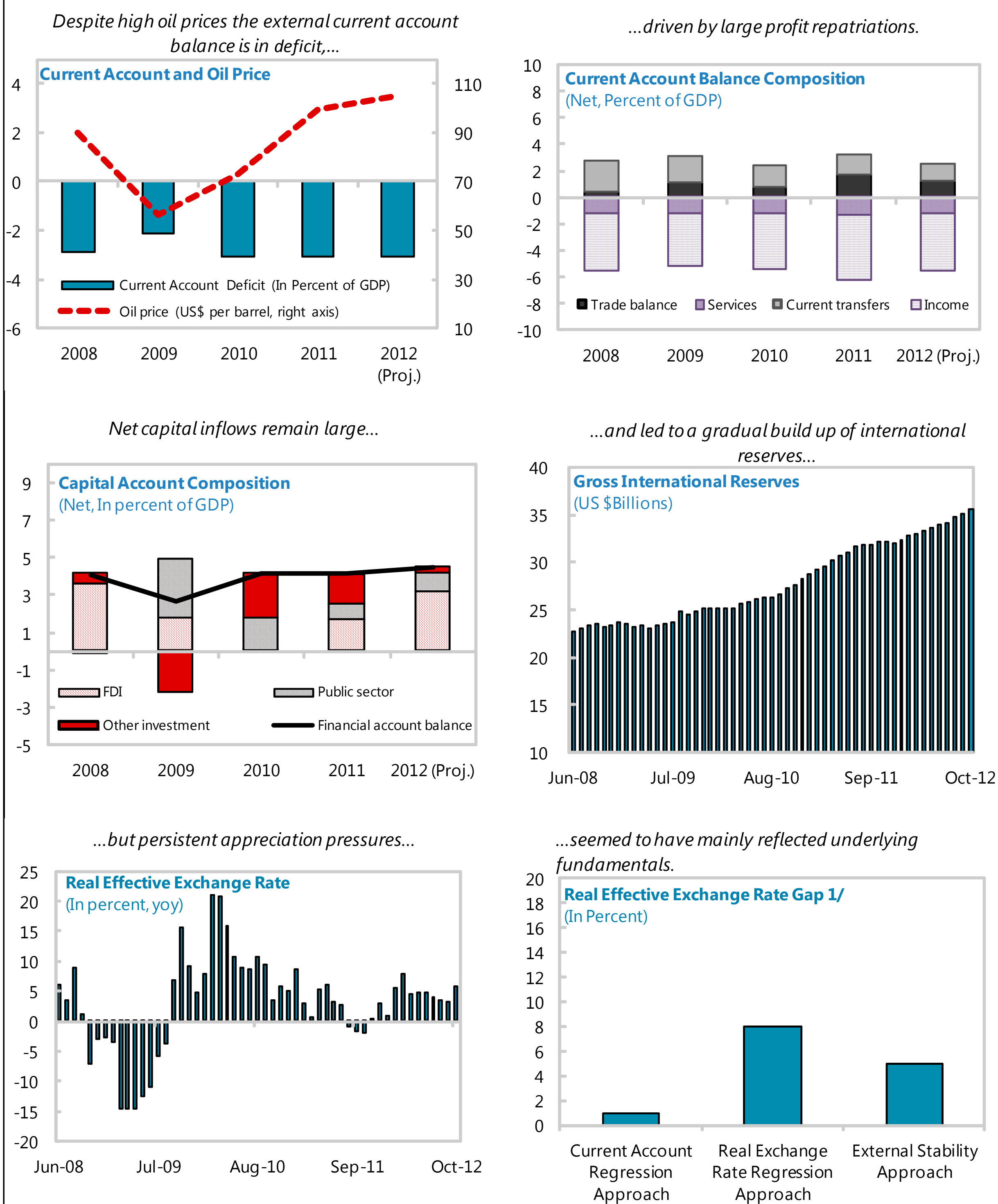
Figure 4. Financial Soundness Indicators: Colombia and Other Emerging Markets 1/



Source: October 2012 GFSR Statistical Appendix.

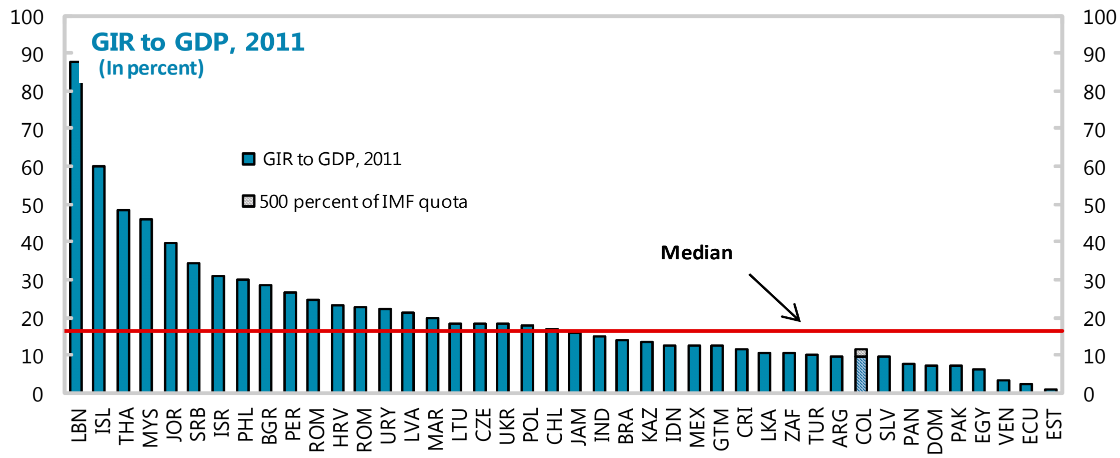
1/ Data on Regulatory Capital to Risk-Weighted Assets and Capital to Assets for the Middle East are unavailable for the year 2012.

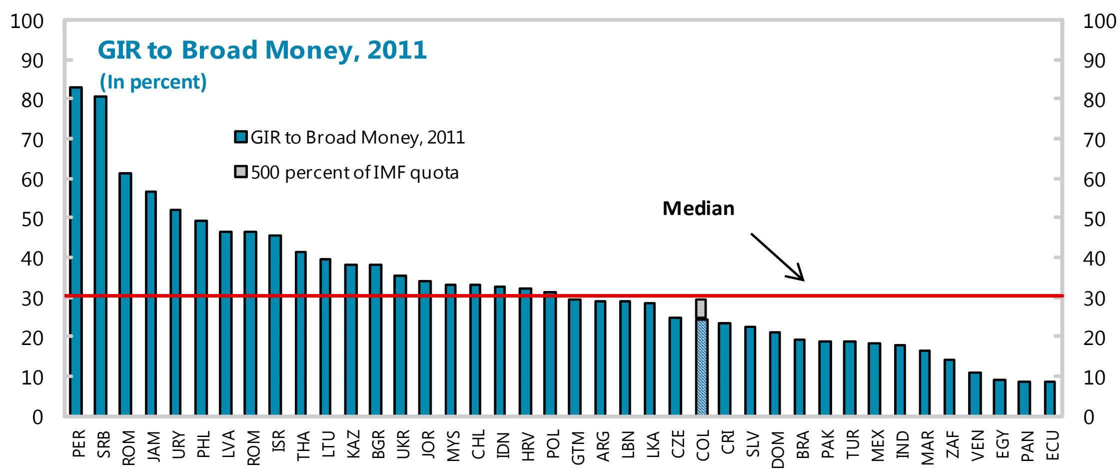
Figure 5. Colombia: External Stability

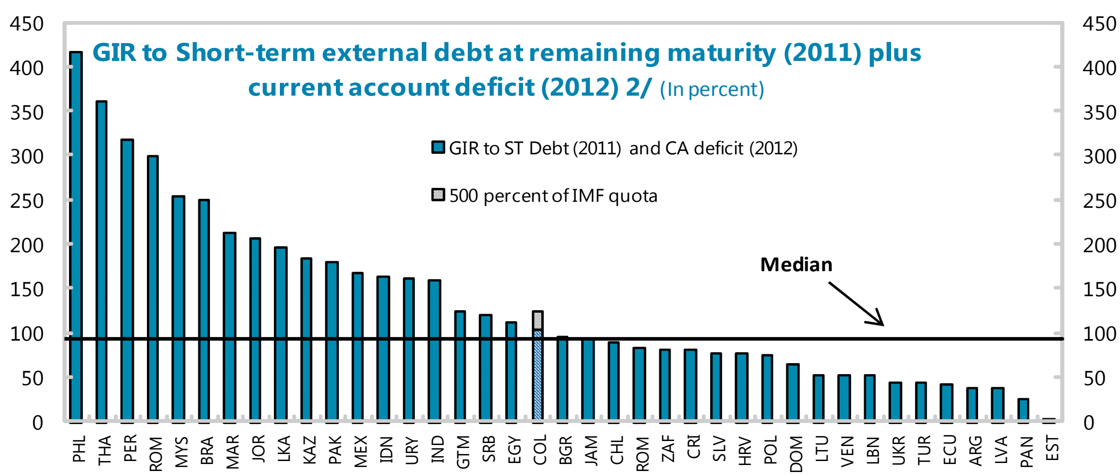


Source: Central Bank of Colombia; World Economic Outlook; and Fund staff estimates.
1/ See Annex III.

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





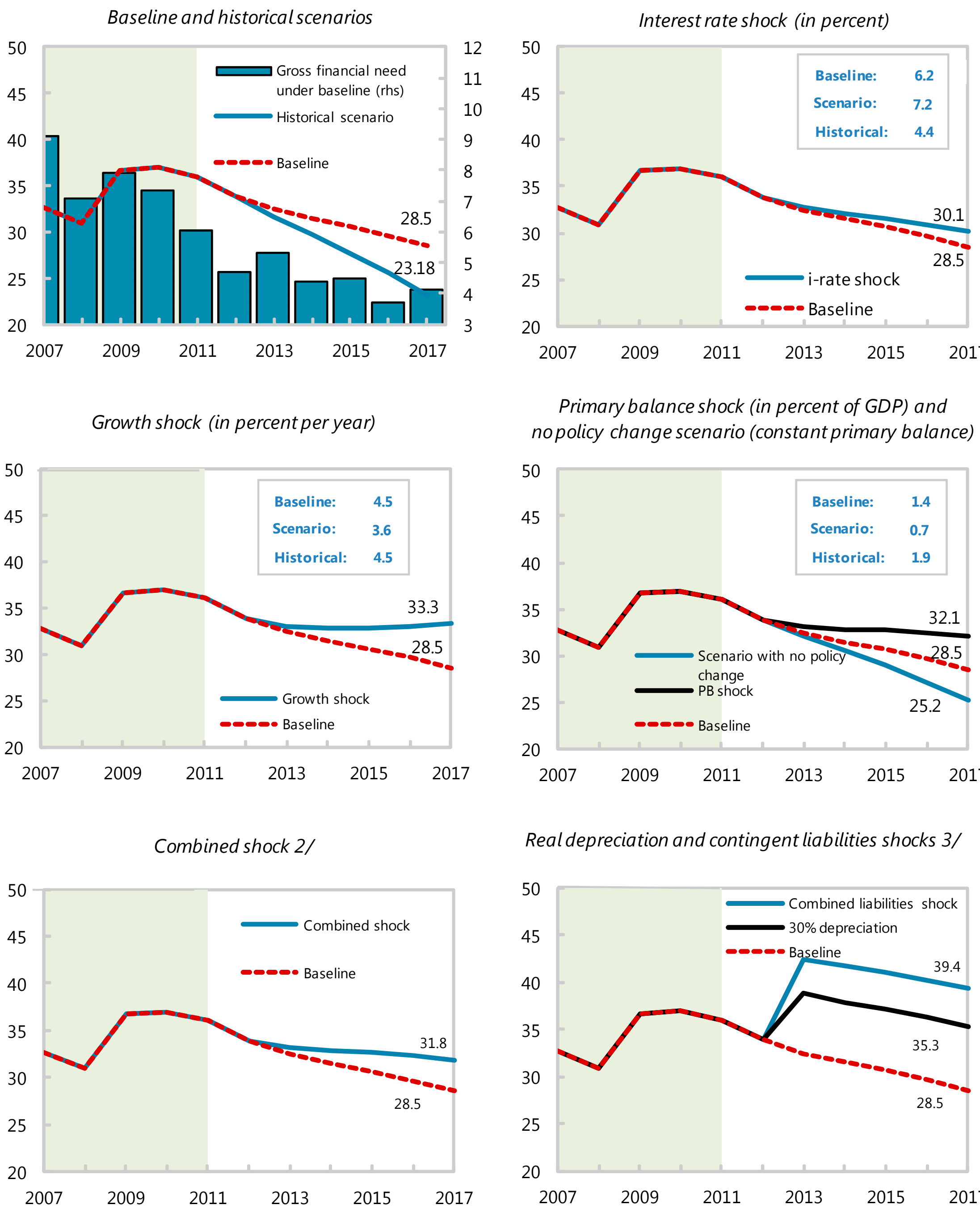


Sources: World Economic Outlook; and IMF staff estimates.

1/ Figures for Mexico and Poland do not include resources available under their FCL arrangements. The reserve metric proposed in "Assessing Reserve Adequacy" (See www.imf.org under "Publications") stands at 146 percent for Colombia, compared with a suggested adequate range of 100-150 percent.

2/ GIR at the end of 2011 in percent of Short Term debt at remaining maturity and current account deficit in 2012. The current account is set to zero if it is in surplus.

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



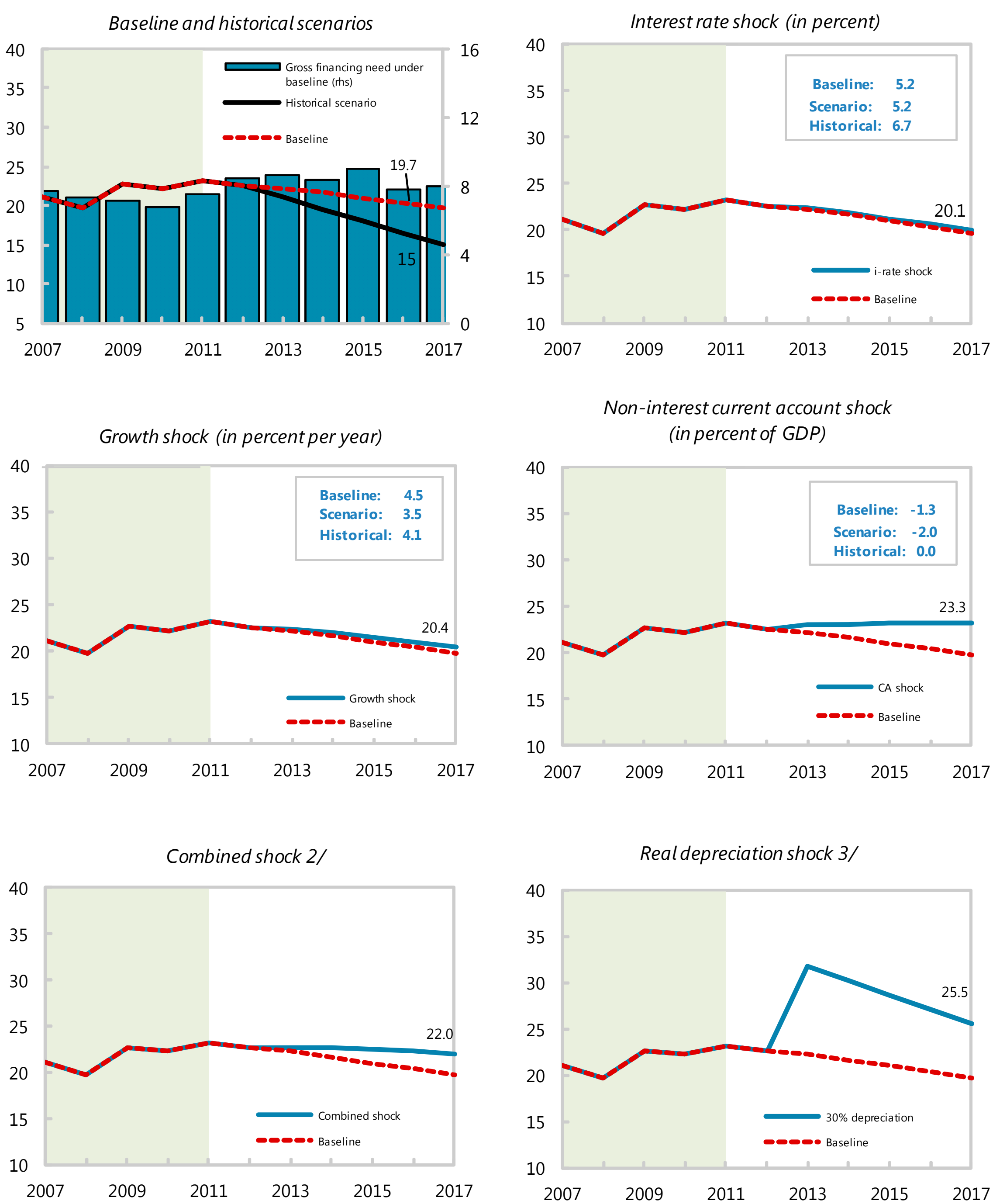
Sources: International Monetary Fund, country desk data, and staff estimates.

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 2013, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Figure 8. 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 2013, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Table 1. Colombia: Selected Economic and Financial Indicators

I. Social and Demographic Indicators

Population (millions), 2011	46.1	Physicians (per 1,000 people), 2010	1.47
GDP, 2011		Adult illiteracy rate (ages 15 and older), 2009	6.8
per capita (US$)	7,114	Gross primary school enrollment rate, 2010	115.4
in billions of Col$	615,727	Sustainable access to safe water, 2006	
in billions of US$	327.6	(percent of population)	92.0
Unemployment rate, October 2012 (percent)	8.9	Gini index, 2010	55.91
Life expectancy at birth (years), 2010	73.4	Poverty rate ($2 a day (PPP)), 2010	15.8
Under 5 mortality rate (per 1,000 live births), 2010	21.7	Extreme poverty rate ($1.25 a day (PPP)), 2010	8.2
Net Foreign direct investment, 2011 (US$ millions)	5,546	Public Debt (in percent GDP) , 2011	36.0
Net Foreign direct investment (in percent GDP)	1.7	o/w external	13.1

II. Economic Indicators

					Prel.	Projections	
	2007	2008	2009	2010	2011	2012	2013
	(Percentage changes, unless otherwise indicated)						
National income and prices							
Real GDP	6.9	3.5	1.7	4.0	5.9	4.3	4.4
GDP deflator	5.0	7.6	3.4	3.6	6.9	3.5	1.9
Consumer prices (average)	5.6	7.0	4.2	2.3	3.4	3.2	2.9
Consumer prices (end of period)	5.7	7.7	2.0	3.2	3.7	2.7	3.0
External sector (on the basis of US$)							
Exports (f.o.b.)	21.4	26.0	-11.7	20.1	41.3	6.5	2.5
Imports (f.o.b.)	25.4	20.5	-16.2	22.7	35.2	9.5	4.0
Terms of trade (deterioration -)	3.9	10.3	-10.0	10.0	13.4	5.3	-4.9
Real effective exchange rate (depreciation -)	7.7	0.4	5.2	5.5	4.0	...	...
Central government							
Revenue	14.8	16.0	2.8	-2.8	25.7	16.2	8.5
Expenditure	9.9	12.9	13.6	-1.9	16.4	9.7	9.4
Money and credit							
Broad money	17.4	18.5	8.1	11.5	18.9	10.1	10.2
Credit to the private sector	25.6	14.0	0.9	16.8	22.9	13.5	13.1
Interest rate (90-day time deposits; percent per year)							
Nominal	9.0	10.1	4.1	3.5	5.1	...	...
Real	3.3	2.4	2.1	0.3	1.4	...	...
	(In percent of GDP)						
Central government balance	-2.7	-2.3	-4.1	-3.9	-2.8	-2.0	-2.2
Combined public sector balance 1/	-0.7	-0.1	-2.7	-3.3	-1.9	-0.8	-1.2
Public debt 2/	32.7	30.9	36.7	36.9	36.0	33.5	32.4
Public debt, excluding Ecopetrol	32.7	30.9	35.6	35.7	35.0	32.3	31.3
Gross domestic investment	23.0	23.5	22.4	22.0	23.5	23.8	23.4
Gross national savings	20.2	20.6	20.3	19.0	20.4	20.7	20.2
Current account (CA) (deficit -)	-2.8	-2.9	-2.1	-3.1	-3.1	-3.1	-3.1
External debt	21.2	19.7	23.2	22.7	23.2	22.5	22.5
Of which: public sector	13.7	12.5	16.0	13.9	13.1	13.3	13.5
GIR in percent of short-term (ST) debt	198.7	207.3	242.5	194.7	157.7	166.4	168.7
	(In percent of exports of goods and services)						
External debt service	39.2	32.0	37.9	30.2	29.0	36.9	39.4
Of which: Public sector	15.6	12.7	11.7	11.0	9.0	10.3	8.9
Of which: Interest payments	9.2	7.7	8.1	7.5	6.0	6.6	6.8
Of which: Public sector	6.4	5.5	5.7	5.4	4.1	3.8	4.1
	(In millions of U.S. dollars)						
Changes in GIR	5,498	3,065	1,321	3,086	3,834	5,237	3,111
Exports (f.o.b.)	30,577	38,534	34,025	40,867	57,739	61,479	63,005
Of which: Petroleum products	7,318	12,204	10,254	16,483	27,954	31,394	33,367
Coffee	1,714	1,883	1,543	1,884	2,608	1,830	1,677
Gross official reserves	20,607	23,672	24,992	28,078	31,912	37,149	40,260
Share of ST debt at remaining maturity + CA deficit	120	145	131	115	101	108	118
In months of imports of goods and services	5.5	7.4	6.4	5.5	5.7	6.4	6.7

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

					Prel.	Projections					
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
					(In millions of U.S. dollars)						
Current account balance	**-5,977**	**-6,743**	**-4,960**	**-8,758**	**-10,032**	**-11,326**	**-12,171**	**-10,340**	**-10,239**	**-10,686**	**-11,170**
Trade balance	-584	971	2,545	2,240	5,509	4,293	3,527	6,100	5,690	4,846	3,983
Exports, f.o.b.	30,577	38,534	34,025	40,867	57,739	61,479	63,005	67,781	69,798	71,975	74,613
Coffee	1,714	1,883	1,543	1,884	2,608	1,830	1,677	1,926	2,123	1,842	1,842
Petroleum products	7,318	12,204	10,254	16,483	27,954	31,394	33,367	36,356	36,328	36,654	37,069
Non-traditional	15,174	17,101	14,623	14,197	16,430	17,732	18,743	19,958	21,416	23,176	24,994
Other	6,370	7,346	7,605	8,304	10,747	10,524	9,219	9,542	9,930	10,303	10,708
Imports, f.o.b.	31,161	37,563	31,479	38,628	52,230	57,186	59,478	61,681	64,108	67,128	70,630
Services (net)	-2,647	-3,072	-2,821	-3,623	-4,647	-4,669	-4,732	-4,598	-4,843	-5,121	-5,422
Income (net)	-7,962	-10,153	-9,298	-11,849	-15,831	-15,718	-15,760	-16,799	-16,243	-15,788	-15,341
Interest (net)	-1,737	-2,067	-2,511	-2,929	-3,229	-3,572	-4,085	-3,900	-3,662	-3,067	-2,536
Of which : Public sector	-1,284	-1,502	-1,779	-2,263	-2,318	-2,139	-2,605	-2,513	-2,324	-1,980	-1,778
Other Income (net)	-6,225	-8,087	-6,787	-8,920	-12,602	-12,146	-11,675	-12,899	-12,582	-12,720	-12,805
Current transfers (net)	5,216	5,512	4,613	4,475	4,938	4,767	4,793	4,957	5,158	5,377	5,609
Financial account balance	**10,347**	**9,492**	**6,255**	**11,813**	**13,494**	**16,563**	**15,282**	**12,693**	**11,928**	**12,147**	**12,653**
Public sector (net)	2,190	-281	7,285	4,781	2,797	3,663	4,370	2,505	1,052	1,301	1,265
Nonfinancial public sector	1,570	-23	7,484	4,669	2,871	3,649	3,801	2,280	1,062	1,320	1,313
Medium- and long-term (net)	1,298	998	7,360	1,338	3,038	6,319	2,792	1,286	1,103	1,361	1,354
Disbursements	4,096	3,246	8,918	3,357	5,077	9,458	4,828	4,264	4,622	3,655	5,444
Amortization	2,798	2,248	1,559	2,019	2,039	3,139	2,037	2,978	3,519	2,293	4,090
Other long-term flows	-19	0	1	-7	-41	-41	-41	-41	-41	-41	-41
Short term 1/	291	-1,021	124	3,338	-127	-2,629	1,051	1,036	0	0	0
Financial public sector	619	-258	-199	112	-73	15	569	226	-10	-19	-48
Private sector (net)	8,157	9,773	-1,029	7,033	10,697	12,900	10,912	10,187	10,876	10,847	11,388
Nonfinancial private sector (net)	7,926	8,785	215	4,704	8,813	12,639	11,273	10,464	10,835	10,796	11,330
Direct investment	8,136	8,342	4,049	184	5,546	11,655	10,760	10,054	10,023	10,086	10,345
Direct investment abroad	913	2,254	3,088	6,562	7,843	3,310	3,664	3,913	3,969	4,034	4,109
Direct investment in Colombia	9,049	10,596	7,137	6,746	13,388	14,965	14,424	13,967	13,992	14,120	14,454
Leasing finance	116	277	733	22	541	131	194	254	308	379	458
Disbursements	656	1,004	1,797	1,039	1,467	1,047	1,092	1,135	1,171	1,225	1,287
Amortization	540	726	1,064	1,017	926	916	898	880	862	845	828
Long-term loans	951	408	642	3,334	2,499	199	291	307	497	359	374
Disbursements	3,031	2,263	3,365	6,410	4,674	4,174	6,118	6,453	10,445	7,530	7,854
Amortization	2,080	1,854	2,724	3,075	2,176	3,975	5,827	6,146	9,948	7,171	7,480
Short term 2/	-1,278	-243	-5,209	1,164	228	654	27	-152	6	-27	152
Financial private sector (net)	231	988	-1,245	2,328	1,884	262	-361	-276	41	50	58
Valuation changes/Contribution to FLAR 3/	800	442	-27	-50	89	0	0	0	0	0	0
Net errors and omissions	**328**	**-127**	**52**	**80**	**282**	**0**	**0**	**0**	**0**	**0**	**0**
Changes in GIR 4/ 5/	**5,498**	**3,065**	**1,321**	**3,086**	**3,834**	**5,237**	**3,111**	**2,352**	**1,689**	**1,461**	**1,483**
Memorandum Items:											
Current account balance (in percent of GDP)	-2.8	-2.9	-2.1	-3.1	-3.1	-3.1	-3.1	-2.5	-2.4	-2.3	-2.3
Oil Price (Colombian mix US$ per barrel)	66.2	90.2	56.6	73.1	99.4	105.3	100.0	97.0	94.4	91.7	89.4
Gross international reserves (in US$ billion)	20.6	23.7	25.0	28.1	31.9	37.1	40.3	42.6	44.3	45.8	47.2
Gross international reserves / (ST debt at remaining maturity + CA deficit)	120.4	144.5	131.1	114.8	101.1	107.7	117.7	110.2	125.2	121.0	127.9
Gross international reserves (months of imports of goods and services)	5.5	7.4	6.4	5.5	5.7	6.4	6.7	6.8	6.7	7.0	6.8
Nominal GDP (US$ billion)	210.6	235.3	231.6	284.9	327.6	369.3	388.0	410.3	433.8	459.3	487.9

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)

	2007	2008	2009	2010	Prel. 2011	Projections 2012	2013	2014	2015	2016	2017
Total revenue	**15.0**	**15.6**	**15.3**	**13.8**	**15.3**	**16.5**	**16.8**	**16.5**	**15.9**	**15.8**	**15.7**
Current revenue	**15.0**	**15.6**	**15.3**	**13.8**	**15.3**	**16.5**	**16.8**	**16.5**	**15.9**	**15.8**	**15.7**
Tax revenue	13.4	13.4	12.9	12.3	13.6	14.6	14.3	14.0	13.8	13.6	13.6
Net income tax and profits 2/	5.6	5.1	5.6	4.8	5.4	6.5	6.4	6.4	6.2	6.2	6.2
Goods and services	5.7	5.9	5.4	5.6	6.0	5.8	5.7	5.8	5.7	5.7	5.7
Value-added tax	5.4	5.6	5.1	5.3	5.7	5.6	5.5	5.5	5.5	5.5	5.4
Gasoline tax	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
International trade	1.0	0.9	0.8	0.9	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Financial transaction tax	0.7	0.7	0.6	0.6	0.8	0.8	0.8	0.5	0.5	0.3	0.3
Stamp and other taxes	0.5	0.8	0.5	0.5	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Nontax revenue	1.6	2.2	2.4	1.5	1.7	1.9	2.5	2.5	2.1	2.2	2.1
Property income	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Other	1.4	2.0	2.2	1.4	1.5	1.8	2.3	2.3	2.0	2.0	2.0
Total expenditure and net lending	**17.7**	**17.9**	**19.4**	**17.7**	**18.1**	**18.4**	**19.0**	**18.5**	**18.1**	**17.7**	**17.8**
Current expenditure	**14.5**	**14.4**	**15.6**	**14.3**	**13.8**	**14.3**	**14.6**	**14.7**	**14.8**	**14.3**	**14.3**
Wages and salaries	2.0	2.0	2.2	2.1	2.0	2.2	2.3	2.3	2.3	2.2	2.1
Goods and services	1.2	1.2	1.0	1.0	1.0	1.0	1.0	1.0	1.0	0.9	0.9
Interest	3.7	3.2	3.0	2.7	2.7	2.8	2.7	2.6	2.6	2.4	2.5
External	0.9	0.8	0.8	0.7	0.6	0.6	0.8	0.7	0.8	0.6	0.6
Domestic	2.8	2.4	2.2	2.1	2.1	2.2	2.0	1.9	1.8	1.7	1.7
Current transfers	7.6	8.0	9.4	8.4	8.1	8.4	8.6	8.8	9.0	8.9	8.8
Of which: Fuel subsidies 3/	0.1	0.1	1.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital expenditure	**3.1**	**3.5**	**3.7**	**3.3**	**4.3**	**4.1**	**4.3**	**3.8**	**3.3**	**3.4**	**3.4**
Fixed capital formation	1.9	2.2	2.3	1.9	2.9	2.7	2.9	2.4	2.0	2.0	2.1
Capital transfers	1.3	1.2	1.4	1.4	1.4	1.4	1.5	1.4	1.4	1.4	1.4
Net lending	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	**-2.7**	**-2.3**	**-4.1**	**-3.9**	**-2.8**	**-2.0**	**-2.2**	**-2.1**	**-2.2**	**-1.9**	**-2.1**
Memorandum items:											
Oil-related revenues 4/	1.2	1.2	1.6	0.8	1.7	2.6	3.1	3.1	2.7	2.7	2.7
Overall structural balance 5/	-3.3	-3.2	-3.4	-3.6	-3.5	-2.5	-2.3	-2.2	-2.4	-2.1	-2.2
Adjusted overall balance 6/	-3.0	-2.6	-4.5	-4.6	-3.3	-2.4	-2.5	-2.3	-2.4	-2.1	-2.2
Non-oil balance	-4.0	-3.6	-5.6	-4.6	-4.6	-5.2	-5.0	-4.9	-4.9	-4.7	-4.8
Primary balance	1.0	0.9	-1.1	-1.1	-0.1	0.8	0.6	0.5	0.4	0.4	0.4
Nominal GDP (in COP trillion)	431.1	480.1	504.6	543.7	615.7	664.6	707.3	759.0	813.3	871.0	933.7

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

1/ Includes central administration only.

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

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

6/ Excludes private pension transfers from revenues.

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

(In COP Trillion)

	2007	2008	2009	2010	Prel. 2011	Proj. 2012	2013	2014	2015	2016	2017
Total revenue	**64.7**	**75.1**	**77.2**	**75.0**	**94.2**	**109.5**	**118.8**	**125.2**	**129.7**	**137.5**	**146.6**
Current revenue	**64.7**	**75.1**	**77.2**	**75.0**	**94.2**	**109.5**	**118.8**	**125.2**	**129.7**	**137.5**	**146.6**
Tax revenue	57.9	64.3	65.2	66.8	83.8	96.8	101.4	106.5	112.4	118.7	126.8
Net income tax and profits 2/	24.0	24.4	28.1	26.2	33.5	43.2	45.2	48.6	50.6	54.4	58.1
Goods and services	24.6	28.4	27.2	30.2	36.7	38.7	40.4	43.8	46.6	49.8	53.2
Value-added tax	23.4	27.1	25.9	28.8	35.1	36.9	39.2	41.8	44.5	47.5	50.8
Gasoline tax	1.2	1.3	1.3	1.4	1.6	1.7	1.8	2.0	2.1	2.3	2.4
International trade	4.3	4.3	4.0	4.7	4.1	4.6	4.9	5.1	5.4	5.7	6.1
Financial transaction tax	3.0	3.2	3.1	3.2	5.1	5.5	5.8	3.5	3.8	2.5	2.6
Stamp and other taxes	2.0	4.1	2.8	2.5	4.5	4.9	5.2	5.6	6.0	6.4	6.8
Nontax revenue	6.8	10.7	12.0	8.2	10.4	12.6	17.4	18.6	17.3	18.7	19.8
Property income	0.8	1.0	0.8	0.5	0.9	1.0	1.1	1.1	1.2	1.3	1.4
Other	6.1	9.7	11.2	7.7	9.5	11.7	16.3	17.5	16.1	17.4	18.4
Total expenditure and net lending	**76.3**	**86.1**	**97.9**	**96.0**	**111.8**	**122.6**	**134.2**	**140.8**	**147.4**	**154.4**	**166.2**
Current expenditure	**62.5**	**69.4**	**78.9**	**77.8**	**85.2**	**95.2**	**103.4**	**111.4**	**120.0**	**124.9**	**133.9**
Wages and salaries	8.7	9.7	10.9	11.6	12.4	14.6	16.2	17.5	18.5	19.1	20.0
Goods and services	5.3	5.7	5.3	5.6	6.2	6.5	7.0	7.6	7.8	8.0	8.4
Interest	15.9	15.4	15.1	14.8	16.8	18.3	19.4	19.7	20.9	20.6	23.3
External	3.9	3.7	3.8	3.7	3.6	3.7	5.4	5.2	6.3	5.5	5.8
Domestic	12.0	11.7	11.3	11.2	13.2	14.5	14.0	14.5	14.6	15.1	15.7
Current transfers	32.6	38.6	47.6	45.7	49.8	55.7	60.9	66.6	72.8	77.3	82.1
Of which: Fuel subsidies 3/	0.2	0.7	4.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital expenditure	**13.6**	**16.6**	**18.8**	**18.0**	**26.4**	**27.4**	**30.6**	**29.2**	**27.2**	**29.3**	**32.1**
Fixed capital formation	8.0	10.7	11.5	10.5	17.7	18.2	20.3	18.5	16.0	17.4	19.4
Capital transfers	5.6	5.9	7.3	7.5	8.7	9.2	10.4	10.7	11.2	11.9	12.7
Net lending	0.3	0.2	0.2	0.2	0.2	0.1	0.1	0.1	0.2	0.2	0.2
Overall balance	**-11.6**	**-11.1**	**-20.7**	**-21.0**	**-17.5**	**-13.1**	**-15.4**	**-15.6**	**-17.7**	**-17.0**	**-19.6**
Memorandum items:											
Oil-related revenues 4/	5.2	5.9	8.1	4.2	10.6	17.6	21.9	23.6	21.9	23.9	25.0
Overall structural balance 5/	-14.4	-15.2	-16.9	-19.7	-21.4	-16.4	-16.2	-16.5	-19.3	-18.4	-20.2
Adjusted overall balance 6/	-12.9	-12.6	-22.6	-24.9	-20.5	-15.9	-17.8	-17.7	-19.3	-18.3	-20.6
Non-oil balance	-17.4	-17.1	-28.0	-25.2	-28.1	-34.5	-35.4	-37.3	-39.7	-40.9	-44.6
Primary balance	4.3	4.3	-5.6	-6.2	-0.7	5.1	4.0	4.1	3.2	3.6	3.7

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

1/ Includes central administration only.

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

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

6/ Excludes private pension transfers from revenues.

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

(In percent of GDP)

	2007	2008	2009	2010	Prel. 2011	Projections 2012	2013	2014	2015	2016	2017
Total revenue	**27.2**	**26.4**	**26.7**	**26.2**	**26.9**	**27.9**	**28.2**	**27.8**	**27.2**	**27.0**	**26.8**
Tax revenue	19.4	19.3	18.4	18.7	19.3	20.2	20.0	19.7	19.5	19.3	19.2
Nontax revenue	7.8	7.1	8.3	7.4	7.6	7.7	8.2	8.1	7.7	7.7	7.6
Financial income	1.4	1.3	1.7	1.2	0.9	1.0	0.9	0.9	0.8	0.8	0.8
Operating surplus of public enterprises	3.2	0.3	0.1	0.1	0.2	0.1	0.1	0.1	0.1	0.1	0.1
Other 2/	3.2	5.4	6.5	6.2	6.6	6.6	7.2	7.1	6.8	6.8	6.7
Total expenditure and net lending 3/	**28.2**	**26.3**	**29.3**	**29.3**	**28.7**	**28.7**	**29.3**	**28.9**	**28.5**	**28.0**	**27.9**
Current expenditure	21.8	21.3	23.1	22.4	20.6	20.9	21.2	21.2	21.3	20.9	20.6
Wages and salaries	5.6	5.5	5.8	5.8	5.2	5.4	5.5	5.5	5.5	5.4	5.4
Goods and services	3.6	3.4	3.2	3.3	2.9	2.9	2.9	2.9	2.9	2.8	2.8
Interest	4.1	3.5	3.4	2.9	2.8	2.8	2.8	2.7	2.6	2.4	2.4
External	1.0	0.8	0.8	0.7	0.6	0.6	0.8	0.7	0.8	0.7	0.7
Domestic	3.1	2.6	2.5	2.2	2.2	2.2	2.0	1.9	1.8	1.8	1.7
Transfers to private sector	7.2	7.4	8.8	8.1	7.4	7.7	7.9	8.1	8.3	8.2	8.1
Of which: Fuel subsidies 4/	0.1	0.1	1.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other 5/	1.3	1.5	2.0	2.4	2.2	2.1	2.0	2.0	2.0	2.0	2.0
Capital expenditure	6.4	5.0	6.2	6.8	8.1	7.8	8.2	7.7	7.2	7.2	7.2
Statistical discrepancy	0.2	-0.3	-0.2	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Nonfinancial public sector balance	**-0.8**	**-0.3**	**-2.8**	**-3.3**	**-1.8**	**-0.8**	**-1.2**	**-1.1**	**-1.2**	**-1.1**	**-1.1**
Quasi-fiscal balance (BR cash profits)	0.4	0.3	0.1	0.0	0.0	-0.1	-0.1	0.0	0.0	0.1	0.1
Fogafin balance	0.1	0.1	0.2	0.1	0.0	0.1	0.1	0.1	0.1	0.1	0.1
Net cost of financial restructuring 6/	-0.3	-0.3	-0.2	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Combined public sector balance	**-0.7**	**-0.1**	**-2.7**	**-3.3**	**-1.9**	**-0.8**	**-1.2**	**-1.0**	**-1.1**	**-0.9**	**-0.9**
Overall financing	0.7	0.1	2.7	3.3	1.9	0.8	1.2	1.0	1.1	0.9	0.9
Foreign, net	1.6	0.3	1.6	1.7	1.2	1.3	0.7	0.3	0.3	0.3	0.3
Domestic, net	-2.4	-0.2	0.9	1.5	0.7	-0.7	-0.1	0.1	0.8	0.5	0.5
Privatization (including concessions)	1.4	0.1	0.2	0.1	0.0	0.1	0.5	0.6	0.0	0.0	0.0
Memorandum items:											
Overall structural balance 7/	-1.6	-1.8	-1.5	-2.9	-3.2	-1.5	-1.3	-1.2	-1.4	-1.1	-1.0
Adjusted overall balance 8/	-1.0	-0.5	-3.1	-4.0	-2.4	-1.2	-1.5	-1.3	-1.3	-1.0	-1.0
Non-oil balance	-3.8	-3.2	-5.5	-5.5	-5.5	-5.7	-5.7	-5.5	-5.5	-5.3	-5.1
Primary balance 9/	3.4	3.3	0.7	-0.4	0.9	2.0	1.7	1.6	1.5	1.6	1.5
Oil-related revenues 10/	2.9	3.0	2.9	2.3	3.6	4.3	4.8	4.7	4.4	4.4	4.2
Total public debt 11/	32.7	30.9	36.7	36.9	36.0	33.5	32.4	31.3	30.5	29.3	28.2
Nominal GDP (in COP trillions)	431.1	480.1	504.6	543.7	615.7	664.6	707.3	759.0	813.3	871.0	933.7

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. From 2008 onwards, including projections, figures exclude Ecopetrol operations and privatized health care.

2/Includes royalties, dividends and social security contributions.

3/ Expenditure reported on commitments basis.

4/ 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.

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

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

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

8/ Excludes private pension transfers from revenues.

9/ Includes statistical discrepancy.

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

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

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

(In COP Trillion)

	2007	2008	2009	2010	Prel. 2011	Proj. 2012	2013	2014	2015	2016	2017
Total revenue	**117.2**	**126.7**	**134.9**	**142.2**	**165.7**	**185.6**	**199.1**	**210.7**	**221.3**	**234.9**	**250.3**
Tax revenue	83.6	92.6	92.9	101.7	118.7	134.5	141.5	149.5	158.5	168.1	179.7
Nontax revenue	33.6	34.1	42.0	40.5	47.0	51.1	57.7	61.2	62.9	66.8	70.6
Financial income	6.1	6.3	8.5	6.4	5.6	6.5	6.3	6.6	6.7	6.8	7.2
Operating surplus of public enterprises	13.7	1.7	0.7	0.6	1.0	0.5	0.4	0.6	0.7	0.8	0.8
Other 2/	13.8	26.1	32.8	33.5	40.4	44.1	51.0	54.0	55.5	59.3	62.5
Total expenditure and net lending 3/	**121.6**	**126.5**	**147.7**	**159.1**	**177.0**	**190.6**	**207.4**	**219.1**	**231.5**	**244.3**	**260.4**
Current expenditure	94.1	102.4	116.4	121.9	126.9	138.9	149.7	160.8	173.0	181.6	192.8
Wages and salaries	24.3	26.6	29.2	31.3	32.2	35.9	38.9	41.8	44.5	47.0	50.0
Goods and services	15.6	16.3	16.1	17.9	17.9	19.0	20.4	22.1	23.4	24.6	26.2
Interest	17.5	16.7	17.0	15.6	17.2	18.7	19.8	20.2	21.5	21.2	22.1
External	4.3	4.0	4.1	3.9	3.8	4.0	5.7	5.6	6.7	5.8	6.2
Domestic	13.2	12.7	12.9	11.7	13.4	14.7	14.2	14.7	14.8	15.3	15.9
Transfers to private sector	30.9	35.7	44.2	43.9	45.8	51.3	56.2	61.6	67.5	71.6	76.0
Of which: Fuel subsidies 4/	0.2	0.7	4.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other 5/	5.7	7.1	9.9	13.1	13.8	13.9	14.3	15.1	16.1	17.3	18.5
Capital expenditure	27.5	24.1	31.4	37.2	50.1	51.7	57.7	58.3	58.5	62.7	67.6
Statistical discrepancy	0.8	-1.4	-1.2	-1.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Nonfinancial public sector balance	**-3.7**	**-1.2**	**-14.1**	**-18.0**	**-11.3**	**-5.0**	**-8.3**	**-8.4**	**-10.2**	**-9.4**	**-10.1**
Quasi-fiscal balance (BR cash profits)	1.6	1.3	0.6	0.2	0.0	-0.6	-0.4	-0.1	0.4	1.0	1.2
Fogafin balance	0.3	0.5	0.9	0.4	0.1	0.6	0.6	0.7	0.7	0.8	0.8
Net cost of financial restructuring 6/	-1.2	-1.3	-1.1	-0.4	-0.3	-0.1	-0.1	0.0	0.0	0.0	0.0
Combined public sector balance	**-2.8**	**-0.7**	**-13.7**	**-17.7**	**-11.6**	**-5.2**	**-8.1**	**-7.9**	**-9.0**	**-7.6**	**-8.0**
Overall financing	2.8	0.7	13.7	17.7	11.6	5.2	8.1	7.9	9.0	7.6	8.0
Foreign, net	6.9	1.3	8.3	9.0	7.1	8.9	5.2	2.5	2.5	3.0	2.9
Domestic, net	-10.3	-1.1	4.5	8.2	4.4	-4.6	-0.8	0.8	6.6	4.7	5.0
Privatization (including concessions)	6.2	0.5	0.9	0.5	0.0	0.9	3.7	4.6	0.0	0.0	0.0
Memorandum items:											
CPS overall structural balance 7/	-6.7	-8.8	-7.7	-15.6	-19.7	-10.2	-9.4	-9.2	-11.5	-10.0	-8.9
Adjusted overall balance 8/	-4.1	-2.2	-15.6	-21.6	-14.6	-8.0	-10.6	-9.9	-10.7	-8.9	-8.9
Non-oil balance	-16.2	-15.4	-27.7	-30.1	-33.9	-37.9	-40.1	-41.9	-44.5	-45.8	-47.5
Primary balance 9/	14.7	16.0	3.3	-2.1	5.7	13.5	11.7	12.4	12.4	13.5	14.1
Oil-related revenues 10/	12.7	14.6	14.8	12.4	22.4	28.8	33.9	35.9	35.5	38.1	39.5
Total public debt 11/	141.1	148.4	185.1	200.8	221.8	222.5	229.4	237.9	247.8	255.5	263.1

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. From 2008 onwards, including projections, figures exclude Ecopetrol operations and privatized health care.

2/Includes royalties, dividends and social security contributions.

3/ Expenditure reported on commitments basis.

4/ 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.

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

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

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

8/ Excludes private pension transfers from revenues.

9/ Includes statistical discrepancy.

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

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

Table 5. Colombia: Monetary Indicators

	2007	2008	2009	2010	2011	Sep-12
	(In billions of Colombian pesos, unless otherwise indicated)					
Central Bank						
Net Foreign Assets	42,876	54,661	50,526	53,265	61,750	63,604
Gross official reserve assets	42,343	53,720	51,650	54,583	63,566	64,187
In billions of US$	21.0	23.9	25.3	28.5	32.7	35.6
Short-term foreign liabilities	136	613	562	844	1,575	414
Other net foreign assets	1,161	2,106	1,955	1,865	2,117	2,000
Net domestic assets	-9,964	-18,403	-10,958	-8,373	-10,393	-17,523
Net credit to the public sector	-4,038	-1,792	622	-2,098	-4,624	-21,550
Net credit to the financial system	5,039	-143	-419	1,516	3,078	8,106
Other	-10,965	-16,468	-11,160	-7,792	-8,847	-4,079
Monetary base	32,415	36,195	39,547	44,878	51,342	46,073
Currency in circulation	22,417	24,352	25,671	29,674	33,367	29,021
Deposit money banks reserves	9,970	11,832	13,865	15,157	17,946	17,007
Other deposits	29	12	10	47	29	44
Financial system 1/						
Net foreign assets	37,886	49,670	48,267	44,392	47,389	54,458
In billions of US$	18.4	21.4	24.2	23.0	24.3	30
Net domestic assets	106,762	121,706	136,915	162,008	198,069	205,565
Net credit to public sector	11,926	16,150	32,352	33,782	32,455	18,133
Credit to private sector	130,986	149,366	150,766	176,020	216,410	239,523
Other net	-36,150	-43,809	-46,203	-47,794	-50,797	-52,091
Broad money	144,648	171,376	185,182	206,399	245,458	260,023
	(Annual percentage change)					
y-o-y						
Credit to private sector	25.6	14.0	0.9	16.8	22.9	16.1
Currency	11.4	8.6	5.4	15.6	12.4	6.4
Monetary base	19.9	11.7	9.3	13.5	14.4	8.9
Broad money	17.4	18.5	8.1	11.5	18.9	16.5
	(In percent of GDP)					
Credit to private sector	30.4	31.1	29.9	32.4	35.1	36.4
Currency	5.2	5.1	5.1	5.5	5.4	4.4
Monetary base	7.5	7.5	7.8	8.3	8.3	7.0
Broad money	33.6	35.7	36.7	38.0	39.9	39.5
Memorandum items:						
Central bank inflation target	3.5-4.5	3.5-4.5	4.5-5.5	2.0-4.0	2.0-4.0	2.0-4.0
CPI inflation, eop	5.7	7.7	2.0	3.2	3.7	3.1
Nominal GDP (COP billions)	431,072	480,087	504,647	543,747	615,727	…

Sources: Banco de la República; and Fund staff estimates.
1/ Includes the Central Bank.

Table 6. Colombia: Medium-Term Outlook

					Prelim.	Projections					
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Real GDP	6.9	3.5	1.7	4.0	5.9	4.3	4.4	4.5	4.5	4.5	4.5
Consumer prices											
End of period	5.7	7.7	2.0	3.2	3.7	2.7	3.0	3.0	3.0	3.0	3.0
Gross national savings	20.2	20.6	20.3	19.0	20.4	20.7	20.2	20.2	20.2	20.5	20.6
Private sector	15.5	15.8	17.0	15.5	14.3	13.9	13.4	13.7	14.3	14.3	14.4
Public sector 1/	4.7	4.8	3.3	3.5	6.1	6.8	6.9	6.5	5.9	6.2	6.2
Gross domestic investment	23.0	23.5	22.4	22.0	23.5	23.8	23.4	22.7	22.6	22.8	22.9
Private sector	17.7	18.6	16.6	15.4	15.6	16.3	15.5	15.3	15.7	15.9	15.9
Public sector 1/	5.4	4.9	5.8	6.7	7.8	7.5	7.9	7.4	6.9	6.9	6.9
External current account balance	-2.8	-2.9	-2.1	-3.1	-3.1	-3.1	-3.1	-2.5	-2.4	-2.3	-2.3
Nonfinancial public sector 2/											
Revenue	27.2	26.4	26.7	26.2	26.9	27.9	28.2	27.8	27.2	27.0	26.8
Expenditure	28.2	26.3	29.3	29.3	28.7	28.7	29.3	28.9	28.5	28.0	27.9
Current expenditure	21.8	21.3	23.1	22.4	20.6	20.9	21.2	21.2	21.3	20.9	20.6
Capital expenditure	6.4	5.0	6.2	6.8	8.1	7.8	8.2	7.7	7.2	7.2	7.2
Primary balance 3/	3.2	3.2	0.6	-0.4	1.0	2.1	1.6	1.6	1.4	1.4	1.3
Overall balance 3/	-0.8	-0.3	-2.8	-3.3	-1.8	-0.8	-1.2	-1.1	-1.2	-1.1	-1.1
Combined public sector balance	-0.7	-0.1	-2.7	-3.3	-1.9	-0.8	-1.2	-1.0	-1.1	-0.9	-0.9
External financing	1.6	0.3	1.6	1.7	1.2	1.3	0.7	0.3	0.3	0.3	0.3
Domestic financing	-2.4	-0.2	0.9	1.5	0.7	-0.7	-0.1	0.1	0.8	0.5	0.5
Privatization	1.4	0.1	0.2	0.1	0.0	0.1	0.5	0.6	0.0	0.0	0.0
External current account balance	-2.8	-2.9	-2.1	-3.1	-3.1	-3.1	-3.1	-2.5	-2.4	-2.3	-2.3
Trade balance	-0.3	0.4	1.1	0.8	1.7	1.2	0.9	1.5	1.3	1.1	0.8
Exports	14.5	16.4	14.7	14.3	17.6	16.6	16.2	16.5	16.1	15.7	15.3
Imports	14.8	16.0	13.6	13.6	15.9	15.5	15.3	15.0	14.8	14.6	14.5
Capital and financial account balance	4.9	4.0	2.7	4.1	4.1	4.5	3.9	3.1	2.7	2.6	2.6
Public sector	1.0	-0.1	3.1	1.7	0.9	1.0	1.1	0.6	0.2	0.3	0.3
Private sector	3.9	4.2	-0.4	2.5	3.3	3.5	2.8	2.5	2.5	2.4	2.3
Net errors and omissions	0.2	-0.1	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	2.2	1.1	0.6	1.1	1.1	1.4	0.8	0.6	0.4	0.3	0.3
Total public gross debt 4/	32.7	30.9	36.7	36.9	36.0	33.5	32.4	31.3	30.5	29.3	28.2
Domestic debt	19.0	18.4	20.6	23.1	23.0	20.2	18.9	18.2	17.8	17.1	16.3
External debt	13.7	12.5	16.0	13.9	13.1	13.3	13.5	13.2	12.7	12.3	11.8
Total public gross debt, excluding Ecopetrol	32.7	30.9	35.6	35.7	35.0	32.3	31.3	30.3	29.5	28.5	27.4
Total public net debt 5/	22.7	21.0	27.7	29.0	27.5	25.4	25.1	24.3	23.9	23.1	22.4
Memorandum items:											
Nominal GDP (billions of COP)	431,072	480,087	504,647	543,747	615,727	664,644	707,301	758,977	813,308	871,009	933,694
Crude oil, spot price	71.1	97.0	61.8	79.0	104.0	105.1	99.7	96.8	94.1	91.5	89.1
Crude oil, spot price (Colombian mix)	66.2	90.2	56.6	73.1	99.4	105.3	100.0	97.0	94.4	91.7	89.4

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 7. Colombia: Selected Indicators of External Vulnerability 1/

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

	2007	2008	2009	2010	Prel. 2011	Proj. 2012
External indicators						
Exports of GNFS	34.2	42.7	38.2	45.3	62.6	66.6
Imports of GNFS	37.4	44.8	38.5	46.7	61.7	67.0
Terms of trade (12-month percent change)	3.9	10.3	-10.0	10.0	13.4	5.3
Current account balance	-6.0	-6.7	-5.0	-8.8	-10.0	-11.3
In percent of GDP	-2.8	-2.9	-2.1	-3.1	-3.1	-3.1
Capital and financial account balance	10.3	9.5	6.3	11.8	13.5	16.6
Of which: Foreign direct investment (net)	8.1	8.3	4.0	0.2	5.5	11.7
Of which: Portfolio investment (net)	0.9	-0.9	-2.9	0.1	1.4	-2.3
Total external debt	44.5	46.3	52.5	63.5	75.1	83.1
In percent of gross international reserves	215.8	195.6	210.1	226.3	235.3	223.8
Short-term external debt 2/	5.1	5.6	3.9	8.2	11.4	11.9
Of which: Public sector	0.7	0.6	0.3	1.0	1.2	1.2
Of which: Private sector	4.4	5.1	3.6	7.2	10.2	10.8
Amortization of MLT external debt (in percent of GNFS exports)	16.5	12.2	15.2	14.0	9.9	13.3
External interest payments (in percent of GNFS exports)	9.2	7.7	8.1	7.5	6.0	6.6
Gross international reserves 3/ 4/	20.6	23.7	25.0	28.1	31.9	37.1
In months of prospective GNFS imports	5.5	7.4	6.4	5.5	5.7	6.4
In percent of broad money	29.2	28.2	29.4	26.0	24.4	24.7
In percent of short-term external debt 2/	400.6	421.5	633.6	342.5	280.6	311.0
In percent of short-term external debt on residual maturity basis plus current account deficit	120.4	144.5	131.1	114.8	101.1	107.7
Nominal exchange rate (COP/US$, period average) 5/	2,047.2	2,040.7	2,179.0	1,908.7	1,879.4	1,796.8
Real effective exchange rate (percentage change, + = appreciation)	19.7	5.0	-3.3	15.2	2.8	...

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

1/ GNFS stands for goods and nonfactor services; MLT stands for medium and long-term.
2/ Original maturity of less than 1 year. Stock at the end of the previous period.
3/ Estimate for 2009 includes the SDR allocation (US$972 million).
4/ IMF definition that excludes Colombia's contribution to Fondo Latinoamericano de Reservas (FLAR) and includes valuation changes of reserves denominated in other currencies than U.S. dollars.
5/ For 2012, actual average for January-September.

Table 8. Colombia: Public Sector Debt Sustainability Framework, 2009-2017
(In percent of GDP, unless otherwise indicated)

	Actual			Staff Projections						
	2009	2010	2011	2012	2013	2014	2015	2016	2017	Debt-stabilizing primary balance 10/
Baseline: Public sector debt 1/	36.7	36.9	36.0	**33.5**	**32.4**	**31.3**	**30.5**	**29.3**	**28.2**	**0.5**
o/w foreign-currency denominated	16.0	13.9	13.1	13.3	13.5	13.2	12.7	12.3	11.8	
Change in public sector debt	5.8	0.3	-0.9	-2.5	-1.0	-1.1	-0.9	-1.1	-1.2	
Identified debt-creating flows (4+7+12)	-0.3	0.0	-2.8	-2.0	-1.4	-1.7	-0.8	-0.9	-0.9	
Primary deficit	-0.8	0.2	-1.0	-2.1	-1.6	-1.6	-1.4	-1.4	-1.3	
Revenue and grants	26.7	26.2	26.9	27.9	28.2	27.8	27.2	27.0	26.8	
Primary (noninterest) expenditure	25.9	26.4	26.0	25.9	26.5	26.2	25.8	25.6	25.5	
Automatic debt dynamics 2/	0.7	-0.2	-1.8	0.2	0.8	0.5	0.5	0.4	0.4	
Contribution from interest rate/growth differential 3/	1.9	0.2	-1.5	0.2	0.8	0.5	0.5	0.4	0.4	
Of which contribution from real interest rate	2.3	1.6	0.4	1.6	2.2	1.8	1.9	1.7	1.6	
Of which contribution from real GDP growth	-0.5	-1.4	-1.9	-1.4	-1.4	-1.3	-1.3	-1.3	-1.2	
Contribution from exchange rate depreciation 4/	-1.1	-0.4	-0.3	...	...	...	...	...	...	
Other identified debt-creating flows	-0.2	-0.1	0.0	-0.1	-0.5	-0.6	0.0	0.0	0.0	
Privatization receipts (negative)	-0.2	-0.1	0.0	-0.1	-0.5	-0.6	0.0	0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other (specify, e.g. bank recapitalization)	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/	6.0	0.3	1.9	-0.5	0.3	0.6	0.0	-0.2	-0.3	
Public sector debt-to-revenue ratio 1/	137.2	141.2	133.8	119.9	115.2	112.9	112.0	108.8	105.1	
Gross financing need 6/	7.9	7.4	6.0	4.6	5.3	4.4	4.5	3.6	3.9	
in billions of U.S. dollars	18.3	21.0	19.8	17.0	20.5	18.2	19.6	16.6	19.2	
Scenario with key variables at their historical averages 7/				**33.5**	**31.3**	**29.3**	**27.2**	**25.0**	**22.7**	**0.0**
Scenario with no policy change (constant primary balance) in 2012-2017				**33.5**	**32.0**	**30.4**	**28.8**	**27.0**	**25.0**	**0.4**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline										
Real GDP growth (in percent)	1.7	4.0	5.9	4.3	4.4	4.5	4.5	4.5	4.5	
Average nominal interest rate on public debt (in percent) 8/	11.4	8.5	8.6	8.4	8.9	8.8	9.0	8.5	8.7	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	8.0	4.8	1.7	5.0	7.0	6.1	6.4	6.0	6.1	
Nominal appreciation (increase in US dollar value of local currency, in percent)	9.8	2.7	2.4	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	3.4	3.6	6.9	3.5	1.9	2.7	2.6	2.5	2.6	
Growth of real primary spending (deflated by GDP deflator, in percent)	15.1	5.9	4.2	3.9	7.0	3.2	3.0	3.7	4.1	
Primary deficit 9/	-0.8	0.2	-1.0	-2.1	-1.6	-1.6	-1.4	-1.4	-1.3	

Source: Fund 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 or any contingent liability.

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/ Excludes statistical discrepancy.

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

Table 9. Colombia: External Debt Sustainability Framework, 2009-2017
(In percent of GDP, unless otherwise indicated)

	Actual			Staff Projections 1/						
	2009	2010	2011	2012	2013	2014	2015	2016	2017	Debt-stabilizing non-interest current account 7/
Baseline: External debt	22.7	22.3	22.9	**22.5**	**22.5**	**21.8**	**21.2**	**20.5**	**19.8**	**-2.5**
Change in external debt	3.0	-0.4	0.6	-0.4	0.0	-0.7	-0.7	-0.6	-0.7	
Identified external debt-creating flows (4+8+9)	0.7	-1.2	0.2	-1.0	-0.6	-1.1	-1.1	-1.0	-1.1	
Current account deficit, excluding interest payments	0.9	2.0	2.1	2.0	1.9	1.4	1.1	1.3	1.3	
Deficit in balance of goods and services	0.1	0.5	-0.3	0.1	0.3	-0.4	-0.2	0.1	0.3	
Exports	16.5	15.9	19.1	18.0	17.7	18.0	17.6	17.1	16.7	
Imports	16.6	16.4	18.8	18.1	18.0	17.7	17.4	17.2	17.0	
Net non-debt creating capital inflows (negative)	-1.7	-0.1	-1.7	-3.2	-2.8	-2.7	-2.5	-2.4	-2.5	
Automatic debt dynamics 2/	1.5	-3.2	-0.2	0.2	0.3	0.2	0.3	0.2	0.2	
Contribution from nominal interest rate	1.2	1.0	1.0	1.1	1.3	1.2	1.2	1.1	1.0	
Contribution from real GDP growth	-0.3	-0.7	-1.1	-0.9	-0.9	-0.9	-0.9	-0.9	-0.9	
Contribution from price and exchange rate changes 3/	0.6	-3.5	...	...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 4/	2.3	0.8	0.4	0.6	0.6	0.5	0.4	0.3	0.4	
External debt-to-exports ratio (in percent)	137.4	140.2	120.0	124.8	127.2	121.1	120.4	119.8	118.7	
Gross external financing need (in billions of U.S. dollars) 5/	16.4	19.1	24.5	31.6	34.5	34.2	38.7	35.4	38.3	
in percent of GDP	7.1	6.7	7.5	8.5	8.9	8.3	8.9	7.7	7.8	
Scenario with key variables at their historical averages 6/				**22.5**	**21.0**	**19.5**	**18.1**	**16.6**	**15.3**	**-3.9**
Key Macroeconomic Assumptions Underlying Baseline										
Real GDP growth (in percent)	1.7	4.0	5.9	4.3	4.4	4.5	4.5	4.5	4.5	
GDP deflator in US dollars (change in percent)	-3.2	18.3	8.6	8.1	0.6	1.2	1.2	1.3	1.7	
Nominal external interest rate (in percent)	6.0	5.6	5.1	5.4	6.0	5.5	6.0	5.3	5.3	
Growth of exports (U.S. dollar terms, in percent)	-10.4	18.5	38.1	6.4	3.0	7.8	3.0	3.2	3.7	
Growth of imports (U.S. dollar terms, in percent)	-14.0	21.3	32.2	8.5	4.2	3.8	4.0	4.7	5.2	
Current account balance, excluding interest payments	-0.9	-2.0	-2.1	-2.0	-1.9	-1.4	-1.1	-1.3	-1.3	
Net non-debt creating capital inflows	1.7	0.1	1.7	3.2	2.8	2.7	2.5	2.4	2.5	

Source: Fund staff estimates.

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

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

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

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

6/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

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

Annex I. Risks and Channels of Contagion[1]

1. **Colombia is navigating the current episode of global turbulence from a position of strength.** Macroeconomic management has been underpinned by a strong policy framework, including a flexible exchange rate and inflation targeting regime. In recent years, the authorities have considerably strengthened the policy and prudential frameworks, including by adopting fiscal responsibility legislation, and enhancing financial sector supervision. This strong record of macroeconomic management has allowed a decline in debt-to-GDP ratios and an increase in financial and external buffers.

2. **Despite the strong policy framework, the Colombian economy remains exposed to external shocks**.

- ***Trade and FDI linkages have increased.*** Trade openness, as measured by the sum of total exports and imports, has increased from 28 percent of GDP in 2000 to 34 percent of GDP in 2011, largely reflecting the increase in oil and mining exports. FDI inflows have also been strong, averaging 4 percent of GDP, and are heavily concentrated in those sectors. The share of government's commodity-based revenue has also increased to 14 percent of total central government revenue (up from 6 percent in 2005). Colombia has thus become a major commodity exporter, with its current account, public finances, and activity heavily influenced by world commodity prices. In addition, Colombia remains heavily dependent on U.S. and European Union markets despite progress in increasing trade with neighboring countries (Peru, Brazil and Chile). Therefore, a protracted global recession or a hard landing in China (a major market for Colombian commodity exports), could be detrimental to growth and government revenues.

Colombia:Trade and Financial Integration 1/

	2003	2008	2011
Exports	14.6	16.4	17.6
of which Oil-related	3.6	5.2	8.5
Exports to EU	2.0	2.0	2.7
Exports to U.S.	6.1	6.0	6.6
Imports	14.0	16.0	15.9
FDI	1.8	4.5	4.1
of which oil-related	0.3	1.4	1.6
External Debt	40.2	19.7	23.2
Private Sector Credit	21.1	31.1	35.1
Foreign Banks Ownership (in percent of total banking assets)	25.1	25.2	22.7
Capital Adequacy Ratio	-	12.6	14.3
Combined Public Sector Deficit	-2.3	-0.1	-1.9
Oil Revenue (in percent of total revenues)	10.1	11.5	13.5
GIR (months of imports of NFGS)	6.4	7.4	5.7
GIR (% of short-term external debt +CAB)	110.5	144.5	101.1

Source: Colombia's National Department of Statistics (DANE); Fund staff estimates.
1/ In percent of GDP unless otherwise noted.

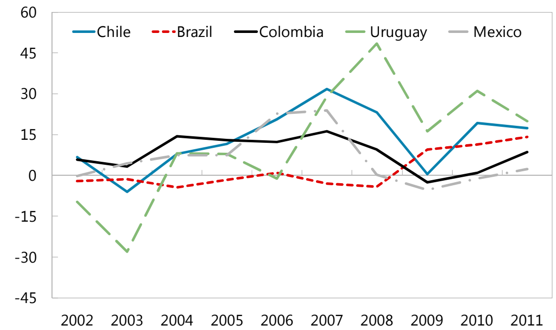
[1] Prepared by Teresa Daban Sanchez and Madelyn Estrada.

- ***Direct financial linkages are limited, but a deterioration in global sentiment would have an adverse impact.*** Foreign bank participation, at 22 percent of banking assets, is lower than in regional peers. European banks (comprising two Spanish banks) account for only 11 percent of banking assets. Colombian banks and non-financial corporations have limited foreign borrowing, either through cross-border banking loans or bonds, especially from the Euro area. Reflecting regulatory and tax barriers, portfolio inflows and non-resident holdings of public debt remain low in comparison to regional peers. That said, a sharp rise in global risk aversion or global interest rates, could affect Colombia's relatively low but fluid access to external financing or, in an extreme case, lower FDI inflows.

Annex II. Bank Credit to the Private Sector: Recent Developments and Risks[1]

1. **Colombia has experienced a decade of buoyant credit growth.** Supported by a stable macroeconomic environment, an improved security situation, and stronger banking supervision, credit to the private sector grew at an average of 8 percent in real terms during 2003–2011, among the highest in the region. The development of capital markets and innovation may also have played a role with the arrival of retail-lending-oriented foreign banks, with new technologies and business models, which resulted in a large increase in credit card business. The government's program to subsidize interest payments of mortgages, as part of the fiscal stimulus implemented in 2009, may also have contributed to credit growth.

Latin America: Credit Growth
(y-o-y, in percent)

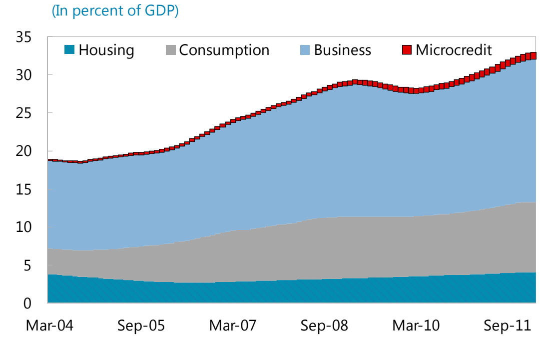


Source: World Ecomic Outlook (WEO).

2. **The benefits from the strong credit expansion are likely to have been sizeable, but new vulnerabilities have arisen.** These include:

- **A shift in credit composition towards household consumption.** The share of consumer loans in total credit has increased to almost 30 percent (up from 18 percent in 2004). Mortgages, however, account for only 12 percent of total credit. The caps on mortgage rates (at 10 and 12 percent for social and non-social housing, respectively) may exclude some higher-risk debtors from the mortgage market and tilt their borrowing toward short-term consumer finance.

Colombia: Private Credit Composition
(In percent of GDP)

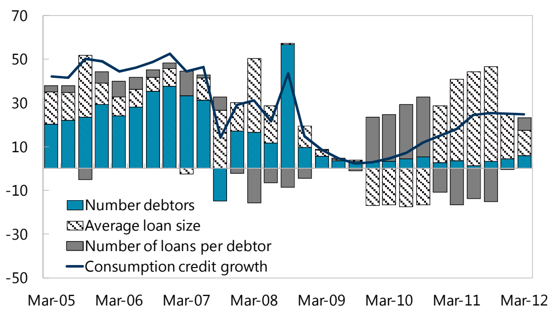


Source: Financial Superintendence of Colombia.

[1] Prepared by Teresa Daban Sanchez.

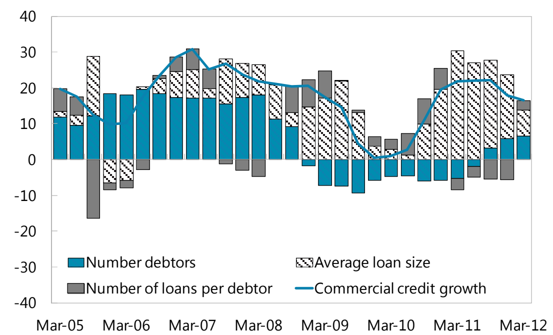
- **Credit growth in recent years has mainly reflected an increase in the average size of loans rather than in the number of debtors.** The exception to this has been micro-finance. Thus, the expansion in banking credit has not brought a commensurate increase in the population's access to the banking system, which would help promote investment and reduce concentration risk.

Colombia: Breakdown of Consumption Credit Growth
(In percent)



Source: Financial Superintendence of Colombia and Banco de la República.

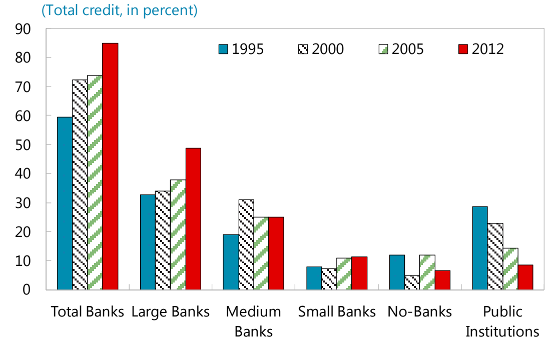
Colombia: Breakdown of Commercial Credit Growth
(In percent)



Sources: Financial Superintendence of Colombia and Banco de la República.

- **Credit growth has taken place in a context of high concentration of banks and debtors.** The four largest banks account for 50 percent of the total credit to the private sector. These banks have increased their market shares in recent years to the detriment of medium-size banks and public sector financial institutions. The demand is also concentrated. The 30 largest debtors have received 18 percent of total lending on average.

Colombia: Market Shares of Main Financial Institutions
(Total credit, in percent)



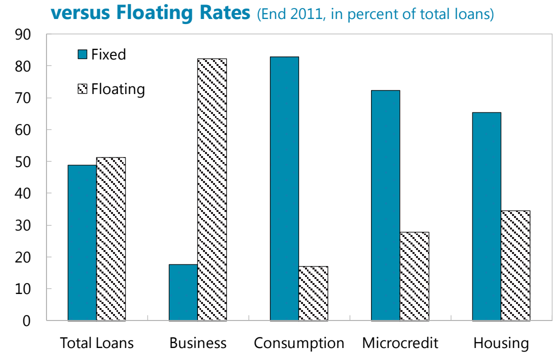
Source: Financial Superintendence of Colombia.

3. The FSAP Update notes a number of factors that could mitigate credit risks.

- ***Credit is still low compared with peers.*** Despite its recent growth, financial deepening in Colombia remains relatively low, with credit at 35 percent of GDP.

- ***Risks from currency mismatches and floating interest rates appear contained.*** Reflecting strict regulations on foreign currency-denominated operations and banks' net open positions, local currency loans account for 93 percent of bank loans. Moreover, more than half of the banks do not offer any foreign currency loans. Housing and microcredit loans are generally denominated in local currency. On average, 51 percent of loans are contracted at a floating rate. Most loans for consumption, mortgage and microcredit carry a fixed rate.

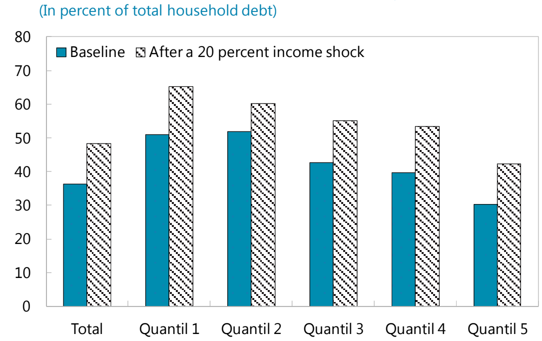
Colombia: Breakdown of Banking Loans at Fixed versus Floating Rates (End 2011, in percent of total loans)



Source: Financial Superintendence of Colombia.

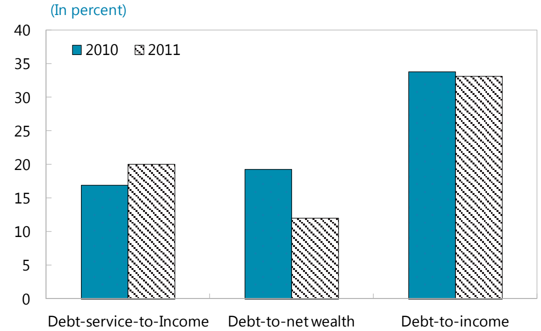
- ***The level of household indebtedness, although increasing, remains low.*** Aggregate data indicate that household debt service (measured as amortization and interest payments on consumption loans and mortgages) has increased recently, but still accounts for only 13 percent of wages and salaries. Micro-data,[2] using a broader debt definition, show that the average debt-service-to-income (DSI) ratio is around 20 percent (although it could rise to above 30 percent for some income levels after a 20 percent income shock). Moreover, the *debt-at-risk ratio*, defined as the debt of those debtors with a DSI ratio above 40 percent, is 36 percent of total household debt (could increase to 48 percent after a 20 percent income shock). This suggests that a few debtors, especially at the medium-high and high-income levels, have relatively high levels of debt and DSI ratios. The potential vulnerabilities stemming from this situation could be mitigated by the existing low loan-to-value ratios (around 50 percent).

Colombia: Household Debt-at-Risk by Income Groups
(In percent of total household debt)



Source: Banco de la República estimates based on the survey on Household Financial Conditions.

Colombia: Indicators of Household's Balance Sheet
(In percent)

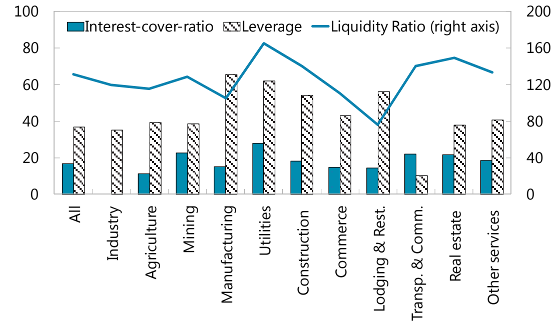


Source: Banco de la República; estimates based on the survey on Household Financial Conditions.

[2] Micro-data derive from a household survey conducted jointly by the central bank and the national statistics institute (the Survey on Households' Financial Conditions). It covers around 4,000 households in Bogotá (where 40 percent of banking credit is originated).

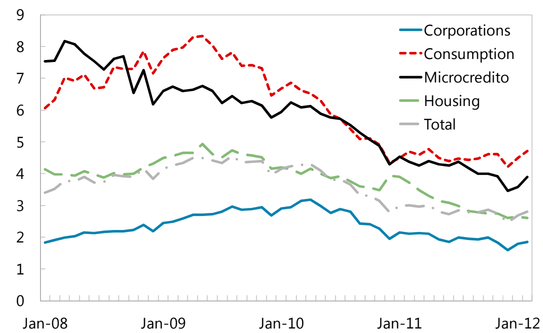
- ***Non-financial corporations' balance sheets look resilient, although with important differences across sectors.*** Colombian non-financial corporations have moderate levels of leverage (36 percent on average), reflecting the practice of relying on retained earnings as a key source of funding. Bank loans (mostly from domestic banks) represent about 43 percent of corporations' total liabilities. Financial stress appears low, with liquidity ratio (LR) and the interest cover ratio (ICR) of about 130 percent and 17 percent, respectively, and broadly resilient to interest shocks.[3] However, there are important differences across sectors. In fact, 20 percent of firms have an ICR below 1 (i.e. are financially stressed), and their debt (considered *debt-at-risk*), accounts for 36 percent of total corporate debt. Most financially stressed firms are concentrated in agriculture and mining, the two sectors with higher exposure to commodity prices swings.

Colombia: Corporations Financial Indicators
(In percent, 2011)



Source: Financial Superintendence of Colombia.

Colombia: NPL Ratio by Type of Loan
(In percent of total credit by type of loan)



Source: Financial Superintendence of Colombia.

- ***Nonperforming loans (NPLs) are manageable***. NPLs increased during the global financial crisis, reaching 4 percent at end-2009, but have since declined, partially due to increased write-offs during this period. NPL ratios vary by portfolio, with consumer and micro loans exhibiting slightly higher ratios at 4.8 and 4.5 percent, respectively, and commercial and housing at 1.8 and 2.5 percent, respectively. Provisions appear adequate, covering 163 percent of total NPLs (one-fifth of the provisions come from the dynamic provisioning system).

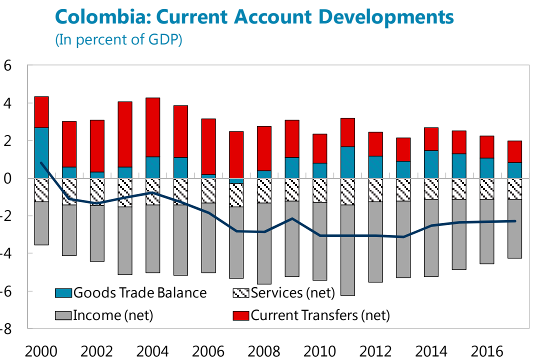
[3] A 300 basis point interest shock will reduce the average ICR to 13 percent and will increase the share of firms financially stressed to 23 percent and the debt-at-risk to 38 percent.

Annex III. External Sector Assessment[1]

Results from the External Balance Assessment (EBA) suggest that Colombia's current account is weaker than its medium-term norm and its exchange rate is above levels that can be explained by underlying fundamentals and desirable policies. Key country-specific characteristics, such as the large profit repatriation by foreign firms investing in Colombia and the recent expansion of the oil and mining sectors, do not seem to be appropriatetely captured in those results. Domestic policies that strengthen the current account balance can play a role in addressing the appreciation pressure, including continued fiscal consolidation, enhancing productivity through labor market reforms, and efforts to diversify export markets and products.

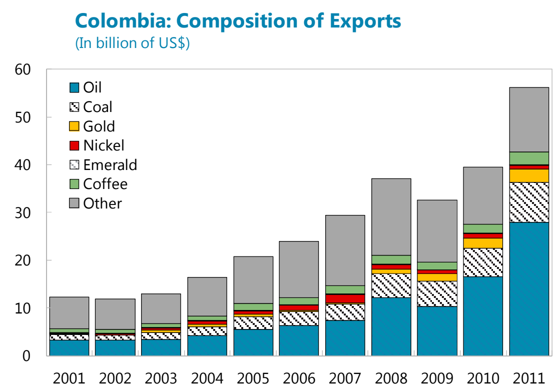
A. Current Account

1. Colombia has had a current account (CA) deficit since 2001, which widened after the global financial crisis, despite improvements in terms of trade and an expansion of the commodity sector. A strong oil balance owing to the expanding oil sector has been offset by a negative non-oil balance. This reflects the strong import demand for intermediate and capital goods, partly associated with foreign direct investment (FDI), and profit repatriation by foreign firms investing in Colombia, mainly in the oil and mining sectors. In 2011 net income outflows amounted to 4.8 percent of GDP, compared to a trade surplus of 0.3 percent of GDP and net current transfers of 1.5 percent of GDP.



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

2. Exports have increased substantially in recent years, driven by price effects and the expansion of the commodity sector, though nontraditional exports are also growing. Exports of goods have increased by 166 percent in U.S. dollar value terms and 51 percent in volume since 2005. Oil exports amounted to US$28 billion in 2011, five times larger than in 2005, and their share in total exports increased to 48 percent. The volume of

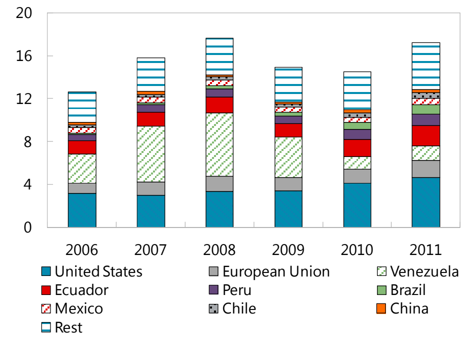


Sources: Banco de la República.

[1] Prepared by Toshiyuki Miyoshi. Madelyn Estrada provided research assistance.

oil exports increased by about 144 percent, reflecting the higher oil production. Nontraditional exports declined by about 18 percent (25 percent if gold and emerald exports are excluded) from 2008 to 2010, due to trade disputes with Venezuela (a large trading partner). However, nontraditional exports to other markets increased by 14 percent during the same period, especially to regional partners such as Brazil, Chile, Ecuador, and Peru. Moreover, recent trade data indicate that the recovery of exports to Venezuela has accelerated. While products heavily reliant on the Venezuelan market, such as textile and paper products, have not fully recovered, some other exports, such as chemicals and metal-related products, have been growing steadily.

Colombia: Destination of Nontraditional Exports
(In billion of US$)



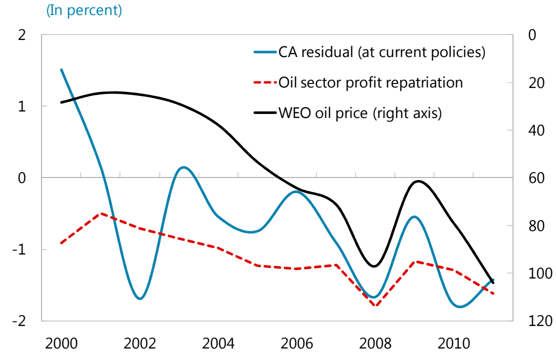
Source: DANE.

3. The results of the CA regression approach of the pilot External Balance Assessment (EBA) indicate that Colombia's actual CA deficit is close to its norm, with a large unexplained residual offset by policy gaps. Some country-specific characteristics might not be well captured in the analysis. According to the results, Colombia's cyclically-adjusted CA norm in 2012 is -2.6 percent of GDP, compared to an actual cyclically-adjusted CA balance of -2.7 percent of GDP.

- In terms of the cyclical adjustment, the higher terms of trade is more than offset by the relative output gap; although Colombia's output gap is almost closed, its main trading partners have larger negative output gaps on average.

- The total CA gap of -0.2 percent of GDP can be divided into policy gaps (fiscal balance, social spending, capital controls, and international reserves), which total 2.2 percent of GDP (of which 1.0 percent of GDP can be explained by domestic policies). This yields an unexplained residual of -2.3 percent of GDP. This large unexplained residual is likely associated with the expansion of the oil sector of the last decade. The CA residual has fluctuated in line with oil prices and profit repatriation by foreign oil companies, which has become increasingly synchronized as the share of oil exports in total exports increased. This behavior is not well captured by the CA regression approach.

Oil Sector and Current Account Regression Residual
(In percent)



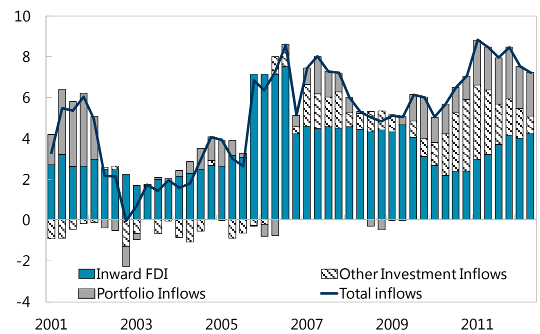
Source: Fund staff estimates.

4. The current account is projected to strengthen gradually over the medium term. FDI in the oil and mining sectors is projected to stabilize at recent levels. Import demand for intermediate and capital goods is expected to gradually decline, offsetting the impact of weakening terms of trade on exports. The recent rate of profit repatriation has been high, but is expected to decline in percent of GDP in line with the projected gradual decline of oil prices.

B. Capital Flows and International Investment Position

5. Since 2005, Colombia has received capital inflows in the range of 5–8 percent of GDP, mainly in the form of FDI. Inflows into Colombia have been stable compared to those in other countries where the share of portfolio and other short-term flows is larger. The increase in other investment inflows in 2010−11 reflects external borrowing to finance FDI by Colombian corporations and financial institutions, while equity inflows have also increased against the background of favorable growth prospects.

Colombia: Gross Capital Inflows
(Four-quarter cumulative, in percent of GDP)

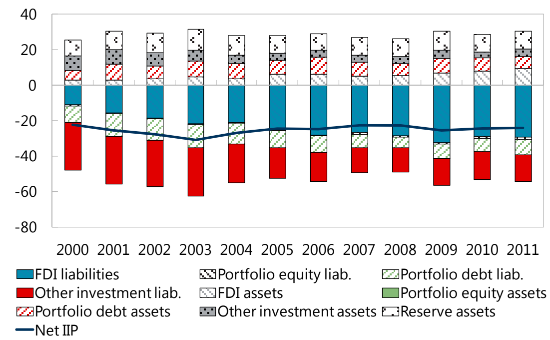


Sources: Banco de la República; IFS; Fund staff estimates.

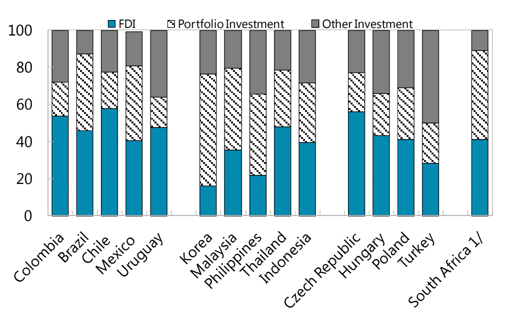
6. FDI inflows to Colombia are projected to remain at large owing to its strong medium-term fundamentals. In order for the oil and mining sectors to maintain their current level of production, FDI inflows are necessary. Colombia's investment climate is assessed to be 42nd of 183 countries in World Bank indicators on ease of doing business, which is higher than some regional peers. The improved security situations relative to the 1990s and earlier also boost Colombia's status as one of the main investment destinations in Latin America.

7. Despite their recent increase, portfolio and other short-term inflows to Colombia remain relatively low. Colombia's relatively small financial markets, partly a result of tight regulations on currency and maturity mismatches and net foreign exchange positions, is part of the reason. The absence of short-term instruments, and requirements for participation of foreign investors in the Colombian market (such as the requirement that their transactions be undertaken through a Colombia-based custodian or broker) are the others.

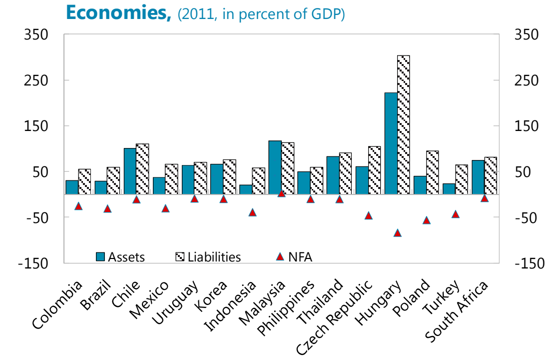
8. Colombia's net international investment position (IIP) and, in particular, its composition have improved with increasing share of FDI liabilities. The net IIP position in 2011 rose to -24 percent of GDP, from -30 percent in 2003. Liabilities amount to 54 percent of GDP, and the share of FDI in total liabilities increased from 23 percent in 2000 to 54 percent in 2011, which is relatively high. Colombia's net IIP position and level of external debt are relatively low compared to its peer countries.



Source: Banco de República; Haver Analytics.



Source: Banco de la República; Haver Analytics.
1/ Values for 2010.

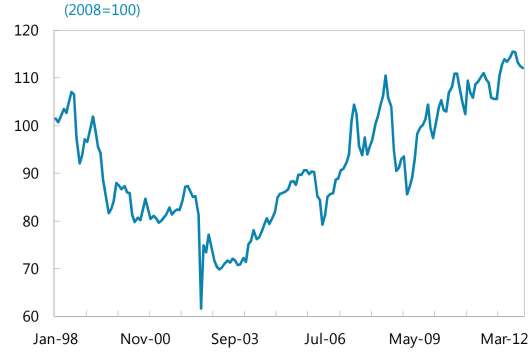


Source: IFS.

C. Real Exchange Rate

9. The real exchange rate has been trending upwards since 2004. The EBA's real exchange rate (RER) regression approach points to commodity terms of trade and the output gap (relative to Colombia's trade partners) as main drivers of an appreciation of the equilibrium exchange rate, consistent with the results of the CA regression approach (see Section A above).

10. The EBA results indicate that the real exchange rate is overvalued by a range of 1 to 8 percent, but large residuals warrant caution in interpreting the assessment. The RER regression approach points to an overvaluation of about 8 percent in 2012, after taking into account policy gaps of -10 percent, including from the fiscal balance and financial openness. The CA regression approach suggests a CA gap of -0.2 percent of GDP



Source: Information Notice System(INS).

in 2011, implying overvaluation of 1 percent.[2] However, there are residuals that cannot be explained (19 percent for the RER regression). This sizable residual may suggest that the models are not fully capturing the transformation of the Colombia's exports, with greater weights for the oil sector. The external stability approach suggests that the real exchange rate is broadly in line with the rate that would stabilize Colombia's external position (overvaluation of 5 percent).

Colombian Peso: External Balance Assessment Results

(Deviation from equilibrium, in percent)

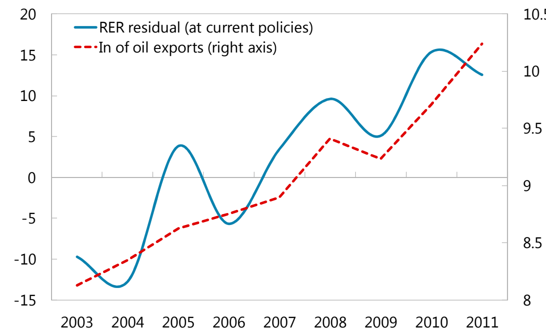
Methodology	
CA regression approach	1
Real exchange rate regression approach	8
External stability approach	5

Source: Fund staff estimates.

11. Since the real exchange rate strengthening seems to reflect improvements in fundamentals, domestic policies that lower the current account deficit have important roles to play in addressing the appreciation pressure. The government intends to strengthen the fiscal balance in the context of the structural fiscal rule and Congress has approved a comprehensive tax reform to reduce labor market informality. Other medium-term policies to enhance productivity growth could also help. These include strengthening tax administration, preserving resources for productive investment spending through streamlining current expenditure, and agriculture sector reform.

Colombia: RER Regression Residual and Oil Exports

(In percent)



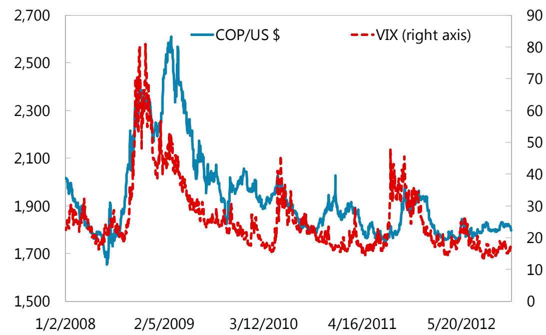
Source: Fund staff estimates.

[2] This represents the quotient of the CA gap and CA elasticity as used in the CGER methodology (see Lee, J. *et al.* (2008), *Exchange Rate Assessments: CGER methodologies*, IMF Occasional Paper No. 261).

D. Volatility in the Nominal Exchange Rate

12. The nominal exchange rate has fluctuated broadly in parallel with those in other countries in the region. There have been noticeable short-term fluctuations in recent years—for example, the peso appreciated by 12 percent in the first six months of 2011 but returned to end-2010 level by November, then appreciated again by 12 percent from December 2011 to April 2012 and became more stable thereafter. These fluctuations appear to be driven by changes in the degree of global risk aversion.

Colombia: Nominal Exchange Rate and VIX



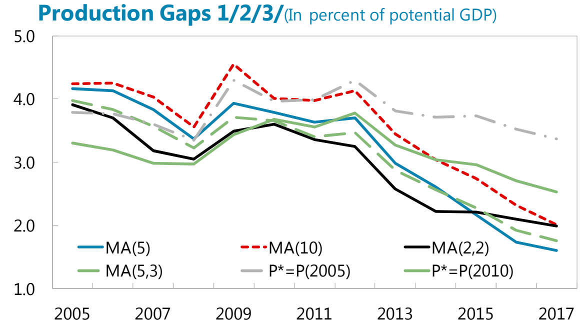
Source: Bloomberg.

Annex IV. Operationalizing Colombia's Structural Balance Fiscal Rule[1]

1. **Colombia introduced a structural fiscal balance rule for the central government in 2011 as part of a reform package to further strengthen the fiscal framework.** The new rule will provide a stabilizing and sustainable anchor for its fiscal policy by basing policy decisions on the country's underlying fiscal position adjusting for the impact of economic and commodity cycles. This framework helps avoid pro-cyclical fiscal policies that undermine macroeconomic stability and long-term public finances.

2. **The aim of the structural balance rule is to help insulate fiscal policy decisions from cyclical developments and to smooth the use of revenue gains over time.** The law establishes a ceiling on the central government structural deficit of 1 percent of GDP effective in 2022 and mandates that windfall revenues be saved in a stabilization fund. The resources in the stabilization fund could be used to finance counter-cyclical stimulus during years in which the output gap is negative and real growth is projected to lag potential growth by 2 percentage points or more. The law also establishes an independent advisory commission to help operationalize the rule and assess its implementation.

Structural Deficit Adjusted for Commodity Price and Production Gaps 1/2/3/(In percent of potential GDP)



Source: Fund staff estimates.
1/Oil production benchmark uses MA(2,1) smoothing process.
2/Reference oil price(P*).
3/ MA (x,y) stands for moving average with x years lag and y years lead.

3. **To implement the fiscal rule, the methodology for calculating the structural balance needs to be adapted to Colombia's characteristics and policy objectives.** In the short-run, a simple approach that is predictable and robust in its application can be useful for communicating the framework to the public. For example, a simple HP filter can be used to estimate the output gap; the cyclical component of non-commodity revenues can be derived on an aggregated basis; and the reference price and reference production level for oil can be based on relatively short moving averages of past and projected future oil prices and production volumes, respectively. One-off factors could be removed to better measure the underlying fiscal position, but should be used very sparingly to preserve transparency and credibility of the rule. Over the next two or three years, a more sophisticated approach could be developed where the output gap is estimated using a production function approach, revenue elasticities are estimated relative to individual taxes and tax bases, and additional commodities are added to the calculation once they contribute a substantial amount to government revenues.

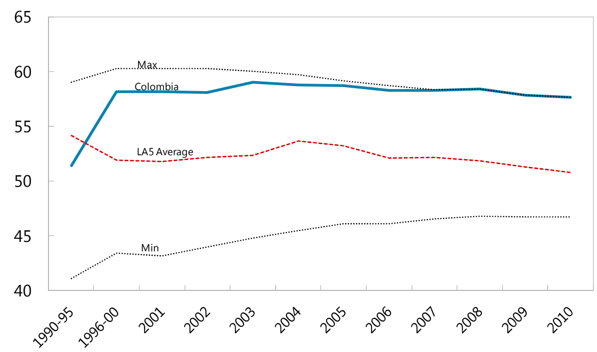
[1] Prepared by Chris Faircloth.

4. **An important policy decision facing the authorities is on what basis to save windfall oil revenues**. The method for determining the reference price for oil has a key influence on the degree of savings and smoothing of oil price fluctuations. Basing the reference price on a long backward-looking moving average (MA) approach would typically provide a greater degree of smoothing compared to approaches emphasizing shorter moving averages including current and projected future prices. A long backward-looking MA approach would also generate more savings if oil prices trend upward over time. However, this approach could also undermine credibility and acceptance of the rule if it leads to significant over-saving. Likewise, if oil prices trend down over long periods, the associated under-saving could threaten fiscal sustainability, especially if the price decline occurred before a sufficient savings buffer had been built. According to staff calculations, a symmetric (forward and backward) MA approach would be likely to deliver structural balances consistent with the authorities' 2014 target while also building some windfall savings.

Annex V. Inclusive Growth—A Long-Term Policy Challenge[1,2]

1. High income inequality in Colombia constitutes a long-standing policy challenge. Colombia has the highest Gini coefficient among major Latin American countries and the seventh highest worldwide, with inequality levels comparable to Haiti and Angola. Moreover, while income inequality in most Latin American and middle income countries has decreased over the past two decades, Colombia's Gini coefficient has been stagnant, a feature that is at odds with the country's relatively strong and stable growth profile over this period. Research suggests that this outcome is explained by distortions in Colombia's redistributive policy framework, which have undermined the sharing of economic gains.

Income Inequality in Latin America 1/
(GINI Index)



Source: World Bank.
1/LA5 is compromised of Brazi, Chile, Mexico, Peru, and Uruguay

2. Redistribution through fiscal policy is largely ineffective due to distortions in the institutional and policy framework. Public monetary transfers and tax policy (direct and indirect) are key policy levers to reduce income inequality. In Colombia, institutional policy weaknesses in these areas have contributed to high inequality.[3] A recent World Bank report characterized Colombia's tax system as overly complex, inefficient—as measured by revenue yields using regional and developmental metrics—and regressive. The report attributed these deficiencies to the pervasive use of tax expenditures. Specifically, tax expenditures, which have increased by 60 percent over the past decade, have seriously eroded the tax base (by an estimated 4½ percent of GDP) and generally benefit the richest segment of the population, thus compromising the system's redistributive potential. Additionally, Colombia's public pension system is regressive, with 86 percent of all pension payments being received by the richest

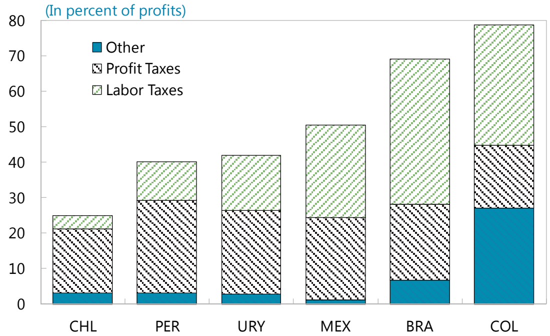
[1] Prepared by Chris Faircloth.

[2] Background papers for this note are: IMF, 2012, Colombia—A Framework for Analyzing Long-Term Fiscal Projections and Pension Reform (Washington); IMF, 2011a, Colombia—Towards a More Competitive Tax System (Washington); IMF, 2011b, Colombia—2011 Article IV Consultation (Washington); Moller, L., 2012, "Fiscal Policy in Colombia—Tapping its Potential for a More Equitable Society," Policy Research Working Paper No. 6092, (Washington: World Bank); and World Bank, 2012, Tax Expenditures in Colombia: A Proposal for a Comprehensive and Systematic Evaluation of this Policy Instrument (Washington).

[3] Pre market income inequality (i.e. pre tax and transfers) in Colombia is similar to that observed in the United Kingdom (U.K.). However, the U.K. uses its tax-transfer system more actively to reduce its Gini coefficient by 16 points more than in Colombia.

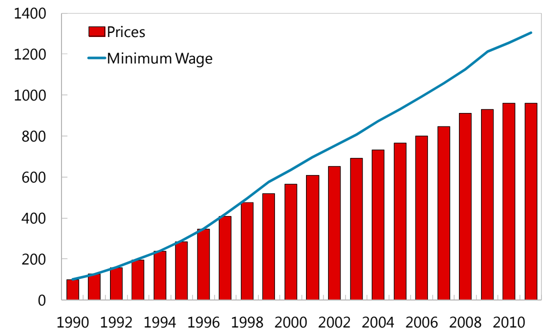
quintile of the population, and has low coverage (only 25 percent of the population). Labor market studies have also identified high non-wage costs and the rapid real increases in the minimum wage as main contributing factors to the high structural unemployment and informality, which in turn perpetuate a cycle of poverty (see 2011 Article IV Consultation). Finally, the tradition of linking the increase in monetary transfers—such as the minimum pension payment—to minimum wage growth has, in practice, effectively reduced the resource envelope that could be dedicated to other redistributive initiatives.

Labor Taxes and Mandatory Contributions in Major Latin American countries
(In percent of profits)



Source: World Bank Doing Business Indicators (2011).

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



Source: Fund staff estimates.

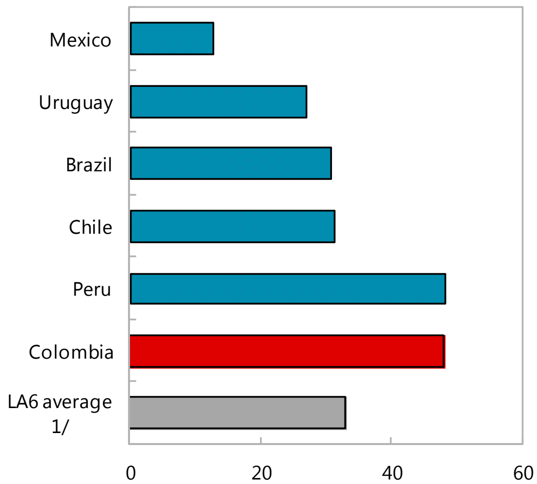
3. The government considers reducing income inequality to be a policy priority and has taken some modest measures. The National Development Plan targets a reduction of 1 percentage point in the Gini coefficient per year between 2010 and 2014, and the administration has introduced several policy measures that may help in achieving this objective. The recently approved Victim's Law is likely to improve land distribution. A 2010 tax reform increased the rate and base of the wealth tax paid by corporations and individuals, but is a temporary measure that lapses in 2014. The government is making progress in phasing in universal and equal access to healthcare, and the recent reform of the royalty system from natural resource production implies a more equitable distribution of revenue across sub-national entities. Finally, a recent tax reform approved by Congress has equity as a main objective.

4. A comprehensive and coordinated overhaul of existing institutional redistributive frameworks could achieve multiple priority policy objectives. Strengthening inclusive growth, improving economic efficiency, and securing needed fiscal savings to safeguard fiscal sustainability are not mutually exclusive objectives. A holistic tax reform package coupled with other priority structural reforms could make meaningful progress on all these fronts. For example, streamlining the VAT system, including by consolidating VAT rates and eliminating VAT exemptions (except on health, education, transport and leasing), alongside reforms to the personal income tax system that (i) eliminate the exemption on the first 25 percent of income; (ii) remove the deduction for other voluntary savings accounts; and (iii) introduce the taxation of pension income in line with international best practice, are estimated to generate fiscal savings in the order of 2½ percent of GDP. Part of these savings could be allocated to increasing Colombia's conditional cash transfer program, which has proven to be an effective poverty reducing scheme. This tax overhaul could be complemented by parametric reforms to the public pension system—including equalizing and increasing the retirement ages for men and women, reducing replacement rates for new retirees, and imposing a 10 percent surcharge on high-income retires—to help improve equity and secure important fiscal savings.[4] Finally, Colombia's tradition of linking the increases in fiscal transfers to the growth in the minimum wage could be dismantled.

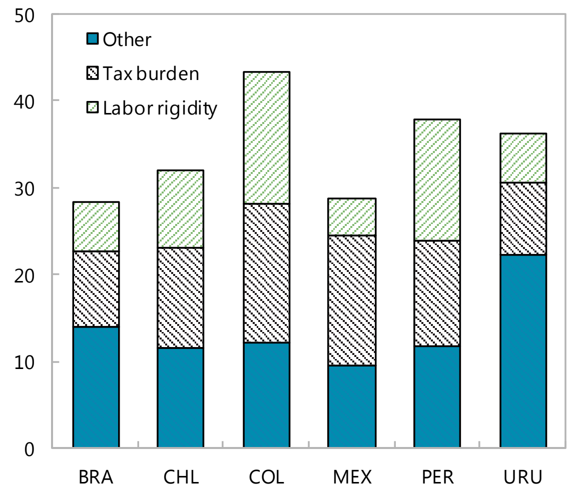
[4] A recent Fund TA mission estimated that these reforms would generate fiscal savings of 1 percent of GDP over the long-term. Nevertheless, even after these reforms, Colombia's replacement rate would remain among the highest in the world and additional fiscal measures would be necessary to meet the targets under the fiscal rule. In this context, a fuller range of pension reform measures should be considered, including increases in the degree and magnitude of contribution rates as well as shifting to a framework where benefits are calculated on the basis of average lifetime incomes.

Latin America: Labor Market and Social Indicators

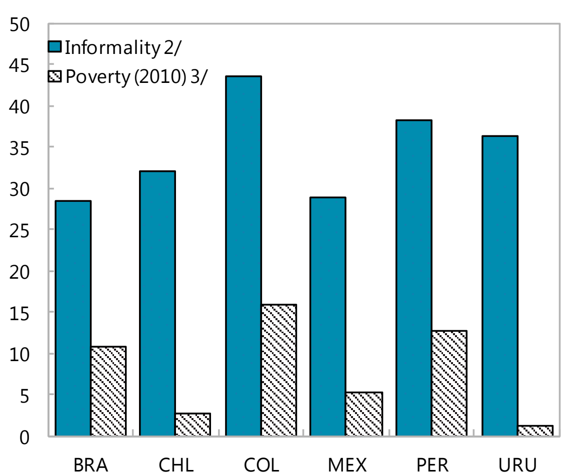
Minimum Wage in Major Latin American Countries
(In percent of per capita GDP, 2011)



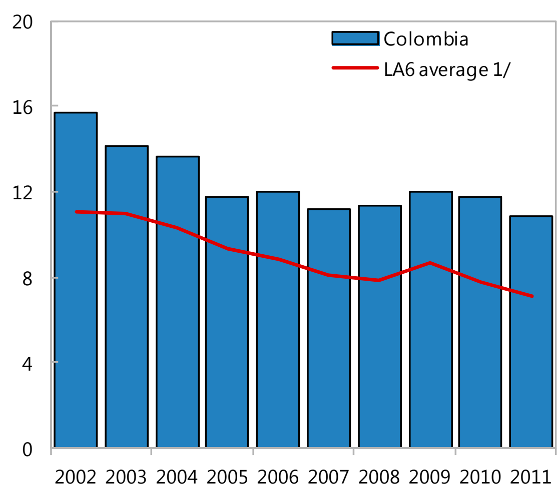
Size and Causes of the Informal Economy in LA6 Countries 2/ (In percent)



Informality and Poverty in Major Latin American Countries (In percent)



Unemployment in Major Latin American Countries
(Average, in percent)



Sources: World Bank; International Labor Organization; IMF WEO.

1/ LA6 is comprised of Brazil, Colombia, Mexico, Peru, Chile and Uruguay.

2/ Guillermo Vuletin, Measuring the Informal Economy in Latin America and the Caribbean, IMF Working Paper (WP/08/12), Washington DC, 2008. The informal economy is measured using a multiple indicators, multiple causes structural estimation approach. The measures differ from national estimates (in particular, around 60 percent in Colombia and an LA6 average of 50 percent).

3/ Poverty rate ($2 a day (PPP)). Data for Brazil and Chile correspond to 2009, and for Mexico to 2008. Colombia's poverty was 20.9 percent in 2008 and 18.5 percent in 2009.

INTERNATIONAL MONETARY FUND

COLOMBIA

STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

January 8, 2013

Prepared By

The Western Hemisphere Department
(In collaboration with other departments)

CONTENTS

FUND RELATIONS

(As of November 30, 2012)

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

General Resources Account:

	SDR Million	Percent Quota
Quota	774.00	100.00
Fund holdings of currency	518.73	67.02
Reserve position	255.28	32.98

SDR Department:

	SDR Million	Percent Allocation
Net cumulative allocation	738.32	100.00
Holdings	736.06	99.69

Outstanding Purchases and Loans: None.

Latest Financial Arrangements:

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

Projected Payments to Fund (in SDR Million):

	Forthcoming				
	2012	2013	2014	2015	2016
Principal					
Charges/interest	0.01	0.01	0.01	0.01	0.01
Total	**0.01**	**0.01**	**0.01**	**0.01**	**0.01**

Implementation of HIPC Initiative: Not applicable.

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

WORLD BANK RELATIONS[1]

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

For FY 13–16 the lending program is expected to be US$800−1,000 million per annum. Actual delivery of the lending program will depend on Colombia's performance, IBRD lending capacity, demand from other borrowers, global economic developments, and disbursement profiles that keep exposure within the country limits.

Trust funds have continued to be an integral part of the Bank's engagement with Colombia. As trust fund resources are not predictable for the purpose of the CPS, the WBG is ensuring that activities financed by trust funds follow the thrust of this strategy in agreement with the government counterparts.

The CPS thematic areas are managed under an enhanced thematic business model approach. This approach aims to improve the impact of the Bank's engagement in Colombia. Financial, knowledge, and convening services are developed as a comprehensive package of support under each theme to deliver timely and flexible development solutions.

As of end of November 2012, Colombia was among the 10 top Bank borrowers in terms of IBRD exposure with US$7.4 billion debt outstanding, representing close to 6.8 percent of the IBRD's total portfolio. Net commitments currently stand at US$2.5 billion of which US$1.2 billion remains undisbursed. The active portfolio is composed of 21 IBRD projects. During FY 12, the Bank approved three projects for a total of US$600 million. Total FY 13 lending is envisaged at around US$700 million and FY 14 US$450 million.

[1] Prepared by World Bank staff.

Operations Portfolio (IBRD/IDA and Grants)
As of November, 2012
(In millions of .U.S. Dollars)

Closed Projects	196
Active Projects	21
IBRD/IDA	
Total Disbursed (Active)	1.348
Of which has been repaid	79.28
Total Disbursed (Closed)	6.488.2
Of which has been repaid	2.392.55
Total Disbursed (Active + Closed)	7836.2
Of which has been repaid	2471.83
Total Undisbursed (Active)	1.187

Loan Information (IBRD)
As of November, 2012
(In millions of U.S. dollars)

FY*	2007	2008	2009	2010	2011	2012
Total Disbursements	830	638	1240	1592	488	396
Repayment Amount	278	381	170	258	277	241
Net Disbursements	477	257	1070	1334	211	155

*Fiscal Year: July 1 - June 30

International Finance Corporation (IFC) Portfolio
(as of Nov. 30, 2012)

Debt ($m)	Equity ($m)	Quasi Equity ($m)	Total ($m)	Guarantee
336	242	125 (Loan + Equity)	707	4

Investment Business – Top sectors and Clients

Sector 1	Finance & Insurance
Sector 2	Transportation & Warehousing
Sector 3	Electric Power
Sector 4	Pulp & Paper
Sector 5	Information
Top client	DAVIVIENDA I

INTER-AMERICAN DEVELOPMENT BANK RELATIONS[2]

The Bank's ongoing country strategy with Colombia (2012–2014) identifies the main targets of engagement in the areas of Transportation, Science, Technology, and Innovation, Trade and Integration, Access to Financial Services, Education and Vocational Training, Social Protection, Health, Water Supply and Sanitation, Housing and Urban Development, Risk Management.[3] These areas are part of a comprehensive vision for the development process of the country, aimed at creating a "virtuous circle" between the objectives of increased growth, and reducing poverty and inequality. 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.

The sovereign guarantee lending envelope under the current Strategy was estimated at US$852 million per year, which total US$3.40 billion for the years 2012 to 2014. During 2012 the Bank approved US$508 million in sovereign guarantee operations, non-sovereign guarantee lending reached US$7.2 million, US$13.1 million were approved for Technical Cooperations, and US$4.25 million were approved for Investment Grants. This year disbursements of US$454.2 million took place.

The Bank portfolio is currently composed of 27 sovereign guarantee operations totaling US$2.86 billion, with a disbursed amount of US$1.73 billion (60 percent). A total of 14 operations for US$1.54 billion are concentrated in competitiveness, trade and integration areas (52 percent of the portfolio), 5 are operations for social development (18 percent) and 8 are operations of governance and institutions (30 percent). The non-reimbursable technical cooperation portfolio includes 109 operations with an approved value of US$68.9 million.

The current portfolio of private sector initiatives (non-sovereign guarantee) in Colombia consists of 7 loans, totaling US$219.08 million. This portfolio supports interventions in the transport 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 38 operations valued at US$40.46 million that supports microfinance institutions in

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

[3] The Strategy for 2012–14 was approved in February 2012.

underserved areas, provides seed capital and helps improve management practices of small and medium enterprises.

Colombia Sovereign Loan Portfolio As of December 26, 2012			
	Number of Operations	Current Approved US$M	Disbursement (percent)
Competitiveness	14	1,546.6	37
Social Development	5	476.0	89
Governance	8	841.4	88
Total	27	2,864.0	60

STATISTICAL ISSUES

(as of December 26, 2012)

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. Annual and quarterly estimates of GDP by the production and the expenditure approaches use 2005 as reference year. GDP compilation conforms to the methodological recommendations of the System of National Accounts 1993 (*1993 SNA*) and some recommendations from the *2008 SNA*. The rebasing of the national accounts' base year included a methodological change regarding the volume measures from a fixed-base Laspeyres index to a Laspeyres chain index with 2005 as a reference 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 an upward 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. The Colombian authorities have reaffirmed their commitment to adopt the *GFSM 2001* framework, enhance inter-institutional coordination, and increase the resources allocated to compiling government finance statistics. While significant progress has been made, there is still a need to take additional steps. In the short term these include: adopting a common list of public sector entities, and disseminating high-frequency data on a national and international level.

The General Accounting Office (GAO) has developed a single accounting 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 Financial Superintendence (FS) 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 services sector, have enhanced coverage and consistency and financial account data are now based on actual disbursement rather than registers.

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

II. Data Standards and Quality

Colombia subscribes to the Special Data Dissemination Standard (SDDS) and metadata are posted on the Fund's Dissemination Standards Bulletin Board (DSBB).	A data ROSC was published in October 2006.

III. Reporting to STA (optional)

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

Colombia: Table of Common Indicators Required for Surveillance

As of December 21, 2012

	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]	Data Quality – Accuracy and Reliability[9]
Exchange Rates	Nov. 2012	Dec. 5, 2012	D	W	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[2]	Nov. 2012	Dec. 10, 2012	M	M	M		
Reserve/Base Money	Nov. 2012	Dec. 13, 2012	D	W	W	LO, O, LO, LO	O, O, O, O, O
Broad Money	Oct. 2012	Dec. 12, 2012	D	W	W		
Central Bank Balance Sheet	Nov. 2012	Dec. 13, 2012	M	M	M		
Consolidated Balance Sheet of the Banking System	Oct. 2012	Dec. 12, 2012	M	M	M		
Interest Rates[3]	Nov. 2012	Dec. 5, 2012	D	W	D		
Consumer Price Index	Nov. 2012	Dec. 13, 2012	M	M	M		
Revenue, Expenditure, Balance and Financing Composition[4] – General Government (GG)[5]	2011	Dec. 2012	Q	Q	Q	O, O, LO, O	LO, O, O, O, NO
Revenue, Expenditure, Balance and Composition of Financing[4] – Central Government	2011	Dec. 2012	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[6]	2011	Dec. 2012	Q	Q	Q		
External Current Account Balance	Q2 2012	Oct. 11, 2012	Q	Q	Q	O, LO, LO, LO	O, O, O, O, LO
Exports and Imports of Goods and Services	Q2 2012	Oct. 11, 2012	Q	Q	Q		
GDP/GNP	Q2 2012	Oct. 18, 2012	Q	Q	Q	O, LO, O, O	LO, O, LO, LO, NO
Gross External Debt	Aug. 2012	Dec. 2012	M	M	M		
International Investment Position[7]	Q2 2012	Nov. 9, 2012	Q	Q	Q		

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

Statement by the IMF Staff Representative on Colombia
January 23, 2013

1. This statement provides additional information that has become available since the staff report was issued. It does not alter the thrust of the staff appraisal.

2. **Real GDP growth slowed to 2.1 percent in the third quarter (y/y), from 4.9 percent (y/y) in the second quarter.** The slowdown mainly reflects weak performance of the construction and the oil and mining sectors, resulting from delays in the approval of construction licenses and slow implementation of public investments. In light of these, the staff report projection of annual output growth of 4.3 percent may prove optimistic.

3. **Headline inflation fell to 2.4 percent in December (y/y) from 2.8 percent (y/y) in November,** owing to lower regulated and food price inflation. Core inflation eased slightly to 3.2 percent.

4. **Unemployment fell to 9.2 percent in November 2012, down from an average of 10.8 percent in 2011.**

5. **According to preliminary data, the central government deficit in 2012 was 2.4 percent of GDP, somewhat above the staff report's projection.** Lower-than-envisaged revenue accounts for the difference.

6. **Monetary policy was eased further in December.** On December 21, the central bank lowered the policy rate by 25 basis points (to 4.25 percent), bringing total cuts to 100 basis points in the second half of 2012. The nominal exchange rate closed the year at 1,768.2 pesos per dollar (1,942.7 at end 2011) while gross international reserves at end-December were US$37.0 billion (US$31.9 billion at end-December 2011).

7. **On January 1, 2013, the government raised the minimum wage by 4 percent.**

8. **The tax bill approved by Congress on December 20, 2012 preserved most of the government's proposals to address inequality and informality.** The reform (effective January 1, 2013) mandates:

i. the elimination of payroll taxes for salaries less than 10 minimum wages;

ii. the creation of an "equity tax" for corporations, with a statutory rate of 9 percent for 2013–2015 (8 percent afterwards) and a tax base slightly broader than the corporate income tax; proceeds from this tax will be earmarked to social spending programs previously financed by payroll taxes;

iii. a reduction in the statutory corporate income tax rate (from 33 percent to 25 percent); and a reduction in the withholding tax rate on non-residents' earnings from portfolio investment (from 33 percent to 14 percent);

iv. the creation of a minimum personal income tax with rates from 0 percent to 27 percent, levied on individuals with monthly incomes above 4.2 minimum wages;

v. a consolidation of seven VAT rates to three rates of 0, 5 and 16 percent; and the creation of a national consumption tax for certain goods (e.g. luxury goods, vehicles) and services (e.g. restaurants);

vi. other administrative measures aimed at reducing tax evasion.

9. **In early January 2003, the Ministry of Health announced the government's intention to submit draft legislation for health care reform to Congress by March.** The reform would include: (i) the definition and costing of health services, especially under the subsidized regime; (ii) the unification of public funds earmarked to finance health services; and (iii) the modernization of the Superintendence of Health Services.

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February 4, 2013

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

IMF Executive Board Concludes 2012 Article IV Consultation with Colombia

On January 23, 2013, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Colombia.[1]

Background

Colombia's economy has been resilient to the adverse global shocks of recent years. A very strong policy framework and skillful policy management provided the authorities with policy space to undertake effective countercyclical measures to mitigate the impact of the global crisis of 2008-09. Output growth rebounded strongly in 2010 and rose to almost 6 percent in 2011, supported by sound macroeconomic policies, favorable terms of trade, and Flexible Credit Line

[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.

arrangements. As the output gap closed, the central bank raised the policy rate from 3 percent at end-2010 to 5.25 percent in February 2012.

During 2012 growth is expected to have moderated to below its estimated potential rate of 4½ percent, largely reflecting the lagged impact of countercyclical policies, supply shocks, and weaker external demand. Headline inflation fell to 2.4 percent (year-on-year) by end-year, from 4 percent in late 2011. Following several years of robust economic expansion, the unemployment rate declined to 9.2 percent at end 2012 (from more than 17 percent in 2002). The external current account deficit remained broadly unchanged at 3 percent of GDP despite the moderation in growth and the high export prices; large imports and profit repatriations by multinational firms seem to have been key contributing factors. The current account deficit continued to be more than covered by large net inflows of foreign direct investment, putting upward pressure on the peso and leading to a balance of payments surplus that is likely to exceed US$5 billion.

The macroeconomic policy stance during 2012 was broadly neutral. The fiscal stance, measured in terms of the non-oil balance, is estimated to have been broadly the same as in 2011, and the public debt ratio is projected to fall to 33½ percent. The monetary tightening of 2011, combined with higher provisioning requirements, helped rein in the rate of growth of bank credit. Amidst an economic slowdown that was more pronounced than anticipated, the central bank lowered the policy rate by 100 basis points to 4.25 percent in the second half of the year.

The financial health of Colombia’s credit institutions appears sound. The banking system remains well-capitalized and profitable; nonperforming loans are low and well-provisioned; and funding is stable, relying mostly on domestic deposits. The Financial Superintendency effectively supervises all financial institutions, and is taking steps to strengthen supervision further.

In 2013, Colombia’s real GDP growth is projected to be around its estimated potential rate while inflation is projected to remain close to the midpoint of the central bank’s target range. The external current account deficit is expected to remain at about 3 percent of GDP. Spillovers from the global turmoil have been limited so far. However, Colombia remains vulnerable to a sharp growth slowdown in trading partners, a steep drop in oil prices, or a sharp rise in global risk aversion.

Executive Board Assessment

Executive Directors commended the Colombian authorities for their strong policy framework and skillful macroeconomic management, supported by the Flexible Credit Line (FCL) arrangement, which have helped increase resilience to adverse shocks and maintained strong growth and low inflation. Directors recognized that spillovers from the global turmoil had been limited so far, but noted that the economy remains vulnerable to a steep drop in oil prices, a sharp growth slowdown in trading partners, and a sharp rise in global risk aversion. They considered, however, that Colombia appears well positioned to address the important medium-term challenges facing the economy.

Directors agreed that the broadly neutral policy stance planned for 2013 is appropriate, and that the 2013 budget is in line with medium-term fiscal consolidation plans. They concurred that, in the context of a flexible exchange rate regime, there is room for further monetary easing if downside risks materialize. A comfortable level of international reserves, reinforced by the FCL arrangement, and low ratios of external and public debt provide additional buffers. Directors noted the staff's assessment that the exchange rate is broadly in line with fundamentals.

Directors commended the authorities for the recently approved tax reform and their plans to reform the pension system. Most Directors encouraged the authorities to consider a more ambitious fiscal consolidation plan, focused on increasing non-commodity revenues, which could help mitigate the appreciation pressures, build buffers against adverse commodity price shocks, and create fiscal space for improving public infrastructure.

Directors noted the soundness of the financial system, which appears resilient to a wide range of shocks and is effectively supervised, although concentration risks remain a source of fragility. They urged the authorities to step up their efforts to improve the risk-based approach to supervision in line with Pillar 2 of the Basel II framework, promote the de jure independence and legal protection of supervisors, strengthen the financial safety net, guard against concentration risks, and extend supervisory and regulatory powers to holding companies of financial institutions. Directors emphasized the need to continue making progress in financial deepening to entrench financial stability further and reduce the risks from concentration.

Looking ahead, Directors considered that Colombia's strong policy frameworks bolster its ability to address medium-term challenges, including the uncertain global environment, high unemployment and income inequality, high reliance on commodity-based revenues, and low labor productivity. Addressing these challenges will require decisive actions to boost competitiveness, reduce the high rates of informality, increase national saving, and diversify exports.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case. The staff report (use the free Adobe Acrobat Reader to view this pdf file) for the 2012 Article IV Consultation with Colombia is also available.

Colombia: Selected Economic Indicators

	2006	2007	2008	2009	2010	Prel. 2011	Proj. 2012	Proj. 2013
	(Annual percentage changes, unless otherwise indicated)							
National Income and Prices								
Real GDP	6.7	6.9	3.5	1.7	4.0	5.9	4.3	4.4
Consumer price index (period average)	4.3	5.5	7.0	4.2	2.3	3.4	3.2	2.9
Consumer price index (end of period)	4.5	5.7	7.7	2.0	3.2	3.7	2.4	3.0
GDP deflator	5.8	5.0	7.6	3.4	3.6	6.9	3.5	1.9
Terms of trade (deterioration -)	2.5	3.9	10.3	-10.0	10.0	13.4	5.3	-4.9
Real effective exchange rate (depreciation -)	-1.0	7.7	0.4	5.2	5.5	4.0	...	...
	(In percent of GDP, unless otherwise indicated)							
Public finances								
Central government balance	-3.4	-2.7	-2.3	-4.1	-3.9	-2.8	-2.0	-2.2
Combined public sector	-0.7	-0.7	-0.1	-2.7	-3.3	-1.9	-0.8	-1.2
Public debt 1/	36.8	32.7	30.9	36.7	36.9	36.0	33.5	32.4
External Sector								
Current account (deficit -)	-1.9	-2.8	-2.9	-2.1	-3.1	-3.1	-3.1	-3.1
External debt	25.0	21.2	19.7	23.2	22.7	23.2	22.5	22.5
Of which: Public sector	16.4	13.7	12.5	16.0	13.9	13.1	13.3	13.5
GIR in percent of short-term debt	147.6	198.7	207.3	242.5	194.7	157.7	166.4	168.7
Savings and Investment								
Gross domestic investment	22.4	23.0	23.5	22.4	22.0	23.5	23.8	23.4
Gross national saving	20.5	20.2	20.6	20.3	19.0	20.4	20.7	20.2
	(12-month percentage changes, unless otherwise indicated)							
Money and credit								
Broad money (M2)	18.0	17.4	18.5	8.1	11.5	18.9	10.1	10.2
Credit to the private sector	35.6	25.6	14.0	0.9	6.8	22.9	13.5	13.1
Interest rate (90-day time deposits; percent per year)								
Nominal	6.8	9.0	10.1	4.1	3.5	5.1	...	...
Real	2.3	3.3	2.4	2.1	0.3	1.4	...	...

Sources: Colombian authorities; and IMF staff estimates and projections.
1/ Includes Ecopetrol and Banco de la Republica's outstanding external debt.

Colombia: Selected Economic Indicators

	2006	2007	2008	2009	2010	Prel. 2011	Proj. 2012	Proj. 2013
	(Annual percentage changes, unless otherwise indicated)							
National Income and Prices								
Real GDP	6.7	6.9	3.5	1.7	4.0	5.9	4.3	4.4
Consumer price index (period average)	4.3	5.5	7.0	4.2	2.3	3.4	3.2	2.9
Consumer price index (end of period)	4.5	5.7	7.7	2.0	3.2	3.7	2.4	3.0
GDP deflator	5.8	5.0	7.6	3.4	3.6	6.9	3.5	1.9
Terms of trade (deterioration -)	2.5	3.9	10.3	-10.0	10.0	13.4	5.3	-4.9
Real effective exchange rate (depreciation -)	-1.0	7.7	0.4	5.2	5.5	4.0	...	...
	(In percent of GDP, unless otherwise indicated)							
Public finances								
Central government balance	-3.4	-2.7	-2.3	-4.1	-3.9	-2.8	-2.0	-2.2
Combined public sector	-0.7	-0.7	-0.1	-2.7	-3.3	-1.9	-0.8	-1.2
Public debt 1/	36.8	32.7	30.9	36.7	36.9	36.0	33.5	32.4
External Sector								
Current account (deficit -)	-1.9	-2.8	-2.9	-2.1	-3.1	-3.1	-3.1	-3.1
External debt	25.0	21.2	19.7	23.2	22.7	23.2	22.5	22.5
Of which: Public sector	16.4	13.7	12.5	16.0	13.9	13.1	13.3	13.5
GIR in percent of short-term debt	147.6	198.7	207.3	242.5	194.7	157.7	166.4	168.7
Savings and Investment								
Gross domestic investment	22.4	23.0	23.5	22.4	22.0	23.5	23.8	23.4
Gross national saving	20.5	20.2	20.6	20.3	19.0	20.4	20.7	20.2
	(12-month percentage changes, unless otherwise indicated)							
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Credit to the private sector	35.6	25.6	14.0	0.9	6.8	22.9	13.5	13.1
Interest rate (90-day time deposits; percent per year)								
Nominal	6.8	9.0	10.1	4.1	3.5	5.1	...	...
Real	2.3	3.3	2.4	2.1	0.3	1.4	...	...

Sources: Colombian authorities; and IMF staff estimates and projections.
1/ Includes Ecopetrol and Banco de la Republica's outstanding external debt.

Statement by Maria Angelica Arbelaez, Alternate Executive Director for Colombia
January 23, 2013

Article IV Consultation

The Colombian authorities thank the mission team for the constructive and open-minded discussions held in Bogota. They broadly agree with staff's assessment and policy recommendations. The marginal differences in perception in some specific areas were adequately addressed in the staff report.

Economic outlook

After reaching a growth rate of 5.9 percent in 2011, the economy slowed down in 2012 with growth expected to be around 4 percent. The deceleration is partially explained by the tightening of monetary policy undertaken by the central bank (Banco de la República, BR) since the first quarter of 2011 in response to demand and credit pressures. However, other factors have accentuated the downward trend in the second semester, such as the decline in external demand, currency appreciation and supply difficulties that emerged in some sectors. Growth has been led mainly by domestic investment (25.5 percent of GDP), as well as by foreign investment (4.5 percent of GDP). It is expected that the economy will grow by around 4.5 percent in 2013, close to its potential.

Macroeconomic policies have continued to be prudent and well complemented by the FCL, and economic fundamentals remain strong. In 2012 inflation held at 2.4 percent; the consolidated fiscal deficit slowed to around 0.4 percent of GDP and the central government deficit to 2.4; the debt of Non Financial Public Sector declined to 26 percent of GDP (to 34 percent for the Central Government); the current account deficit remained around 3 percent of GDP financed mostly by FDI inflows; and the level of international reserves increased and remains adequate. Access to markets has continued to be comfortable and spreads have constantly narrowed. In September 2012, Colombia issued foreign sovereign debt denominated in Colombian pesos at the lowest rate in history (4.5 percent).

Looking ahead, while maintaining sound macroeconomic fundamentals, bringing down unemployment and informality, as well as closing the infrastructure gap, remain pressing challenges that the authorities have already been addressing. Although the authorities acknowledge that more efforts are needed, social indicators have improved and unemployment has declined.

Monetary policy and exchange rate

The inflation targeting regime has served the economy well and the BR benefits from great credibility. Inflation is below the 3 percent target, the interest rate is close to the neutral level and the output gap is close to zero. The authorities started tightening monetary policy in the first quarter of 2011 based on a forward-looking assessment of the economy, with the double objective of keeping inflation low and smoothing the business and credit cycles. However, owing to a reduction of inflation (below target) as well as a larger-than-expected deceleration of growth, the BR has adopted an accommodative monetary stance and the benchmark interest rate was reduced by 25 basis points in December 2012. The authorities concur with staff that, should the economy slows down further and forecast inflation remain on or below target, there is room for more monetary easing.

Exchange rate flexibility (de jure and de facto) has continued to be the main shock absorber. The BR renewed its pre-announced daily purchases in the FX market of 20 million USD until next March with the main objective of building up reserves and curbing the downward trend in some IR indicators, although it also helps mitigate exchange rate volatility.

The authorities consider that the current account deficit of around 3 percent of GDP is well financed by FDI and is consistent with the country's position with regards to the oil sector. Colombia is still in a phase of high exploration and exploitation (which means sharp increases of FDI and imports) that partially offset income from oil exports. Therefore, higher oil prices are less reflected in an expansion of production (which would improve the current account), than rather in more exploration and exploitation.

Fiscal stance and policy

The solid institutional framework adopted in past years at the level of regional and the central governments (e.g. Fiscal Responsibility Law, Fiscal Rule, Lights Law) has allowed the fiscal stance to approach equilibrium. The authorities anticipate a lower-than-expected combined public sector deficit of around 0.4 percent of GDP in 2012 and 2.4 percent for the central government, which will be further reduced to attain the surplus goal of 0.2 percent in 2016 and a deficit of 1.7, respectively. The short-term fiscal policy, based on the Medium-Term Fiscal Framework that is updated and approved by Congress every year, is guided by the main objectives of debt sustainability and reduction, and increase in the primary balance in order to meet the fiscal rule which will enter into force in 2014. According to the rule, the structural deficit of the central government of around 2.4 percent of GDP in 2012 will decrease gradually to reach 1 percent in 2022, and the Non-Financial Public Sector debt will fall from 26 percent to 8.8 percent and that of the Central Government from 34 to 24.5.

With regard to revenues, an ambitious structural tax reform was recently passed in Congress which seeks to increase employment, reduce informality and inequality, enhance competitiveness, improve tax collection efficiency and administration and reduce evasion. Although the reform is considered revenue neutral in the sense that it does not raise tariffs, it will certainly increase structural revenues. Staff mentions in the report that a reduction in revenues is foreseeable in the next years (owing to the phase out of some taxes) and will be offset by capital expenditure cuts. In this regard, it has to be highlighted that the additional revenues stemming from the tax reform have not been considered yet in the projections; the authorities' strategy is to wait for the proceeds of the tax reform and mobilize new revenues if needed to finance capital spending.

Revenues in 2012 behaved better than projected (reaching historical records) resulting in part from oil-related activity but also from improvements in tax collection. Some of these extra revenues were used to reduce the deficit, and some went to finance investment in infrastructure. Indeed, public investment played a critical role in supporting domestic demand in the third quarter of 2012 when signs of deceleration were more pronounced. The 2013 budget also includes a higher rate of capital spending relative to the current component.

The authorities concur with staff on the importance of strengthening savings. In fact, public and national savings have been increasing and will continue to do so as a consequence of the planned deficit reduction and, most importantly, of the royalty savings mandated by the fiscal rule and the royalty law recently approved.

Structural reforms

The promotion of sectors different from oil and minerals, with emphasis on agriculture and manufacturing (more labor intensive), is a priority for the government. Several reforms have been undertaken in agriculture as well as measures to enhance productivity and competitiveness. Among others, the tax reform will reduce labor costs significantly; the Ministry of Finance is working with the Energy Commission to reduce energy costs and an ambitious plan to enhance infrastructure and transportation is being adopted.

The authorities are preparing a structural Pension Reform to address the pressing issues of the system, which are low coverage, low progressivity and arbitrage between public and private systems, rather than unsustainability. To tackle the coverage issue, a mechanism to allow informal workers to attain a pension (Beneficio Económico Periódico, BEPS) was recently implemented. They are also designing a comprehensive health care reform aiming at correcting deficiencies of the system and containing costs.

Social Issues

Unemployment, inequality and informality remain the most urgent challenges. The authorities have adopted several measures to address them and some progress has been achieved. Although still high, unemployment fell to single digits and stands now at 9.2 percent. October's unemployment rate of 8.9 percent was the lowest in 12 years of comparable data. In addition, the reduction in labor costs stemming from the tax reform is a critical step in the direction of bolstering formal employment. Inequality is being tackled not only through pension and tax reforms (through more progressivity), but also several targeted assistance programs to reduce social gaps and poverty have been put in place. Indeed, the poverty rate dropped 10 percent from 2006 to 2011.

Financial System Stability Assessment

In 2011, Colombia requested the IMF and the World Bank to conduct a comprehensive financial sector assessment, including the specific analysis of standards applicable to the banking, insurance, securities, payment systems, and financial infrastructure providers. The last FSAP was done in 2004, previous to the international financial crises and with a different institutional arrangement, insofar as there were two supervisory authorities (banking and securities) responsible for oversight of the entities within the financial sector. The authorities are grateful to the Fund for the opportunity to have an updated, deep and comprehensive assessment of the financial sector and particularly to the mission team for their dedication, skillful work, and useful discussions and recommendations.

The FSSA concludes that Colombia has a broad financial system, with complex financial conglomerates and with a variety of intermediaries. Credit institutions are sound, with healthy corporate and households balance sheets, strong credit quality and profitable banks. Nonbank financial intermediaries have been performing in a satisfactory fashion.

Most importantly, the stress tests conducted by the mission show that Colombian banks are resilient to a variety of shocks that included extreme scenarios of external crises and its effects on the quality of the loan portfolios. The authorities used in the past different macroprudential tools and policies that have proved to be beneficial for the financial system as a whole and are prepared to implement new ones, if necessary. Adequate coordination between the different institutions that are responsible for the Financial Safety Net (BR, Ministry of Finance, MHCP, Colombian Financial Superintendent, SFC, and FOGAFIN) has been crucial for adopting sound preventive policies.

The FSSA also concludes that Colombia has demonstrated considerable progress in implementing the standards and principles applicable to the regulation and supervision of banks, insurance companies, the securities market, and providers of financial infrastructure. The assessment recognizes that the SFC has improved its capacity to fulfill its responsibilities. In particular, the mission underscored the progress of the supervisory mechanism since the merger of the banking and securities in the SFC and the enactment of important laws (Law 964 of 2005 and Law 1328 of 2009). A single supervisory authority serves to cover all financial sectors and activities, ensuring transparency and efficiency in terms of regulatory enforcement and eliminating regulatory gaps and arbitrage that may arise when there is more than one supervisory authority. This is important in Colombia due to the existence of important financial conglomerates with activities in different financial services.

The authorities are aware that more work has to be done in order to improve regulation and supervision and will include in the pipeline of reforms some of those suggested in the FSSA. Nevertheless, we would like to highlight that the new capital adequacy regime, which was published in August 2012 and will take full effect on August 1, 2013, will address many of the shortcomings pointed out in the assessment. In the same token, regulation related to the adoption of International Financial Reporting Standards (IFRS) has been implemented. Financial institutions must issue IFRS financial statements starting in 2015, with a clear timetable established for that purpose. Additional reforms have been undertaken in other areas such as new reserves and solvency requirements for insurance companies.

On the issue of the independence of the SFC, we want to emphasize that, while Colombia's legal and constitutional framework may make it difficult to establish de jure independence (an aspect that could be improved), the SFC has full de facto independence. It conducts supervision of the financial system without any political interference whatsoever, and works with the MHCP to develop regulations and other aspects of the legal framework without political influence.

On enhancing risk supervision, we would also like to feature the close collaboration of the SFC with the Toronto Center over the past few years, which has strengthened the capacity for risk-based supervision and improved the comprehensiveness of risk assessments conducted by the SFC as well as by the financial institutions themselves. We fully expect that this program of technical cooperation will continue to bear fruit in the next years and to strengthen supervision even further.

On the risks of credit growth, it is worth noting that the SFC established in June 2012 an additional provision applicable to banks that show a sustained increase in NPLs. In these cases banks are requested to raise each loan provisioning to a value between 0.2 percent and 0.5 percent over the corresponding balance loan. Based on figures as of November 2012, the additional provision represents an increase of 4.7 percent in the provisions of the consumer portfolio. In addition, a robust monitoring of the origination process was undertaken. Both measures proved to be effective in reducing the upward trend of consumption credit since 2009.

Strengthening the consolidated supervision is a key recommendation from staff. Indeed, the government is considering presenting a legal reform to include, under full supervision of the SFC, the holding companies of financial institutions.

On the stress testing methodologies, the BR continues to enhance its models and during the exercises conducted for FSAP new improvements were introduced and permanently adopted.

With regard to concentration of commercial loans, the authorities welcome FSSA recommendations and acknowledge that high levels of concentration increase risks and can harm the financial sector's stability. We would like to offer some comments.

- Although 90 percent of commercial loans are concentrated in 7 percent of total debtors, this proportion corresponds to a significant amount of companies (28,101 firms). In addition, institutions diversify their portfolios in different economic activities that are not necessarily positively correlated. This is one among other tools adopted by them to mitigate the possible effects that concentration can have on their balance sheet in case of default.

- Concentration is a common phenomenon in emerging economies. Social and economic development requires that credit institutions finance important projects in areas such as the ones involved in mining, energy and infrastructure sectors. Due to their size and value, these projects need an important capital investment and are financed mainly by credit institutions.

- The SFC has several credit risk administration requirements to credit institutions, especially regarding loan origination and monitoring, which force the credit institutions to make proper risk evaluations from the moment the loan operation is done and periodic monitoring during its lifetime. Furthermore, taking into account that the aforementioned requirements are fully met by the credit institutions so they are able to respond appropriately should risk factors materialize, an instant and unexpected impairment of borrowers, including those who have important participations in the institution's portfolio, is unlikely. Regulation establishes credit exposure limits, tolerated loss levels and methodologies for credit granting that allows monitoring of the credit exposure in the institution's portfolios.

- The stress tests show that when a 1 or 2 notch downgrading is done to the system's most significant borrowers, only one credit institution falls under a solvency level of 9 percent and only 3 institutions below the Tier 1/Risk Weighted Assets ratio of 4.5 percent. This exercise allows us to conclude that, given a sudden and unexpected impairment of systemic borrowers, credit institutions are able to respond properly due to their capacity to absorb losses that derivate from the significant increase in provision volume. Then, the risk associated to concentration is mitigated by the different mechanisms used by institutions (proper loan origination, permanent monitoring, provisions, countercyclical component and capital).

Finally, regarding coordination among entities, in October 2012 the SFC and Fogafín signed a MOU to improve coordination and resolution mechanisms. It was agreed that the SFC will inform Fogafín when an institution is at significant risk of being intervened and the SFC will support Fogafín in the process of collecting information about bank's deposits directly from banks. For that purpose, it was decided that banks must submit this information directly to Fogafín beginning in 2014 and that banks and Fogafín shall work jointly during 2013 on the systems and coordination procedures required for this purpose.