



# COLOMBIA

May 2016

## 2016 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR COLOMBIA

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2016 Article IV consultation with Colombia, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its April 29, 2016 consideration of the staff report that concluded the Article IV consultation with Colombia.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on April 29, 2016, following discussions that ended on March 18, 2016, 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 April 18, 2016.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Colombia.

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

### Selected Issues

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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**International Monetary Fund**  
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INTERNATIONAL MONETARY FUND



Press Release No. 16/199  
FOR IMMEDIATE RELEASE  
May 5, 2016

International Monetary Fund  
700 19<sup>th</sup> Street, NW  
Washington, D. C. 20431 USA

## **IMF Executive Board Concludes 2016 Article IV Consultation with Colombia**

April 29, 2016, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation<sup>1</sup> with Colombia.

Colombia showed strong resilience to changing global conditions in 2015. Despite facing a terms-of-trade shock larger than most of its peers, Colombia posted one of the highest growth rates in the region (3.1 percent) and achieved important social gains with improvements in poverty reduction, income inequality and financial inclusion. Growth was underpinned by a strong real private consumption while private investment slowed down. The decline in oil prices eroded exports and fiscal revenue, and led to a strong depreciation of the peso which fueled inflationary pressures as the external adjustment process got under way. The central government reaffirmed its commitment to the fiscal rule and achieved its structural balance target through timely expenditure cuts and revenue increases from the end-2014 tax reform. The central bank initiated a tightening cycle in September to ensure the anchoring of inflation expectations and contain the widening current account deficit.

A moderation in domestic demand will guide a soft-landing in 2016. Colombia is facing a second large terms of trade shock. Growth will slow to 2.5 percent, as private investment will moderate despite the advances in the 4G infrastructure agenda. As the current weather shocks subside, inflation will moderate and gradually converge toward the target band. The ongoing fiscal restraint and monetary policy tightening will help bring the current account toward levels consistent with a more subdued outlook for global financing. The large peso depreciation would boost non-traditional exports but they will also be constrained by the weak economic outlook in Colombia's neighbors.

A broadly sound financial system and corporate and household balance sheets also contributed to Colombia's resilience. The real growth in bank credit has moderated in recent months but some areas are still growing at a fast pace. Consumption-related credit has slowed down more markedly in line with subdued durable-good consumption; however, commercial credit has

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<sup>1</sup> 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.

remained buoyant due in part to corporates' efforts to replace external credit lines. Corporate and household leverage remains modest by international standards.

The medium-term outlook is favorable but surrounded by downside risks. Growth will gradually approach its medium-term potential of about 4 percent supported by the 4G infrastructure agenda and some recovery in non-traditional exports and oil prices. The current account deficit will gradually decline and approach its medium-term sustainable level through a combination of import compression and export expansion. The main near-term risks stem from Colombia's still significant near-term external financing needs and potential capital inflow reversals resulting from volatile global financial conditions. Further declines in oil prices could fuel additional currency depreciation and inflation. On the upside, bringing the peace process to fruition could further improve business confidence and capital inflows, reinforcing the recovery that will follow the necessary adjustment process.

### **Executive Board Assessment<sup>2</sup>**

Executive directors were encouraged by the Colombian economy's resilience to adverse global conditions, which has been supported by its strong policy framework and the authorities' coordinated and proactive policy response. Directors commended the tightening of macroeconomic policies, in particular by allowing the flexible exchange rate to be the first line of defense to absorb the impact of a large and persistent terms-of-trade shock. They also noted that the country recorded one of the strongest growth rates in the region over the past year, which supported further progress in reducing income inequality and enhancing financial inclusion.

Directors noted that Colombia's medium term outlook is generally favorable, but clouded by heightened downside risks. They shared the view that volatility in global financial markets, including stemming from China's ongoing economic adjustment, vulnerability to swings in market sentiment, and the weak economic outlook of some of Colombia's neighbors pose key risks. Directors concurred that the resolution of the domestic peace process could unleash further regional development and foster business competitiveness.

Directors welcomed the central bank's resolve to tighten monetary policy to guide inflation expectations back to the target range. Some additional policy tightening may be needed, if conditions warrant it, to help guide the current account deficit toward its medium term equilibrium level. They emphasized that exchange rate flexibility should continue to be used as a shock absorber. Directors noted that the broadly smooth functioning of local financial markets amid the very large peso depreciation reflects the well earned credibility of the inflation targeting regime.

Directors saw merit in further fiscal consolidation and welcomed the authorities' commitment to the fiscal rule. They called for prompt efforts to implement a structural tax reform this year

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<sup>2</sup> 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>.

which will protect key social spending, while adhering to the rule's targets. Directors encouraged efforts to step up domestic revenue mobilization by broadening the base and enhancing tax administration, while also making the tax system more efficient and progressive in order to replace revenues lost with the oil price shock.

Directors commended recent advances in financial regulation and supervision that have further expanded the ability to respond to changing global and local conditions. They encouraged the authorities to continue reforming the regulatory framework in line with Basel III and strengthening the resolution framework. Directors welcomed the authorities' efforts to enhance their stress testing framework and corporate surveillance, but also noted the importance of continued vigilance of corporate sector developments and the timely approval of the financial conglomerates law. They commended the authorities for volunteering to be the first emerging market to undertake a pilot self assessment under the FSB's "Key Attributes of Effective Resolution Regimes for Financial Institutions."

Directors welcomed further efforts to advance a well designed structural reform agenda that will underpin economic diversification and inclusive growth over the medium term. They welcomed recent progress on the public-private partnership based infrastructure agenda and called for continued efforts to improve the business environment, strengthen competitiveness, and improve access to quality education.

## Colombia: Selected Economic Indicators 1/

	2014	Est. 2015	Proj. 2016
(Annual percentage changes, unless otherwise indicated)			
<b>National Income and Prices</b>			
Real GDP	4.4	3.1	2.5
Consumer price index (period average)	2.9	5.0	7.5
Consumer price index (end of period)	3.7	6.8	5.6
GDP deflator	2.1	2.6	3.9
Terms of trade (deterioration -)	-3.4	-16.9	-8.3
Real effective exchange rate (depreciation -)	-5.5	-24.1	...
(In percent of GDP, unless otherwise indicated)			
<b>Public finances</b>			
Central government balance	-2.4	-3.0	-3.6
Combined public sector	-1.8	-2.8	-3.2
Public debt 2/	44.2	50.6	49.9
<b>External Sector</b>			
Current account (deficit -)	-5.2	-6.5	-6.0
External debt	30.1	41.8	51.3
of which: Public sector	18.5	25.8	27.7
GIR in percent of short-term debt (residual maturity)	110.4	118.4	116.0
<b>Savings and Investment</b>			
Gross domestic investment	26.3	27.7	27.2
Gross national saving	21.1	23.3	21.4
(12-month percentage changes, unless otherwise indicated)			
<b>Money and credit</b>			
Broad money (M2)	10.0	9.1	9.9
Credit to the private sector	14.7	15.5	9.2
Interest rate (90-day time deposits; percent per year)			
Nominal	4.3	5.2	n.a.

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

1/ Based on information available on May 1, 2015.

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



# COLOMBIA

## STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION

April 18, 2016

### KEY ISSUES

**Context.** A strong policy framework has allowed Colombia to begin to adjust smoothly to the large decline in oil prices since mid-2014. The current account deficit, relative to GDP, widened to historical highs with the steep drop in oil exports. In 2015, macroeconomic policies were tightened to curb the growth in domestic demand and contain inflationary pressures arising from the sharp currency depreciation. A sound financial system and resilient corporate and household balance sheets have also contributed to the smooth adjustment. Real GDP growth slowed last year but still outperformed most countries in the region. The authorities are pressing ahead with their infrastructure program and a completion of the peace process is expected later this year.

**Outlook and risks.** Colombia is facing another large terms of trade shock in 2016, together with tightening global financial conditions. Staff projects real growth to slow further to 2.5 percent in 2016 and gradually rise toward its potential of about 4 percent a year over the medium term, supported by the government's PPP-based infrastructure program and some gradual export diversification. Risks are mainly to the downside, stemming in part from large gross external financing needs, and include bouts of global financial volatility, a protracted period of slower growth in advanced and emerging economies and a further decline in oil prices.

**Macro-financial policies.** Additional tightening of demand policies will help ensure a soft-landing and spearhead the external adjustment to a dimmer outlook for oil exports and fiscal revenue. Fiscal restraint will also put public debt back on a downward path. A tighter monetary stance will keep inflation expectations anchored and contain credit growth. Approval of the financial conglomerates law will improve the authorities' ability to manage cross-border risks.

**Medium-term challenges.** Continued progress in the authorities' structural reform agenda will facilitate economic diversification and further advance inclusive growth. A structural tax reform that improves progressivity and strengthens business competitiveness is urgently needed to protect key expenditure areas while complying with the fiscal rule targets.

Approved By  
**Robert Rennhack and  
 Mary Goodman**

Discussions took place in Bogotá during March 7–18, 2016. The team comprised Jorge Roldós (Head), Sergi Lanau, Francisco Roch, and Daniel Rodríguez-Delgado (all WHD), Manrique Saenz (SPR), and Mohamed Afzal Norat (MCM). María Angélica Arbeláez (OED) participated in most of the meetings. Cristina Barbosa and Andrea Herrera provided editorial support.

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## BACKGROUND

1. **Despite adverse global circumstances, Colombia's successful policies and inclusive growth agenda continued in 2015.** During the last decade Colombia's strong policy framework has underpinned high GDP growth, a steady reduction in poverty rates and, to a lesser extent, in income inequality. In 2015, the poverty rate further declined to 24.1 percent from 24.6 percent in 2014. Income inequality, as measured by the Gini coefficient declined to 52.2 in 2015 after being near 54 for three consecutive years. Financial inclusion improved as well. Colombia's process of accession to the OECD is on track, which has resulted in further strengthening of the institutional framework.<sup>1</sup>
2. **The Colombian government has intensified its efforts to reach the completion of the multi-year peace negotiations.** The government has been holding peace talks with the main guerilla group (FARC) since 2012 and this represents a key objective for President Santos' administration. In September 2015, President Santos announced an agreement on a framework for transitional justice, an important milestone. This follows previous achievements on land reform, FARC participation in the political process and agreement on illicit narcotic crops. Pending issues include the timeline for disarmament, and the procedure to ratify the peace agreements. A deadline set to reach an agreement (March 23, 2016) was missed, but both the government and the FARC are committed to continue negotiations and reach an agreement in the near-term. Recently, the government announced the initiation of peace talks with the second largest guerrilla movement (ELN).
3. **Exchange regime and economic data.** Colombia has a floating exchange rate 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 (see IMF Country Report No. 13/35 for details). Data provision is adequate for surveillance.
4. **Past Fund advice.** Recent policy measures have been broadly aligned with past Fund advice with no major area of disagreement. Since the 2015 Article IV Consultation, the authorities have advanced on some key remaining 2012 FSAP recommendations including on legal protection and independence of supervisors, regulation and supervision of conglomerates and stress tests analysis. They also made progress on the infrastructure agenda and streamlining of regulations. The authorities plan to submit a structural tax reform later this year to create space for key social spending while complying with the fiscal rule, and while they agreed with the importance of pension reform, the urgency to adjust to changing global conditions has understandably delayed efforts on this area. At the same time, the authorities aptly tightened policies in response to more protracted global shocks and inflationary pressures than anticipated at the time of the 2015 Article IV consultation.

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<sup>1</sup> As of April 10, 2016, 15 OECD committees (the approval of 23 committees is required for accession) have given green light to Colombia's accession.

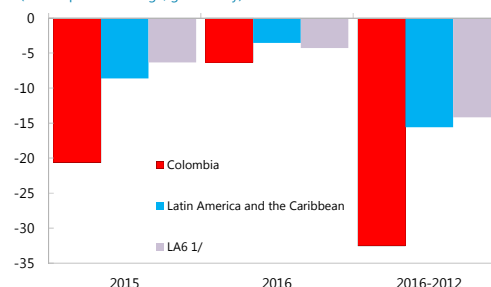
## RECENT DEVELOPMENTS: RESILIENCE UNDER ADVERSITY

### 5. Colombia's external environment

**worsened in 2015.** The large decline in oil prices, a much larger terms-of-trade shock than the regional average, was accompanied by weaker growth among Colombia's trading partners (notably Venezuela and Ecuador). External financial conditions also tightened with an increase in government bond spreads and smaller portfolio inflows (after record levels in 2014)

**Selected LAC: Large Terms of Trade Shock**

(annual percent change; goods only)

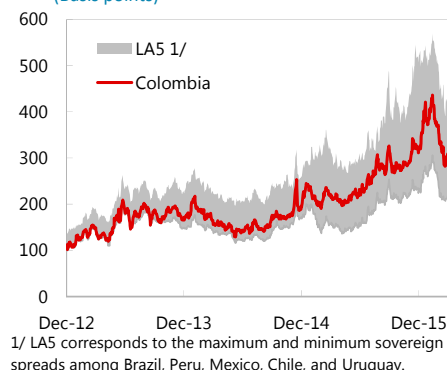


Sources: WEO Live and Fund staff calculations  
1/ Brazil, Chile, Colombia, Mexico, Peru, and Uruguay

### 6. Despite the large external shock, Colombia's economy showed remarkable resilience in 2015.

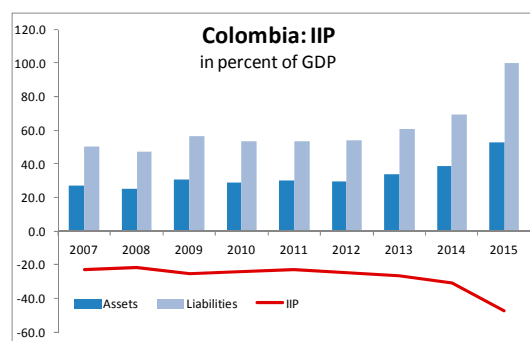
The fall in oil prices led to a reduction in national income and a strong peso depreciation. Real GDP growth moderated to 3.1 percent as investment weakened, while private consumption remained brisk on the back of relatively strong credit growth (Figure 1). Still, staff estimates that the economy posted a small positive output gap in 2015. The depreciation and weather-related food shocks pushed inflation outside the target band (2–4 percent) since February, closing the year at 6.8 percent; core inflation ended at 5.2 percent, while expectations increased to 4.5 percent.

**Sovereign Spreads**  
(Basis points)



### 7. Notwithstanding some import contraction, the current account deficit as a share of GDP reached a record level in 2015.

The current account deficit widened to 6.5 percent of GDP, despite similar levels in nominal terms as in 2014.<sup>2</sup> The depreciation led to a reduction in imports and in the income and services accounts that broadly matched the strong decline in total exports caused by the fall in commodity prices (Figure 2). Capital inflows remained strong as non-oil FDI and portfolio inflows proved resilient, while borrowing by public and corporate entities increased. International reserves remained



<sup>2</sup> The ratios of the current account, external debt and NIIP to GDP increase to a large extent because the large depreciation lowers GDP in US dollar terms.

broadly constant at US\$46.3 billion, while external debt increased to 40 percent of GDP, and the NIIP deteriorated to -44 percent of GDP (see Annex I).

### 8. Colombia's strong policy framework helped ensure an orderly adjustment to the deteriorated external conditions.

The government cut expenditures early in 2015 (by about 0.5 percent of GDP) and benefited from the tax yield of the end-2014 tax reform (0.5 percent of GDP) to meet the structural target on the central government deficit. It also announced an expenditure reallocation program with special focus on school construction and housing subsidies, while strong expenditure by sub-national governments provided additional support for economic activity. Meanwhile, the central bank started increasing the policy rate in September 2015 in response to increasing inflation expectations (Figure 3). Despite a cumulative 200 basis point spike, overall financial conditions remained supportive of economic activity (Box 1). On October 30, the central bank reactivated a foreign exchange sale program to prevent disorderly market conditions and ease liquidity pressures—the program remains unused despite repeated bouts of volatility since October (see Text Box below).

### 9. Bank real credit growth slowed during the year, but still exceeded 8 percent in real terms (y/y) in December.

Analysis of the real and financial cycles indicates that while the output gap is near zero at the end of 2015, credit has been growing above trend in 2015. However, common metrics do not show signs of a credit boom and credit growth showed signs of deceleration in the last quarter of 2015. Commercial credit growth was faster, in part due to the peso depreciation and corporates' efforts to replace external credit lines, but is in line with trend growth of the commercial-credit-to-private-investment ratio (Figure 4). Similarly, consumer credit growth was slower and consistent with the current growth of private consumption. Mortgage credit and house price growth remains brisk despite some moderation.

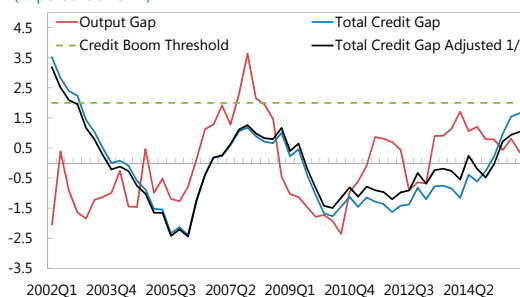
#### Colombia's Central Bank's Dollar Auction Program

<b>Start date:</b>	October 30, 2015 with subsequent adjustments (see below)
<b>Objective:</b>	Moderate disorderly increases in the exchange rate, which might contribute to un-anchor inflation expectations, as well as to provide liquidity to the foreign exchange market.
<b>Modality:</b>	Auction of call dollar options for about US\$500 million, which is about 1/3 of daily turnover. The option's strike price is the average spot exchange rate at the previous day. Options are sold through Dutch auctions.
<b>Rule-based:</b>	Trigger for the sale (as well as for exercise) requires the daily exchange rate movement to exceed a threshold, usually a given percentage vis-à-vis the 20-days moving average
<b>Trigger:</b>	On October 30, a trigger of 7 percent (depreciation vs 20-days moving average) was established. As fx-volatility subsided, the threshold was lowered to 5 percent (on December 23, 2015) and to 3 percent (on February 19, 2016).
<b>Execution:</b>	The auction program has not been triggered yet, which is likely in part due to the relative stability in oil prices and the program's success in reducing fx-uncertainty

Sources: National authorities and Fund staff estimates.

#### Output Gap vs Credit Gap

(in percent of GDP)



Sources: BanRep and Fund staff estimates

1/ Total credit valued at end-June 2014 exchange rate.

### Box 1. Monetary and Financial Conditions in Colombia

A study of monetary and financial conditions indices provides useful insights about macro-financial linkages. Traditional indices based on interest rates and spreads suggest that financial Conditions have loosened since mid-2014. However, a more recent indicator that can be related to intermediaries' balance sheet data suggests otherwise—in line with our assessment of a moderation in credit and demand growth.

#### Monetary Conditions and Financial Conditions Indices (MCI and FCI) explore the link between broad financial conditions and real economic activity.

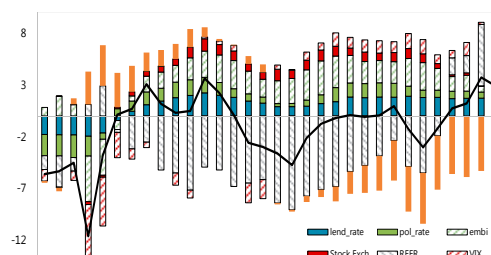
These indices suggest that financial conditions eased since mid-2014, reflecting largely the depreciation of the currency. However, the ongoing monetary policy tightening and subsequent increase in lending spreads, together with a slowdown in the depreciation rate, are likely to tighten financial conditions and weigh on growth going forward

#### These indices summarize the information in financial price variables, ignoring balance sheet data.

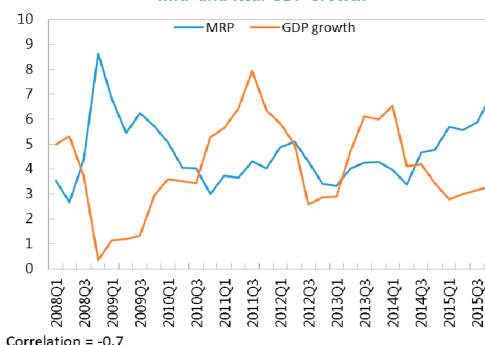
Moreover, they give too much weight to exchange rates—which are performing an important in the current economic adjustment process in Colombia. Thus, we follow Adrian et al (2010) and study the impact of balance sheet indicators on the determination of an aggregate “Macro Risk Premium” (MRP) that excludes the exchange rate. They show that when intermediaries are less capital constrained by their value at risk limit, their risk appetite and the supply of credit increase, while the MRP decreases. We find that the MRP is indeed negatively correlated with GDP growth, and that higher credit growth is associated with lower MRP.

**Overall, the MRP has been increasing since mid-2014, suggesting that the risk appetite of financial intermediaries is decreasing as their balance sheets tighten**—which is consistent with a slight moderation of credit growth. Moreover, the ongoing monetary policy tightening will further reduce the risk-taking capacity of the banks and contribute to the slowdown of credit growth in line with the envisaged slowdown in aggregate demand.

Contributions to FCI, 2008Q1-2015Q4  
(percentage points of annualized q/q growth)



MRP and Real GDP Growth



Correlation = -0.7

MRP on different categories of credit growth				
	1	2	3	4
Total Credit	-0.04***			
Commercial Credit		-0.03***		
Consumption Credit			-0.03***	
Mortgage Credit				-0.07**
Constant	2.39	2.24	2.21	3.02
R-sq	0.35	0.25	0.41	0.16

**10. Corporate and household balance sheets remained resilient but with some signs of vulnerability in commodity-related sectors.** Bank loans remain the main source of corporate financing and foreign currency funding represents about 33 percent of total corporate debt. Corporate debt is modest by international standards but the authorities' analysis shows that debt-at-risk—owed by firms with an interest coverage ratio (ICR) less than 2—amounts to 30 percent of total sample debt. Debt indicators have worsened mainly in the oil and airline industries but solvency problems remain contained (Box 2). Moreover, debt service capacity had improved for the largest 100 firms through end-2014, but these gains have been partially erased by the materialization of commodity price and depreciation shocks in 2015. Household debt is also modest

at 20.5 percent of GDP and 31.8 percent of disposable income. Debt-service capacity seems ample with debt payments representing about 9½ percent of disposable income. Banks' remain sound, with robust asset quality and profitability indicators (Table 7).

**11. The 4G-PPP infrastructure agenda is on track and efforts to finance the agenda started to pay off.** All first-wave projects were allocated and the construction phase has started. The development fund (FDN) is facilitating financial arrangements with major banks and institutional investors, and successful funding deals with global banks have been recently completed. The timely sale of ISAGEN (the public electricity company) for about US\$2 billion will help finance the upcoming waves.

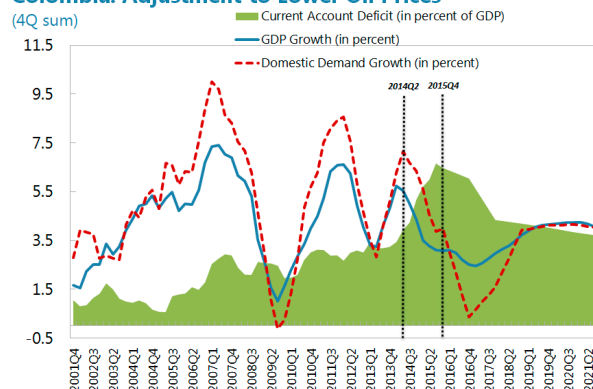
**12. The latest data suggests that the coordinated policy tightening has started to be transmitted to the economy.** The central bank has continued the tightening cycle this year and increased the policy rate to 6.5 percent in March. Despite a further increase in inflation to 8 percent in March, inflation expectations have moderated somewhat in early 2016. Weak consumer confidence in January and February and a further slowdown in credit growth would help contain private consumption, and there are signs that the currency depreciation is boosting industrial activity and non-traditional exports.

## OUTLOOK AND RISKS

**13. Colombia's adjustment to the worsened outlook for commodity prices and tighter global financial conditions would mean subdued growth in the near future.** Staff projects growth to slow to 2.5 percent in 2016 and gradually increase over the medium-term supported by the construction phase of the 4G agenda. Some rebound in manufacturing would only compensate in part the impact of low oil prices and tightened policies in 2016. The main short-term adverse impact of the oil shock on growth is expected through investment (Annex II), which could consequently weaken the oil production outlook. On the positive side, the cumulative peso depreciation since mid-2014 would help rebalance spending spur import substitution and buttress non-oil exports. As a result, the current account deficit will decline to 6 percent of GDP this year and gradually approach its medium-term sustainable level thereafter (3.8 percent of GDP in 2020).

**14. Monetary and financial conditions will continue to be tightened and contribute to domestic and external adjustment.** The acceleration in inflation continued in early 2016 but is expected to reverse during the year guided by some further tightening and as the weather-related food shock and the pass-through from the depreciation die out (Box 3); inflation is expected to return to the target range by early 2017. Overall credit activity will moderate, as banks absorb the

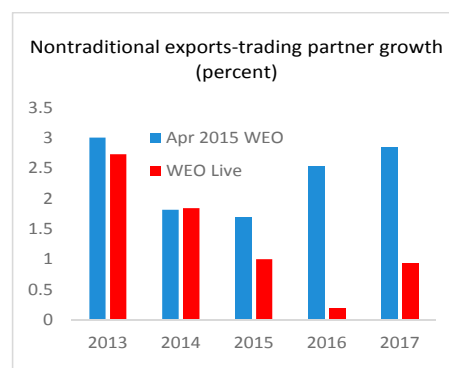
Colombia: Adjustment to Lower Oil Prices



Sources: National authorities and Fund staff estimates and projections

credit losses from the recent shocks and the slowdown, contributing to a further moderation in domestic demand and a reduction in external imbalances. A reallocation of credit away from consumption and toward construction, as the source of growth shifts from commodities to infrastructure, would underpin the pickup in activity from 2017 onwards. A strong and well-supervised banking system will withstand the materialization of downside risks.

**15. Large risks threaten on the downside and stem mostly from Colombia's increased near-term external financing needs.** While the strong policy framework and apt macroeconomic management are supporting an orderly adjustment process, Colombia will remain vulnerable to a deterioration in market sentiment that may slow or reverse capital inflows. Factors that could amplify the impact of such potential shocks on Colombia include the sheer size of the current account deficit, sizeable corporate short-term external debt, and higher reliance on portfolio inflows to cover the current account deficit. Global risks have increased since the last Article IV Consultation and include weaker growth in advanced economies and uncertainties around issues such as the Fed's next steps and the asynchronous unwinding of unconventional monetary policies across reserve-currency economies. These factors could fuel global risk aversion and lead to reduced risk appetite for emerging markets assets. Further, a sharper-than-expected growth slowdown in China would have important spillovers including by further compressing oil and other commodity prices, trade and capital flows (see RAM). Sharp and persistent drops in oil prices could make large swathes of the oil industry unprofitable and drastically reduce production. Similarly, delays in the 4G infrastructure agenda would reduce demand and competitiveness. On the upside, bringing the peace process to fruition and a prompt approval of a structural tax reform could improve business confidence and capital inflows.



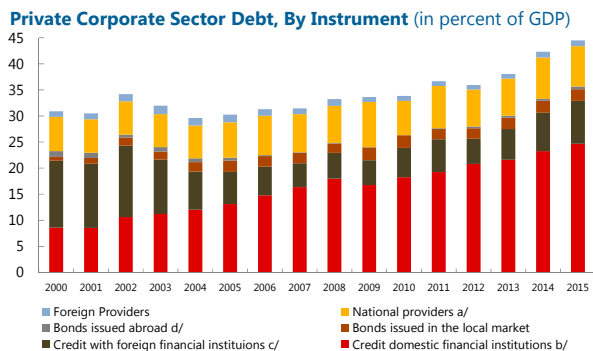
### Box 2. Corporate Sector Vulnerabilities

#### Background

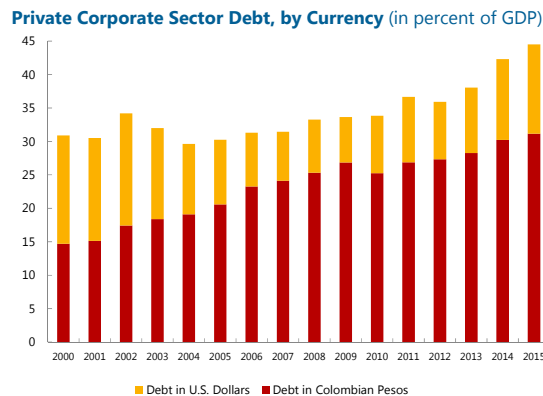
Colombian private sector corporate debt and leverage have steadily increased from early 2000, in part influenced by the effects of the peso depreciation. As of June 2015 private sector corporate debt stood at 45 percent of GDP which is modest by international standards. Slightly more than half of total corporate debt is owed to domestic financial institutions and about 2/3 is peso-denominated.

#### Colombian Corporate Debt by Instrument and Currency

Corporate debt increasingly domestic and bank dependent



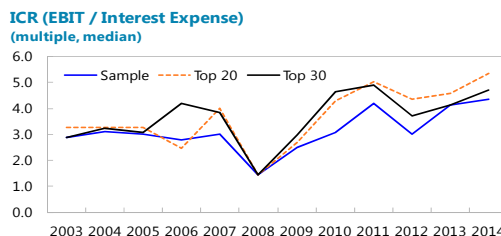
And largely peso dominated but some growth in US dollar



Source: BanRep.

#### Fragile Firms

The central bank’s analysis (based on end-2014 data) suggests a broadly stable corporate health, with fragile firms hovering at about 25 percent during the last three years –in line with previous studies (see GFSR, October 2015), firms are identified as fragile if their ICR (interest coverage ratio) is less than 2 (BanRep Financial Stability Report, September 2015). Debt of these fragile firms (debt at risk) amounted to 30.1 percent of total debt in the entire sample. At the same time, there are important differences across industrial sectors. The share of debt at risk is higher in agriculture (36 percent of debt in that sector is owed by fragile firms), real estate (39 percent) and retail (33 percent).



Staff analysis focused on the largest 100 Colombian corporates, suggests that large firms are less fragile, with only 5 percent of debt is at risk. The decline of this indicator in recent years (40 percent in 2009) is consistent with the observed growth in profitability and still favorable external financial conditions.

The S&P Capital IQ data used by staff, also only covers up to end 2014 which does not fully account for the additional adversity (further depreciation and even lower oil prices) faced by Colombian corporates in 2015 and early 2016. As an attempt to capture developments since between end-2014, and end-2015 we applied a “shock” in line with the observed changes in earnings (10 percent increase) and depreciation shock (30 percent) to latest available 2014 corporate data. Under this scenario debt at risk increases to about 12 percent. Hence, while large

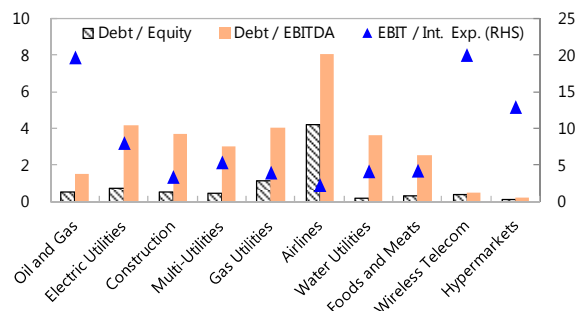




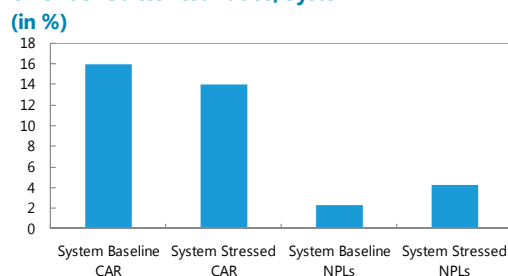
### Box 2. Corporate Sector Vulnerabilities (Concluded)

corporate balance sheets remain vulnerable to further adversity, the impact appears contained. The central bank also conducted a stress test, to June 2015, of a subset of firms exposed to FX risk. After 40 percent depreciation distressed firms would represent only 3.2 percent of the commercial loan portfolio

**Sectoral Leverage Multiples, Median**



**Oil Shock Stress Test Ratios, System**

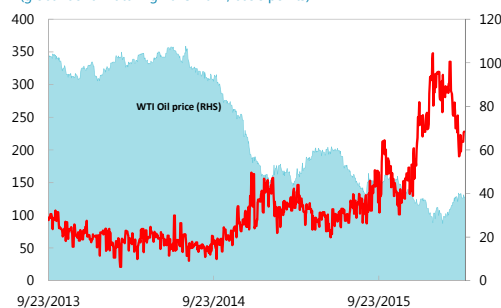


**Macro-financial implications of the oil sector conjuncture.**

As described in Annex II, the Colombian economy remains somewhat dependant on oil-related activities, primarily in terms of export concentration. Yet, the oil sector only represents about 4 percent of total corporate loans from the banking sector. About half of these loans are to oil industry suppliers and the other half is related to government-owned oil company Ecopetrol. Given the low direct portfolio exposure to oil and oil-related entities this would imply relatively contained impact on bank losses (NPLs) and bank solvency from distress and default in this industrial sector (see IMF Country Report No. 15/142). No other significant financial stability impact or broader macro-financial implications would result from this direct oil-bank sector loan linkage. However the financial stability impacts could become more significant if downgrades in oil-sector entities were to result in downgrades for the sovereign and Colombian banks.

Ecopetrol’s response to the oil shock has included a large reduction in investment and a shutdown of operations with higher marginal cost of production. Capex will be cut by about 25 percent in 2016. While Ecopetrol has limited debt amortizations in the next three years, a lower capex outlook will constraint near-term production outlook and weaken debt service capacity.

**Ecopetrol spread over sovereign bonds**  
(global bond maturing 2023-2024; basis points)



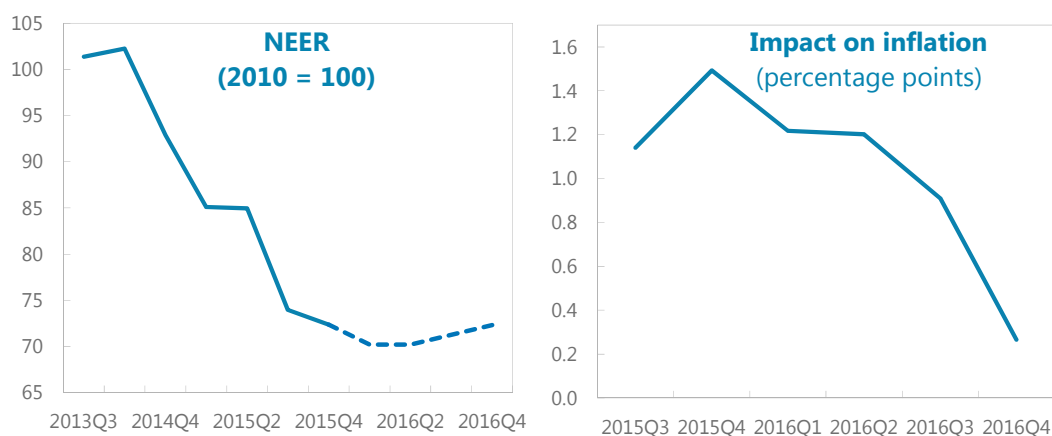
Sources: Bloomberg and Fund staff estimates



### Box 3. Estimating Exchange Rate Pass-Through in Colombia

*The pass-through to inflation from the 30 percent NEER depreciation since mid-2014 and the ongoing El Niño episode are temporarily adding up to 320bps to inflation. On this basis, staff expects inflation to decrease in coming months and converge to the target band in 2017.*

**The exchange rate depreciation contributed around 120bps to inflation in 2016Q1 but its effects are expected to vanish quickly.** Two types of econometric exercises (VAR and local projections) using information on the NEER, inflation, economic activity, and external variables (oil prices and U.S. growth) indicate that a one percent depreciation results in an increase in inflation of 0.04-0.07 percent that materializes in full in about 6-9 months (this is the so-called pass-through coefficient). The results are in line with other studies. As the Western Hemisphere April 2016 REO notes, Colombia's pass-through is relatively low in regional perspective. Given the econometric results and the projected stabilization of the NEER in coming quarters, staff projects the impact of depreciation on inflation to have peaked in 2015Q4 and decline rapidly.



**The drought caused by the ongoing El Niño episode is also contributing to inflation through high food prices.** Estimates based on the relationship between the Southern Oscillation Index (a measure of El Niño based on oceanographic data) and Colombian inflation indicate that the current El Niño episode could be adding 125-200bps to inflation. Since El Niño is a highly temporary phenomenon, its influence on inflation is very likely to vanish in the second half of 2016.

**Indexation mechanisms may add persistence to inflationary pressures.** The increase in regulated goods inflation to 6.3 percent in February 2016 reflects the existence of indexation in markets such as education and health and will push up inflation for the remainder of the year. Since there is no clear statistical link between salaries and inflation, the 7 percent increase in the minimum salary in 2016 may not be an additional source of inflationary pressures (see accompanying SIP).

**16. The authorities broadly agreed with the outlook and characterization of risks.** They noted that Colombia is indeed undergoing a gradual adjustment that will require a slowdown in domestic demand, and consequently expect some growth slowdown in 2016. They also emphasized the benefit of a coordinated policy response in order to contain the current account deficit, which has become a source of concern. Among the sources of risk, the authorities emphasized the weak outlook for neighboring countries (e.g. Ecuador, Venezuela, Brazil) that represents both a headwind for the ongoing external adjustment (as they were natural markets for

Colombia: Risk Assessment Matrix<sup>1</sup>

	<i>Likelihood</i>	<i>Impact</i>	<i>Policy Advice</i>
<b>Tighter or more volatile global financial conditions:</b>			
<b>Sharp asset price decline and decompression of credit spreads</b> as investors reassess underlying risk and respond to unanticipated changes in growth and financial fundamentals in large economies, Fed policy rate path, and increases in U.S. term premia, with poor market liquidity amplifying volatility.	Medium	High	Use the exchange rate and international reserves as shock absorber. Rule-based fx intervention in place could ease disorderly behavior.
<b>Surge in the US dollar.</b> Improving U.S. economic prospects versus the rest of the world leads to a further dollar surge, boosting non-U.S. trade but creating balance sheet strains for dollar debtors.	High	Medium	Use the exchange rate and international reserves as shock absorber. Monetary policy tightening to mitigate pass-through. Rule-based fx intervention could ease disorderly behavior. Continued monitoring of corporate and household balance sheets.
<b>Sharper-than-expected global growth slowdown:</b>			
<b>Significant China slowdown</b> , triggered by corporate distress that propagates through shadow banks, precipitating deleveraging, uncertainty and capital outflows. Weak domestic demand further suppresses commodity prices, roils global financial markets, and reduces global growth (Likelihood: low in short-term, medium thereafter).	Low/Medium	High	Monetary policy to support growth if expectations anchored; speed up execution of capital projects in the public sector and measures to foster diversification.
<b>Significant slowdown in other large EMs/frontier economies.</b> Turning of the credit cycle and fallout from excess household and corporate leverage (incl. in FX) as investors withdraw from EM corporate debt, generating disorderly deleveraging, with potential spillbacks to advanced economies.	Medium	Medium	Monetary policy to support growth if expectations anchored; speed up execution of capital projects in the public sector and measures to foster diversification.
<b>Structurally weak growth in key advanced and emerging economies.</b> Weak demand and persistently low inflation from a failure to fully address crisis legacies and undertake structural reforms, leading to low medium-term growth and persisting financial imbalances in the Euro area and Japan (high likelihood). Easy global financial conditions coming to an end and insufficient reform progress undermine medium-term growth in emerging markets and suppress commodity prices (medium likelihood).	High/Medium	Medium	Speed up execution of capital projects in the public sector and measures to foster diversification.
<b>Risks to energy prices:</b>			
<b>Persistently lower energy prices</b> , triggered by supply factors reversing only gradually.	High	High	Use the exchange rate and international reserves as shock absorber. Speed up execution of development measures to foster diversification.
<b>Country-specific risks:</b>			
<b>Economic distress in Central America affecting Colombia's banks' subsidiaries</b>	Low	Medium	Provide liquidity support to systemic institutions.
<b>Economic and social implosion in Venezuela</b>	High	Medium	Use the exchange rate and international reserves as shock absorber. Emergency support to border region. Develop new financing instruments while avoiding to increase government exposure and alter optimum risk distribution. Seek to remove other obstacles for the PPP agenda.
<b>Delay in the implementation of the PPPs</b> due to insufficient financing or other obstacles.	Low	Medium	Develop new financing instruments while avoiding to increase government exposure and alter optimum risk distribution. Seek to remove other obstacles for the PPP agenda.
<b>Continued high growth of credit and house prices and balance sheet weakening</b>	Low	Low	Adopt prudential measures tailored to the risk profile of financial institutions.

<sup>1</sup> The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.

Colombia's non-traditional exports) and a source of additional risks if the situation were to further weaken in those countries. The authorities agreed that a disorderly adjustment in China is an important global risk that will have important implications for financial flows, despite limited direct trade links. They also noted that the banking system is robust to severe credit and market risk stress tests.

## POLICY DISCUSSIONS

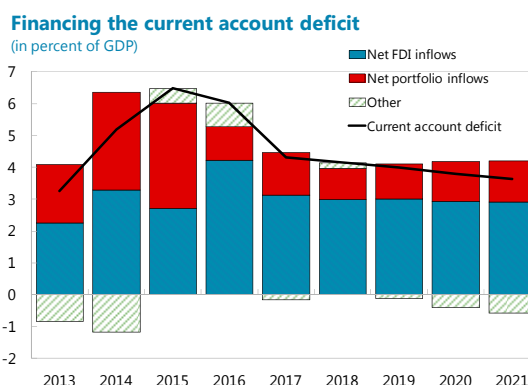
*Discussions focused on the appropriate policy mix to facilitate a near-term soft-landing amid the large and protracted oil shock; reforms to mobilize fiscal revenue and actions to promote financial stability and medium-term economic diversification.*

### A. Preserving External Stability

**17. The authorities agreed that a tighter policy mix in 2016 will significantly contribute to the external adjustment.** In addition, the flexible exchange rate should continue to serve as the first line of defense in addressing external sector pressures with the rules-based FX auction program mechanism preventing disorderly depreciation. In this regard, staff shares the authorities' view that as volatility subsides and the exchange rate stabilizes in line with oil prices a lower intervention threshold is appropriate.

**18. The current account deficit would remain large in 2016 (6.0 percent of GDP) but gradually narrow over the medium-term helped in part by the authorities' reform efforts and the delayed impact of the real exchange rate depreciation.**

Exports in 2016 are expected to decline due to lower oil and commodity prices only partially offset by a modest recovery in non-traditional exports. However, the trade balance would improve as a depreciated real exchange rate and slower domestic demand support a continued decline in imports. Non-traditional exports would also benefit from the authorities' efforts to simplify custom procedures and disseminate preferential trade agreements, managerial best practices and innovation. Valuation effects keep the current account to GDP ratio high, but those effect are reversed from 2017 onwards (see Footnote 2). By 2019, the current account deficit would fall below 4 percent of GDP. While investment in the oil sector is expected to decline significantly, FDI inflows into other sectors are expected to finance most of the current account deficit. External debt to GDP has also risen due mostly to valuation effects, but it remains sustainable (Table 11 and Figure 8).



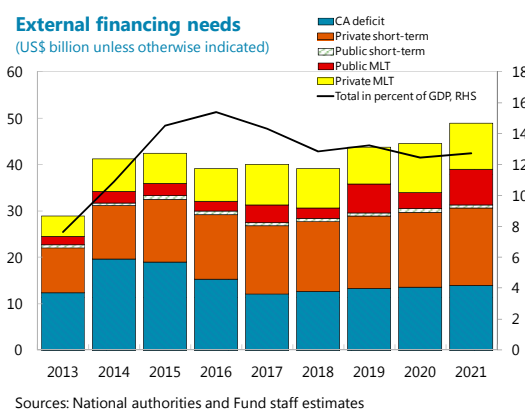
Sources: National authorities and Fund staff estimates

**19. In the staff's baseline scenario, exposure to rollover risks would remain elevated but manageable due to ample buffers.** Gross external financing needs would increase to about 16

percent of GDP in 2016, double the level in 2013, driven in part by the valuation effect of the peso depreciation. In the baseline scenario, there is no ex-ante funding gap, but the outcome remains sensitive to shifts in investors' risk aversion. Reserve buffers would cover more than 100 percent of annual gross external financing needs over the medium-term, with the FCL providing additional buffers.

## 20. The external position appears weaker than implied by fundamentals while the economy is adjusting to a new equilibrium.

Mainly driven by oil price developments, the peso depreciated by around 30 percent in real effective terms during 2014–15, and is considered to be broadly in line with fundamentals and desirable policy settings. The relatively large current account deficit reflects the lagged response of exports and imports to relative price changes. While EBA methodologies produce conflicting results about exchange rate over-undervaluation (see Annex I), staff considers a current account norm of around -2 to -3 percent as appropriate, in line with historical averages and with the EBA ES method. The current gap to the norm, about 3 percent, is expected to narrow gradually in the medium term as imports contract further and non-traditional exports respond to increased profitability and the opening of new markets. The authorities' broadly agreed with this assessment and noted that their models and methodologies also produce a wide range of results. They also noted the high correlation between the peso/USD exchange rate and the oil price.<sup>3</sup>



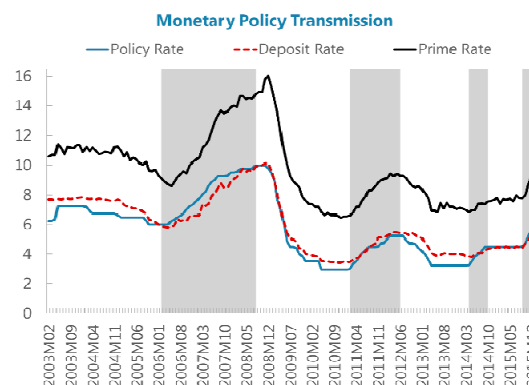
## B. Macroeconomic Policy Mix: More Tightening is Needed

**21. The authorities' plans for a further tightening of macroeconomic policies in 2016 are welcome.** The authorities' coordinated policy response will help domestic demand adjust to the decline in income associated with permanently lower oil prices. The transitory acceleration of inflation and widening of the current account deficit require a further slowdown in aggregate demand to supplement the expenditure-switching associated with the real exchange rate depreciation.

**22. The central bank's tightening cycle will most likely continue during early 2016 in order to guide inflation expectations back to the target range.** In the context of a moderately negative output gap, the authorities agreed that raising the policy rate further would help guide inflation expectations back to the target range and credit growth to lower levels more in line with the expected moderation in domestic demand. Staff suggested that some further tightening would be

<sup>3</sup> The authorities also noted that, while Colombia is an oil exporter, it should not be placed in the same group as other countries that produce oil in a much larger scale.

needed and the authorities agreed, though they noted their decisions would be highly data-dependent. They also noted that the transmission to bank lending rates was much more effective this tightening cycle than during the previous one in 2014 (see Figure), when strong capital inflows tended to override this key transmission mechanism. The authorities also agreed that while a persistent current account deficit and the possibility that prolonged high inflation could activate indexation mechanisms called for continued tightening, a stronger-than-anticipated slowdown in activity could prompt a re-calibration of the policy stance.



**23. Despite the authorities’ announced fiscal cuts, achieving the fiscal targets for 2016 could require further expenditure measures.**

For the central government, the authorities are aiming at a 2016 headline deficit of 3.6 percent of GDP, to facilitate the adjustment and to protect market confidence and the credibility of the fiscal framework.<sup>4</sup> To this effect, the authorities committed early this year to reduce spending by 0.7 percent of GDP through an expenditure freeze that affects investment, the wage bill and transfers, while protecting key social programs. They also plan to bolster revenue collection by about 0.5 percent of GDP through tax administration efforts underpinned by recent strengthening in technical and human resources at the tax authority. However, under staff growth assumptions, further adjustments of around 0.3 percent of GDP would be needed to meet the headline deficit target. The authorities noted that while they have identified possible additional cuts, the additional expenditure restraint could come instead from the normal level of under execution. Staff encourages the continued emphasis on tax administration that would also build from the gains achieved in 2015 (see table) and noted the importance to protect the execution of key social programs. Further fiscal restraint will come from sub-national governments’ weaker spending after the 2015 election cycle. In all, staff estimates a negative fiscal impulse of about 1.6 percent of GDP. Public debt will reach around 50 percent of GDP in 2016, decline over the medium term and remain sustainable (Figure 7).

<b>Fiscal response to oil shock</b>	
(in percent of GDP; changes 2016 vs 2013)	
Size of the shock	<b>4.0</b>
Lost oil-related fiscal revenue	3.2
Higher interest payments (including depreciation impact)	0.7
Fiscal measures	<b>4.0</b>
Mobilization of non-oil tax revenue	<b>1.4</b>
o/w tax reform end-2014	0.5
o/w tax administration yield 2015	0.4
o/w expected tax administration yield 2016	0.5
Primary expenditure cuts 1/	<b>1.3</b>
o/w capital expenditure cuts	1.7
Wider overall deficit within fiscal rule allowance	<b>1.3</b>

Source: National authorities and Fund staff estimates  
 1/ includes staff estimate of necessary adjustment to meet 2016 target

<sup>4</sup> Staff estimates that this is tighter than what would be allowed by the structural fiscal rule by around 1 percent of GDP.

## C. Structural Tax Reform and the Medium-Term Fiscal Outlook

**24. Staff shares the authorities' urgency to mobilize revenue to help offset the decline in oil revenue and protect key expenditure areas.** Central government's oil fiscal revenue will decline from 3 percent of GDP in 2013 to near zero in 2016 (1 percent of GDP lower than anticipated during the last Article IV Consultation). Staff estimates suggests that absent a structural tax reform, achieving the structural balance targets imposed by the rule would require about 1.4 pp of GDP of primary expenditure cuts between 2017 and 2021, which would leave virtually no room to address pressures stemming from high social needs and the multi-year infrastructure plan. The tax expert commission's report published early this year is closely aligned with recent technical assistance from FAD and will set the basis for the authorities' proposal that will be fine-tuned to specific revenue needs. Staff welcomes the authorities' commitment to seek the approval of a structural tax reform this year. This is essential to not only make the fiscal adjustment more balanced and less reliant on expenditure restraint and also help cover expenses related to the completion of the peace agreement. The authorities noted their continued commitment to the fiscal rule as the underlying fiscal anchor and to identify and include any potential peace-related expenses in their medium-term fiscal framework.

<b>Near-Term Fiscal Outlook 1/</b>										
(In percent of GDP; unless otherwise indicated)										
	2013	2014	2015	2016	2017	2018	2019	2020	2021	2021-2016
<b>Central Government Fiscal Stance</b>										
Headline balance	-2.3	-2.4	-3.0	-3.6	-3.3	-2.7	-2.1	-1.8	-1.4	2.2
Oil-Revenue	3.3	2.6	1.2	0.1	0.0	0.0	0.0	0.0	0.0	-0.1
Expenditure	19.2	19.0	19.3	18.5	18.1	17.7	17.1	16.8	16.5	-2.1
Primary expenditure	16.9	16.8	16.6	15.5	15.3	14.8	14.2	13.8	13.8	-1.7
Structural balance (staff estimate)	-3.5	-3.4	-3.8	-3.0	-2.8	-2.5	-2.1	-1.8	-1.5	1.5
Structural primary non-oil balance	-3.5	-3.0	-1.7	-0.6	-0.3	0.4	0.9	1.1	1.1	1.7
Fiscal Impulse	1.1	-0.5	-1.2	-1.1	-0.3	-0.6	-0.5	-0.3	0.0	
<b>Consolidated Public Sector</b>										
Headline Balance	-0.9	-1.8	-2.8	-3.2	-2.9	-2.3	-1.8	-1.5	-1.3	1.9
Structural primary non-oil balance	-2.8	-3.4	-1.8	-0.2	0.0	0.5	0.9	1.0	0.9	1.1
Fiscal Impulse	0.7	0.6	-1.6	-1.6	-0.2	-0.5	-0.4	-0.1	0.1	
<b>Memorandum items:</b>										
Real Gdp Growth (in percent)	4.9	4.4	3.1	2.5	3.0	3.7	4.1	4.3	4.0	
Brent price (U.S. dollars per barrel)	108.8	98.9	52.4	36.1	42.2	45.4	47.8	49.6	51.0	14.9
Public sector gross debt	37.8	44.2	50.6	49.9	49.0	47.9	46.1	44.4	43.2	-6.7
Public sector net debt	27.0	33.7	42.2	43.9	43.5	42.7	41.3	39.9	38.9	-5.0

Source: National authorities and Fund staff estimates.

1/ The medium-term fiscal outlook is broadly based on the authorities' medium-term fiscal framework. It assumes that taxes currently scheduled to disappear starting in 2019 (about 1.2 percent of GDP) will be extended as done in the past. It does not assume any structural tax reform and already incorporates expenses related to existing peace-related programs such as victims' reparation.

## D. Protecting Financial Stability

**25. The financial system has also been resilient to changing global and local conditions, but there is a need for continued vigilance.** As noted in previous consultations, Colombian banks' expansion into Central America in recent years continues to pose risks, including in terms of the exposure of systemically important financial conglomerates (see Annex III). Further, the sharp fall in commodity prices and the recent increase in corporate debt has created some pockets of vulnerability in specific industries (oil and airlines in particular, Box 2) and the impact of exchange

rate moves bears monitoring given that 1/3 of corporate debt is FX-denominated. The authorities have increased their vigilance of potential materialization of credit and liquidity risks, applying a battery of stress tests to the corporate and financial systems. Stress tests indicate that under standard earnings and depreciation shocks to corporate profitability and debt service, banks' solvency remains above regulatory minima for the large majority of banks and the risks of these shocks adversely affecting the supply of credit and economic growth are low given large countercyclical provisions. Similarly, risks from weaker household balance sheets have risen marginally and remain contained. Risks from rising house prices are mitigated by low loan-to-value ratios (51.4 percent) and small mortgage portfolios of banks (12.3 percent of total loans). The authorities broadly shared the staff assessment of the financial system and welcome ongoing technical assistance from MCM to further strengthen their framework for conducting stress tests of the financial system.

**26. The funding structure of some financial entities has changed in recent months in response to structural changes and the ongoing monetary policy tightening.** During 2015, as part of the establishment of a single-treasury-account (CUN), the government moved its cash deposits to the central bank and away from the four largest commercial banks, which have, as a result, sought to replace them with similarly stable longer-maturity deposits. The increased competition for these deposits, as banks gear up to fund the authorities' infrastructure program, combined with the ongoing monetary policy tightening have increased funding costs, in particular for smaller entities. However, liquidity stress tests indicate bank liquid assets would remain more than 2.5 times their liquidity needs as identified by their short-term liquidity risk indicator (IRL), raising no systemic funding concerns. The supervisory authority (SFC) has undertaken actions for banks and other financial institutions to strengthen their liquidity planning, management and stress testing capabilities. Staff welcomes the authorities' continued efforts to intensify the supervision of all entities including of their liquidity models and contingency plans.

Selective SFC Actions and Enhanced Surveillance on Liquidity in 2015		
Liquidity Management Banks	Liquidity Stress Tests	Other Actions
Strengthen contingency plans for foreign subsidiaries	Assess and discount access to credit lines fully	Assess liquidity impact of increased competition of funding
Link liquidity measurement with banks own stress tests and corporate governance	Address high dependency funding in some financial institutions	Impact of higher funding rates on liquidity
Banks own liquidity stress tests to include persistent shocks and inclusion of macroeconomic variables	Evaluate implementation of a 90-day IRL	Impact on profitability, solvency and liquidity due lower net-interest margins and higher deposit rates

Source: Financial Superintendency (SFC).

**27. While the Colombian authorities have finalized and implemented many of the FSAP recommendations, including those that help address cross-border risks, there remain**



**important areas that require further action.** Since December 2015 the supervisor has the authority to impose higher levels of capital and liquidity to individual financial institutions that exhibit a higher risk profile. In addition, laws granting independence and legal protection of the supervisor came into effect in January 2016 and laws awarding further regulatory powers over holding companies of financial conglomerates are currently before Congress—a prompt approval of this law would further expand the authorities’ ability to manage cross-border risks. The authorities noted that while work on addressing the identification of systemic financial conglomerates has progressed, assessing risks from mixed conglomerates remains challenging given complex ownership and offshore structures where SFC regulatory reach is limited (see Annex III). The authorities’ plans to further embed Basel III elements in their regulatory framework and enhance their resolution frameworks, measures that would bring Colombia closer to international best practices. Staff encouraged the supervisory authority to engage in further communication efforts to explain the peculiarities of the Colombian regulatory regime and the strengths of the supervisory framework.

## E. Structural Reforms

**28. Despite recent advances, Colombia’s lingering structural bottlenecks could hinder its productive transformation away from commodities.** As measured by the World Bank’s Doing Business database, Colombia’s overall business competitiveness has improved in recent years and is among the strongest in the region. At the same time, it still ranks low in some items including ease of trading across borders (110<sup>th</sup>) and paying taxes (126<sup>th</sup>), both critical to unleashing the potential for non-traditional exports. Colombia also faces an important infrastructure gap (Box 4) especially on roads, as it ranks 126<sup>th</sup> according to the WEF’s Global Competitiveness Report which also highlight primary education (105<sup>th</sup>) and taxation on investment (131<sup>th</sup>) and employment (113<sup>th</sup>) as important obstacles.

**29. The authorities’ structural agenda rightly targets key areas now that stand to foster economic diversification and inclusive growth.** A recently approved customs code will reduce important bottlenecks for international trade. Regarding infrastructure, the growth impact of the ongoing 4G infrastructure agenda will be amplified by the recently launched plan to improve multi-mode transportation logistics including tertiary roads. Advances in these areas will also help achieve more inclusive growth by integrating distant geographical areas and promoting agricultural development. Recent progress at the planning department (DNP) to streamline regulations and reduce subsidies in line with OECD best practices, has the potential to improve business competitiveness including of non-traditional exports, which would also benefit from the planned simplification of import tariffs and identification of production clusters. On education and training, the authorities recently launched programs to expand school coverage and better link training centers with firms’ demands. Advances in reducing labor informality have been significant in recent years, but consideration could be given to further easing hiring costs. The implementation of peace-related initiative will have important consequences for regional development, competitiveness and could provide momentum for further structural reforms. Staff encouraged the authorities to continue prioritizing and deepening this rich structural reform agenda.



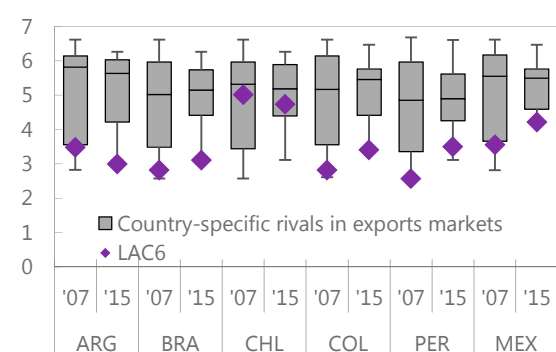
### Box 4. Infrastructure Agenda, a Medium-Term Growth Driver <sup>1</sup>

Colombia is undergoing a gradual adjustment to a large terms-of-trade shock, which calls for further diversifying the production and export base. Infrastructure gaps are an important obstacle for economic diversification. The urgency to improve infrastructure, including road transport, is being addressed by the authorities' 4G infrastructure program. A general equilibrium model is used to illustrate the main channels through which stronger infrastructure will contribute to growth over the medium-term.

**Colombia's infrastructure is an important obstacle for inclusive growth.** As discussed in previous consultations (see Country Report 15/142), investment in infrastructure has lagged behind peers, and has resulted in important gaps, especially in road transport. Inadequate supply of infrastructure has been identified as the third most important obstacle for doing business (Global Competitiveness Report). Export competitiveness has been particularly affected by weak infrastructure as Colombia has an important infrastructure quality gap with its trade competitors. Further, access to quality infrastructure differs greatly across regions in Colombia, also contributing to regional income inequality.

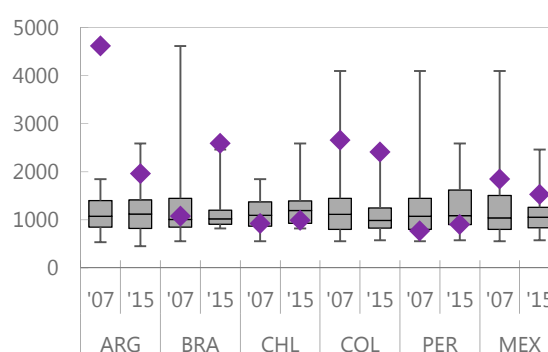
**Quality of Infrastructure (2007–15)**

(Index, 0 = worst, 7 = best)



**Cost to Export (2007–15)**

(Constant U.S. dollars)



<sup>1</sup> Trade rivals sample defined as the top 5 exporters of each of the top 5 goods exported by the respective country.

<sup>2</sup> ARG = Argentina; BRA = Brazil; CHL = Chile; COL = Colombia; PER = Peru; MEX = Mexico.

**The government's structural reform agenda rightly aims to reduce infrastructure gaps and improve competitiveness.** The government's 4G PPP-based infrastructure agenda is on track and efforts to introduce innovative financing instruments and secure seed capital (e.g. ISAGEN sale) have come to fruition. The authorities are also pressing ahead with an overall plan to improve transportation (multi-mode)-infrastructure with special emphasis on tertiary roads, which stand to complement and amplify the benefits of the 4G agenda and foster agriculture and regional development.

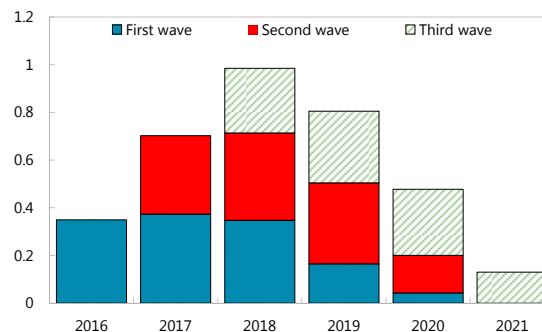
**The wave-structure of the 4G agenda will result in a staggered distribution of the construction-phase capex.** Capital expenditures will peak at around 1 percent of GDP in 2018. As discussed in last year's staff report (IMF Country Report No. 15/142), financing of the agenda will come from a combination of public resources, local financing (including, banks and pension funds) and foreign financing (including equity and debt).

<sup>1</sup> In collaboration with Felipe Zanna and Ioana Moldovan (both RES).

### Box 4. Infrastructure Agenda, a Medium-Term Growth Driver (Concluded)

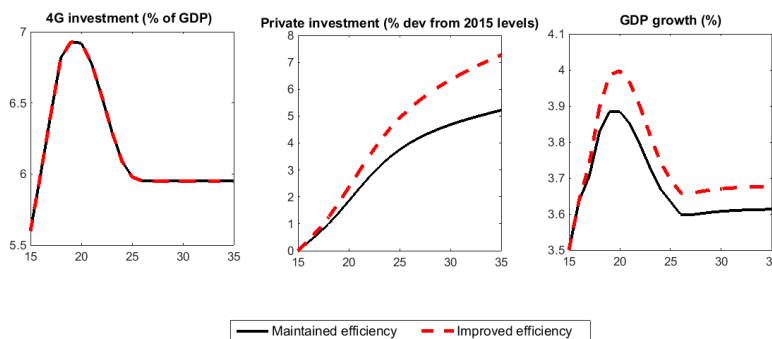
Staff calibrated the DIGNAR model to Colombia and used it to assess the potential impact of the 4G agenda on economic growth.<sup>2</sup> The model captures important growth channels of the 4G agenda: (i) the direct growth effect of expanding the roads network and (ii) the indirect channel of boosting private investment, as the road expansion will likely increase the marginal product of private capital. This improved return in private production fosters stronger private investment over the medium-term. At the same time, the model also captures the short-term demand impact on growth together with relevant offset factors (crowding out) that would also be at play during the construction phase (including the growth drag of additional taxation to cover the fiscal contribution to the projects, as well as the real appreciation that would result from the increased demand for non-tradable goods).

**4G Agenda CAPEX Schedule**  
(in percent of GDP)



Sources: National authorities and Fund staff estimates

Once all the general equilibrium effects are internalized, the model suggest a positive growth yield that peaks at about 0.4 percentage points in 2019 as well as positive crowding in effects on private investment (see solid line). This estimate does not incorporate the long-term benefit that a completed agenda could have for export diversification and regional development, nor the impact of parallel infrastructure programs (e.g. tertiary roads) the government is also undertaking (see above).



According to the PIMA, Colombia’s public investment management compares well against regional peers, but also exhibits areas that warrant further strengthening.<sup>3</sup> In line with Colombia’s overall strong fiscal discipline, the public investment framework helps ensure the investment level is sustainable. The PPP framework is broadly transparent in the scrutiny, selection and oversight of projects. However, for public investment as a whole, the process for project selection could be further strengthened. Further, according to the Economist Intelligence Unit (2014), the LA5 (Brazil, Chile, Colombia, Mexico and Peru) are the countries in the region with the most attractive overall environment for PPPs.<sup>4</sup>

<sup>2</sup> The Debt, Public Investment, Growth and Natural Resources (DIGNAR) model was developed in Melina et al. (2014).

<sup>3</sup> Public Investment Management Assessment (PIMA) evaluates institutional features that shape public investment decision-making at three stages: planning, allocating and implementing.

<sup>4</sup> See Western Hemisphere Regional Economic Outlook April 2016.

## STAFF APPRAISAL

**30. Colombia's broad resilience to drastic changes in global conditions reflects its very strong policies.** Despite facing a terms of trade shock larger than its peers, Colombia still posted one of the strongest GDP growth rates in the region and achieved important social gains by reducing poverty and income inequality. This is a reflection of the strength of the policy framework, and the authorities recognize that growth has to moderate to reduce the external and internal imbalances.

**31. The authorities' coordinated policy response will help achieve a soft landing provided Colombia is not hit by another major shock.** Growth will slow down in 2016 due in part to a decline in investment, despite the start of the 4G infrastructure agenda. Some additional fiscal and monetary tightening will help align domestic demand with the subdued outlook for national income and guide inflation expectations back to the target range, as headline inflation returns to the target band in early 2017. The peso depreciation will help boost exports, which together with some import compression will spearhead the decline in the current account deficit toward its medium-term equilibrium level. Credit growth will continue to slowdown as a result of both demand and supply factors in 2016 and subsequently support the reallocation of resources away from commodities and toward construction.

**32. Downside external risks have grown significantly in the last year but should remain manageable.** Colombia is particularly exposed to swings in global financial market sentiment with its currently wide current account deficit and reliance on portfolio inflows. Sources of risks include a disorderly slowdown in China and a reversal in capital inflows. Weak conditions in Colombia's neighbors (who are also exposed to China) and further declines in oil prices also represent important risks. The flexible exchange rate has served as an important buffer against changing global conditions. Reserves are ample for precautionary purposes and the FCL stands as an additional buffer. Stress tests provide reassurances that the financial system would weather the materialization of severe shocks; nevertheless, continued vigilance is warranted as the corporate sector adjusts in line with the process of economic diversification.

**33. A prompt approval of a structural tax reform is essential to help the adjustment, without leading to an undue compression of public spending.** A reform that improves progressivity and business competitiveness will also help achieved strong and inclusive growth. The expert commission recommendations constitute a valuable blueprint which can be fine-tuned to specific revenue needs—including those stemming from the peace process. Staff welcomes the authorities' commitment to incorporate all peace-related initiatives transparently in their medium-term fiscal framework.

**34. The medium-term outlook is favorable in the absence of further major shocks.** The authorities' 4G infrastructure agenda will support growth during its construction phase and once completed stands to ease an important growth bottleneck. Ongoing efforts to eliminate trade

obstacles, streamline customs procedures and regulations, and foster innovation will support growth and economic diversification.

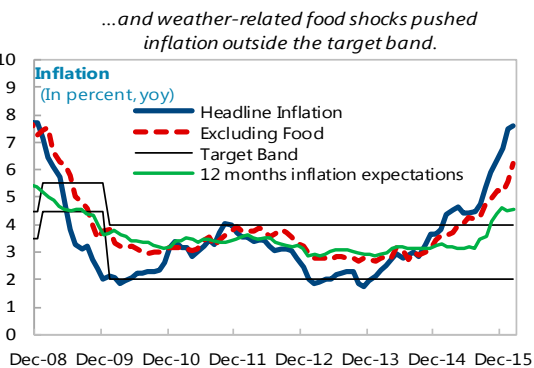
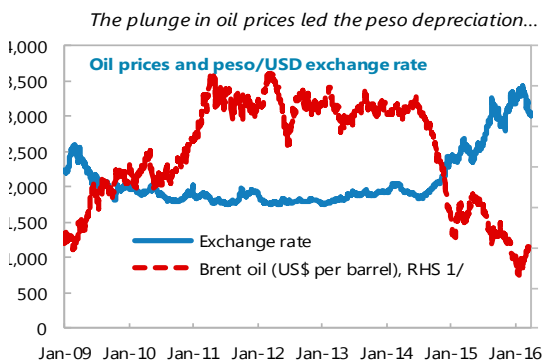
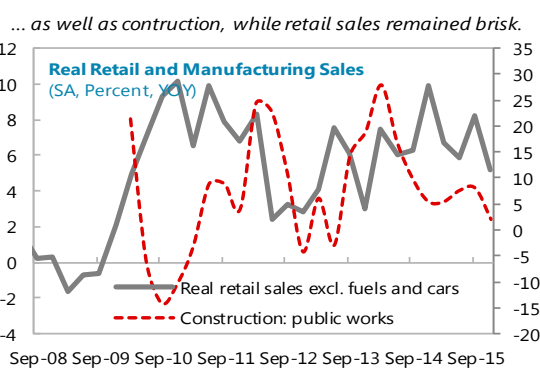
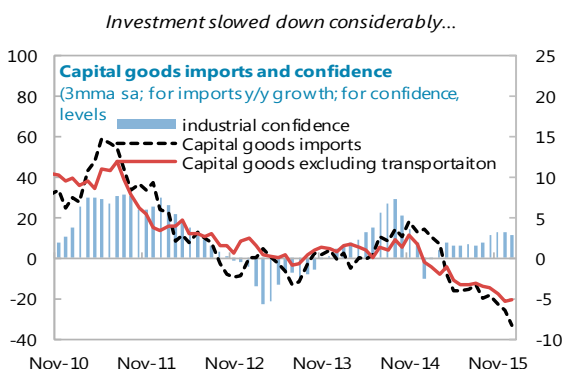
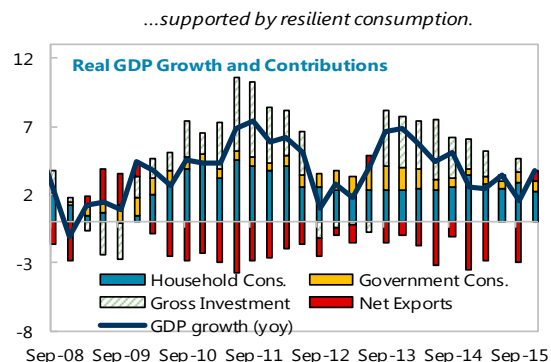
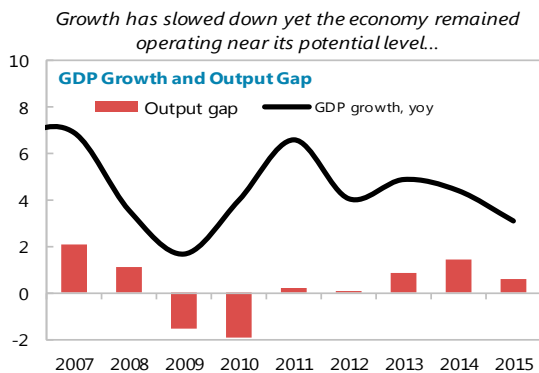
**35. Recent advances in financial regulation and supervision have underpinned the financial system's resilience to changing global conditions; further actions will bring Colombia closer to international best practices.** The financial system solvency and liquidity has remained strong amid less favorable external financing conditions, sectoral credit issues and changes in local funding conditions. Expansions in regulatory and supervisory powers have widened both information availability and the policy toolkit including of macro-prudential tools. Colombia should continue to move its regulatory framework closer to the latest standards by enacting the conglomerates law currently in Congress, adapting key Basel III elements and strengthening its resolution framework.

**36. The development plan offers a useful roadmap of additional measures to foster inclusive growth.** Improving access to quality education, streamlining subsidies and regulations, and expand the logistic network across the country would help improve labor productivity and better integrate all regions, unleashing agriculture and industrial potential.

**37. Staff does not recommend approval of the retention of the exchange restriction arising from the special regime for the hydrocarbon sector, since the authorities have no plans for its removal.**

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

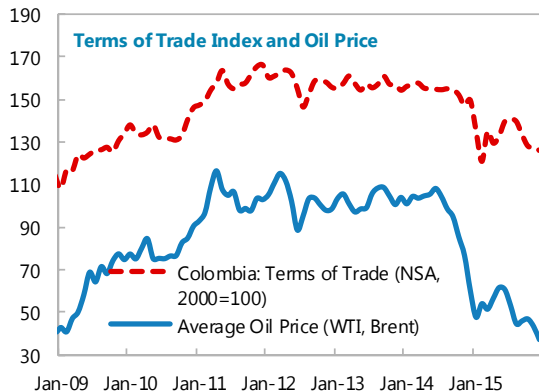
**Figure 1. Colombia: Recent Economic Developments**



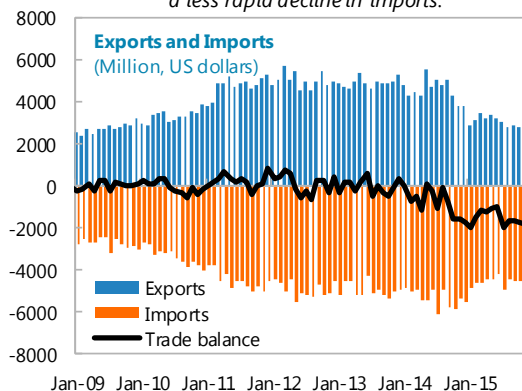
Source: Banco de la República; DANE; Bloomberg; and Fund staff estimates.  
1/ Colombia mix follows closely Brent oil prices.

**Figure 2. Colombia: External Sector Developments**

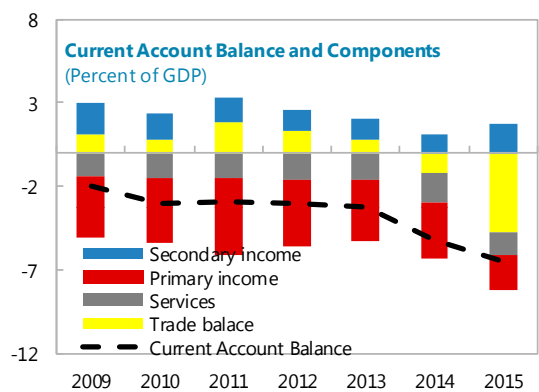
*The terms of trade deteriorated in 2015...*



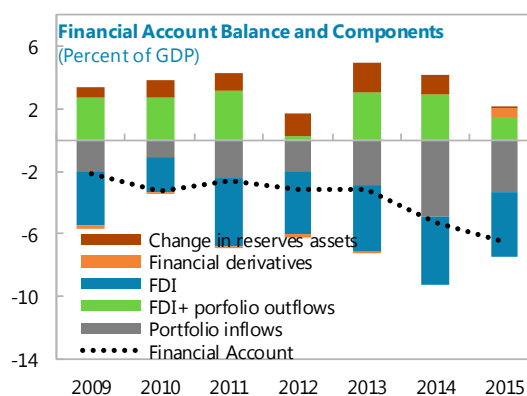
*...contributing to the sudden fall in exports and a less rapid decline in imports.*



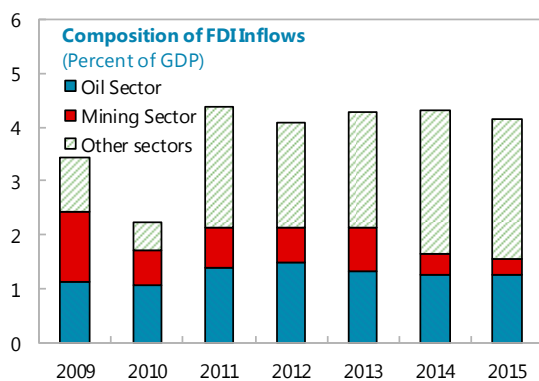
*The current account deficit worsened...*



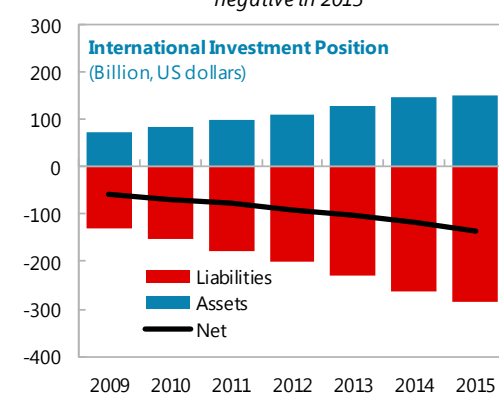
*... but remained financed mainly by strong FDI and portfolio flows ...*



*...with FDI directed to sectors other than oil.*

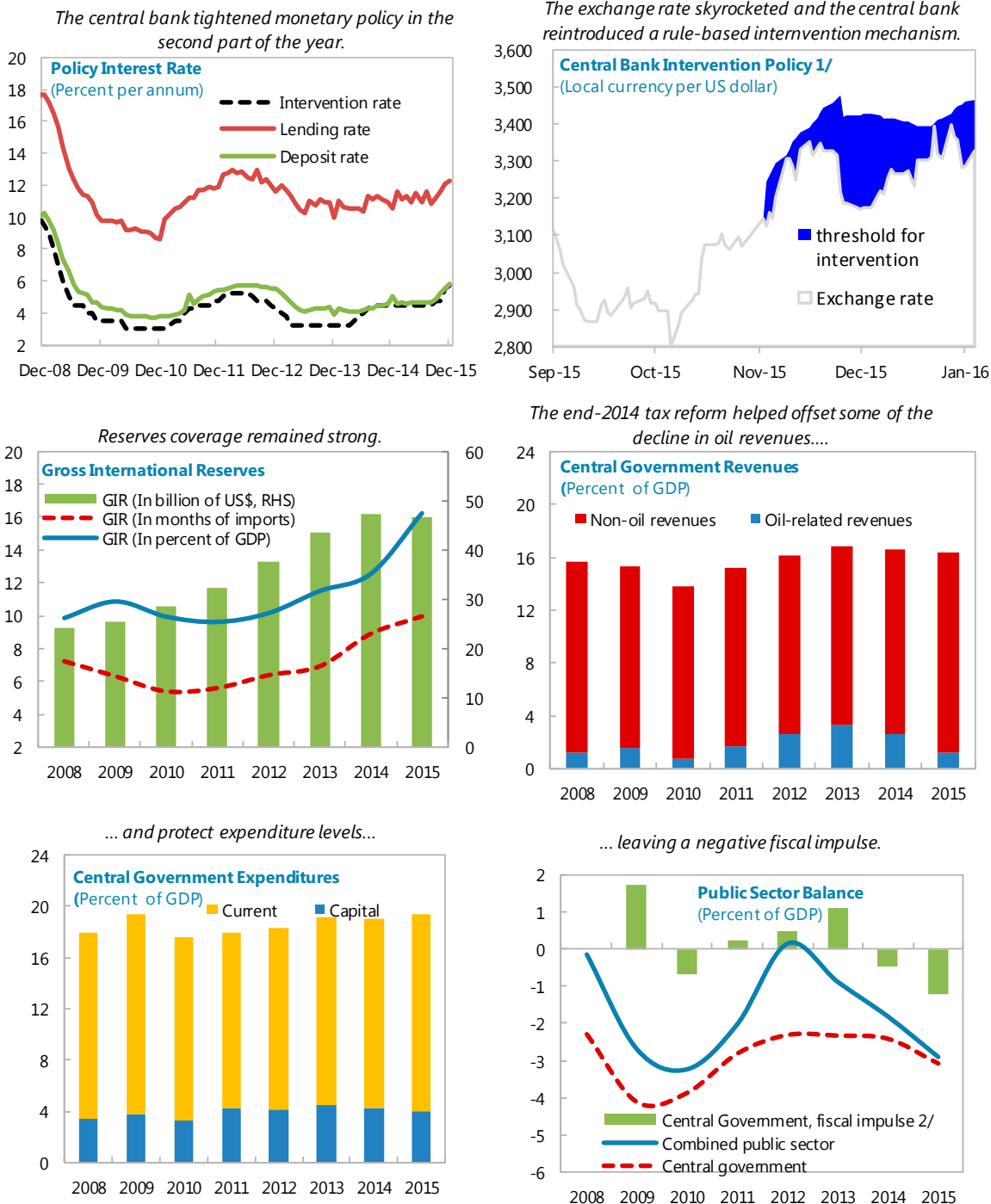


*The international investment position became more negative in 2015*



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

**Figure 3. Colombia: Macroeconomic Policies**



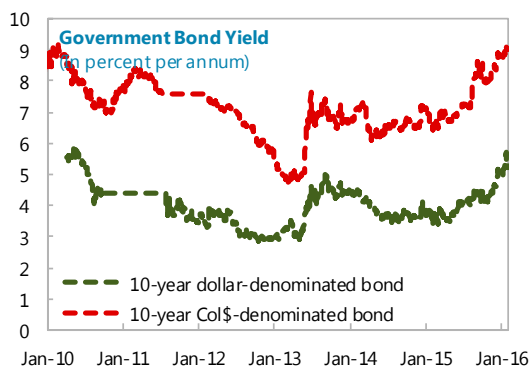
Sources: Banco de la República; and Fund staff estimates.

1/The central bank would intervene in the spot market once the exchange rate is above 5 percent of its 20 day moving average. Before december 23/2015 the rate was 7 percent.

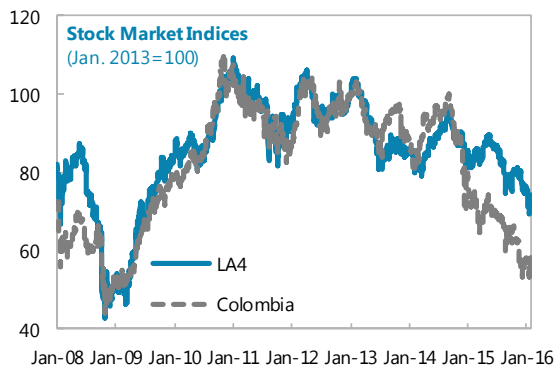
2/ Corresponds to the change in the non-oil structural primary deficit.

**Figure 4. Colombia: Recent Macro-Financial Developments**

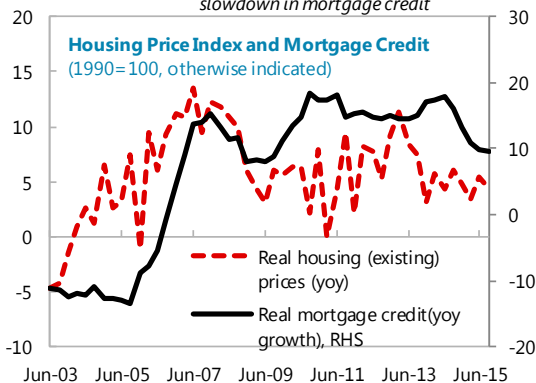
*Government debt yields increased ...*



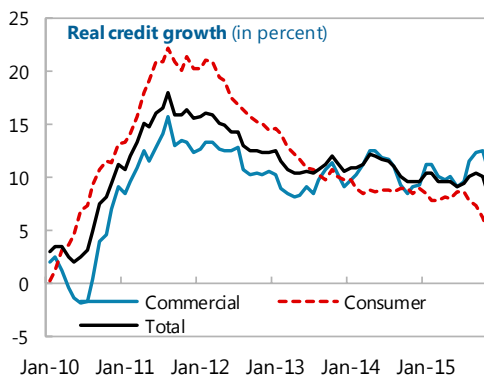
*... and local assets prices rapidly declined.*



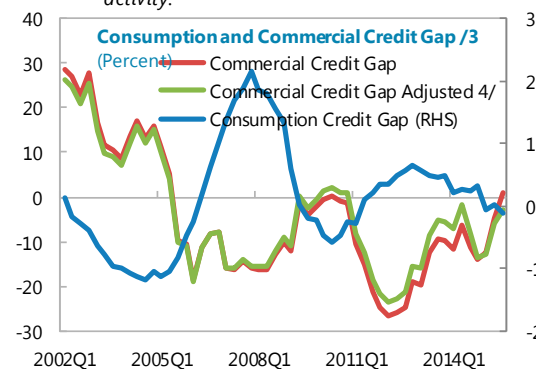
*Housing prices growth have moderated amid a slowdown in mortgage credit*



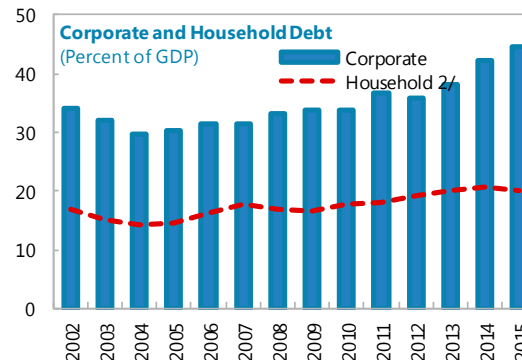
*Bank credit growth has declined in most credit categories*



*...but it remained broadly aligned with economic activity.*



*Corporate and household debt remains modest.*



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

1/ LA4 corresponds to the average of Brazil, Colombia, Peru and Mexico.

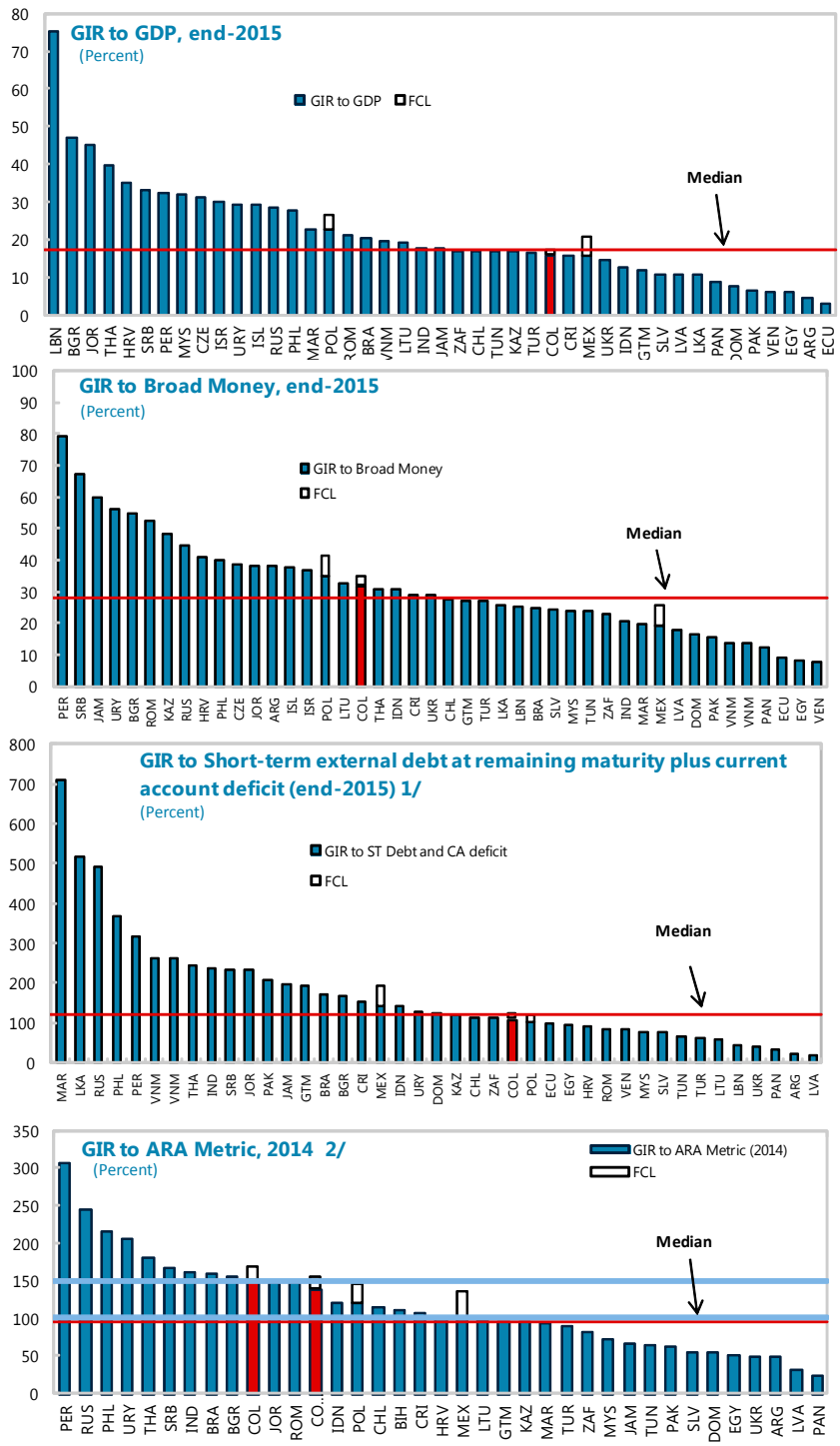
2/ Data for 2015 refers to June 2015.

3/ Consumer and commercial credit gaps are computed as percentage-point deviations from an HP-filtered consumer-credit-to-private-consumption ratio and commercial-to-private-investment ratio, respectively.

4/ Commercial credit valued at end-June 2014 exchange rate

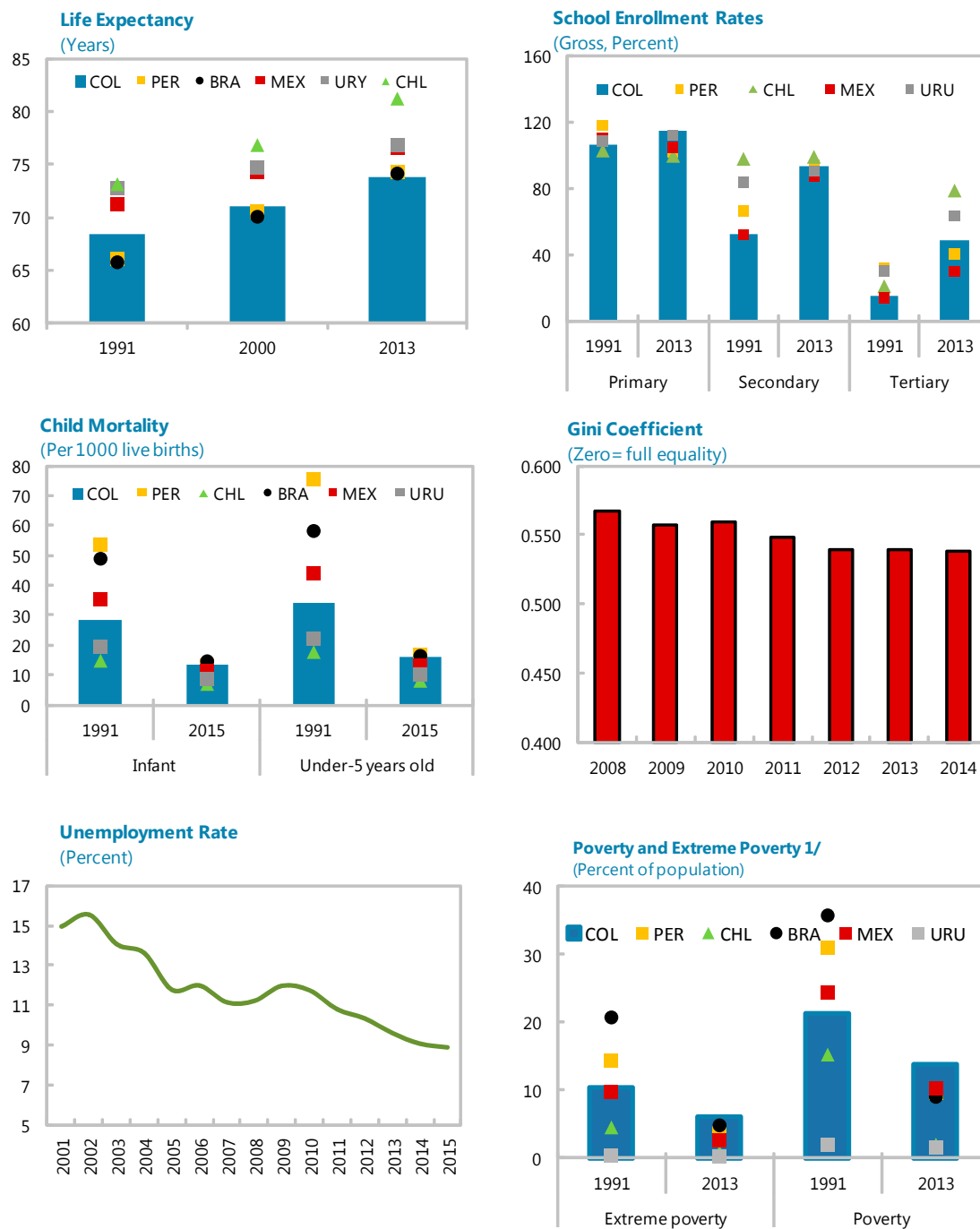


Figure 5. Colombia: Reserve Coverage in an International Perspective



Sources: World Economic Outlook ; IFS; and Fund staff estimates.  
 1/ The current account is set to zero if it is in surplus.  
 2/ The blue lines denote the 100-150 percent range of reserve coverage regarded as adequate for a typical country under this metric.  
 3/ Calculated based on the ARA metric augmented by a buffer for commodity exporters.

Figure 6. Colombia: Social Indicators



Sources: World Development Indicators; and DANE.  
 1/ Poverty corresponds to the poverty headcount ratio at \$3.10 a day (2011 PPP) and extreme poverty to the headcount ratio at \$1.90 a day (2011 PPP).

Table 1. Colombia: Selected Economic and Financial Indicators

<b>I. Social and Demographic Indicators</b>										
Population (million), 2015	48.2				Unemployment rate, 2015 (percent)				8.9	
Urban population (percent of total), 2014	76.2				Physicians (per 1,000 people), 2010				1.5	
GDP, 2015					Adult illiteracy rate (ages 15 and older), 2011				6.4	
per capita (US\$)	6,060				Net secondary school enrollment rate, 2013				73.8	
in billion of Col\$	800,849				Access to water (percent of population), 2015				91.4	
in billion of US\$	292				Gini coefficient, 2015				52.2	
Life expectancy at birth (years), 2013	73.8				Poverty rate (US\$3.1 a day, PPP), 2013				5.3	
Mortality rate, (under 5, per 1,000 live births), 2015	15.9				Extreme poverty rate (US\$1.9 a day, PPP), 2013				2.5	
<b>II. Economic Indicators</b>										
					Projections					
	2013	2014	2015		2016	2017	2018	2019	2020	2021
(In percentage change, unless otherwise indicated)										
<b>National income and prices</b>										
Real GDP	4.9	4.4	3.1		2.5	3.0	3.7	4.1	4.3	4.0
Potential GDP	4.2	3.9	3.6		3.4	3.4	3.6	3.7	3.8	3.7
Output Gap	0.6	1.1	0.6		-0.3	-0.8	-0.6	-0.2	0.2	0.4
GDP deflator	2.0	2.1	2.6		3.9	3.6	3.2	3.1	3.0	2.8
Consumer prices (average)	2.0	2.9	5.0		7.5	3.5	3.0	3.0	3.0	3.0
Consumer prices (end of period)	1.9	3.7	6.8		5.6	3.3	3.0	3.0	3.0	3.0
Exchange rate (average)	1868.9	2001.1	2741.8		3356.5	...	...	...	...	...
(% change)	3.9	7.1	37.0		22.4	...	...	...	...	...
<b>External sector</b>										
Exports (f.o.b.)	-2.1	-5.6	-33.0		-15.3	11.2	5.7	7.0	6.7	6.6
Imports (f.o.b.)	0.8	7.8	-15.3		-13.6	1.5	4.3	4.5	4.2	4.6
Export volume	5.2	-1.3	-3.6		2.3	6.9	3.0	4.9	5.3	5.6
Import volume	6.0	7.8	-5.0		-6.9	-1.1	2.7	3.0	3.1	4.0
Terms of trade (deterioration -)	-2.0	-3.4	-16.9		-8.3	0.9	0.7	0.1	-0.5	-0.2
Real effective exchange rate (depreciation -)	-3.4	-5.5	-24.1		...	...	...	...	...	...
<b>Money and credit</b>										
Broad money	13.4	10.0	9.1		9.9	10.1	10.5	10.8	10.8	10.3
Credit to the private sector	12.1	14.7	15.5		9.2	7.1	8.0	9.0	10.0	11.0
(In percent of GDP)										
Central government balance	-2.3	-2.4	-3.0		-3.6	-3.3	-2.7	-2.1	-1.8	-1.4
Central government structural balance	-3.6	-3.4	-3.8		-3.0	-2.8	-2.5	-2.1	-1.8	-1.5
Combined public sector (CPS) balance 1/	-0.9	-1.8	-2.8		-3.2	-2.9	-2.3	-1.8	-1.5	-1.3
CPS non-oil structural primary balance	-2.8	-3.4	-1.8		-0.2	0.0	0.5	0.9	1.0	0.9
CPS fiscal impulse	0.7	0.6	-1.6		-1.6	-0.2	-0.5	-0.4	-0.1	0.1
Public debt	37.8	44.2	50.6		49.9	49.0	47.9	46.1	44.4	43.2
Public debt, excluding Ecopetrol	36.1	41.4	45.9		45.2	44.5	43.5	42.3	40.6	39.4
Gross domestic investment	24.3	26.3	27.7		27.2	27.0	27.2	27.3	27.4	27.2
Gross national savings	21.1	21.1	23.3		21.4	23.0	23.4	23.9	24.1	24.2
Current account (deficit -)	-3.2	-5.2	-6.5		-6.0	-4.3	-4.2	-4.0	-3.8	-3.6
External debt 2/	25.7	30.1	41.8		51.3	49.1	47.6	46.4	45.7	45.6
Of which: public sector 2/	13.8	18.5	25.8		27.7	25.8	24.2	22.6	21.2	19.8
(In percent of exports of goods and services)										
External debt service	30.1	40.1	61.7		71.4	75.3	69.4	74.2	71.4	75.0
Of which: public sector	7.3	9.0	14.1		15.3	17.5	13.2	20.4	13.7	20.2
Interest payments	5.4	6.2	9.9		11.8	12.1	12.8	13.0	13.2	13.4
Of which: public sector	3.5	4.1	6.8		8.1	7.3	6.9	6.4	5.8	5.5
(In billion of U.S. dollars; unless otherwise indicated)										
Exports (f.o.b.)	60.3	56.9	38.1		32.3	35.9	37.9	40.6	43.3	46.2
Of which: Petroleum products	32.0	28.9	14.2		9.1	10.6	11.1	11.4	11.5	11.3
Gross official reserves 3/	43.6	47.3	46.7		46.9	46.8	46.4	46.9	48.7	51.5
Share of ST debt at remaining maturity + CA deficit	105	110	118		116	119	105	104	98.6	n.a.
Sources: Colombian authorities; UNDP Human Development Report; World Development Indicators; and Fund staff estimates.										
1/ Includes the quasi-fiscal balance of Banco de la República, sales of assets, phone licenses, and statistical discrepancy.										
2/ Includes foreign holdings of locally issued public debt (TES); does not include Banco de la República's outstanding external debt.										
3/ Excludes Colombia's contribution to FLAR and includes valuation changes of reserves denominated in currencies other than U.S. dollars.										

**Table 2a. Colombia: Summary Balance of Payments**

(In million of US\$. unless otherwise indicated)

	2013	2014	2015	Projections					
				2016	2017	2018	2019	2020	2021
<b>Current account balance</b>	<b>-12,326</b>	<b>-19,593</b>	<b>-18,925</b>	<b>-15,281</b>	<b>-12,070</b>	<b>-12,650</b>	<b>-13,213</b>	<b>-13,585</b>	<b>-13,979</b>
Goods balance	3,180	-4,630	-14,026	-12,741	-9,800	-9,751	-9,228	-8,580	-8,112
Exports, f.o.b.	60,281	56,923	38,125	32,298	35,902	37,931	40,589	43,310	46,157
Commodities	43,361	41,019	23,868	17,063	18,596	19,345	19,917	20,247	20,336
Fuel	32,011	28,885	14,224	9,083	10,623	11,089	11,430	11,487	11,294
Non-fuel	11,350	12,134	9,644	7,981	7,972	8,256	8,487	8,760	9,043
Non-traditional exports	12,447	11,846	10,443	11,090	12,788	13,805	15,511	17,473	19,724
Other	4,473	4,057	3,814	4,144	4,519	4,780	5,161	5,590	6,097
Imports, f.o.b.	57,101	61,553	52,151	45,038	45,702	47,682	49,817	51,890	54,270
Consumer goods	12,073	13,120	11,040	9,459	9,416	9,786	10,225	10,696	11,143
Intermediate goods	24,145	26,277	21,608	19,296	19,323	20,036	20,834	21,622	22,564
Capital goods	18,795	20,160	17,792	14,989	15,414	16,227	17,034	17,751	18,524
Other	2,088	1,996	1,711	1,294	1,549	1,633	1,724	1,821	2,038
Services balance	-5,943	-6,682	-3,981	-2,685	-2,116	-2,265	-2,483	-2,807	-3,041
Exports of services	6,859	6,876	7,265	7,674	8,274	8,777	9,358	9,876	10,422
Imports of services	12,802	13,558	11,247	10,358	10,390	11,042	11,841	12,683	13,463
Primary income balance	-14,157	-12,638	-5,989	-5,105	-5,603	-6,264	-7,347	-8,269	-9,139
Receipts	3,627	3,999	4,439	5,217	5,665	6,143	6,206	6,992	7,460
Expenditures	17,783	16,637	10,427	10,322	11,268	12,407	13,553	15,261	16,599
Secondary income balance	4,594	4,358	5,071	5,249	5,449	5,631	5,845	6,072	6,313
<b>Financial account balance</b>	<b>-11,845</b>	<b>-19,836</b>	<b>-19,201</b>	<b>-15,281</b>	<b>-12,070</b>	<b>-12,650</b>	<b>-13,213</b>	<b>-13,585</b>	<b>-13,979</b>
Direct Investment	-8,557	-12,426	-7,890	-10,753	-8,778	-9,107	-9,952	-10,533	-11,209
Assets	7,652	3,899	4,218	2,785	2,798	2,863	2,926	2,989	2,989
Liabilities	16,209	16,325	12,108	13,538	11,576	11,970	12,878	13,522	14,198
Oil sector	5,112	4,732	3,708	2,337	2,225	2,369	2,474	2,405	2,305
Non-oil sectors	11,097	11,593	8,399	11,201	9,350	9,601	10,404	11,117	11,893
Portfolio Investment	-6,978	-11,654	-9,685	-2,651	-3,726	-2,986	-3,662	-4,454	-4,953
Assets	4,096	7,007	122	1,364	2,023	3,294	3,958	4,926	5,742
Liabilities	11,073	18,661	9,807	4,016	5,749	6,280	7,620	9,380	10,695
Equity	1,926	3,883	1,780	1,013	1,408	1,900	2,240	2,850	3,330
Debt instruments	9,147	14,778	8,027	3,003	4,340	4,380	5,380	6,531	7,365
General government	4,908	10,775	7,228	3,426	4,227	4,527	5,577	6,552	7,364
Banks	1,300	-17	366	50	633	549	411	631	630
Corporates and households	2,939	4,020	434	-473	-520	-696	-608	-652	-630
Derivatives	-33	268	1,526	0	0	0	0	0	0
Other Investments	-3,225	-461	-3,567	-1,991	492	-189	-113	-337	-615
Change in reserve assets	6,946	4,437	415	114	-58	-368	513	1,739	2,797
<b>Net errors and omissions</b>	<b>480</b>	<b>-243</b>	<b>-276</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>Memorandum items:</b>									
GDP (billion USD)	380	379	292	254	280	305	332	359	385
Gross international reserves (billion USD) - IMF definition	43.2	46.8	46.3	46.4	46.3	45.9	46.5	48.2	51.0
GIR / (st debt at remaining maturity + ca deficit)	104.7	110.4	118.4	116.0	118.5	104.9	104.3	98.6	n.a.
GIR / GDP	11.4	12.4	15.8	18.3	16.6	15.1	14.0	13.5	13.3
GIR (months of imports of G&S)	6.9	8.9	10.0	9.9	9.5	8.9	8.6	8.5	n.a.

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

**Table 2b. Colombia: Summary Balance of Payments**

(In Percent of GDP)

	2013	2014	2015	Projections					
				2016	2017	2018	2019	2020	2021
<b>Current account balance</b>	<b>-3.2</b>	<b>-5.2</b>	<b>-6.5</b>	<b>-6.0</b>	<b>-4.3</b>	<b>-4.2</b>	<b>-4.0</b>	<b>-3.8</b>	<b>-3.6</b>
Goods balance	0.8	-1.2	-4.8	-5.0	-3.5	-3.2	-2.8	-2.4	-2.1
Exports, f.o.b.	15.9	15.0	13.1	12.7	12.8	12.4	12.2	12.1	12.0
Commodities	11.4	10.8	8.2	6.7	6.6	6.3	6.0	5.6	5.3
Fuel	8.4	7.6	4.9	3.6	3.8	3.6	3.4	3.2	2.9
Non-fuel	3.0	3.2	3.3	3.1	2.8	2.7	2.6	2.4	2.3
Non-traditional exports	3.3	3.1	3.6	4.4	4.6	4.5	4.7	4.9	5.1
Other	1.2	1.1	1.3	1.6	1.6	1.6	1.6	1.6	1.6
Imports, f.o.b.	15.0	16.3	17.9	17.7	16.3	15.6	15.0	14.5	14.1
Consumer goods	3.2	3.5	3.8	3.7	3.4	3.2	3.1	3.0	2.9
Intermediate goods	6.4	6.9	7.4	7.6	6.9	6.6	6.3	6.0	5.9
Capital goods	4.9	5.3	6.1	5.9	5.5	5.3	5.1	4.9	4.8
Other	0.5	0.5	0.6	0.5	0.6	0.5	0.5	0.5	0.5
Services balance	-1.6	-1.8	-1.4	-1.1	-0.8	-0.7	-0.7	-0.8	-0.8
Exports of services	1.8	1.8	2.5	3.0	3.0	2.9	2.8	2.8	2.7
Imports of services	3.4	3.6	3.9	4.1	3.7	3.6	3.6	3.5	3.5
Primary income balance	-3.7	-3.3	-2.1	-2.0	-2.0	-2.1	-2.2	-2.3	-2.4
Receipts	1.0	1.1	1.5	2.1	2.0	2.0	1.9	1.9	1.9
Expenditures	4.7	4.4	3.6	4.1	4.0	4.1	4.1	4.3	4.3
Secondary income balance	1.2	1.2	1.7	2.1	1.9	1.8	1.8	1.7	1.6
<b>Financial account balance</b>	<b>-3.1</b>	<b>-5.2</b>	<b>-6.6</b>	<b>-6.0</b>	<b>-4.3</b>	<b>-4.2</b>	<b>-4.0</b>	<b>-3.8</b>	<b>-3.6</b>
Direct Investment	-2.3	-3.3	-2.7	-4.2	-3.1	-3.0	-3.0	-2.9	-2.9
Assets	2.0	1.0	1.4	1.1	1.0	0.9	0.9	0.8	0.8
Liabilities	4.3	4.3	4.1	5.3	4.1	3.9	3.9	3.8	3.7
Oil sector	1.3	1.3	1.3	0.9	0.8	0.8	0.7	0.7	0.6
Non-oil sectors	2.9	3.1	2.9	4.4	3.3	3.2	3.1	3.1	3.1
Portfolio Investment	-1.8	-3.1	-3.3	-1.0	-1.3	-1.0	-1.1	-1.2	-1.3
Assets	1.1	1.9	0.0	0.5	0.7	1.1	1.2	1.4	1.5
Liabilities	2.9	4.9	3.4	1.6	2.1	2.1	2.3	2.6	2.8
Equity	0.5	1.0	0.6	0.4	0.5	0.6	0.7	0.8	0.9
Debt instruments	2.4	3.9	2.7	1.2	1.5	1.4	1.6	1.8	1.9
General government	1.3	2.8	2.5	1.3	1.5	1.5	1.7	1.8	1.9
Banks	0.3	0.0	0.1	0.0	0.2	0.2	0.1	0.2	0.2
Corporates and househo	0.8	1.1	0.1	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
Derivatives	0.0	0.1	0.5	0.0	0.0	0.0	0.0	0.0	0.0
Other Investments	-0.8	-0.1	-1.2	-0.8	0.2	-0.1	0.0	-0.1	-0.2
Change in Reserve Assets	1.8	1.2	0.1	0.0	0.0	-0.1	0.2	0.5	0.7
<b>Net errors and omissions</b>	<b>0.1</b>	<b>-0.1</b>	<b>-0.1</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

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

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

(In percent of GDP, unless otherwise indicated)

	2013	2014	Projections						
			2015	2016	2017	2018	2019	2020	2021
<b>Total revenue</b>	<b>16.9</b>	<b>16.6</b>	<b>16.2</b>	<b>14.9</b>	<b>14.9</b>	<b>15.0</b>	<b>15.0</b>	<b>15.0</b>	<b>15.0</b>
<b>Current revenue</b>	<b>14.3</b>	<b>14.4</b>	<b>14.6</b>	<b>14.1</b>	<b>14.1</b>	<b>14.2</b>	<b>14.2</b>	<b>14.2</b>	<b>14.2</b>
<b>Tax revenue</b>	<b>14.2</b>	<b>14.3</b>	<b>14.5</b>	<b>14.0</b>	<b>14.0</b>	<b>14.1</b>	<b>14.1</b>	<b>14.1</b>	<b>14.1</b>
Net income tax and profits 2/	6.3	5.0	4.6	3.9	3.9	4.0	4.1	4.2	4.2
Goods and services	4.9	5.1	5.2	5.6	5.5	5.6	5.5	5.4	5.4
Value-added tax	4.9	5.1	5.2	5.6	5.5	5.6	5.5	5.4	5.4
International trade	0.5	0.5	0.5	0.5	0.5	0.4	0.4	0.4	0.4
Financial transaction tax	0.8	0.9	0.9	0.7	0.7	0.7	0.7	0.7	0.7
Stamp and other taxes	1.6	2.8	3.3	3.2	3.4	3.4	3.4	3.4	3.4
<b>Nontax revenue</b>	<b>2.7</b>	<b>2.3</b>	<b>1.7</b>	<b>1.0</b>	<b>0.9</b>	<b>0.9</b>	<b>0.9</b>	<b>0.9</b>	<b>0.9</b>
Property income	0.1	0.2	0.4	0.2	0.2	0.2	0.2	0.2	0.2
Other	2.6	2.2	1.3	0.8	0.7	0.7	0.7	0.7	0.7
<b>Total expenditure and net lending</b>	<b>19.2</b>	<b>19.0</b>	<b>19.3</b>	<b>18.5</b>	<b>18.1</b>	<b>17.7</b>	<b>17.1</b>	<b>16.8</b>	<b>16.5</b>
<b>Current expenditure</b>	<b>14.6</b>	<b>14.8</b>	<b>15.2</b>	<b>15.7</b>	<b>15.3</b>	<b>15.0</b>	<b>14.6</b>	<b>14.5</b>	<b>14.1</b>
Wages and salaries	2.1	2.3	2.5	2.5	2.4	2.3	2.2	2.1	2.0
Goods and services	0.9	0.8	0.8	0.9	0.9	0.9	0.9	0.8	0.8
Interest	2.3	2.2	2.6	3.0	2.9	2.9	3.0	2.9	2.6
External	0.5	0.5	0.8	0.9	0.9	0.8	0.8	0.8	0.7
Domestic	1.8	1.7	2.2	2.2	2.0	2.1	2.2	2.2	2.0
Current transfers	9.3	9.4	9.4	9.2	9.1	8.8	8.6	8.6	8.6
<b>Capital expenditure</b>	<b>4.5</b>	<b>4.3</b>	<b>4.0</b>	<b>2.8</b>	<b>2.8</b>	<b>2.7</b>	<b>2.5</b>	<b>2.3</b>	<b>2.4</b>
Fixed capital formation	3.2	2.9	2.7	1.5	1.4	1.2	1.0	0.9	0.9
Capital transfers	1.3	1.3	1.3	1.3	1.4	1.5	1.5	1.4	1.5
<b>Net lending</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
<b>Overall balance</b>	<b>-2.3</b>	<b>-2.4</b>	<b>-3.0</b>	<b>-3.6</b>	<b>-3.3</b>	<b>-2.7</b>	<b>-2.1</b>	<b>-1.8</b>	<b>-1.4</b>
Memorandum items:									
Oil-related revenues 3/	3.3	2.6	1.2	0.1	0.0	0.0	0.0	0.0	0.0
Structural balance 4/	-3.6	-3.4	-3.8	-3.0	-2.8	-2.5	-2.1	-1.8	-1.5
Structural primary non-oil balance	-3.5	-3.0	-1.7	-0.6	-0.3	0.4	0.9	1.1	1.1
Fiscal Impulse	1.1	-0.5	-1.2	-1.1	-0.3	-0.6	-0.5	-0.3	0.0
Non-oil balance	-5.7	-5.0	-4.2	-3.7	-3.3	-2.7	-2.1	-1.8	-1.5
Primary balance	0.0	-0.2	-0.4	-0.6	-0.4	0.3	0.8	1.2	0.0

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

4/ 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. Adjustments are made to account for fuel subsidy expenditures and the accrual of Ecopetrol dividends.

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

(In percent of GDP, unless otherwise indicated)

	2013	2014	2015	Projections					
				2016	2017	2018	2019	2020	2021
<b>Total revenue</b>	<b>28.1</b>	<b>27.7</b>	<b>26.7</b>	<b>25.4</b>	<b>25.4</b>	<b>25.5</b>	<b>25.4</b>	<b>25.3</b>	<b>25.3</b>
Tax revenue	19.8	19.9	20.2	19.6	19.6	19.7	19.7	19.7	19.7
Nontax revenue	8.3	7.7	6.6	5.8	5.8	5.7	5.7	5.6	5.5
Financial income	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Operating surplus of public enterprises	-0.1	-0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other 2/	7.8	7.5	6.1	5.3	5.3	5.2	5.2	5.1	5.0
<b>Total expenditure and net lending 3/</b>	<b>29.1</b>	<b>29.4</b>	<b>29.6</b>	<b>28.7</b>	<b>28.2</b>	<b>27.8</b>	<b>27.2</b>	<b>26.9</b>	<b>26.6</b>
Current expenditure	21.5	21.9	22.6	22.9	22.5	22.4	22.2	22.0	21.6
Wages and salaries	5.2	5.3	5.3	5.4	5.3	5.2	5.1	5.0	4.9
Goods and services	3.1	3.1	3.1	3.2	3.2	3.2	3.2	3.1	3.1
Interest	2.6	2.6	3.6	3.7	3.5	3.5	3.4	3.3	3.0
External	0.6	0.6	1.1	1.3	1.3	1.2	1.1	1.1	1.0
Domestic	2.0	2.0	2.5	2.4	2.2	2.3	2.3	2.3	2.0
Transfers to private sector	7.8	8.0	7.7	7.7	7.7	7.7	7.7	7.7	7.7
Other 4/	2.7	2.9	2.9	2.9	2.9	2.9	2.9	2.9	2.9
Capital expenditure	7.6	7.6	7.0	5.8	5.7	5.4	5.0	4.9	5.0
Statistical discrepancy	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<b>Nonfinancial public sector balance</b>	<b>-0.9</b>	<b>-1.8</b>	<b>-2.9</b>	<b>-3.2</b>	<b>-2.9</b>	<b>-2.3</b>	<b>-1.8</b>	<b>-1.6</b>	<b>-1.3</b>
Quasi-fiscal balance (BR cash profits)	-0.1	-0.1	0.0	0.0	-0.1	0.0	0.0	-0.1	0.0
Foqafin balance	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Net cost of financial restructuring 5/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<b>Combined public sector balance</b>	<b>-0.9</b>	<b>-1.8</b>	<b>-2.8</b>	<b>-3.2</b>	<b>-2.9</b>	<b>-2.3</b>	<b>-1.8</b>	<b>-1.5</b>	<b>-1.3</b>
<b>Overall financing</b>	<b>0.9</b>	<b>1.8</b>	<b>2.8</b>	<b>3.2</b>	<b>2.9</b>	<b>2.3</b>	<b>1.8</b>	<b>1.5</b>	<b>1.3</b>
Foreign, net	1.2	2.8	2.5	1.8	1.2	1.3	1.5	1.1	1.1
Domestic, net	-0.3	-1.0	0.3	1.4	1.6	1.0	0.2	0.5	0.2
<b>Memorandum items:</b>									
Overall structural balance 6/	-2.5	-3.1	-3.3	-2.1	-1.7	-1.8	-1.7	-1.7	-1.5
Structural primary non-oil balance	-2.8	-3.4	-1.8	-0.2	0.0	0.5	0.9	1.0	0.9
Fiscal Impulse	0.7	0.6	-1.6	-1.6	-0.2	-0.5	-0.4	-0.1	0.1
Primary balance 7/	1.8	0.7	0.8	0.6	0.6	1.2	1.6	1.8	1.7
Oil-related revenues 8/	4.9	4.0	2.4	1.0	0.9	0.9	0.8	0.8	0.7
Total public debt 9/	37.8	44.2	50.6	49.9	49.0	47.9	46.1	44.4	43.2

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

1/ The combined public sector includes the central, regional and local governments, social security, and public sector enterprises. Excludes Ecopetrol.

2/ Includes royalties, dividends and social security contributions.

3/ Expenditure reported on commitments basis.

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

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

6/ Adjusts non-commodity revenues for the output gap and commodity revenues for differentials between estimated equilibrium oil price and production levels. Adjustments are made to account for fuel subsidy expenditures and the accrual of Ecopetrol dividends. Excludes private pension transfers from revenues.

7/ Includes statistical discrepancy. Overall balance plus interest expenditures

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

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

Table 5. Colombia: Monetary Indicators

	2013	2014	2015	Projections					
				2016	2017	2018	2019	2020	2021
(In billion of Col\$, unless otherwise indicated)									
<b>Central Bank</b>									
Net Foreign Assets	83,092	112,111	145,917	160,097	156,700	154,938	157,010	164,516	176,661
Gross official reserve assets	88,928	112,101	145,726	157,287	151,186	147,780	147,716	151,818	159,953
In billion of US\$	46.2	46.9	46.3	47.0	46.5	46.2	46.8	48.5	51.3
Short-term foreign liabilities	5,770	25	43	1,946	671	887	1,168	909	988
Other net foreign assets	2,298	2,812	3,657	4,756	6,186	8,045	10,462	13,606	17,696
Net domestic assets	-17,993	-42,429	-63,395	-72,212	-62,921	-54,557	-49,223	-48,777	-52,981
Net credit to the public sector	-14,526	-21,026	-9,270	-10,559	-9,200	-7,977	-7,197	-7,132	-7,747
Net credit to the financial system	3,732	6,768	6,525	7,432	6,476	5,615	5,066	5,020	5,453
Other	-7,199	-28,171	-60,651	-69,085	-60,197	-52,195	-47,092	-46,665	-50,688
Monetary base	65,099	69,682	82,522	87,885	93,779	100,381	107,787	115,739	123,680
Currency in circulation	39,751	45,429	46,755	49,794	53,133	56,874	61,070	65,575	70,074
Deposit money banks reserves	25,254	24,170	32,283	22,891	24,404	26,084	27,967	30,031	32,164
Other deposits	94	83	84	84	84	84	84	84	84
<b>Financial system</b>									
Net foreign assets	67,826	92,815	145,917	138,371	133,517	130,123	130,364	135,904	146,086
In billion of US\$	35.2	38.8	46.3	41.3	41.1	40.7	41.3	43.4	46.9
Net domestic assets	261,480	269,523	352,446	384,157	438,893	498,924	563,143	628,764	693,201
Net credit to public sector	33,151	30,800	25,081	29,308	38,191	47,552	60,727	69,178	79,591
Credit to private sector	281,747	323,152	373,344	407,689	436,456	471,546	513,881	565,154	627,100
Other net	-53,417	-84,429	-45,979	-52,839	-35,754	-20,174	-11,465	-5,567	-13,491
Broad money	329,307	362,338	395,441	434,643	478,631	528,666	585,720	648,929	715,607
(Annual percentage change)									
Credit to private sector	12.1	14.7	15.5	9.2	7.1	8.0	9.0	10.0	11.0
Currency	13.4	14.3	2.9	6.5	6.7	7.0	7.4	7.4	6.9
Monetary base	15.3	7.0	18.4	6.5	6.7	7.0	7.4	7.4	6.9
Broad money	13.4	10.0	9.1	9.9	10.1	10.5	10.8	10.8	10.3
(In percent of GDP)									
Credit to private sector	39.7	42.7	46.6	47.8	48.0	48.4	49.1	50.3	52.2
Currency	5.6	6.0	5.8	5.8	5.8	5.8	5.8	5.8	5.8
Monetary base	9.2	9.2	10.3	10.3	10.3	10.3	10.3	10.3	10.3
Broad money	46.3	47.8	49.4	51.0	52.6	54.3	56.0	57.8	59.6
Memorandum items:									
Central bank inflation target	2.0-4.0	2.0-4.0	2.0-4.0	2.0-4.0	2.0-4.0	2.0-4.0	2.0-4.0	2.0-4.0	2.0-4.0
CPI inflation, eop	1.9	3.7	6.8	5.6	3.3	3.0	3.0	3.0	3.0
Nominal GDP (In Col\$ billion)	710,497	757,506	800,849	852,899	910,097	974,164	1,046,037	1,123,209	1,200,272

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



**Table 6. Colombia: Medium-Term Outlook**

	2013	2014	2015	Projections					
				2016	2017	2018	2019	2020	2021
	(In percent of GDP, unless otherwise indicated)								
Real GDP (in percent change)	4.9	4.4	3.1	2.5	3.0	3.7	4.1	4.3	4.0
Consumer prices (in percent change; end of per	1.9	3.7	6.8	5.6	3.3	3.0	3.0	3.0	3.0
Gross national savings	21.1	21.1	23.3	21.4	23.0	23.4	23.9	24.1	24.2
Private sector	14.8	15.7	19.4	18.3	20.0	19.9	19.9	20.1	20.0
Public sector	6.2	5.4	3.9	3.1	3.1	3.6	4.0	4.1	4.2
Gross domestic investment	24.3	26.3	27.7	27.2	27.0	27.2	27.3	27.4	27.2
Private sector	17.2	19.0	21.0	20.9	21.1	21.3	21.6	21.7	21.7
Public sector	7.1	7.2	6.7	6.3	5.9	5.8	5.7	5.6	5.5
	(In percent change)								
Credit to the private sector									
Commercial	10.8	15.5	17.2	9.4	7.2	8.1	9.1	10.1	11.1
Consumption	10.5	12.5	12.0	8.8	6.7	7.6	8.6	9.6	10.5
Mortgage	26.2	17.9	15.0	9.2	7.5	8.5	9.5	10.5	11.4
Microcredit	15.8	8.9	15.0	9.2	7.1	8.0	9.0	10.0	11.0
Total	12.1	14.7	15.5	9.2	7.1	8.0	9.0	10.0	11.0
	(In percent of GDP, unless otherwise indicated)								
Nonfinancial public sector 1/									
Revenue	28.1	27.7	26.7	25.4	25.4	25.5	25.4	25.3	25.3
Expenditure	29.1	29.4	29.6	28.7	28.2	27.8	27.2	26.9	26.6
Current expenditure	21.5	21.9	22.6	22.9	22.5	22.4	22.2	22.0	21.6
Capital expenditure	7.6	7.6	7.0	5.8	5.7	5.4	5.0	4.9	5.0
Primary balance 2/	1.8	0.8	0.8	0.5	0.6	1.1	1.6	1.8	1.7
Overall balance 2/	-0.9	-1.8	-2.9	-3.2	-2.9	-2.3	-1.8	-1.6	-1.3
Combined public sector balance	-0.9	-1.8	-2.8	-3.2	-2.9	-2.3	-1.8	-1.5	-1.3
External financing	1.2	2.8	2.5	1.8	1.2	1.3	1.5	1.1	1.1
Domestic financing	-0.3	-1.0	0.3	1.4	1.6	1.0	0.2	0.5	0.2
External current account balance	-3.2	-5.2	-6.5	-6.0	-4.3	-4.2	-4.0	-3.8	-3.6
Trade balance	0.8	-1.2	-4.8	-5.0	-3.5	-3.2	-2.8	-2.4	-2.1
Exports	15.9	15.0	13.1	12.7	12.8	12.4	12.2	12.1	12.0
Imports	15.0	16.3	17.9	17.7	16.3	15.6	15.0	14.5	14.1
Financial account balance	-3.1	-5.2	-6.6	-6.0	-4.3	-4.2	-4.0	-3.8	-3.6
Direct Investment	-2.3	-3.3	-2.7	-4.2	-3.1	-3.0	-3.0	-2.9	-2.9
Portfolio Investment	-1.8	-3.1	-3.3	-1.0	-1.3	-1.0	-1.1	-1.2	-1.3
Other Investments and Derivatives	-0.9	-0.1	-0.7	-0.8	0.2	-0.1	0.0	-0.1	-0.2
Change in Reserve Assets	1.8	1.2	0.1	0.0	0.0	-0.1	0.2	0.5	0.7
Gross public sector debt 3/	37.8	44.2	50.6	49.9	49.0	47.9	46.1	44.4	43.2
Gross public sector debt, excluding Ecopetrol	36.1	41.4	45.9	45.2	44.5	43.5	42.3	40.6	39.4
Total public net debt 4/	27.0	33.7	42.2	43.9	43.5	42.7	41.3	39.9	38.9
Memorandum items:									
Nominal GDP (in Col\$ billion)	710,497	757,506	800,849	852,899	910,097	974,164	1,046,037	1,123,209	1,200,272
Crude oil, spot price	104.1	96.2	50.8	34.8	41.0	44.5	47.6	49.4	50.5

Sources: Colombian authorities and Fund staff estimates and projections.

1/ Excludes Ecopetrol.

2/ Includes statistical discrepancy.

3/ Includes debt of the non-financial public sector, plus Ecopetrol, FOGAFIN and FINAGRO.

4/ Gross debt minus financial assets (public sector deposits in domestic and foreign financial institutions).

**Table 7. Colombia: Financial Soundness Indicators 1/**

(In percent, unless otherwise indicated; end-of-period values)

	2009	2010	2011	2012	2013	2014	2015
<b>Capital Adequacy</b>							
Regulatory capital to risk-weighted assets	17.2	17.3	16.9	18.1	17.0	17.0	16.6
Regulatory Tier 1 capital to risk-weighted assets	13.4	13.0	13.4	13.7	12.0	11.7	11.7
Capital (net worth) to assets	14.2	14.2	14.3	14.7	14.8	14.9	14.0
<b>Asset Quality and Distribution</b>							
Nonperforming loans to gross loans	4.0	2.9	2.5	2.8	2.8	2.9	3.0
Provisions to nonperforming loans	140.1	175.0	182.0	163.9	160.7	151.3	148.3
Gross loans to assets	64.3	67.9	70.4	69.6	68.2	69.3	69.6
<b>Earnings and Profitability</b>							
ROAA	3.5	3.4	3.3	3.1	2.8	2.9	2.9
ROAE	26.2	23.7	23.0	21.2	19.5	19.8	21.0
Interest margin to gross income	54.0	55.6	58.4	58.7	61.3	60.6	58.8
Noninterest expenses to gross income	43.2	47.0	49.3	47.2	47.0	44.6	42.2
<b>Liquidity</b>							
Liquid assets to total assets 2/	9.2	7.5	8.6	21.6	21.4	19.8	18.9
Liquid assets to short-term liabilities 2/	14.2	12.1	13.9	43.6	41.9	40.3	38.7
Deposit to loan ratio	98.8	93.5	91.4	94.7	96.3	91.6	88.8
<b>Other</b>							
Foreign-currency-denominated loans to total loans	4.2	6.9	7.7	7.5	7.3	8.4	8.0
Foreign-currency-denominated liabilities to total liabilities	6.6	9.4	10.5	10.5	11.9	13.5	12.7
Net open position in foreign exchange to capital	5.3	4.5	4.8	0.6	0.5	0.7	0.4

Source: Superintendencia Financiera.

1/ Total Banking System. All deposit taking institutions.

2/ Data after 2011 refers to broader definition of liquid assets in line with international standards.

**Table 8. Colombia: Indicators of External Vulnerability 1/**

(In billion of US\$, unless otherwise indicated)

	2013	2014	2015	Projections					
				2016	2017	2018	2019	2020	2021
<b>External indicators</b>									
Exports of GNFS 1/	67.1	63.8	45.4	40.0	44.2	46.7	49.9	53.2	56.6
Imports of GNFS 1/	69.9	75.1	63.4	55.4	56.1	58.7	61.7	64.6	67.7
Terms of trade (12-month percent change)	147.4	142.3	118.3	108.5	109.5	110.3	110.4	109.9	109.7
Current account balance	-12.3	-19.6	-18.9	-15.3	-12.1	-12.6	-13.2	-13.6	-14.0
In percent of GDP	-3.2	-5.2	-6.5	-6.0	-4.3	-4.2	-4.0	-3.8	-3.6
Financial account balance	-11.8	-19.8	-19.2	-15.3	-12.1	-12.6	-13.2	-13.6	-14.0
<i>Of which:</i> Foreign direct investment (net)	-8.6	-12.4	-7.9	-10.8	-8.8	-9.1	-10.0	-10.5	-11.2
<i>Of which:</i> Portfolio investment (net)	-7.0	-11.7	-9.7	-2.7	-3.7	-3.0	-3.7	-4.5	-5.0
Total external debt 2/	97.8	113.8	122.2	130.4	137.4	144.9	153.8	164.1	175.6
<i>Of which:</i> Public sector 2/	57.9	72.1	78.0	81.3	85.1	89.5	94.5	100.4	107.1
In percent of gross international reserves	224.1	240.4	261.5	278.4	293.7	312.2	327.7	337.1	341.1
Short-term external debt 3/	12.0	14.3	14.6	15.4	15.8	16.3	16.9	17.3	17.9
<i>Of which:</i> Public sector	0.5	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7
<i>Of which:</i> Private sector	11.5	13.6	13.9	14.7	15.1	15.6	16.2	16.6	17.2
Amortization of MLT external debt (in percent of GNFS exports)	9.3	15.0	20.2	22.9	28.2	22.8	28.5	26.5	31.0
External interest payments (in percent of GNFS exports)	5.4	6.2	9.9	11.8	12.1	12.8	13.0	13.2	13.4
Gross international reserves 4/ 5/	43.6	47.3	46.7	46.9	46.8	46.4	46.9	48.7	51.5
In months of prospective GNFS imports	6.9	8.9	10.0	9.9	9.5	8.9	8.6	8.5	n.a.
In percent of broad money	24.5	25.9	31.8	35.8	31.4	27.6	24.7	22.7	n.a.
In percent of short-term external debt on residual maturity plus current account deficit	104.7	110.4	118.4	116.0	118.5	104.9	104.3	98.6	n.a.
Nominal exchange rate (Col\$/US\$, period average)	1,869	2,001	2,742	...	...	...	...	...	...
Real effective exchange rate (percentage change, + = appreciation)	-3.4	-5.5	-24.1	-13.2	5.2	2.4	2.0	1.6	1.3
Sources: Banco de la República; and Fund staff estimates and projections.									
1/ GNFS stands for goods and nonfactor services; MLT stands for medium and long-term.									
2/ Includes foreign holdings of locally issued public debt (TES).									
3/ Original maturity of less than 1 year. Stock at the end of the previous period.									
4/ Estimate for 2009 includes the SDR allocation (US\$972 million).									
5/ 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.									

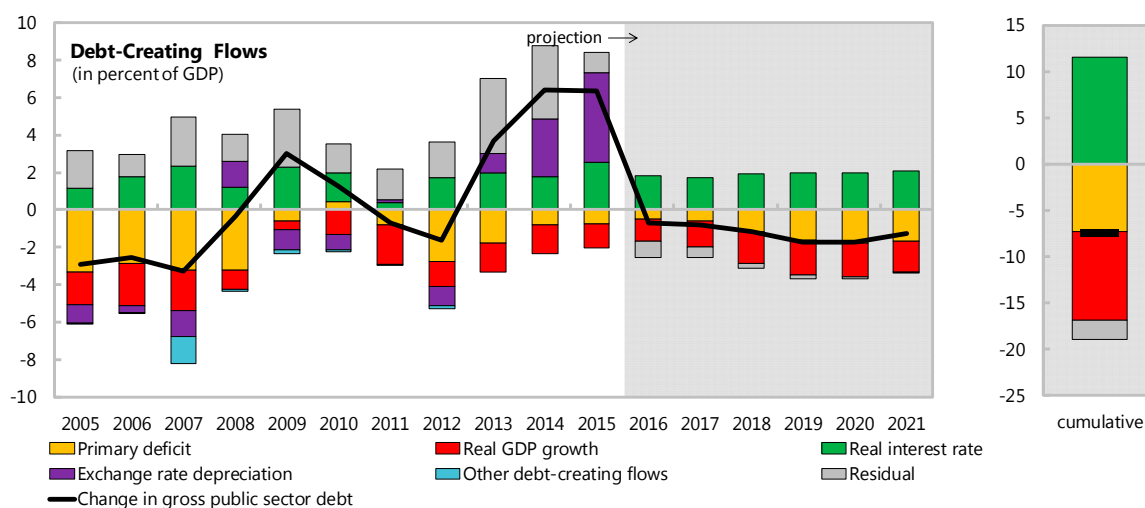
**Table 9. Colombia: Public Sector Debt Sustainability Analysis (DSA)—Baseline Scenario**

(In percent of GDP unless otherwise indicated)

	Actual			Projections						As of February 09, 2016	
	2005-2013 <sup>2/</sup>	2014	2015	2016	2017	2018	2019	2020	2021	Sovereign Spreads	
Nominal gross public debt	35.3	44.2	50.6	49.9	49.0	47.9	46.1	44.4	43.2	EMBIG (bp) 3/	425
Public gross financing needs	7.2	4.5	5.7	5.7	4.9	4.2	4.0	2.9	2.6	5Y CDS (bp)	308
Real GDP growth (in percent)	4.8	4.4	3.1	2.5	3.0	3.7	4.1	4.3	4.0	Ratings	Foreign Local
Inflation (GDP deflator, in percent)	4.8	2.1	2.6	3.9	3.6	3.2	3.1	3.0	2.8	Moody's	Baa2 Baa2
Nominal GDP growth (in percent)	9.8	6.6	5.7	6.5	6.7	7.0	7.4	7.4	6.9	S&Ps	BBB BBB+
Effective interest rate (in percent) <sup>4/</sup>	10.0	7.3	8.7	7.9	7.5	7.6	7.6	7.8	7.9	Fitch	BBB BBB+

**Contribution to Changes in Public Debt**

	Actual			Projections						cumulative	debt-stabilizing primary balance <sup>9/</sup>
	2005-2013	2014	2015	2016	2017	2018	2019	2020	2021		
Change in gross public sector debt	-0.4	6.4	6.4	-0.7	-0.8	-1.2	-1.7	-1.7	-1.3	-7.4	primary
Identified debt-creating flows	-2.5	2.5	5.3	0.2	-0.3	-0.9	-1.5	-1.6	-1.3	-5.4	balance <sup>9/</sup>
Primary deficit	-2.0	-0.8	-0.8	-0.5	-0.6	-1.1	-1.6	-1.8	-1.7	-7.3	0.42
Primary (noninterest) revenue and grants	27.0	27.7	26.7	25.4	25.4	25.5	25.4	25.3	25.3	152.3	
Primary (noninterest) expenditure	24.9	26.9	26.0	24.9	24.8	24.3	23.8	23.6	23.6	145.0	
Automatic debt dynamics <sup>5/</sup>	-0.3	3.3	6.0	0.7	0.3	0.2	0.1	0.2	0.4	2.0	
Interest rate/growth differential <sup>6/</sup>	0.0	0.2	1.3	0.7	0.3	0.2	0.1	0.2	0.4	2.0	
Of which: real interest rate	1.6	1.8	2.5	1.9	1.7	1.9	2.0	2.0	2.1	11.5	
Of which: real GDP growth	-1.6	-1.6	-1.3	-1.2	-1.4	-1.7	-1.8	-1.8	-1.6	-9.6	
Exchange rate depreciation <sup>7/</sup>	-0.3	3.1	4.8	...	...	...	...	...	...	...	
Other identified debt-creating flows	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Privatization proceeds (negative)	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Short-term debt 1/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes <sup>8/</sup>	2.2	3.9	1.1	-0.9	-0.6	-0.3	-0.2	-0.1	0.0	-2.1	



Source: Fund staff estimates.

1/ Public sector is defined as non-financial public sector.

2/ Based on available data.

3/ EMBIG.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as  $[(r - \pi(1+g) - g + ae(1+r))/(1+g+\pi+g\pi)]$  times previous period debt ratio, with  $r$  = interest rate;  $\pi$  = 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).6/ The real interest rate contribution is derived from the numerator in footnote 5 as  $r - \pi(1+g)$  and the real growth contribution as  $-g$ .7/ The exchange rate contribution is derived from the numerator in footnote 5 as  $ae(1+r)$ .

8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

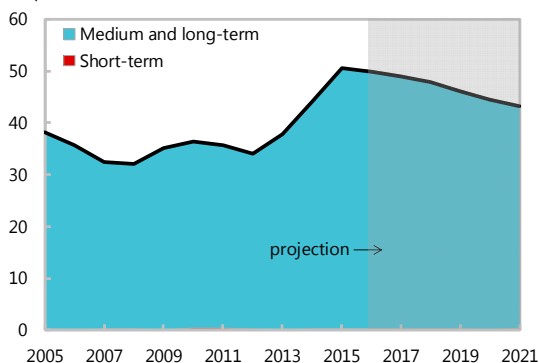
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

**Table 10. Colombia: Public DSA—Composition of Public Debt and Alternative Scenarios**

**Composition of Public Debt**

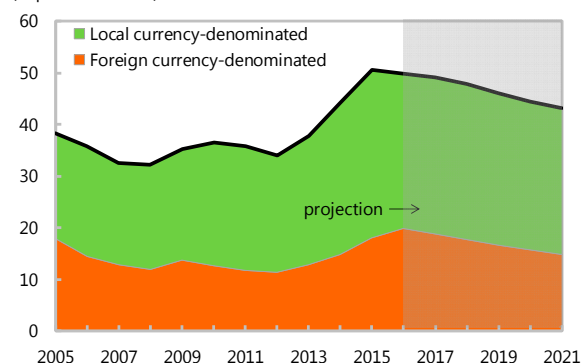
**By Maturity**

(In percent of GDP)



**By Currency**

(In percent of GDP)



**Alternative Scenarios**

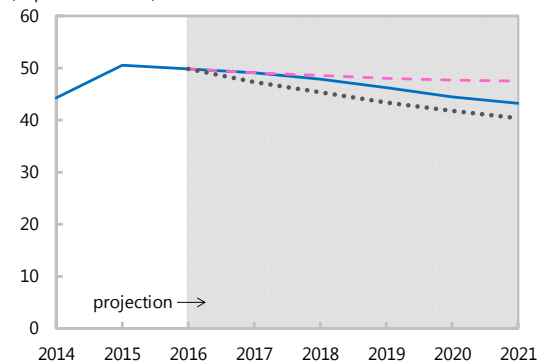
— Baseline

..... Historical

- - - Constant Primary Balance

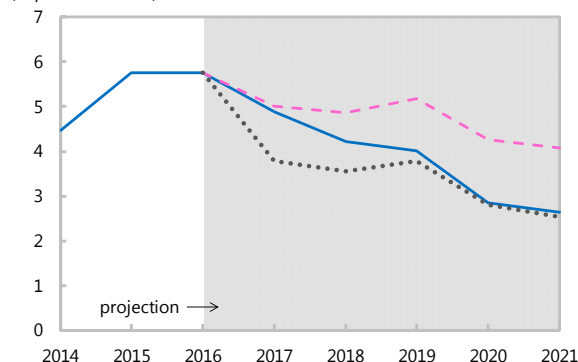
**Gross Nominal Public Debt**

(In percent of GDP)



**Public Gross Financing Needs**

(In percent of GDP)



**Underlying Assumptions**

(In percent)

Baseline Scenario	2016	2017	2018	2019	2020	2021
Real GDP growth	2.5	3.0	3.7	4.1	4.3	4.0
Inflation	3.9	3.6	3.2	3.1	3.0	2.8
Primary Balance	0.5	0.6	1.1	1.6	1.8	1.7
Effective interest rate	7.9	7.5	7.6	7.6	7.8	7.9

Constant Primary Balance Scenario	2016	2017	2018	2019	2020	2021
Real GDP growth	2.5	3.0	3.7	4.1	4.3	4.0
Inflation	3.9	3.6	3.2	3.1	3.0	2.8
Primary Balance	0.5	0.5	0.5	0.5	0.5	0.5
Effective interest rate	7.9	7.5	7.6	7.7	7.8	7.9

Historical Scenario	2016	2017	2018	2019	2020	2021
Real GDP growth	2.5	4.6	4.6	4.6	4.6	4.6
Inflation	3.9	3.6	3.2	3.1	3.0	2.8
Primary Balance	0.5	1.6	1.6	1.6	1.6	1.6
Effective interest rate	7.9	7.5	7.6	7.8	8.0	8.1

30 percent depreciation	2016	2017	2018	2019	2020	2021
Real GDP growth	3.4	3.7	4.0	4.2	4.3	4.3
Inflation	1.0	3.7	3.1	3.0	2.9	3.0
Primary Balance	0.0	0.4	0.4	0.6	0.9	1.0
Effective interest rate	8.9	9.2	8.0	7.9	7.9	7.9

Source: Fund staff estimates.

**Table 11. Colombia: External Debt Sustainability Framework, 2011–21**  
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						Debt-stabilizing non-interest current account 6/ -3.8	
	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021		
<b>1 Baseline: External debt</b>	23.2	22.2	25.7	30.1	41.8	<b>51.3</b>	<b>49.1</b>	<b>47.6</b>	<b>46.4</b>	<b>45.7</b>	<b>45.6</b>		
2 Change in external debt	0.1	-1.1	3.6	4.3	11.8	9.5	-2.3	-1.5	-1.2	-0.6	-0.1		
3 Identified external debt-creating flows (4+8+9)	-2.8	-3.8	0.4	1.3	11.9	1.6	0.6	0.1	-0.3	-0.6	-0.7		
4 Current account deficit, excluding interest payments	2.0	2.1	2.3	4.1	4.9	4.2	2.4	2.2	2.0	1.8	1.7		
5 Deficit in balance of goods and services	-0.3	0.2	0.7	3.0	6.2	6.1	4.3	3.9	3.5	3.2	2.9		
6 Exports	19.0	18.4	17.7	16.9	15.5	15.7	15.8	15.3	15.1	14.8	14.7		
7 Imports	18.8	18.6	18.4	19.8	21.7	21.8	20.0	19.3	18.6	18.0	17.6		
8 Net non-debt creating capital inflows (negative)	-2.3	-4.7	-2.2	-3.9	-2.3	-3.3	-2.3	-2.4	-2.5	-2.6	-2.7		
9 Automatic debt dynamics 1/	-2.4	-1.1	0.3	1.1	9.2	0.7	0.5	0.3	0.1	0.1	0.3		
10 Contribution from nominal interest rate	0.9	0.9	1.0	1.0	1.5	1.9	1.9	2.0	2.0	2.0	2.0		
11 Contribution from real GDP growth	-1.3	-0.9	-1.0	-1.1	-1.2	-1.2	-1.4	-1.7	-1.8	-1.8	-1.7		
12 Contribution from price and exchange rate changes 2/	-2.1	-1.2	0.4	1.1	8.9	...	...	...	...	...	...		
13 Residual, incl. change in gross foreign assets (2-3) 3/	2.9	2.7	3.1	3.0	-0.1	7.9	-2.8	-1.6	-0.9	0.0	0.6		
External debt-to-exports ratio (in percent)	121.8	120.3	145.6	178.3	269.3	326.3	311.1	310.3	307.9	308.5	310.3		
<b>Gross external financing need (in billions of US dollars) 4</b>	23.9	33.7	29.0	41.2	42.4	39.1	40.0	39.1	43.8	44.5	48.9		
in percent of GDP	7.1	9.1	7.6	10.9	14.5	10-Year	10-Year	15.4	14.3	12.8	13.2	12.4	12.7
<b>Scenario with key variables at their historical averages 5/</b>						<b>51.3</b>	<b>49.9</b>	<b>48.6</b>	<b>47.8</b>	<b>47.6</b>	<b>47.8</b>	<b>-4.1</b>	
<b>Key Macroeconomic Assumptions Underlying Baseline</b>						Historical Average	Standard Deviation						
Real GDP growth (in percent)	6.6	4.0	4.9	4.4	3.1	4.6	1.7	2.5	3.0	3.7	4.1	4.3	4.0
GDP deflator in US dollars (change in percent)	10.0	5.6	-1.9	-4.6	-25.1	3.3	13.4	-15.1	7.0	4.9	4.5	3.8	3.3
Nominal external interest rate (in percent)	4.8	4.4	4.4	4.1	4.0	5.3	1.2	3.9	4.1	4.4	4.5	4.5	4.6
Growth of exports (US dollar terms, in percent)	39.3	6.5	-1.3	-5.0	-28.9	8.0	19.8	-11.9	10.5	5.7	6.9	6.5	6.4
Growth of imports (US dollar terms, in percent)	31.8	9.4	1.5	7.5	-15.6	10.7	15.9	-12.6	1.3	4.7	5.0	4.7	4.9
Current account balance, excluding interest payments	-2.0	-2.1	-2.3	-4.1	-4.9	-2.1	1.4	-4.2	-2.4	-2.2	-2.0	-1.8	-1.7
Net non-debt creating capital inflows	2.3	4.7	2.2	3.9	2.3	2.9	1.3	3.3	2.3	2.4	2.5	2.6	2.7

1/ Derived as  $[r - g - r(1+g) + ea(1+r)] / (1+g+r+gr)$  times previous period debt stock, with  $r$  = nominal effective interest rate on external debt;  $r$  = 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.

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

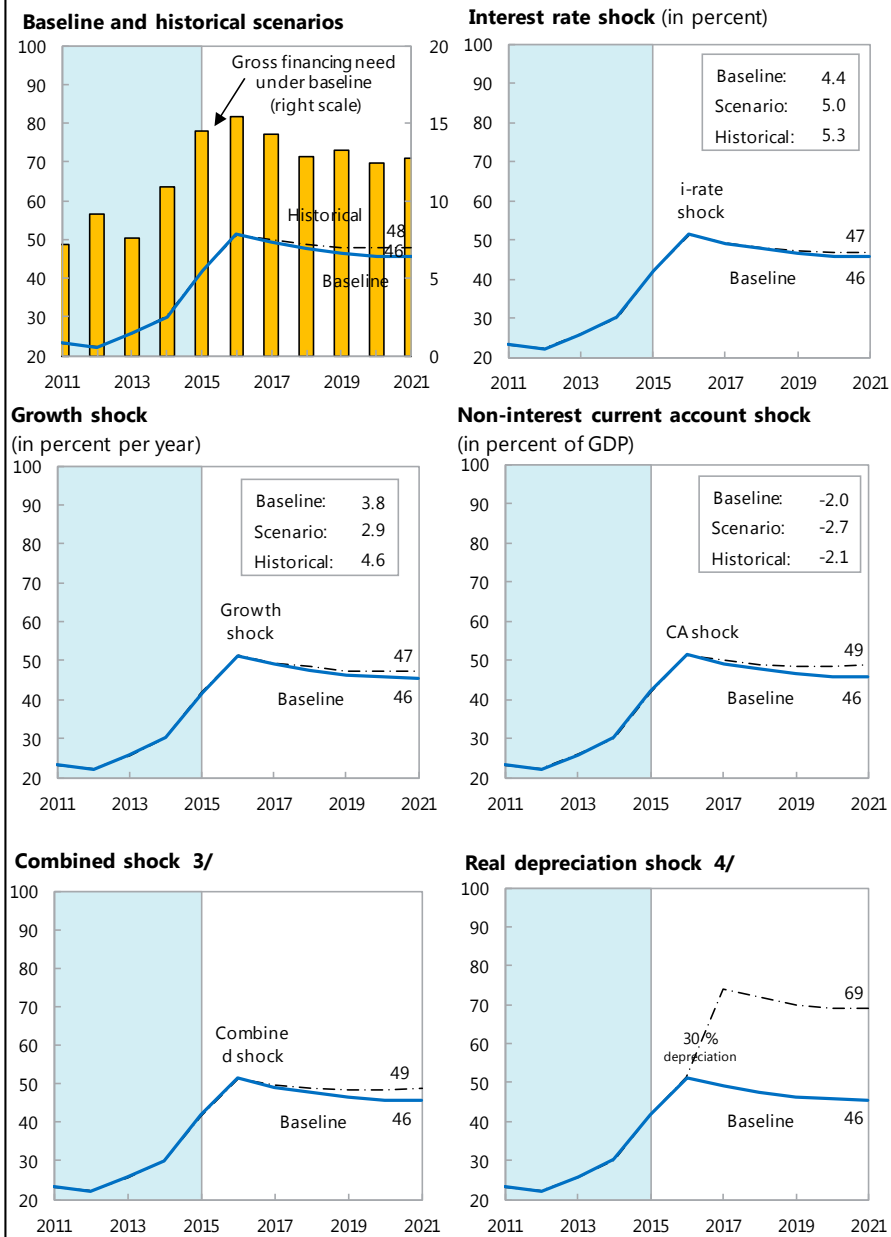
3/ For projection, line includes the impact of price and exchange rate changes.

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

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

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

**Table 12. Colombia: External Debt Sustainability: Bound Tests 1/ 2/**  
(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/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.  
 3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.  
 4/ One-time real depreciation of 30 percent occurs in 2017.

## Annex I. External Sector Assessment<sup>1</sup>

Colombia's external position appears weaker than implied by fundamentals although there is significant uncertainty around equilibrium exchange rate estimates. EBA estimates vary over a wide range from overvaluation to undervaluation, potentially reflecting lags in the current account adjustment to a depreciated exchange rate. Significant adjustment has yet to occur in the current account deficit, but non-traditional exports have already started to shift away from slow growing regional partners, and the demand for imports has contracted and is expected to continue to do so as a result of a depreciated exchange rate and additional fiscal adjustment.

### 1. The external position appears weaker than implied by fundamentals while the economy is adjusting to a new equilibrium.

While the real exchange rate depreciated by 34 percent over the last two years, its full impact on exports and imports is likely to take place more gradually. This would explain, to a large extent, why the current account deficit in 2015 is significantly

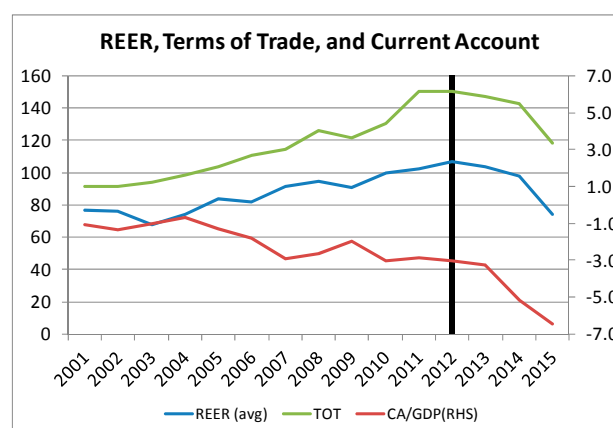
Exchange Rate Assessment

	ER misalignment	CA norm	Cyclically adjusted CA in 2015
ES	11.2	-2.1	-5
CA	38.0	0.6	-5
REER	(15.1)	na	-5

Source: EBA

higher than current account norm estimates under EBA ES and EBA CA methodologies, while the methodology based on a model for the real exchange rate (EBA REER) indicates a 15 percent undervaluation. In staff's view, the current account norm is closer to the ES estimate; in the -2 to -3 percent of GDP range also more in line with historical levels. The fact that the EBA CA norm estimate is much higher may reflect the fact that it does not take into account the sizable repatriation of profits. It also reflects a relatively low ratio of proven oil reserves to production, which may underestimate the number of years left of production relative to other oil producing countries as proved reserves have been and may continue to be subject to significant upward revisions in Colombia.

2. **With the end of the commodities super cycle, the real exchange rate has reverted close to its 2000 levels, but the current account has yet to adjust.** From 2000 through 2012, the country saw a sustained improvement in terms of trade accompanied by an appreciating trend in the real exchange rate. Despite improved terms of



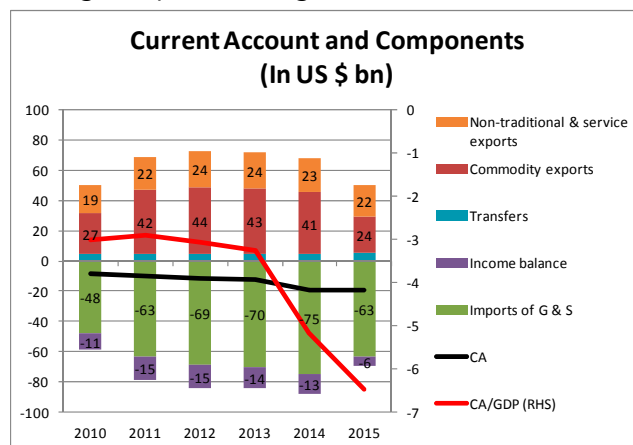
<sup>1</sup> This Annex was prepared by Manrique Saenz



trade, the current account deficit gradually expanded as percent of GDP. After 2012, both the terms of trade and REER dropped with the end of the commodities super cycle. The current account deficit as percent of GDP, however, continued to deteriorate as the valuation impact of the exchange rate depreciation has not been compensated by a significant reduction in the US\$ value of the deficit. Looking forward, a correction in the current account deficit is expected, as export and import volumes react to the ER depreciation and as the fiscal sector adjusts to meet the targets under the current fiscal rule.

**3. The CA deficit has widened significantly since 2013, mainly driven by a reduction in commodity and non-traditional exports.** With average oil prices falling from a 104 in 2013 to 51

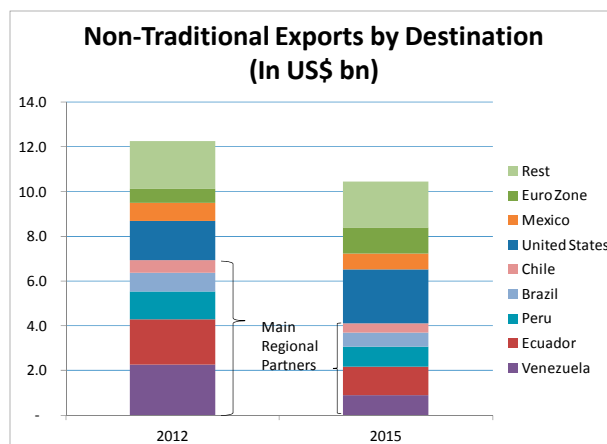
in 2015, commodity exports have contracted by US\$19 bn. At the same time non-traditional exports have also contracted, with key regional trading partners, Venezuela and Ecuador, hit by low commodity prices and raising barriers to trade with Colombia. Imports contracted significantly over the last year and the primary balance has improved significantly as payments to foreign capital in the oil sector have dropped. However, the



latter do not compensate for the impact of the steep reduction in exports in US dollar terms on the current account. The deterioration in CA/GDP is particularly steep, as the valuation effect from exchange rate depreciation significantly reduced the US dollar value of GDP in 2015.

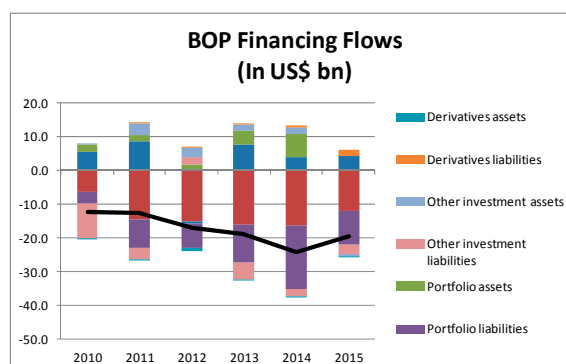
**4. As demand for non-traditional exports by regional trading partners has dropped, exports are starting to shift to alternative markets, albeit at slow pace.** Exports to the United

States and the Euro Zone increased from US\$2.4 billion to US\$3.6 billion. This helped attenuate the steep contraction in exports to the region, which fell by almost US\$3 billion partly reflecting the negative impact of lower commodity prices on these countries. The recent real exchange rate depreciation should help continue this transition towards deeper or faster growing markets over the following years.

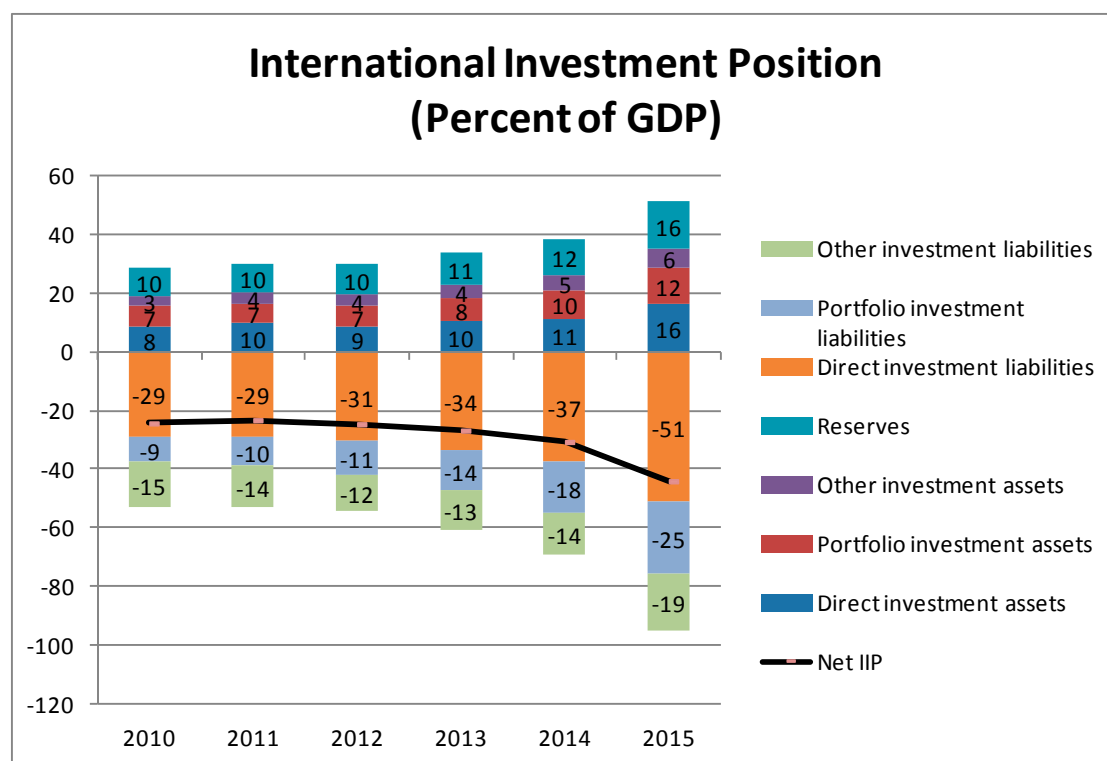


**5. The fall in commodity prices has also negatively impacted FDI, while portfolio flows returned to more normal levels. thereby supporting the view that the current external position is weaker than supported by fundamentals.**

Gross FDI into both Colombian oil and non-oil sectors contracted in 2015 by US\$4 billion or 25 percent. Other gross capital inflows, including portfolio flows that had reached record levels in 2014 (after the increase in Colombia’s weight in the EMBI), also dropped in 2015. Although accumulation of assets abroad also diminished, capital inflows still contracted in net terms over the last year.



**6. The IIP reached -44 percent of GDP in 2015 from -30 percent of GDP in 2014.** Most of the drop observed in 2015 reflects the valuation impact from the depreciation in the exchange rate, which accounts for 12 percentage points. Gross liabilities are estimated at 95 percent of GDP in 2015, of which, 51 percentage points correspond to FDI. While the NIIP is sustainable, increases in portfolio liabilities over the last few years and now amounting to 25 percent of GDP could lead to heightened vulnerability to global financial volatility.



## Annex II. Macroeconomic Adjustment to the Decline in Commodity Prices<sup>1</sup>

*This annex presents cross-country analysis on the macroeconomic adjustment to the decline in commodity prices. The experiences of Chile, Colombia, and Peru highlight the importance of flexible exchange rates to help with the adjustment to the new commodity prices. The analysis also suggests that a stronger adjustment in domestic demand would be needed in Colombia in order to facilitate the current account adjustment.*

1. **The “commodity super-cycle” has come to an end as commodity prices have been decreasing steadily since 2011, and this external shock is likely to be persistent.** First, this annex summarizes the impact of the decline in oil prices in Colombia. Second, it analyzes the macroeconomic adjustment in Chile, Colombia and Peru induced by the significant drop in commodity prices. This comparison is relevant as these are commodity exporters’ emerging economies (copper for Chile and Peru, and oil for Colombia), which are comparable in size and feature sound macroeconomic frameworks (with both fiscal rules and inflation-targeting regimes in place). Moreover, given that the adjustment started earlier in Chile and Peru, this analysis could inform about the expected response in Colombia.

### A. The impact of the shock in Colombia

2. **Since the second half of 2014, Colombia has confronted a severe oil price shock.** This shock is expected to reduce Colombia’s fiscal oil revenues from 3.3 percent of GDP in 2013 to almost 0 in 2016. Similarly, oil exports declined from 8.4 percent of GDP in 2013 to 4.9 percent of GDP in 2015, and are projected to further decline to 3.6 percent of GDP in 2016, contributing to the widening of the current account deficit. At the same time, the authorities have allowed the exchange rate to depreciate substantially, which is playing a key role in the adjustment process. As a consequence of this depreciation, public debt has increased by around 9 pp since 2013. Moreover, the lower oil prices induced a drop in oil-related investment, including FDI and

	Impact of Oil Shock			
	2013	2014	2015	2016 (proj.)
<b>Oil-related investment (US\$ bn)</b>	9.6	9.2	6.2	4.4
o/w FDI in oil sector (US\$ bn)	5.1	4.7	3.7	2.3
<b>Fiscal</b>				
Oil revenue (% of GDP)	3.3	2.6	1.2	0.1
Public Debt (% of GDP)	37.8	44.2	49.6	49.9
o/w effect of depreciation	1.0	3.1	5.5	1.4
<b>External</b>				
Oil exports (% of GDP)	8.4	7.6	4.9	3.6
Oil exports (US\$ bn)	32.0	28.9	14.2	9.1
<b>Prices and exchange rate</b>				
Peso depreciation	3.9	7.1	37.0	22.4
Tradable inflation	1.2	1.7	4.7	n.a.
<b>Cruce oil, spot price</b>	104.1	96.2	50.8	34.8
<b>EMBI Spread</b>	179.4	182.23	294.0	n.a.

Source: National authorities and Fund staff estimates

<sup>1</sup> This Annex was prepared by Francisco Roch.

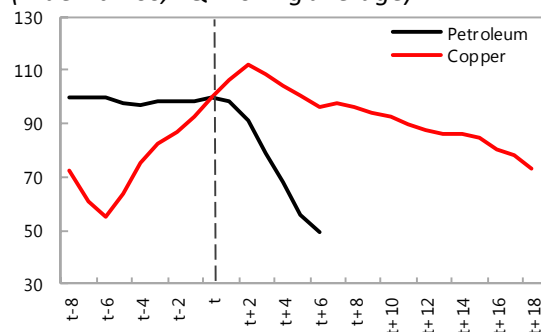
Ecopetrol's capex expenditures. Finally, Colombia's sovereign risk premium increased more than in other emerging economies, due to the strong dependence on oil.

## B. The experience in Chile, Colombia, and Peru

3. **An initial consideration is that both the timing and size of the shock in Chile and Peru have been different than in Colombia.** While the price of copper has been declining since 2011, the oil price decline began in the second half of 2014. Thus, Chile and Peru are in the final stages of the adjustment process, while Colombia is in the midst of adjusting to more recent price declines in oil. Moreover, the shock that Colombia suffered was more severe in that oil prices plunged by about 40 percent in 5 quarters, whereas the price of copper took 18 quarters to decrease by 45 percent. As expected, these large commodity price shocks deteriorated their terms of trade substantially, with Colombia suffering the most.

### Commodity Prices

(Index:  $t=100$ , 4Q moving average)

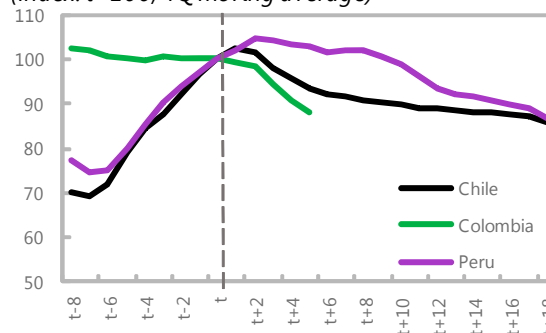


Sources: IMF, World Economic Outlook database; and IMF staff calculations.

Note: Chile and, Peru  $t = 2011Q1$ ; and Colombia  $t = 2014Q2$ .

### Terms of Trade

(Index:  $t=100$ , 4Q moving average)



Source: Haver Analytics, and IMF staff calculations.

Note: for Chile and, Peru  $t = 2011Q1$ , and for Colombia  $t = 2014Q2$ .

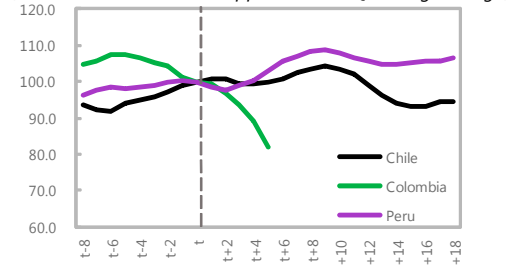
4. **The exchange rate and current account adjustments are important elements of the macroeconomic response to the terms of trade fall.**<sup>2</sup> In the case of Chile, when the terms of trade initially started to fall, the exchange rate was relatively slow to adjust. However, by the end of its adjustment process, Chile's real effective exchange rate had depreciated by 5 percent. In contrast, given the magnitude and speed of the shock, Colombia experienced a sharp and fast real depreciation of its exchange rate of around 18 percent (data is through 2015Q3). Peru, however, had a minor real appreciation of about 6 percent, which could be in part the result of the Central Bank of

<sup>2</sup> Recent analysis on the external adjustment and the role of the real exchange rate in Latin America shows that the deterioration in the terms of trade explains the majority of the exchange rate depreciations in Chile and Colombia. See the April 2015 WHD Regional Economic Outlook.

Peru FX interventions to prevent sharp movements in its currency. Consistent with this more muted adjustment in the real exchange rate, the current account deficit in Peru has slightly deteriorated since 2011, from 2 percent to 4 percent of GDP. The exchange rate adjustment in Chile allowed for a significant adjustment in the current account, with a deficit that is now mostly closed. Finally, in Colombia the current account deteriorated as a result of the oil prices decline, and has yet to reflect the adjustment in quantities.

**Real Effective Exchange Rate**

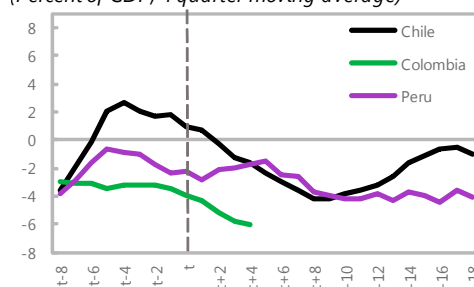
(Index:  $t = 100$ , increase=appreciation, 4Q moving average)



Source: IMF, International Financial Statistics database, and IMF staff calculations.  
Note: for Chile and, Peru  $t = 2011Q1$ , and Colombia  $t = 2014Q2$ .

**Current Account**

(Percent of GDP, 4 quarter moving average)

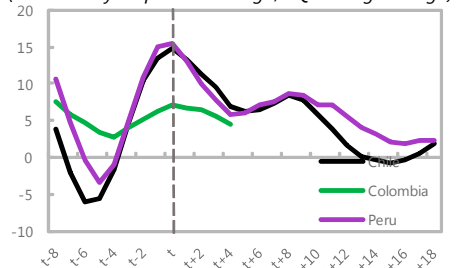


Source: Haver Analytics, and IMF staff calculations.  
Note: for Chile and, Peru  $t = 2011Q1$ , and for Colombia  $t = 2014Q2$ .

5. **Another element of the adjustment is the response in domestic demand. In the three cases we observe a slowdown in total domestic demand at the time the shock hit.** However, one salient difference is that the initial slowdown in Chile and Peru was significantly more abrupt than in Colombia, despite the shock being more acute in the latter. Furthermore, in the final stages of the transition, Chile had a stronger adjustment in domestic demand than Peru, which is consistent as well with the adjustment in the current account explained above. The macroeconomic adjustment in these countries has also affected the dynamics of GDP growth. In the cases of Chile and Peru, real GDP growth has decreased continuously after the fall in their terms of trade. Colombia seems to be following the same path as GDP growth also declined after oil prices started plunging.

**Total Domestic Demand**

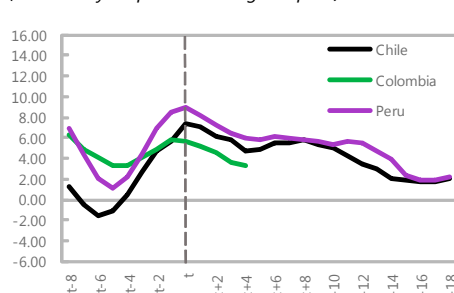
(Year-over-year percent change, 4Q moving average)



Source: Haver Analytics, and IMF staff calculations.  
Note: for Chile and, Peru  $t = 2011Q1$ , and for Colombia  $t = 2014Q2$ .

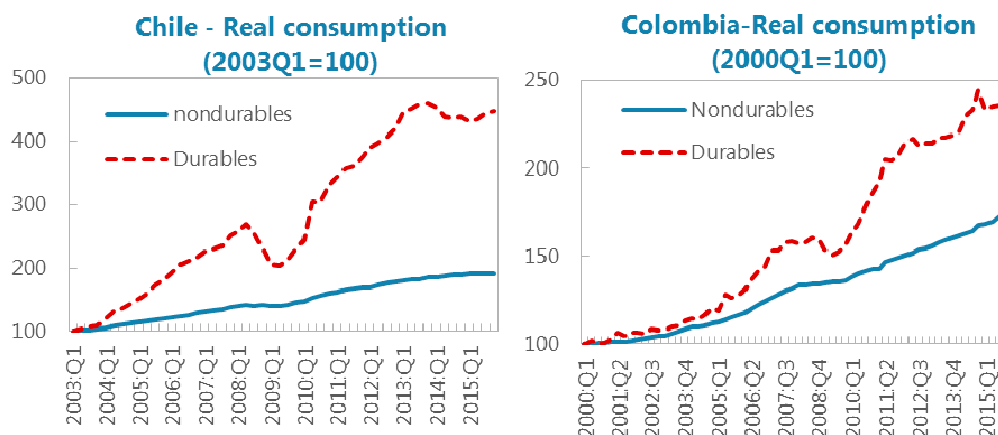
**Real GDP Growth**

(Year over year percent change- 4q MA)



Source: Haver Analytics, and IMF staff calculations.  
Note: for Chile and, Peru  $t = 2011Q1$ , and Colombia  $t = 2014Q2$ .

6. **A variable that seems to be crucial in both the boom and the adjustment process, is consumption of durable goods.** The growth in durable consumption in Colombia and Chile was very pronounced in the expansionary phase of the commodity cycle. In line with the Chilean experience, durable consumption is expected to slow down significantly in Colombia as the adjustment process gathers pace. Regression analysis indicates that factors such as depreciation, increasing interest rates, and slowing credit will weigh on durable consumption in 2016.



#### Determinants of durable consumption 1/

Variable	Coefficient
Income	0.03
Lagged REER	-0.16 ***
Credit growth	0.15 ***
Interest rate	-0.20 **
House prices	-0.04
Consumer confidence	0.06 ***

1/ Dependent variable and all independent variables but real interest rates and consumer confidence in log differences. All variables in real terms. Sample: 2003Q3-2015Q3.

7. **In sum, the experiences of Chile, Colombia, and Peru highlight the importance of flexible exchange rates to help with the adjustment to the new commodity prices.** The analysis also suggests that a stronger adjustment in domestic demand would be needed in Colombia in order to facilitate the current account adjustment.

## Annex III. Macroeconomic Stability Assessment<sup>1</sup>

The financial sector has continued to develop in Colombia resulting in deeper macrofinancial linkages. Colombian banks' have performed relatively well despite recent commodity and depreciation shocks. Non-performing loans (NPLs) remain low and well provisioned. Funding has become more challenging but is manageable. The annex also details how corporate vulnerabilities under adverse shocks could lower bank capital, credit and economic growth but are not impactful. Colombia has continued to make supervisory and regulatory enhancements with regard to risk based and financial conglomerate supervision. Work on financial integration is also discussed. Finally Colombia has remained committed to strengthening its AML/CFT framework.

### A. Structural Features and Forward-Looking Vulnerabilities

1. **As the financial sector has continued to develop in Colombia macrofinancial linkages have grown and deepened.** This annex provides a summary of financial sector stylized facts charting recent developments in Colombia. Banks' asset-liability and performance have been impacted by their loans and funding to the real sector. The annex also details how corporate vulnerabilities and shocks impact bank capital, credit and economic growth. Key supervisory and regulatory enhancements are detailed for Colombia whose aim is to ensure macrofinancial stability is maintained. Finally financial integration is discussed as a means to enable the safe and sound development of the financial system in support of the macroeconomy.
  
2. **The financial system in Colombia has continued to grow and deepen macrofinancial linkages despite adverse shocks.** The financial system in Colombia grew 4.72 percent in real terms in 2015 despite lower commodity and oil prices and large depreciation shocks. The resulting increased market volatility and lower economic growth in 2015 did not adversely impact the growth of credit institutions such as banks, financial companies and cooperatives (7 percent real). Macrofinancial linkages and financial deepening has continued:
  - Robust year-on-year real growth of the financial system has led to an increased importance of the financial sector resulting in greater macrofinancial linkages. Financial assets were equivalent to 1.56 times GDP in December 2015, compared to 1.45 times in 2014. The share of credit as a share of GDP also increased, from 44.13 percent in Dec-14 to 49.16 percent in Dec-15 (Figure 1).

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<sup>1</sup> This Annex was prepared by Mohamed Afzal Norat

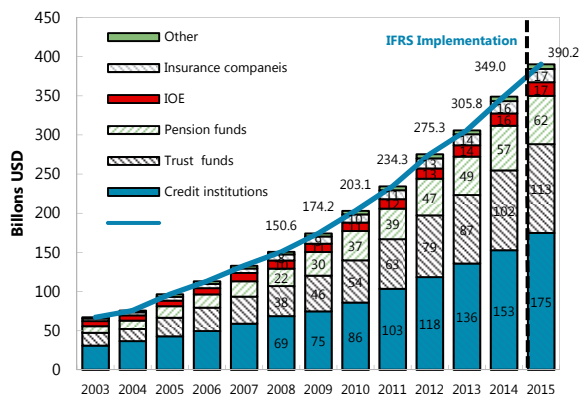
- Loan growth to key economic sectors remained strong in 2015: Wholesale & Retail (17 percent); manufacturing (16 percent); construction (14 percent). Loan growth to the mining, quarrying and oil sectors fell, as expected reflecting lower commodity prices, large losses and some defaults in the sector.
- Financial access and inclusion continues to grow in Colombia with 75 percent of all adults in households having access to some type of financial products especially banking products (Figure 1).
- In December 2015, investments in pesos by mandatory pension funds in domestic public debt represented 49.6 percent of total investments, followed by investments in dollars with 29.4 percent. Compared to 2014, there was a sizeable portfolio shift towards investments in dollars increasing by 6 percentage points while peso assets decreased by 8 percentage points. This was in the main due to valuation effects from depreciation.

3. **Deposits form a large proportion of banks and other credit institutions liabilities while loans and bonds held as assets are mainly domestic.** The majority of funding for banks are deposits and demand accounts (84 percent of total liabilities). Around 40 percent of those deposits are from large (100) institutional depositors, mainly from fiduciaries, other entities, government and pension funds. Under funding stress the rates for these can rise more sharply than for individual checking and savings accounts. Moreover around 10 percent of liabilities also come from issuance of debt securities which are sensitive to credit ratings with 5 percent coming from money market operations (usually short term) (Figure 2). On the asset side the large proportion of bank loans are domestic (91 percent), with nearly all government bond holdings by banks also domestic (99.6 percent) (Figure 2).



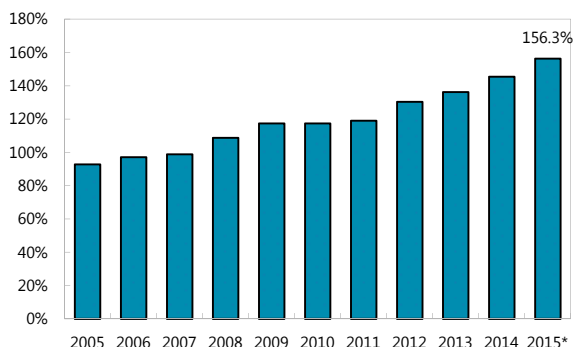
**Figure 1. Financial System Structure**

Financial sectors continue to grow despite adverse shocks



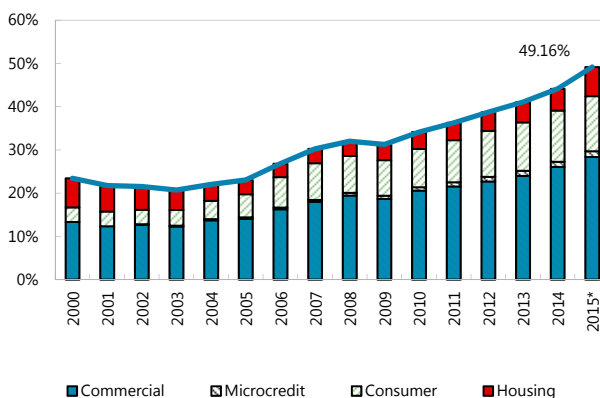
... and becoming a more important part of the economy.

**Financial assets/GDP**



Resulting in greater credit availability...

**Credit/GDP**



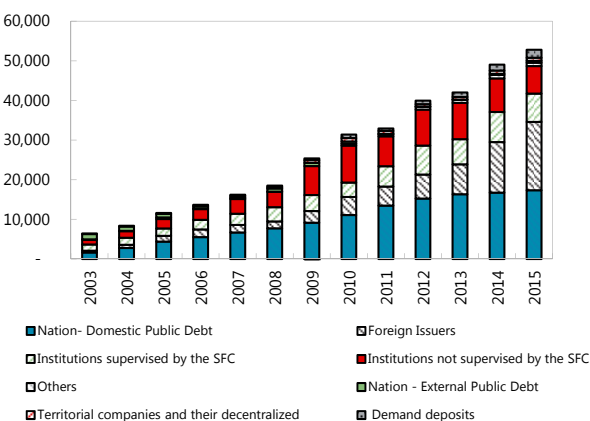
... and continued financial access and inclusion

	Dec-12	Dec-13	Dec-14	Dec-15
<b>Physical presence</b>				
Banking correspondents	34,178	49,147	95,686	92,561
Bank Office	5,962	6,267	6,248	6,452
<b>Transactions</b>				
Banking correspondents	62,852,309	90,707,565	118,495,894	147,528,050
Bank Office	689,249,358	690,715,737	700,644,424	664,830,147
Mobile banking	32,712,408	77,509,667	119,014,908	132,811,894
<b>Use of products</b>				
Adults with at least one financial product *	67.1%	71%	72.5%	75.1%
Savings accounts	43,193,633	46,090,797	50,453,640	54,511,936
Electronic savings accounts	2,696,161	3,180,284	3,296,428	3,782,260
Simplified savings accounts*	18	102	102	103
Electronic deposits*	809,605	1,889,446	2,190,890	2,801,702
Microcredit disbursements ** USD	935	1,096	1,251	1,689

\*Source: CFIN september 2015  
 \*\* TRM 31-dec-2015 \$3,149.47  
 Superintendencia Financiera de Colombia, Banca de las Oportunidades and CFIN

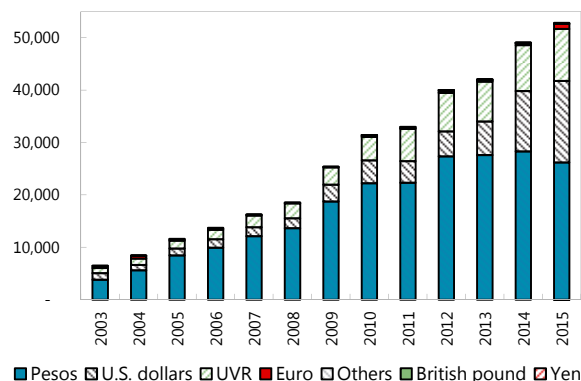
Pension funds to shift assets overseas

**Million USD**



... in part due to valuation of USD denominated assets

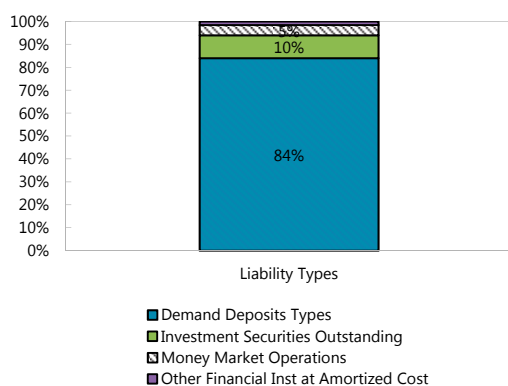
**Million USD**



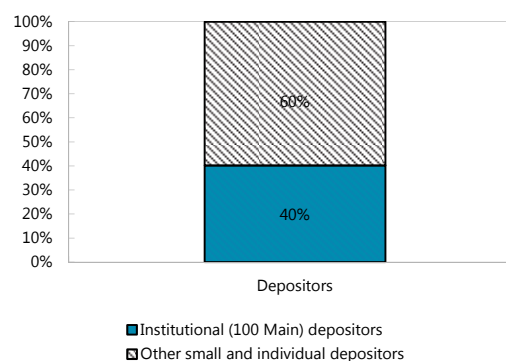
Source: SFC.

**Figure 2. Liabilities and Assets Proportions of Credit Institutions**

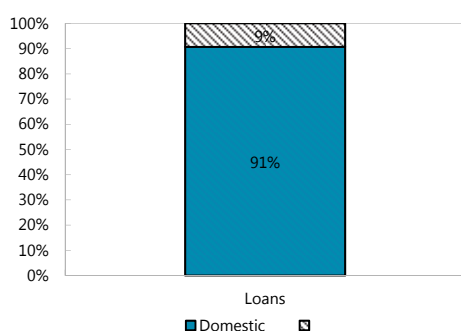
*Deposits form large proportion of liabilities*



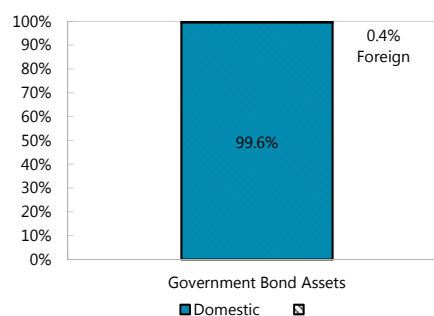
*...Institutional depositors are important part of funding*



*The majority of loans for banks are domestic*



*...also banks hold mostly domestic bonds*

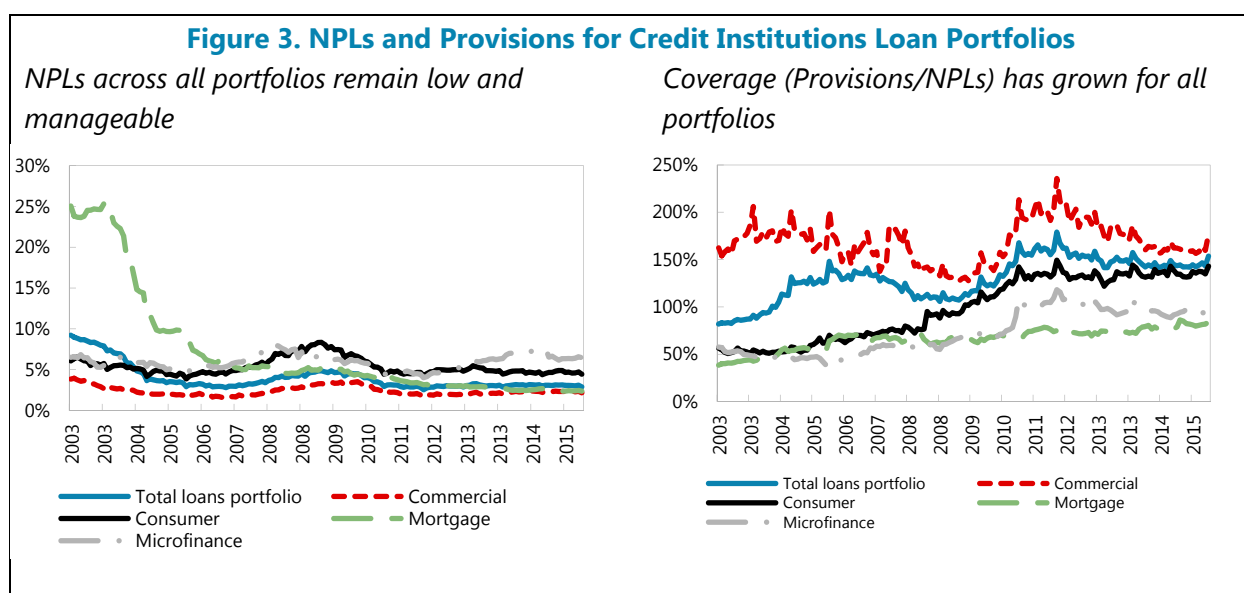


Source: SFC.

4. **Banks remain profitable and well provisioned and unlikely to see dramatic increase in NPLs due to slower growth in 2016.** Bank profitability remains robust with ROA (3 percent) and ROE (22 percent) unchanged from 2014, though overall net-interest (58 percent) and non-net-interest margins (42 percent) are little lower in 2015 in part reflecting impact of adverse commodity and depreciation shocks with slower growth (Table 7). NPLs for all loan portfolios remains relatively low (3 percent) while coverage in terms of provisions for NPLs has increased (154 percent). As growth continues to slow in 2016 profitability will be more adversely impacted from higher general provisions as NPLs rise. However given robust (general and countercyclical) provisioning practices in Colombia NPLs are expected to remain manageable (Figure 3).

5. **Macrofinancial impacts from adverse corporate shocks are contained.** Stress tests by staff indicate that under adverse but plausible earnings and depreciation shocks to corporate profitability and debt service, the banking system solvency remains above regulatory minima though

capital buffers are lower (Figure 4).<sup>2</sup> Two banks with the lowest capital starting positions fall just below the 9 percent regulatory minimum. The risks of these shocks adversely affecting the supply of credit and economic growth are low given release of countercyclical provisions to absorb losses.<sup>3</sup> Authorities continue to make great strides in stress testing, linking real sector (corporate and household) vulnerabilities with financial sector solvency concerns into liquidity impacts and contagion assessments. Advanced model development using DSGE and network models allied to more straight-forward balance sheet assessments, including more focused specific (thematic) liquidity and contagion stress testing will enable interconnected and systemic risks to be accommodated while identifying weaknesses in financial institutions business models and forward-looking plans. The Fund is continuing to provide Technical Assistance (TA) on stress testing developments and encouraging authorities to ensure resourcing and coordination between BanRep, Superfinanciera (SFC) and the corporate superintendency (Supersociedades) for such work remains a high-priority.



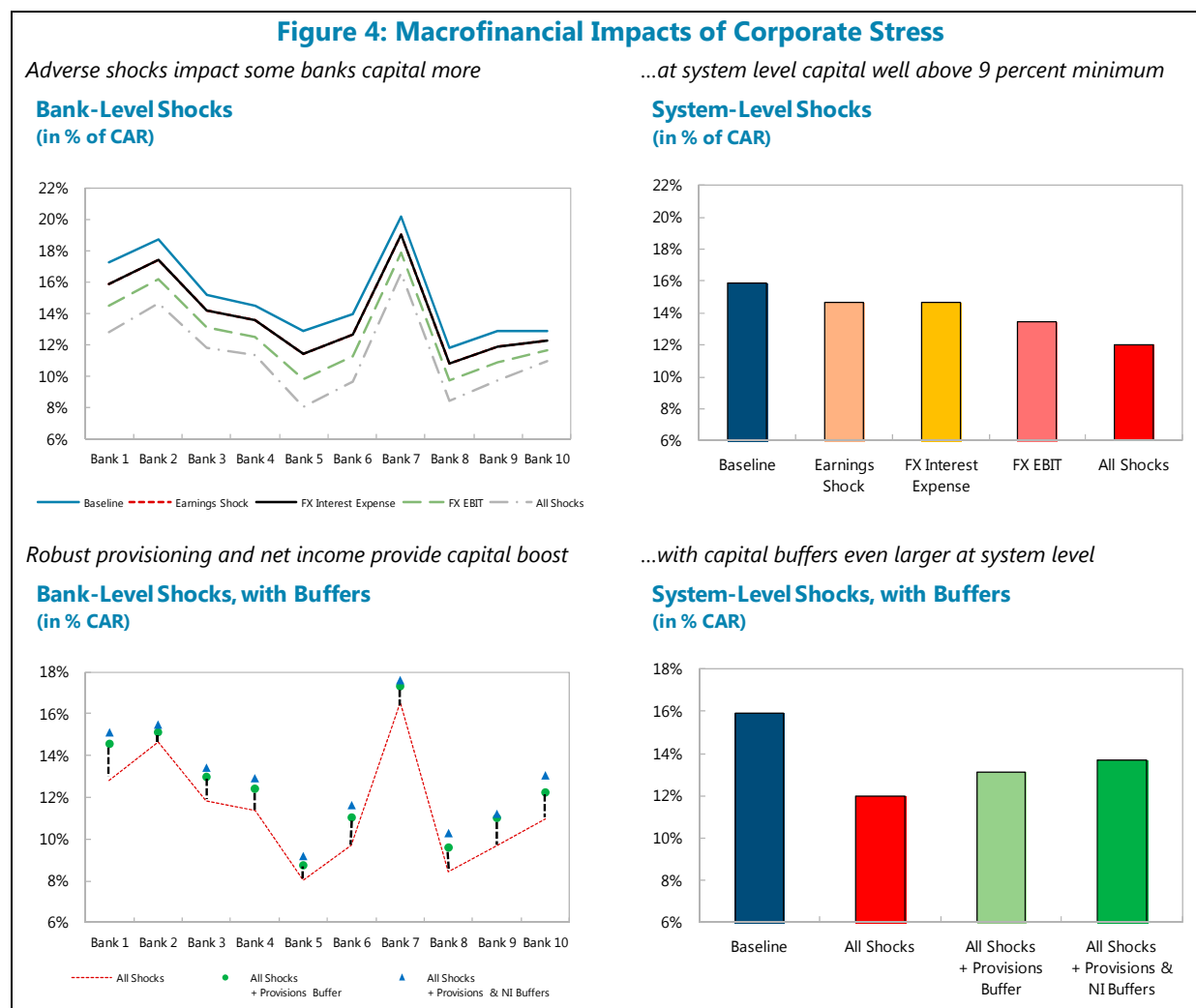
Source: SFC.

**6. Colombian banks and the SFC are working to increase the quantity and quality of banks' capital buffers.** Colombian banks usually retain around 30-40 percent of earnings, and the SFC under its current powers and application of risk-based supervision can enforce capital and

<sup>2</sup> See *Colombian Corporate Vulnerabilities and Macrofinancial Implications* by Mohamed Afzal Norat and David Jutsra, 2016, *Colombia Selected Issues Paper*, International Monetary Fund, Washington D.C.

<sup>3</sup> The shock undertaken involved a 20 percent earnings and 70 percent depreciation, corporate loans were around 65 percent of bank balance sheets. We also applied stressed probability of defaults of 25 percent and loss given default of 60 percent to determine credit losses and NPLs.

liquidity strengthening by banks, including through restriction of dividend disbursements. The authorities have also created additional opportunities for banks to strengthen their capital positions voluntarily through introduction of greater loss-absorbing Basel III-type hybrid (debt-to-equity) instruments. Some banks have indicated that they intend to increase capitalization levels further in 2016.



Source: SFC, S&P Capital IQ, Fund staff estimates.

## Supervision and Regulation

7. **Risk based supervision (RBS) has started to become more coherent and consistent.** The SFC has started to consolidate the work on RBS for the banks through deeper risk-led inspections, monitoring and assessment of internal controls. To that end more forward looking thematic stress tests exercises are being carried out with regard to potential future financial system (bank and nonbank) solvency vulnerabilities arising from: (i.) direct and indirect impact related to Oil and oil

related industries; (ii.) impact of El Niño on agricultural and commercial and microcredit loan portfolios; (iii.) Commercial loan portfolio impacts from sustained depreciation; and (iv.) payment capacity deterioration of housing and consumer loans. The SFC is also challenging credit institutions assumptions of the credit deterioration arising from slowdown in 2016. They are undertaking a deeper assessment of SME portfolios and ensuring provisions remain robust to avoid risk underestimation by financial institutions. The SFC is also broadening out its forward-looking RBS methodology to brokerage firms, pension funds, trust companies and securities issuers. The SFC continues to develop tools which will enable it to better identify systemic, country and interest rate risk on the banking book from financial conglomerates activities. This will include also monitoring and mapping foreign exchange and liquidity concerns of conglomerates.

8. **Looking forward the SFC is proposing to further embed the implementation of Basel III and strengthening risk management.** The SFC is drawing up proposals to implement the Basel III Net Stable Funding Ratio as a complement to the short-term liquidity (IRL) measure. Adjustments are being made to strengthen financial institutions liquidity risk measurement by incorporating concentration of depositors' sources of funding. Adjustments are also being made to enhance market risk measurement (VaR) in order to improve the response to high volatility (tail-risk) scenarios. Banks will also be required to fully define their procedures in their capital adequacy self-assessments (ICAAP).

9. **On the regulatory front the implementation of the conglomerates law and macroprudential adjustments to existing FX limits will address key systemic risk concerns.** The law awarding regulatory powers over holding companies of financial conglomerates will enable SFC and BanRep to identify and better monitor regulated and unregulated parts of financial conglomerates through improved regulatory data capture. This would cover 21 financial conglomerates that represent 86 percent of Colombian financial system assets and 125 percent of GDP. The law will also provide powers to restructure conglomerates and ultimately enable authorities to impose additional systemic capital add-ons to better address cross-border risks. BanRep recently imposed some additional macroprudential tools to limit systemic concerns from greater currency, maturity and FX liquidity risk. The tools are an FX risk indicator by currency and a short term exposure indicator. The new measures complements the existing FX risk limits on loans, deposits and net open positions for financial institutions.

10. **The law on conglomerates provides limited reach into mixed conglomerates with much of their activity remaining outside of the supervisory and regulatory perimeter.** Mixed conglomerates that offer not only financial services but also non-financial and commercial services have tended to have opaque organizational and ownership structures that consolidate operations in

jurisdictions (including offshore) with relatively more permissive regulations. The mixed conglomerates can then branch out their activities to other countries. Even with backing of the new law the SFC would not have sufficient regulatory powers over the non-financial institutions that form part of a mixed conglomerate to mitigate regulatory arbitrage within the group. Ideally it would be important to impose capital, liquidity, and risk management requirements at group-wide and solo levels but this may not translate into having the same level of “enforcement” powers over the non-financial institutions as over the financial ones within a mixed group. Enhanced monitoring of such intra-group flows between regulated and unregulated entities should be undertaken involving the SFC and the Superintendencia de Sociedades (SS).

11. **Growth and expansion of Colombian conglomerates and banking groups has involved a change in regulatory and supervisory focus as regards consolidated and conglomerate supervision.** The new powers sought by the SFC regarding conglomerates aim to deliver more comprehensive information not just on 21 financial conglomerates but also cover 215 subordinated entities in 21 Latin American and Caribbean countries which represents 29 percent of total Colombian financial system assets. There exists significant potential for risks to the domestic financial system from losses by these cross-border entities. Colombian banks have been very active in the Central American region and Peru (Table A). The current collection of data on these cross-border entities is limited. The SFC has a regulatory project in 2016 which will collect important asset and liability information, asset quality indicators on loan portfolios, profit, solvency, investments and securities information in different currencies for all these cross-border entities to be better able to map exposures and risks from large conglomerates and banking groups.

## Annex Table 1. Participation of Colombian Banks Abroad

Country	Colombian Banks Subordinated Assets (US\$ Millions)	Country Banking System Assets (US\$ Millions)	Banks System Participation (Percent)
El Salvador	8140.20	15373.70	52.95
Nicaragua	1487.20	6480.51	22.95
Panama	26036.70	116024.70	22.44
Honduras	3058.00	16595.74	18.43
Costa Rica	6480.70	39458.40	16.42
Guatemala	2260.60	33625.07	6.72
Paraguay	852.40	18816.50	4.53
Peru	1438.00	107332.23	1.34

Sources: SFC, Banking system assets taken from websites of supervisors.

12. **The Colombian authorities volunteered in 2015 to undertake a pilot self assessment under the recent *Key Attributes of Effective Resolution for Financial Institutions*.**<sup>4</sup> Colombia is the first emerging market (EM) country to undertake this assessment. The findings will help the Financial Stability Board (FSB) to further develop the *Key Attributes* and increase their applicability to EMs. Some of the key recommendations for Colombia suggest: (i.) the need for additional powers to transfer asset and liabilities to a private sector buyer or bridge bank; (ii.) additional powers to enable timely resolution based on early determination of non-viability of financial institutions; and (iii.) the power to override shareholders consent. Staff congratulates the authorities for their commitment to strengthen their resolution and recovery framework for financial institutions in line with best international standards. This will further strengthen Colombia's crisis management tools and powers.

<sup>4</sup> The pilot assessment was carried out by a team comprising the IMF, the FSB and the World Bank. The Colombian authorities have indicated that they are willing to publish the Detailed Assessment of Observation Report.

## Financial integration<sup>5</sup>

13. **There are important ongoing initiatives to foster financial integration within Latin America.** Since 2011 the Presidents of Chile, Colombia, Mexico and Peru have met regularly to take forward the agenda of the Pacific Alliance (PA). Most recently, on July 2, 2015 they issued the Paracas Declaration reaffirming their commitment to foster market integration between their countries. Private sector banks, particularly from Colombia, are moving across the region, establishing themselves as regional institutions with risks being closely monitored. Meanwhile, stock exchanges are establishing regional presence: the Integrated Latin America Market (MILA) initiative aims to foster equity and bond market integration across the PA countries. The combination of political and market enthusiasm may make the PA a more successful initiative than earlier regional attempts. A coordinated approach to remove the remaining barriers, addressing risks particularly if based on reciprocity across the PA countries, and more widely in the region, could enable reforms to proceed more effectively, generating significant early results, which would help sustain momentum. Colombia in particular is fostering its capital market development (and offer diversity away from bank financing) for corporates. However challenges remain in enabling foreign issuers to have access to local investors. Specifically there is a need for:

- Greater recognition of issuers and of the types of instruments, so that the initial placement can be made by issuers in the 4 countries of the PA. This will ensure a greater diversity of assets on offer in the region through primary and secondary public offerings.
- Allowing the free marketing of investment funds which are authorized in any of the member countries of the PA.
- Improving the treatment of the investments of the Pension and Severance Fund Management Companies (AFP) in assets or products of the region. This is so that investments of the AFP in securities, instruments or funds of the PA have the same treatment as for local investments.
- Reviewing the tax and exchange treatment in order to seek efficiencies among the countries of the PA
- Continued PA countries support and further development of the private-led initiative for capital market integration through Integrated Latin America Market (MILA) initiative

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<sup>5</sup> More comprehensive details on the benefits and challenges of financial integration are covered in depth in: *Financial Integration in Latin America*, International Monetary Fund Washington D.C. 2016.

<http://www.imf.org/external/np/pp/eng/2016/030416.pdf>, Enoch, Charles, Norat, Mohamed and Singh, Diva (2016), *Neighborly Business: Regional Financial Integration in Latin America*, March 31 2016.  
<http://www.imf.org/external/np/blog/dialogo/033116.pdf>



14. **Colombia has consolidated a comprehensive risk based supervision scheme of AML/FT for financial institutions that is a reference in Latin America.** In 2017, the IMF will assess the money laundering and terrorist financing prevention system against Colombia's compliance and implementation effectiveness of the 40 FATF Recommendations. The SFC is currently leading an inter-institutional project aimed at reaffirming the important work undertaken in recent years regarding the reinforcement of the AML/FT regime. The original mid-90's system of prevention of money laundering SIPLA, has evolved into a more comprehensive system called SARLAFT. This system engages all entities under surveillance of the SFC to design and implement a Money Laundering and Financing of Terrorism Risk Management System, that permits the adequate identification, measurement, control and monitoring of this risk. The scope of this system has migrated from a strict compliance system to a risk-based supervision scheme, which promotes an anti-money laundering culture and anti-terrorist financing activities. Current regulatory projects intend to improve compliance, as well as deepening, strengthening and consolidating the legal framework for the prevention and control of ML/FT. The current Colombian legal system has earned international recognition, and has served as a referent for other countries such as Costa Rica, Guatemala, Honduras, Panama and soon in Ecuador.

15. **Further strengthening of inter-institutional coordination mechanisms is an expected result of the 2017 assessment.** Although Colombia has a solid scheme for internal AML/FT supervision, the SFC expects to strengthen and encourage memorandums of understanding in order to share relevant information with the national authorities, such as the Ministry of Justice and Law, the Attorney General's Office, the Ministry of Foreign Affairs and international organizations, such as CCICLA, UIAF, UNODC, GAFILAT, the Central American Council of Superintendents of Banks, among others. In this regard, Colombia has been supported by the U.S. government, through agencies such as the Department of Justice, the FBI and OFAC.



# COLOMBIA

## STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

April 18, 2016

Prepared By

The Western Hemisphere Department  
(In collaboration with other Departments)

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## FUND RELATIONS

(As of March 31, 2016)

**Membership status:** Joined: December 27, 1945; Article VIII.

### General Resources Account:

	SDR million	Percent Quota
Quota	2,044.50	100.00
Fund holding of currency (Exchange rate)	2,005.44	98.09
Reserve position	39.06	1.91

### SDR Department:

	SDR million	Percent Quota
Net cumulative allocation	738.32	100.00
Holdings	714.99	96.84

**Outstanding Purchases and Loans:** None.

### Latest Financial Arrangements:

Type	Date of Arrangement	Expiration Date	In million of SDR	
			Amount Approved	Amount Drawn
FCL	Jun 17, 2015	Jun 16, 2017	3,870.00	0.00
FCL	Jun 24, 2013	Jun 16, 2015	3,870.00	0.00
FCL	May 6, 2011	May 5, 2013	3,870.00	0.00

### Projected Payments to the Fund (in SDR million):

	forthcoming				
	2016	2017	2018	2019	2020
Principal					
Charges/interest	0.02	0.02	0.02	0.02	0.02
<b>Total</b>	0.02	0.02	0.02	0.02	0.02

**Implementation of HIPC Initiative:** Not applicable.

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

**Exchange Rate Arrangement:** Colombia's exchange rate arrangement is classified as flexible regime (*de jure* and *de facto*) subject to certain intervention rules specified by the central bank. Colombia maintains an exchange restriction subject to Fund approval under Article VIII arising from the special regime for the hydrocarbon sector.

**Article IV Consultation:** The last Article IV Consultation was concluded on May 18, 2015 (IMF Country Report No. 15/142).

**FSAP participation and ROSCs:** The FSAP took place in 2000 and was updated in 2008 and 2013. A data ROSC took place in 2006 and a fiscal ROSC in 2003.

**Technical Assistance:**

Department	Time of Delivery	Purpose
STA	Jan. 14	National Accounts Statistics
STA	Jan. 14	Consumer Prices/Producer Price
MCM	Jul. 14	Bank Supervision & Regulations
FAD	Jul. 14	RA Gap
FAD	Jun. 14	Customs Administration
FAD	Feb. 15	Tax Policy
FAD	Nov. 14	Public Financial Management
FAD	Sep. 14	Tax and Customs Administration
FAD	Oct. 14	Tax Administration
FAD	Nov. 14	2012 Tax reform and New Challenges for Tax Policy
		Enhancing the Macprudential Stress Testing Framework of Banco de la Republica.
MCM	Jan. 15	

## WORLD BANK RELATIONS<sup>1</sup>

**The World Bank Group Country Partnership Framework (CPF) for FY 16–21 was discussed by the Board on April 7, 2016.** The new CPF is well aligned with both the Government’s National Development Plan and the Bank Group’s twin goals. Informed by a Systematic Country Diagnostic, the demand expressed by Colombian authorities and the WBG’s comparative advantage in Colombia, the CPF selectively focuses on three strategic areas for engagement: (i) fostering balanced territorial development; (ii) enhancing social inclusion and mobility through improved service delivery; and (iii) supporting fiscal sustainability and productivity. Support for the peace building process cuts across all areas of Bank Group engagement, from land property rights in rural areas, for instance, to improving justice service delivery and access to justice.

**The CPF proposes a flexible approach enabling ready adjustments to respond to changing client needs and macroeconomic developments.** In implementing the new CPF the World Bank Group will continue to provide integrated packages of services spanning World Bank, IFC and MIGA contributions to address Colombia’s ambitious development agenda with complementary financial, knowledge and convening services. In addition to providing programmatic knowledge services, a large number of South-South Knowledge Exchanges have been organized by the Bank under the different engagement areas. These include a number of study tours for high-ranking government officials to and from Israel, Pakistan, Indonesia, Vietnam and Peru, to learn more about social assistance programs, health policies, conditional cash transfers and a variety of other issues.

**As of March 2016, Colombia is IBRD’s 7th largest Bank borrower with US\$8.5 billion in outstanding debt.** The active portfolio is composed of 9 IBRD and 2 stand-alone GEF projects totaling US\$3.3 billion in net commitments. Colombia also has a considerable Trust Fund portfolio amounting to US\$53 million and representing a variety of sectors. In FY 16, two large DPF operations of US\$700 million each for Sustainable Development and Sustained Growth and Income Convergence, respectively, were approved. For FY 17, the lending pipeline includes two DPF operations in the areas of territorial development and fiscal and growth productivity, as well as two IPF operations in support of Colombia’s development program for its Pacific region (“Plan Pacifico”). A Multi-Donor Trust Fund has been launched to support the peace and post-conflict initiatives. The WB chairs the steering committee. Current overall contributions are at US\$6.5million, of which the Swedish Development Cooperation contributed SEK 19.5 million and the WB-administered State and Peace Building Fund US\$4 million.

**As of end-February, 2016, IFC’s outstanding portfolio in Colombia amounts to US\$743m in 55 projects.** It is the 11th largest portfolio worldwide and 3rd regionally. In terms of commitments, the top sectors are: finance and insurance (63 percent), transport and warehousing (15 percent), oil, gas and mining (5 percent) and electric power (5 percent). In terms of products, 55 percent is in loans and guarantees and 45 percent in equity and equity-type products. Participants' and Asset Management Company outstanding balances total US\$201 million and US\$545 million, respectively.

<sup>1</sup> Prepared by the World Bank staff.

IFC Advisory in Colombia is active in PPPs (schools), corporate governance, collateral registries, microfinance and sustainable energy finance, royalties, palm oil evaluation, taxes, and green building code.

**MIGA's current portfolio in Colombia stands close to US\$100 million.** MIGA coverage is entirely in the financial service sector across two projects: (i) Findeter, the first Non-Honoring of a Financial Obligation of a State-Owned Enterprise (US\$95 million); and (ii) ProCredit Holding, the insurance of mandatory reserve at the Central Bank of Colombia (US\$ 2million). The Findeter project was issued in December 2015 and supports the expansion of lending operations by Findeter to intermediary financial institutions for urban infrastructure development projects in a number of cities across Colombia; tenor is 10 years. The ProCredit Holding project was issued in December 2010, with a focus on banks' capital optimization, i.e., reduction of risk weighting for mandatory reserves on a group's consolidated balance sheet thereby reducing capital provisioning; tenor is 10 years.

## INTER-AMERICAN DEVELOPMENT BANK RELATIONS<sup>1</sup>

Colombia's current Country Strategy covers the period 2015–2018 and identifies three policy areas of dialogue with the government: productivity, effectiveness of public management and social mobility. These areas are part of a comprehensive vision for the development process of the country, aimed at a vision where the country can achieve a path of sustainable growth and become a developed country in the long run. There are cross-cutting requirements associated with this objective and to growth and overcome conditions of poverty and inequity, which are: (i) increase tax-fiscal revenues in order to ensure a sizable flow of public goods, and (ii) recognizing both infrastructure development, and human and social capital development as necessary factors for greater productivity and strengthen the middle class.

The sovereign guarantee lending envelope under the current Strategy is estimated at US\$822.5 million per year, which total US\$3.3 billion for the years 2015 to 2018. In 2015, the Bank approved 5 operations for US\$941 million in sovereign guarantee operations.

As of March of 2016, the Bank portfolio is currently composed of 27 sovereign guarantee operations, totaling US\$2.0 billion, with a disbursed percentage of 25 percent. Operations are concentrated in infrastructure (62.5 percent), governance (23.8 percent) and social development and integration (13.6 percent). The IDB is the second multilateral creditor with a total debt owed of US\$6.8 billion (42 percent of Colombia's total multilateral debt). The non-reimbursable technical cooperation portfolio includes 59 operations, with an approved value of US\$37.9 million.

The current portfolio of private sector initiatives (non-sovereign guarantee) in Colombia totals US\$289.6 million. The Inter-American Investment Corporation has a portfolio of US\$107 million.

Colombia Sovereign Loan Portfolio (As of March 31, 2016)			
	Number of Operations	Current Approved US\$ million	Disbursement (Percent)
Infrastructure	12	1242	30.7
Governance	12	473	14.0
Social Development	3	271	22.8
<b>TOTAL</b>	<b>27</b>	<b>1,986</b>	<b>25.2</b>

<sup>1</sup> Prepared by Inter-American Development Bank staff.

## STATISTICAL ISSUES

(As of April 8, 2016)

<b>I. Assessment of Data Adequacy for Surveillance</b>
<p><b>General:</b> Data provision is adequate for surveillance.</p>
<p><b>National Accounts:</b> 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 the reference year for the annually chained volume measures. GDP compilation conforms to the methodological recommendations of the System of National Accounts 1993 (1993 SNA) and some recommendations of the 2008 SNA. Development has recently begun, collaboratively between DANE and BdR, of the quarterly accounts for institutional sectors, expected to be completed by mid-2018. DANE also publishes a monthly indicator of economic activity Índice Mensual de Actividad Económica de Colombia (IMACO).</p>
<p><b>Price Statistics:</b> DANE is also responsible for price statistics, and currently compiles and disseminates the consumer price index (CPI) and the producer price index (PPI). The basket and weights of the CPI have not been updated since 2008 and are based on the Income-Expenditure Survey (2006–2007). These CPI weights are out of date and may not reflect current expenditure patterns. DANE disseminated an updated and revised PPI in 2015. There is need to expand PPI coverage to include additional economic activities.</p>
<p><b>Government Finance Statistics:</b> 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 progress has been made, and the authorities submit comprehensive GFS to the IMF's Statistics Department, there are concerns regarding data quality and the latest reported data will not be published in the Government Finance Statistics Yearbook (GFSY). The priority is to improve data compilation and consistency of time series data, and correct unusual data patterns. Next steps include: improving classification of revenue and expense, consolidation, adopting a common list of public sector entities, and disseminating high-frequency data on a national and international level. The General Accounting Office (GAO) developed a single accounting framework for the public sector based on International Public Sector Accounting Standards and maintains a financial management information system containing accounting information of all public sector units. The MFPC's Macroeconomic Policy Unit and the GAO developed a bridge table that converts national accounting classification to the GFSM 2001 framework to compile GFS on accrual and cash bases.</p>
<p><b>Monetary and Financial Statistics:</b> The <i>Bank of the Republic</i> (BdR) reports the Standardized Report Forms (SRFs) 1SR for BdR, 2SR for the other depository corporations (ODCs), and 5SR for monetary aggregates for publication in the IMF's <i>International Financial Statistics (IFS)</i> on a monthly basis with a lag of two to 5 months. The <i>Superintendencia Financiera de Colombia</i> (SFC) compiles data on 4SR for other financial corporations (OFC). However, the last reported OFC data are for December 2014. This delay in reporting is due to an ongoing review of the SFC and efforts to map the former to the International Financial Reporting Standards (IFRS). The classification of financial instruments and economic sectors follows the <i>MFSM</i> with some exceptions. For December 2001 through November 2004, some financial assets and liabilities where economic sectorization is unavailable are allocated to the economic sector having the largest volume of transactions in</p>



the category and accrued interest on various financial instruments is included in Other Items (Net) rather than in the outstanding amounts of the financial assets and liabilities.

**Financial Sector Surveillance:** Colombia is currently reporting some of the core Financial Soundness Indicators (FSI).

**External Sector Statistics:** The BdR is in charge of compiling and disseminating quarterly balance of payments and international investment position (IIP) statistics, which are produced on a sixth edition of the Balance of Payments and International Investment Position Manual (BPM6) basis. Improved surveys, particularly in the services sector, have enhanced the coverage of balance of payments statistics. Recording of transactions in securities between residents and nonresidents in secondary markets could be improved.

The BdR also monthly compiles and disseminates the Data Template on International Reserves and Foreign Currency Liquidity, reports semi-annual data to the Coordinated Portfolio Investment Survey (CPIS), and submits quarterly external debt statistics to the Quarterly External Debt Statistics (QEDS) database. However, Colombia has not reported data to the Coordinated Direct Investment Survey (CDIS) yet.

## 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.

**Colombia: Table of Common Indicators Required for Surveillance**  
(As of April 8, 2016)

	Date of Latest Observation	Date Received	Frequency of Data <sup>1</sup>	Frequency of Reporting <sup>1</sup>	Frequency of Publication <sup>1</sup>	Memo Items:	
						Data Quality – Methodological Soundness <sup>8</sup>	Data Quality – Accuracy and Reliability <sup>9</sup>
Exchange Rates	Apr. 7, 2016	Apr. 8, 2016	D	W	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities <sup>2</sup>	Feb. 2016	Mar. 2016	M	M	M		
Reserve/Base Money	Mar. 2016	Apr. 2016	W	W	W	LO, O, LO, LO	O, O, O, O, O
Broad Money	Feb. 2016	Mar. 2016	W	W	W		
Central Bank Balance Sheet	Sep. 2015	Mar. 2016	W	M	M		
Consolidated Balance Sheet of the Banking System	Oct. 2015	Mar. 2016	M	M	M		
Interest Rates <sup>3</sup>	Apr. 7, 2016	Apr. 8, 2016	D	D	D		
Consumer Price Index	Mar. 2016	Apr. 5, 2016	M	M	M		
Revenue, Expenditure, Balance and Financing Composition <sup>4</sup> – General Government (GG) <sup>5</sup>	Q4 2015	Mar. 2016	Q	Q	Q	O, O, LO, O	LO, O, O, O, NO
Revenue, Expenditure, Balance and Composition of Financing <sup>4</sup> – Central Government	Feb. 2016	Apr. 2016	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt <sup>6</sup>	Feb. 2016	Apr. 2016	M	M	M		
External Current Account Balance	Q4 2015	Mar. 2016	Q	Q	Q	O, LO, LO, LO	O, O, O, O, LO
Exports and Imports of Goods and Services	Q4 2015	Mar. 2016	Q	Q	Q		
GDP/GNP	Q4 2015	Mar. 2016	Q	Q	Q		
Gross External Debt	Dec. 2015	Apr. 2016	M	M	M		
International Investment Position <sup>7</sup>	Q4 2015	Mar. 2016	Q	Q	Q		

<sup>1</sup> Daily (D); Weekly (W); Monthly (M); Bi-monthly (B); Quarterly (Q); Annually (A); Irregular (I); Not Available (NA).

<sup>2</sup> 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.

<sup>3</sup> Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

<sup>4</sup> Foreign, domestic bank, and domestic nonbank financing.

<sup>5</sup> The GG consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

<sup>6</sup> Including currency and maturity composition.

<sup>7</sup> Includes external gross financial asset and liability positions vis-à-vis nonresidents.

<sup>8</sup> 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).

<sup>9</sup> 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 Maria Angelica Arbelaez, Alternate Executive Director for Colombia**  
**April 29, 2016**

The Colombian authorities are grateful to the mission team for the constructive and fruitful discussions held in Bogota. They broadly agree with the staff's assessment and policy recommendations.

**Economic outlook**

The Colombian economy has been hard hit by the sharp decline in the terms of trade since 2014 that has continued in 2016, compounded by a severe supply shock stemming from El Niño weather phenomenon, weaker growth among trading partners notably Venezuela and Ecuador, and tighter and volatile financial conditions. Despite the coincidence of these adverse set of shocks the economy grew 3.1 percent in 2015, one of the highest rates in the Latin American region.

Given the permanent nature of the decline in oil prices, the economy has been gradually adjusting to a new reality. Indeed, growth slowed down in 2015, and lower domestic absorption is expected to continue in 2016. To ensure an orderly adjustment of the economy, the authorities' policy responses have been grounded on exchange rate flexibility as the main shock absorber, and on appropriate fiscal and monetary policies.

As a result of the drop in oil prices, the supply weather-related shock and the tightening of financial conditions, the Colombian peso has depreciated significantly, the current account deficit has widened as a percentage of GDP, the sovereign bond spreads have risen, and inflation and fiscal pressures have mounted. Against this backdrop, the central bank (*Banco de la República*) has tightened the monetary policy and the government has undertaken a fiscal adjustment in order to maintain macroeconomic and external stability, thus supporting confidence. The 4G PPP infrastructure agenda, coupled with the re-entrance into operation of the Cartagena oil refinery, has added to growth and partially offset the negative impact of the shocks. In addition, the authorities have adopted other structural reforms to boost non-traditional exports that will contribute to the adjustment of the current account deficit and help sustain growth.

However, the authorities agree with staff that risks threaten on the downside. The main hazards stem from instability and higher volatility in global financial conditions, disorderly slowdown in China, rising vulnerabilities in emerging markets, further decline in oil prices and weaker growth in Colombian trading partners. To face global financial risks, the authorities are committed to maintaining good macroeconomic policies, a floating exchange rate, keeping an adequate level of international reserves, and closely monitoring banks, corporate and households' balance sheets in order to ensure financial stability. Access to the FCL also plays an important supportive role.

## **Fiscal policy**

The fiscal stance embedded in the Medium-Term Fiscal Framework is well anchored by the fiscal rule, whose compliance is a priority for the authorities. The drop in oil prices has posed significant fiscal challenges as oil-related revenues declined from 3.3 percent of GDP in 2013 to 0.1 percent in 2016, and interest payments increased 0.7 percent of GDP due to the currency depreciation. The total shortfall of 4 percent of GDP between 2013 and 2016 was absorbed through higher non-oil related revenues of 1.5 percent of GDP (a tax reform was approved in December 2014), spending cuts of 1.2 percent of GDP, and the remaining 1.3 percent of GDP corresponds to a cyclical increase of the deficit allowed by the fiscal rule. These measures permitted compliance of the Central Government's fiscal deficit target of 3 percent of GDP in 2015, and 3.6 percent of GDP in 2016. The authorities remain committed to making additional adjustments if needed to meet this year's target.

Under the new normal of oil prices, the government is aware that further revenue mobilization is needed in the years to come in order to comply with the fiscal rule and help the adjustment of the current account deficit. Indeed, they are in the preparation phase of the structural tax reform that will be submitted to Congress in the second semester of this year and that should be approved no later than December 2016. The report and recommendations of the tax expert commission have been an important input, and other institutions such as the IMF, the IDB and the OECD are also supporting the government in fine tuning the proposal.

Mainly due to the exchange rate depreciation, public debt increased around 5 percentage points of GDP since 2014 (the Central Government's net debt grew from 35 percent of GDP in 2014 to 40 percent expected in 2016). However, in accordance to the fiscal rule targets, debt will decline gradually to reach around 29 percent of GDP in 2024.

## **Monetary Policy and External Position**

Inflation targeting serves the economy well. As a result of the supply shock and the depreciation of the Colombian peso, inflation breached the upper bound of the target in 2015 (range of 2-4 percent) and continued to increase in 2016. The central bank started increasing the policy rate in September 2015 to contain temporary inflation pressures and anchor inflation expectations. Inflation is expected to return to target in 2017, as supply shocks recede and the pass-through from depreciation fades.

Exchange rate flexibility has been the main shock absorber and the peso depreciated strongly until early 2016, with a slight reversal in the last month. The freely floating framework has been complemented since October 2015 by a rules-based contingent FX auction program aiming at mitigating excess volatility. This mechanism has not been

triggered yet. The current account deficit widened last year to 6.5 percent of GDP, and is expected to narrow gradually as domestic absorption adjusts and expenditure switching effects kick in. For 2016 the deficit is projected at 6 percent of GDP, but in dollar terms the reduction will be significant (from USD19 billion in 2015 to USD16 billion), remaining comfortably financed by FDI and portfolio inflows.

### **Financial sector**

The financial sector remains sound, liquid, profitable, well provisioned and capitalized, and has sufficient buffers to cope with shocks. Stress tests conducted by the central bank and the Bank Superintendency to financial entities and corporate to assess risks of lower growth, exchange rate depreciation, lower oil prices and external financial tightening, show that, in general, the impact on the capital adequacy ratio and liquidity of credit institutions is limited and would not pose a significant threat to the vulnerability of the financial system.

However, the authorities continue to push ahead with the reform agenda and are finalizing the implementation of the FSAP recommendations. They are moving forward with the adoption of best practices in line with Basel III. In addition, since December 2015 the supervisor has the authority to request higher buffers (levels of capital and liquidity) to individual financial institutions that reveal higher risks. Finally, a law that grants more power to regulate and supervise financial conglomerates is being discussed in Congress.

The authorities continue to closely monitor financial stability risks. Corporate debt has increased as well as that of households in line with deeper financial inclusion, but both remain low by international standards. In addition, the share of foreign currency denominated debt of corporate is low (one third of total debt) with no evidence of large currency mismatches. The regulation of foreign currency in banks' balance sheets is stringent, so their exposure and currency mismatches are contained. The Central Bank has recently tighten the regulation to limit currency mismatches and extended it to conglomerates, and has also imposed liquidity requirements at a consolidated level, important steps to manage cross-border risks.

In October 2015, the FSB, the IMF and the World Bank assessed the Colombian bank resolution regime against the principles exposed in the "FSB Key Attributes of Effective Resolution Regimes for Financial Institutions" (KA). This assessment was carried out as a voluntary request by the authorities, the first time the KA was applied to non-G20 countries. The pilot assessment found out that Colombia has a large and diversified financial system compared with similar countries with significant cross-border institutions, and the authorities have strong powers to manage weak and failing financial institutions. However, the Colombian resolution regime has room for improvement and

the authorities are planning a way forward to implement the very useful recommendations made.

### **Structural Reforms**

The continuous reform process is at the core of the Government's agenda. The social and economic strategies, policies and targets for the next four years are outlined in a development plan law (Plan Nacional de Desarrollo 2014–2018) which is also in line with OECD requirements in some areas. The three pillars are peace, equity and education, which will be developed through, among others, social mobility, rural transformation, and improved competitiveness and infrastructure. The last two areas are critical for the transition to a more diversified economy and less dependent on commodity exports. As shown in the staff report, Colombia is making enormous progress on infrastructure with the successful 4G PPP program complemented by the tertiary roads projects. At the same time, the government is implementing other reforms to boost non-traditional exports, such as a new simplified custom status, tariff reform, education and human capital measures in order to reduce mismatches between labor force supply and demand, and is working closely with businessmen in order to take better advantage of free trade agreements.