COLOMBIAN QUARTERLY REPORT

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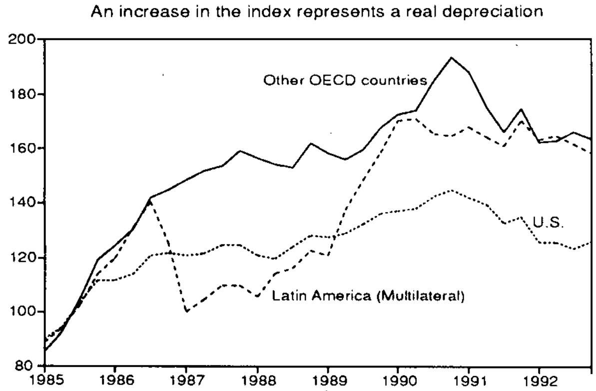
EXCHANGE RATE

During 1992 the representative (market) exchange rate (against the U.S. dollar) was devalued by 16.33% in nominal terms. Sharp oscillations in the rate of devaluation were observed throughout the year, as a result of Colombia's new system of foreign exchange intervention. The system, first established in October 1991, allows the representative rate to freely fluctuate within a band of 7.5%.

The rate of nominal devaluation was substantially below the rate of inflation (25.5%), giving rise to a real appreciation of about 5% during 1992 vis a vis the U.S. dollar (Figure 1). In regard to other industrial economies, the real appreciation was not as significant as a result of the dollar's depreciation in those markets.

Figure 1
Real Exchange Rate Index
1986=100
An increase in the index represents a real depreciation



SOURCES: Banco de la República, Fondo Monetario Internacional and FEDESARROLLO

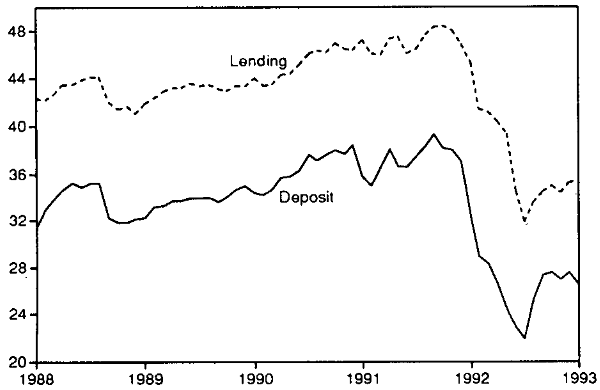
For 1993 it is expected that the authorities will maintain a rate of nominal devaluation in the 14-15% range (oscillations within the band imply less predictable monthly rates). With an inflation target of 22% (which could become 23-24% at the end of the year), a real appreciation (of about 4%) is again a likely outcome for 1993. If the European currencies and the Japanese Yen continue to lose ground against the US dollar, the real appreciation of the Colombian peso will be even stronger. This could have long-lasting damaging effects on the performance of non-traditional exports (a major source of economic growth in the recent past).

INTEREST RATES

Monetary authorities were successful in lowering interest rates during 1992 (Figure 2). Deposit rates were reduced from 37% (on average) during 1991 to a record low of 21.9% last June. The rate for December was 27.4%. Lending rates remain high, a reflection of the inefficiency of the Colombian financial sector. Nonetheless, the spread between the two rates fell from 13.2 percentage points in January to 8 points in December.

The reduction in interest rates was a direct consequence of the ceilings on lending rates imposed by the monetary authority in an effort to dampen foreign capital inflows. Interest rates paid on open market operations (a market leader) were also lowered.

Figure 2
Interest Rates



SOURCES: Superintendencia Bancaria, Informes Semanales

In fact, the interest rate differential (between domestic and foreign deposits) has been brought down to 5-8%, a figure that may still induce some capital inflows (risk premium has been estimated at 3%), but that is substantially below the differential observed during 1991 (which led to a massive capital inflow).

It is expected that the Board of Directors of the Central Bank will maintain throughout 1993 a low interest rate target (and, incidentally, move away from efforts to control the money supply).

CAPITAL FLOWS

As many other Latin American countries, Colombia has received major capital inflows during the last three years. These flows explain most of the accumulation of international reserves, which amounted US$ 1.9 billion in 1991 and US$ 1.3 billion in 1992 (Table 1).

Table 1
Balance of Payments 1989 - 1993

	US$ Millions					Growth Rates			
	1989	1990	1991[1]	1992 (P)	1993 (P)	90/89	91/90	92/91	93/92
I. Trade balance	1474.0	1956.7	2959.4	1454.1	634.1				
A. Merchandice Exports	6031.8	7064.4	7507.4	7202.8	7814.2	17.1	6.3	-4.1	8.5
1. Coffe	1476.8	1399.4	1323.6	1257.2	1133.4	-5.2	-5.4	-5.0	-9.8
2. Mining	2410.2	3001.2	2642.9	2437.0	2874.8	24.5	-11.9	-7.8	18.0
3. Non traditional	2144.8	2663.8	3541.0	3508.6	3806.0	24.2	32.9	-0.9	8.5
B. Merchandice Imports	4557.8	5107.7	4548.0	5748.7	7180.1	12.1	-11.0	26.4	24.9
II. No financial services and transfers balance	303.8	662.4	1219.4	1243.3	784.8				
A. Service exports	1309.8	1583.2	1607.5	1755.2	1928.1	20.9	1.5	9.2	9.9
B. Service imports	1904.2	1947.3	2085.3	2147.4	2293.3	2.3	7.1	3.0	6.8
C. Net transfers	898.2	1026.5	1697.2	1635.5	1150.0	14.3	65.3	-3.6	-29.7
III. Financial service balance	-1975.8	-2087.4	-1831.5	-1707.5	-1778.2				
A. Incomes	278.9	333.0	376.2	444.2	432.9	19.4	13.0	18.1	-2.5
A. Expenditures	2254.7	2420.4	2207.7	2151.7	2211.1	7.3	-8.8	-2.5	2.8
IV. Current account	-198	531.7	2347.3	989.9	-359.3				
V. Financing	484.7	-92.6	-782.1	535.8	1197.0				
A. Direct investment	547.1	470.6	432.5	722.0	653.5				
B. Net long term liabilities	112.4	-206.9	-288.1	-447.7	191.9				
C. Short term capital	-174.8	-356.3	-926.5	261.5	351.6				
VI. Change in reserves	162.3	626.0	1875.7	1347.3	837.6				
VII. Reserves	3971.5	4597.5	6572.5	7919.8	8757.4	15.8	43.0	20.5	10.6

SOURCE: National Planning Department and FEDESARROLLO.
(P) Projected
1/ Provisional data.

Precise measurement of those inflows is a difficult task, as many capital transactions are leaked through the current account of the Balance of Payments (by way of over-invoicing of exports or under-invoicing of imports) in order to avoid taxation. Much research has been done on the origins of those capitals. Analysts agree that the single main explanation is the repatriation of foreign exchange held by Colombians abroad. Very attractive interest rate differentials, as well as high returns on the stock and real estate markets, explain the portfolio switch.

Figure 3 shows the "Indice de la Bolsa de Bogotá" (Bogotá's Stock Market Index). Interestingly, according to IFC data, dollar returns on the Colombian stock market were the second highest in the world during 1991 (after Argentina). However, as in other Latin American countries, the stock market lost most of its dynamism by the end of 1992.

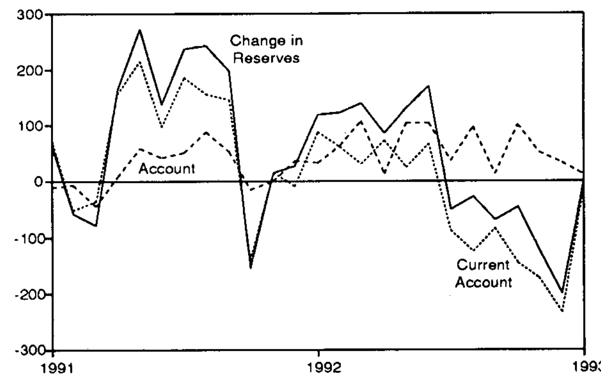
Figure 3
Bogota Stock Exchange Index

SOURCE: Bolsa de Bogotá. Refers to the prices of the 20 most heavily traded stocks

Foreign direct investment also played an important role during 1992. Recent oil discoveries (see below) require large investments by foreign firms operating in the country. In contrast to what has been the rule in most other Latin American countries, privatisations in Colombia have been moderate (efforts to start the process in the telecommunications sector generated strong opposition). In spite of those difficulties the government announced an ambitious plan for 1993, which includes the selling of three major banks, several electricity power plants, a shipping company, as well as many state-owned manufacturing firms.

Monthly data on foreign exchange transactions by the private sector (Figure 4) shows some interesting trends. After a period of deficits, a balanced current account was obtained this past January (the same was true for the capital account, after a period of surpluses). For 1993 it is expected that capital inflows will be less than those of 1992.

Figure 4
Foreing Exchange Transactions
of the Private Sector



SOURCE: Central Bank of Colombia

BALANCE OF PAYMENTS

During 1992 the trade surplus was US$ 1.4 billion, reflecting a mayor reduction compared to that of 1991 (US$ 2.96 b.). Falling coffee, oil and coal prices, as well as a 26% import growth explain that reduction. Non-financial services (and account that is extensively used for capital repatriation) showed a surplus of US$ 1.2 billion (as in 1991). All in all, the year ended with a current account surplus of nearly US$ 1 billion. A reversal in this outcome is expected for 1993 (official forecasts suggest a deficit of US$ 400 million), as a result of declining coffee prices, a substantial increase in imports of intermediate and capital goods (given public and private investment programs), and a reduction of net non-financial services. The capital account is likely to end in surplus. In sum, foreign reserve accumulation during 1993 is expected to be approximately US$ 830 million. By the end of the year the stock of foreign reserves will be close to US$9 billion, 1.3 times the value of total imports.

ECONOMIC ACTIVITY

Economic growth in 1992 has been estimated in 3.3% by private analysts and 3.6% by the Government. Predictions of slower growth were the rule by mid year due to the energy rationing imposed since march 1992, a severe drought throughout the country and the collapse of commodity prices in international markets. But the construction boom, the increase of public expenditures, the reduction of interest rates as a result of monetary expansion and an outburst of private investment boosted demand eventually compensating those factors.

Table 2
GDP Results and Projections

	1991	1992	1993
1. Agriculture	4.9	-0.1	2.2
2. Mining	0.8	3.9	8.0
3. Manufacturing	-0.5	5.1	3.0
Coffee processing	-9.5	24.0	-6.0
Rest of manufacturing	0.8	2.5	4.5
4. Public utilities	3.7	-5.0	7.0
5. Construction	4.2	9.8	5.0
6. Commerce	1.3	3.8	4.3
7. Other	2.7	3.9	4.3
TOTAL GDP	**2.3**	**3.3**	**3.8**

SOURCE: Anif-Fedesarrollo.

Most analysts are expecting GDP to grow between 3 and 4% in 1993. The Government has announced a "target" of 5%. A number of factors will support growth in 1993. The construction boom will continue at least until the second half of the year, although an excess of supply of luxury dwellings may be under way. Public expenditure is expected to grow 14% in real terms, as the Government is committed to accelerate their expenditure programs before 1994 general elections. Monetary policy will be aimed at keeping interest rates low, and the availability of domestic credit will remain high as the increase of the public deficit (to 1.1% of GDP, from virtual balance in 1992) will be largely compensated by the elimination of the current account surplus (estimated in 2.2% of GDP in 1992). Further boosting factors include the reduction of energy blackouts and the cumulative effects of the trade agreements reached last year with Venezuela and Ecuador and the preferential treatment granted by the U.S. and the EC to Colombian goods.

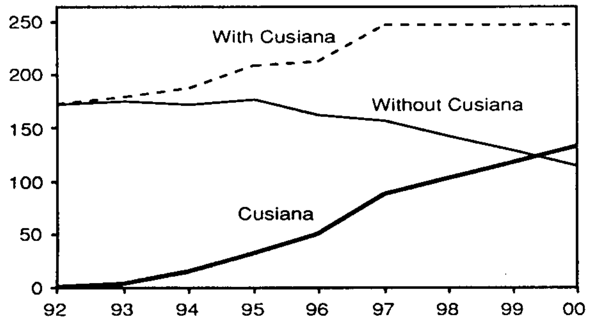
In the negative side, however, there will be the increase of the VAT rate from 12% to 14% effective since January, the coffee crisis which may induce a decrease of production and new (real) domestic price reductions, rising imports that will cut demand for local productions, the escalating guerrilla and narco-related violence and slower growth and mounting economic problems in neighboring Venezuela.

According to Anif and Fedesarrollo, construction, mining and public utilities will grow above 5% in 1993 (Table 2). Manufacturing (excluding coffee processing) will grow 4.5% and agriculture just 2.2%. However, Cega (a think tank specialized in the agricultural sector) is predicting further reductions in commercial agriculture as a result of the dismantling since 1991 of import controls and price support policies.

CUSIANA AND MEDIUM-TERM PERSPECTIVES

Cusiana and Cupiagua oil wells discovered in 1991 have been confirmed to have reserves over 2 billion barrels. In spite of previous speculation on the short term effects of additional oil exports, it is now clear that no oil bonanza is to be expected before 1996. Experimental production in Cusiana will start this year at a rate of just 10.000 barrels per day (bpd). By late 1994 or early 1995 production will climb to a plateau of 150.000 bpd (54 million barrels per year). However, existing oil wells, of which Caño Limón is the largest, will be in their declining phase. As a result, total oil production will go up from 177 million barrels in 1992 to an estimated 212 million barrels in 1996, a mere 4.6% annual growth (Figure 5).

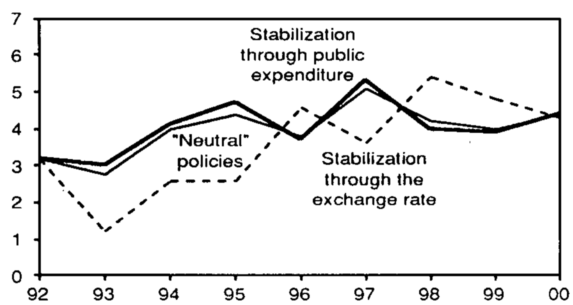
Figure 5
Perspectives of oil production
(Million barrels)



SOURCE: FEDESARROLLO

Additional exchange earnings may provide some room to either a gradual real appreciation of the peso or further increases of public expenditure until 1996. The former may sound appealing to the Central Bank Board of Directors as would help reduce inflation, though at the cost of keeping growth around 3%. The later would boost growth to 5 or 6%, but inflation will remain at its present levels (Figure 6).

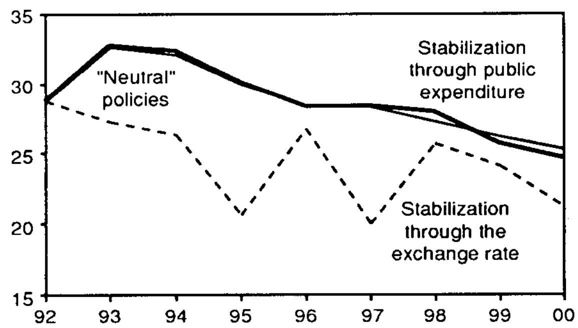
Figure 6
Growth perspectives



SOURCE: FEDESARROLLO

A policy of real appreciation of the peso, which seems highly likely, will keep parity interest rates low though prone to large swings in the medium run, as the crawl may have eventually to be adjusted to changes in the external situation (Figure 7). A policy of further public expenditure will keep interest rates higher but more stable if the present real exchange rate is to be safeguarded. However, the risk exists that while the Central Bank aims at gradually appreciating the peso, the Government attempts to devote their additional external and fiscal earnings to finance public expenditure programs. This combination may prove to be very damaging both to the balance of payments and the fiscal situation as their negative effects will be reinforced while preventing both a reduction of inflation and a sustainable increase of growth.

Figure 7
Parity interest rates
(%)



SOURCE: FEDESARROLLO