Rabobank

Country report **COLOMBIA**

Summary

The security situation in Colombia has improved recently on the back of military successes against guerrillas and drug gangs, but the activities of the latter two groups continue to have a sizeable social cost. The floods that hit Colombia in late 2010 and early 2011 also had a considerable social impact, although the economic impact should be manageable. Meanwhile, the new Santos administration has presented a number of useful fiscal reforms, such as a fiscal rule and a new royalty scheme. There is a strong political consensus in favour of market friendly policies. While the peso has gained in strength on the back of high commodity prices, Colombia has so far, unlike for example Brazil, refrained from implementing capital controls. In May 2011, the government requested the IMF for a renewal of the USD 6bn flexible credit line, which would help Colombia to deal with external shocks.

Things to watch:

- Commodity prices (in particular prices of oil and coal)
- Relations with Venezuela

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Colombia

National facts		
Type of government	Republic	
Capital	Bogota	
Surface area (thousand sq km)	1,109	
Population (millions)	46.3	
Main languages	Spanish	
Main religions	Catholic (90%)	
	Other (10%)	
Head of State (president)	Alvaro Uribe Velez	
Head of Government	Alvaro Uribe Velez	
Monetary unit	Colombian peso (COP)	
Economy	**2010**	
Economic size	*bn USD*	*% world total*
Nominal GDP	288	0.46
Nominal GDP at PPP	435	0.58
Export value of goods and services	45	0.24
IMF quotum (in mln SDR)	774	0.36
Economic structure	*2010*	*5-year av.*
Real GDP growth	4.3	4.7
Agriculture (% of GDP)	9	10
Industry (% of GDP)	38	37
Services (% of GDP)	53	54
Standards of living	*USD*	*% world av.*
Nominal GDP per head	6138	62
Nominal GDP per head at PPP	9277	79
Real GDP per head	3903	49

Social and governance indicators	rank / total
Human Development Index (rank)	79 / 169
Ease of doing business (rank)	39 / 183
Economic freedom index (rank)	45 / 179
Corruption perceptions index (rank)	78 / 178
Press freedom index (rank)	145 / 178
Gini index (income distribution)	58.49
Population below $1.25 per day (PPP)	16%

Foreign trade			2009
Main export partners (%)		*Main import partners (%)*	
US	40	US	29
Venezuela	12	China	11
Netherlands	3	Mexico	7
Ecuador	4	Brazil	7

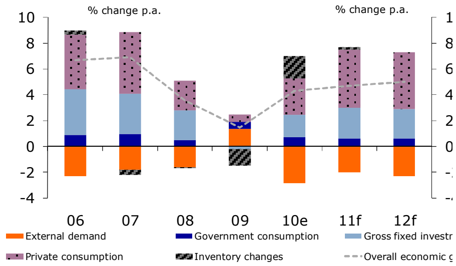
Main export products (%)	*2010*
Petroleum & petroleum products	41
Coal	15
Coffee	5
Nickel	2
Main import products (%)	
Intermediate goods	42
Capital goods	36
Consumer goods	22
Openness of the economy	
Export value of G&S (% of GDP)	16
Import value of G&S (% of GDP)	16
Inward FDI (% of GDP)	2.3

Source: EIU, CIA World Factbook, UN, Heritage Foundation, Transparency International, Reporters Without Borders, World Bank.

Economic structure and growth

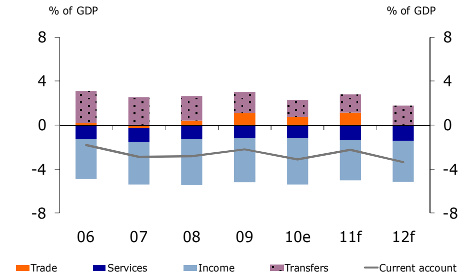
Colombia’s GDP grew 4.3% in 2010, as the economy recovered from the global financial crisis. Growth was driven by monetary and fiscal stimulus implemented by the government. The economy also benefited from higher commodity prices, but at the same time suffered from output disruptions due to the floods, which hit Colombia in late 2010. These floods also resulted in grave human suffering, with almost 2mln people becoming homeless and more than 250 deaths. Even worse, in April 2011 Colombia was hit by floods once again. Nevertheless, Colombia should be able to deal with the economic impact of these natural disasters. Meanwhile, domestic demand is strong, with both investment and consumption growing vigorously. We expect the economy to grow between 4.5 and 5 percent in 2011. Colombia’s economy is rather well diversified, although with exports of coal, oil and oil products together accounting for almost 60% of total exports, and coffee exports accounting for another 5%, the economy is reliant on commodity exports. The economic development of the country is constrained by the rather poor state of its infrastructure. The impact of guerrilla activities on the economy has been reduced, as the government has managed to bring a bigger part of the country under its control. Colombia had a per capita income of USD 6,127 in 2010 and is classified as an upper middle income country by the World Bank. Colombia’s banking sector is relatively strong. Non performing loans ratios have remained low and banks are well capitalized. Moreover, the exposure to foreign funding is low and the financial system is hardly dollarized.

Chart 1: Growth performance



Source: EIU

Chart 2: Current account



Source: EIU

Political and social situation

In 2010, Juan Manual Santos won the elections and thus succeeded Alvaro Uribe, who was not allowed to run for a third term. Santos is a member of the Party of the U, the party formed by Uribe, and his administration is supported by the Liberals and the Conservatives. He enjoys a majority of about 80% in both the Senate and the House of Representatives and has so far been very popular. Santos has more or less continued most of Uribe's economic and security policies. However, his style of government is more consensual and less confrontational. For example, the government has increased its efforts to offer social services in rural areas, but still fights forcefully against guerillas and drug gangs. The security situation in Colombia has improved recently following military successes by the government. The guerrillas have largely retracted from the urban areas and are causing less social harm. However, they are still able to finance themselves through the drug trade. Meanwhile, urban crime has been growing recently. Urban crime and guerrilla activity are certainly not the only social issues Colombia is facing. Just like in other Latin American countries, income inequality in Colombia is very high: in 2009 the Gini coefficient was 58.5. Moreover, although the share of the population living in poverty has gone down, poverty remains high. The Santos administration partially tries to solve these issues by pushing ahead with land reforms and funding the regional economic development of rural areas. However, the recent floods, which have resulted in sizeable damage to the infrastructure, might delay the implementation of the policy agenda. Santos has also applied his more consensual style on the external front. His efforts to improve the strained relationships with neighboring Ecuador and Venezuela have so far been successful. This has helped to reduce external political risks. However, relations with Venezuela might be vulnerable to new setbacks, as Hugo Chavez might once again use confrontational policies to boost his domestic popularity.

Economic policy

Colombia generally has business-friendly policies that are widely supported. The government has demonstrated a strong commitment to the rule of law and macroeconomic stability. For example, earlier this century the government dared to take unpopular measures, which helped to avert a default. The relatively independent central bank maintains a rather successful inflation targeting regime. It aims to keep inflation within a band of 100 basis points around the target of 3%. In May 2011, year-on-year inflation was 3.02%, which is extremely close to the inflation target. Even so, the central bank has raised the policy interest rate in three steps from 3% to 3.75% since February and further hikes are likely, as investment and consumption have been growing rapidly in the last months. Monetary flexibility is boosted by a free floating exchange rate regime, which also helps to absorb external shocks. However, as a result of high commodity prices the Colombian peso has appreciated significantly, which has damaged the competiveness of many labor-intensive producers. The central bank has tried to limit the appreciation by buying reserves. But, unlike its big neighbor Brazil, Colombia has refrained from implementing capital controls. Within the economic policy sphere we consider Colombia's fiscal situation vulnerability. The government has a sizeable structural deficit, and suffers from inflexibility of its spending and an inefficient tax structure. The budget deficit was 2.7% in 2010 and is likely to increase to slightly more than 3% in 2011. To counter these fiscal problems, the new Santos administration has presented a number of useful fiscal reforms, such as a fiscal rule and a new royalty scheme.

Balance of Payments

Colombia has a small surplus on the trade account. Furthermore, the country has a relatively large surplus on the transfers account. However, thanks to a sizeable deficit on the service account and, in particular, a large deficit on the income account, Colombia has been posting current account deficits. The deficit grew to 3.1% of GDP in 2010, but is expected to fall in 2011. Current account deficits have been largely covered by net FDI inflows, except in 2010. In 2011 and 2012 we expect the FDI inflows to grow once again, thanks to high commodity prices, the improved security situation and the investor friendly policy environment. The biggest risk for the balance of payment is a sharp fall of commodity prices, in particular prices of fuel, as exports are dominated by those products. Colombia has asked the IMF for a new USD 6bn precautionary Flexible Credit Line (FCL), as the existing USD 3.4bn FCL is set to expire. A new credit line would help to mitigate the balance of payment risk.

External position

Reserve assets have grown in recent years and stood at USD 30.2bn in April 2011. This equals slightly more than 7 months of imports, which is a rather comfortable level. In 2010 foreign reserves covered debt service almost twice, but this ratio is set to decline in the coming years. Colombia has a negative International Investment Position. However, of the USD 152bn of foreign liabilities per December 2010, USD 82bn consisted of foreign direct investment. This is a comforting factor, as foreign direct investment flows are less volatile than other types of capital. What is more, as the cost of this type of capital depends on the profitability of the underlying investments, the related costs tends to be lower in crisis times. However, we note that foreign indebtedness has increased recently as well.

Colombia

Selection of economic indicators	2006	2007	2008	2009	2010e	2011f	2012f
Key country risk indicators							
GDP (% real change pa)	6.7	6.9	3.5	1.5	4.3	4.7	5.0
Consumer prices (average % change pa)	4.3	5.5	7.0	4.2	2.3	3.7	3.6
Current account balance (% of GDP)	-1.8	-2.9	-2.8	-2.2	-3.1	-2.2	-3.4
Total foreign exchange reserves (mln USD)	15296	20767	23479	24748	27766	34260	38640
Economic growth							
GDP (% real change pa)	6.7	6.9	3.5	1.5	4.3	4.7	5.0
Gross fixed investment (% real change pa)	18.1	14.4	9.9	-0.8	7.1	9.8	8.7
Private consumption (real % change pa)	6.4	7.3	3.5	0.9	4.4	6.9	6.7
Government consumption (% real change pa)	5.6	6.0	3.3	3.5	4.7	3.8	3.8
Exports of G&S (% real change pa)	8.6	6.9	4.5	-2.2	2.2	8.9	8.8
Imports of G&S (% real change pa)	20.0	14.0	10.5	-7.3	14.7	14.4	14.5
Economic policy							
Budget balance (% of GDP)	-0.4	-0.4	0.5	-2.1	-2.7	-3.1	-2.8
Public debt (% of GDP)	47	44	43	45	45	45	44
Money market interest rate (%)	6.5	8.7	9.7	5.6	3.1	3.7	4.6
M2 growth (% change pa)	17	18	17	6	10	16	14
Consumer prices (average % change pa)	4.3	5.5	7.0	4.2	2.3	3.7	3.6
Exchange rate LCU to USD (average)	2358.6	2077.8	1965.1	2157.6	1899.0	1807.8	1810.4
Recorded unemployment (%)	12.0	11.2	11.3	12.0	11.8	11.2	10.7
Balance of payments (mln USD)							
Current account balance	-2987	-6018	-6923	-5141	-8943	-7510	-12060
Trade balance	324	-585	972	2547	2137	3830	110
Export value of goods	25181	30576	38536	34025	40778	51480	54160
Import value of goods	24858	31161	37563	31479	38642	47660	54050
Services balance	-2119	-2648	-3071	-2810	-3465	-4550	-5090
Income balance	-5934	-8002	-10334	-9492	-12096	-12210	-13310
Transfer balance	4742	5216	5511	4613	4481	5420	6230
Net direct investment flows	5558	8136	8342	4119	256	7400	8200
Net portfolio investment flows	-3417	681	-1054	-1743	-1071	-710	740
Net debt flows	1139	4617	3388	6947	10992	6950	6160
Other capital flows (negative is flight)	190	-1901	-1036	-2861	1852	290	1280
Change in international reserves	482	5515	2718	1321	3086	6420	4330
External position (mln USD)							
Total foreign debt	38320	43956	46887	53844	64817	71900	77970
Short-term debt	4763	5161	5684	4165	9151	12290	15160
Total debt service due, incl. short-term debt	15439	12409	12602	14333	14123	21250	25880
Total foreign exchange reserves	15296	20767	23479	24748	27766	34260	38640
International investment position	-40111	-47890	-53838	-59984	n.a.	n.a.	n.a.
Total assets	46998	56646	61899	70844	n.a.	n.a.	n.a.
Total liabilities	87108	104536	115737	130828	n.a.	n.a.	n.a.
Key ratios for balance of payments, external solvency and external liquidity							
Trade balance (% of GDP)	0.2	-0.3	0.4	1.1	0.7	1.1	0.0
Current account balance (% of GDP)	-1.8	-2.9	-2.8	-2.2	-3.1	-2.2	-3.4
Inward FDI (% of GDP)	4.1	4.4	4.3	3.1	2.3	3.0	3.1
Foreign debt (% of GDP)	24	21	19	23	23	22	22
Foreign debt (% of XGSIT)	109	105	93	120	125	112	114
International investment position (% of GDP)	-24.6	-23.1	-22.0	-25.5	n.a.	n.a.	n.a.
Debt service ratio (% of XGSIT)	44	30	25	32	27	33	38
Interest service ratio incl. arrears (% of XGSIT)	7	7	6	6	6	5	6
FX-reserves import cover (months)	6.0	6.7	6.3	7.7	7.2	7.2	7.2
FX-reserves debt service cover (%)	99	167	186	173	197	161	149
Liquidity ratio	103	112	113	116	115	113	107

Source: EIU