



COLOMBIA

May 2014

2014 ARTICLE IV CONSULTATION—STAFF REPORT; PRESS RELEASE; 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 2014 Article IV consultation with Colombia, the following documents have been released and are included in this package:

- The **Staff Report** for the 2014 Article IV Consultation, prepared by a staff team of the IMF for the Executive Board's consideration on May 19, 2014, following discussions that ended on March 13, 2014, 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 May 2, 2014.
- An **Informational Annex** prepared by the IMF.
- A **Press Release** summarizing the views of the Executive Board as expressed during its May 19, 2014 consideration of the staff report that concluded the Article IV consultation with Colombia.
- A **Statement by the Executive Director** for Colombia.

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

Selected Issues

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

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COLOMBIA

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION

May 2, 2014

KEY ISSUES

Context. Colombia's economic performance has been robust, underpinned by a very strong policy framework. Last year, real GDP grew by 4.3 percent, with low inflation. The country has a strong external position; the financial system is sound; and fiscal policy remains guided by a structural fiscal balance rule. The authorities intend to undertake an ambitious infrastructure program to be executed through public-private partnerships.

Outlook and risks. Real GDP growth is projected to converge to potential (about 4½ percent) in 2014, with inflation remaining within the 2–4 percent target range. The medium-term outlook is favorable, but risks are tilted to the downside. Colombia's important and growing ties with the global economy expose the economy to external risks. The most important sources of risk are a decline in oil prices, a deterioration in global financial conditions, and volatility from the normalization of monetary policy in the U.S.

Near-term policy mix. The current policy mix is broadly adequate. As the ongoing economic recovery takes hold, monetary and fiscal policies are expected to shift to a more neutral stance. Colombia continues to rely on a flexible exchange rate to absorb external shocks. The authorities are also taking advantage of abundant foreign inflows, primarily foreign direct investment, to strengthen their international reserve buffer.

Medium-term challenges. Colombia's key challenge is to sustain strong and inclusive growth with macroeconomic stability. To this purpose, it will be important to: (i) adhere to the fiscal consolidation plan, supporting it with revenue mobilization; (ii) address the infrastructure gap, without increasing fiscal risks; (iii) enhance the social security system by increasing coverage and improving equity, and containing health care costs; (iv) address remaining weaknesses in financial sector supervision; and (v) foster financial inclusion.

Approved By
**Robert Rennhack and
 Mary Goodman**

Discussions took place in Bogotá during March 3–13, 2014. The team comprised Valerie Cerra (Head), Naomi Griffin, Izabela Karpowicz, Pablo Morra (all WHD), Shuntaro Hara (SPR), Leonardo Martinez (ICD), and Mohamed Norat (MCM). Robert Rennhack (WHD) joined the mission for the final discussions. María Angélica Arbeláez (OED) participated in most of the meetings.

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BACKGROUND

1. **Colombia has maintained a robust economic performance in recent years.** A strong policy framework—anchored by an inflation-targeting regime, a flexible exchange rate, a structural fiscal balance rule, and effective financial supervision and regulation—has allowed the authorities to respond adequately to shocks and pursue effective demand management. As a result, real GDP grew at a pace of 4 percent and annual inflation averaged 2.7 percent in the last five years. The authorities have continued to improve the policy framework in recent years, by including a fiscal sustainability principle in the constitution; introducing a structural fiscal balance rule; overhauling the oil and mining royalties system; and implementing a comprehensive tax reform that replaced payroll taxes with a corporate income tax.
2. **The economy has important and growing ties with the global economy.** Trade is rising, driven by commodity exports, and the economy is receiving substantial foreign direct investment. At the same time, Colombian firms are expanding abroad, primarily across Central and South America. The corporate sector borrows significant amounts from international banks, and the sovereign and a number of large firms have fluid access to the international capital markets. The participation of nonresidents in the domestic equity and government bond markets is rising. As a result, Colombia's economy is increasingly sensitive to global economic and financial developments. In June 2013, the IMF's Executive Board approved a new two-year Flexible Credit Line (FCL) for SDR 3.87 billion (about US\$6 billion, or 500 percent of quota), which provides Colombia protection against external tail risks.
3. **Colombia will hold presidential elections in late May and the authorities are negotiating a peace agreement to end the country's long armed conflict.** President Juan Manuel Santos (in office since 2010) is running for a second term. The next president will be inaugurated in August. On March 9, 2014, Colombia held congressional elections, in which the ruling coalition maintained a working majority in Congress, although the opposition increased its representation. In October 2012, the authorities began peace talks with the main guerrilla group, the FARC (Revolutionary Armed Forces of Colombia). As of March 2014, agreement has been reached on two of the five topics under discussion.
4. **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 13/35 for details). Data provision is adequate for surveillance.

RECENT DEVELOPMENTS

5. **Real GDP growth rebounded strongly in the second half of 2013.** After slowing down to 2.9 percent y/y in the second half of 2012 and the first half of 2013, growth accelerated to 5.2 percent y/y in the second half of 2013, driven by higher public investment and a solid expansion in private consumption. On the supply side, output growth was broad-based, with strong gains in

construction and agriculture, with the only exception of manufacturing production, which fell by 1.2 percent. Overall, real GDP growth in 2013 as a whole averaged 4.3 percent, up from 4 percent in 2012. In turn, employment rose strongly, particularly in the formal sector of the economy, and unemployment declined to 9.7 percent in 2013, the lowest mark in the last decade.

6. Inflation was subdued. Headline inflation fell to 1.9 percent y/y at end-2013, slightly below the 2–4 percent target range, down from 2.4 percent at end-2012. Core inflation was also subdued at 2.4 percent y/y. A high supply of perishable foods (thanks to favorable weather conditions), stable fuel prices, and one-off price reductions arising from the implementation of the tax reform contributed to the benign inflation behavior of last year. As of March 2014, headline inflation rose to 2.5 percent y/y, and core inflation increased to 2.6 percent. Twelve-month inflation expectations stood at 3 percent, close to the mid-point of the target range.

7. The current account deficit remained broadly stable. The current account deficit amounted to 3.3 percent of GDP in 2013, up from 3.2 percent in 2012. The trade surplus narrowed as a result of lower exports, but was almost fully offset by a smaller deficit in the income account. The current account deficit continued to be financed by sizable surplus in the financial account (5 percent of GDP), largely driven by inward foreign direct investment (4.4 percent of GDP). Portfolio inflows by nonresidents remained firm. Colombia maintained fluid access to the international capital markets, with Ecopetrol and the government issuing long-term bonds in the last quarter of 2013 and early 2014, respectively. The central bank took advantage of the continued surplus in the capital account to strengthen its international reserves, which rose to US\$43.2 billion. The net international investment position (NIIP) was broadly unchanged at 27 percent of GDP, with a high share of foreign direct investment (FDI) in total liabilities. The total external debt remained broadly stable at 24 percent of GDP. Both NIIP and external debt are relatively low compared to peer countries and have remained so for several years.¹

8. The exchange rate depreciated and government bond prices fell after the U.S. Federal Reserve tapering talk began in May 2013. The exchange rate depreciated by about 7 percent from May 22, 2013 to April 4, 2014, and foreign exchange market volatility increased (Box 1). Yields on 10-year domestic government debt initially rose by over 200 basis points (one of the largest increases among emerging markets), but later recovered some of the losses as markets began to differentiate between countries with strong economies such as Colombia. As of April 4, 2014, yields on 10-year domestic government debt had fallen to 130 basis points over the pre-May 22 level. Spreads on external government debt also increased.

9. Fiscal performance was in line with the fiscal rule. Staff estimates that the central government's fiscal deficit was 2.4 percent of GDP in 2013, in line with the fiscal rule. The combined public sector balance is estimated to have slipped into a deficit of 1 percent of GDP, from a surplus of 0.2 percent of GDP in 2012, mainly due to deferred spending by local governments stemming

¹ For detailed analysis of past developments on NIIP and external debt, see IMF (2012), "Colombia 2012 Article IV Consultation."

from a lag in transfers of oil revenues. The public sector debt is estimated at 35.2 percent of GDP at end-2013.

10. The banking system remained stable. Financial soundness indicators remained strong, with low and well-provisioned non-performing loans, strong profitability, and adequate liquidity. New capital requirements became effective in August 2013, significantly enhancing the quality of banks' capital. Growth in credit to private sector slowed to 12 percent y/y at end-2013, from 16 percent at end-2012, and was financed largely through an expansion in domestic deposits.

OUTLOOK AND RISKS

11. Colombia's economic outlook is favorable.

- **Growth is projected to remain robust.** With the output gap nearly closed as of end-2013, real GDP is projected to grow at around potential, estimated at 4½ percent, in 2014 and beyond. Growth is projected to be driven by the private sector, supported by a steady increase in investment largely financed by higher domestic savings (Box 2).
- **Inflation is expected to stay within the (2–4 percent) target range.** In 2014, inflation is projected to rise gradually, as the temporary factors that held it down in 2013 filter out. Given well-anchored inflation expectations, inflation is expected to remain well within the target range throughout the forecast period.
- **The balance of payments would remain in surplus.** The current account deficit is projected to remain at about 3 percent of GDP in the medium term, with the deficit in the income balance (resulting from profit remittances and external interest payments) continuing to exceed the trade surplus. The deficit in the current account is expected to be more than financed by capital inflows, especially foreign direct investment.
- **The near-term fiscal outlook is in line with the fiscal rule.** The 2014 budget envisages a central government deficit of 2.3 percent of GDP, down from 2.4 percent in 2013, and in line with the fiscal rule. The deficit of the combined public sector is projected to decline slightly to 0.9 percent of GDP, from 1 percent in 2013.
- **The fiscal deficit and public debt are projected to decline over the medium term.** Staff projects the deficit of the central government to decline to 1.9 percent of GDP by 2019, following the authorities' fiscal rule, and the combined public sector deficit to reach 0.6 percent of GDP. As a result, the public sector debt would fall to 29 percent of GDP by 2019, from 35 percent at end-2013.
- **The financial system is expected to continue deepening.** Credit and assets under management by pension and other investment funds are poised to continue growing as a share of GDP. The participation of nonresidents in both the local government debt market and the equity market is also projected to rise, driven by the recent increase in Colombia's weight in

global bond indices and further integration of the local stock market with other regional bourses.²

Colombia. Medium Term Outlook							
(In percent of GDP, unless otherwise indicated)							
	Est	Proj					
	2013	2014	2015	2016	2017	2018	2019
Real GDP growth (percent)	4.3	4.5	4.5	4.5	4.5	4.5	4.5
Consumer prices (percent, end of period)	1.9	2.7	3.0	3.0	3.0	3.0	3.0
Current account balance	-3.3	-3.3	-3.3	-3.1	-3.0	-3.0	-2.9
Combined public sector balance	-1.0	-0.8	-0.6	-0.6	-0.7	-0.6	-0.6
Total public sector gross debt	35.2	34.7	33.5	32.2	31.0	29.8	28.6

Sources: Colombian authorities; and Fund staff estimates.

12. However, risks to the outlook are tilted to the downside. As a result of its important linkages with the rest of the world, the Colombian economy is significantly exposed to external risks. Furthermore, the risks associated with emerging markets and geopolitical tensions have increased since the last Article IV consultation. External risks include a sharp decline in commodity prices, especially oil; a deterioration in global financial conditions, including a surge in global financial market volatility related to the normalization of financial conditions in the U.S.; and negative growth shocks in key trading partners. If any of these global shocks materialize, they would slow Colombia's growth, reducing export and fiscal revenues, curtailing foreign direct investment, cutting foreign credit lines, increasing the burden of debt service, and putting pressure on the exchange rate and local asset prices.

- **A decline in oil prices** would cut export receipts (oil exports account for more than one half of total exports), reduce fiscal revenues (oil-related revenues amount to about 4½ percent of GDP and 16 percent of total government revenue), and adversely affect economic activity. It could also reduce foreign direct investment (since a significant share of it goes to the oil sector), with a further negative impact on the external accounts. According to staff estimates, a US\$10 drop in the price of oil would reduce exports by about US\$3.3 billion (0.9 percent of GDP) and fiscal revenue by about 0.4 percent of GDP. In addition, a VAR model estimated by staff suggests that the same shock would cut real GDP growth by ½ of a percentage point on a cumulative basis after six months after the shock.
- **A rise in U.S. interest rates** could negatively impact Colombia, if not accompanied by a corresponding increase in U.S. growth (e.g., in the event of an increase in the term premium driven by a surge in U.S. inflation expectations) or if it led to higher global risk aversion and capital outflows and weaker growth in emerging markets. In turn, financial volatility in emerging

² Since 2011, Chile, Colombia and Peru integrated the operations of their stock markets, creating MILA ("Integrated Latin American Market"), with the aim of providing companies and investors greater access to each of the three individual capital markets. MILA has become Latin America's second largest stock market after Brazil, and could become the largest if ongoing plans to integrate Mexico's stock market into MILA materialize.

markets could also trigger dislocations in the domestic capital market and a sharp decline in the value of domestic financial assets, with negative implications for the real economy (Box 3).

- **Deterioration in global financial conditions** could also reduce external bank credit lines and portfolio flows, negatively affecting the external accounts and economic activity. Data from the Bank of International Settlements (BIS) shows that claims of international banks on Colombian borrowers amounted to US\$47 billion (12 percent of GDP) as of September 2013, largely on account of corporate borrowers. A simulation exercise developed by staff³ suggests that lending from international banks (including those operating in Colombia) to Colombian borrowers could decline by up to 6.6 percent of GDP in the event of a sizable shock to the balance sheets of international banks.
- **A negative growth shock in key trading partners** would reduce the demand for Colombian exports, weakening economic growth. A multi-country vector autoregressive (VAR) model estimated by staff suggests that a 1 percentage point slowdown (vis-à-vis baseline projections) in real GDP growth of China, the Euro area, and the U.S. could reduce real GDP growth in Colombia by 0.3, 0.2 and 0.1 percentage points, respectively. The exercise also pointed to a significant adverse growth impact in the event of a slowdown in the growth pace of regional trade partners, with whom the bulk of Colombia's manufacturing trade takes place (¶13).

13. Shocks in the region could also be a source of negative spillovers to Colombia. Shocks in the region could affect Colombia through trade and financial channels. Colombian exports to Latin America account for about a quarter of total exports and the bulk of manufacturing exports. The Latin American trade partners are in turn exposed to shocks to the global economy, in particular in the U.S. and China. A multi-country VAR model estimated by staff suggests that a combined 1 percentage point slowdown (vis-à-vis baseline projections) in real GDP growth of Colombia's main trading partners in the region could reduce Colombia's real GDP growth by about ½ of a percentage point. The main risks are comprised of an increase in restrictions to trade with Ecuador (which has become Colombia's main market for manufacturing products), an intensification of economic stress in Venezuela (which despite the significant reduction in trade since 2009 remains an important market for Colombian goods), and a growth slowdown in Central America (which has become an important trade partner in recent years). On the financial side, the main sources of risk are a shock in Central America affecting the balance sheets of Colombian banks (which have become prominent players in the Central American banking system, ¶135), or possible financial contagion arising from an increase in investors' perception of regional risk in response to adverse political or economic developments in one or more countries of the region.

14. On the domestic front, the main risks relate to high growth of house prices and consumer credit, as well as contingent liabilities from public-private partnerships (PPPs). House prices rose significantly in recent years, fuelled by a robust expansion of income and credit

³ See the accompanying 2014 Selected Issues Papers—"Colombia: Assessing Spillover Risks."

growth and government subsidies. If prices were to fall, banks' non-performing loans could increase. However, the risk is mitigated by low households' loan-to-value ratios (about 55 percent), fixed borrowing rates, and a low exposure of banks to mortgage loans. High growth in credit to the private sector, including consumer loans, has been a concern in recent years (IMF Country Report 13/35), but has been abating (f132). On the fiscal front, one source of risk is that road concessions or other infrastructure projects lead to unforeseen public sector liabilities. This risk, however, is mitigated by a revamped legal framework for PPPs, approved in 2012.

15. The authorities broadly agreed with the outlook and characterization of risks. Their forecasts for the main macroeconomic variables are broadly in line with staff's projections. In relation to risks, the authorities highlighted Colombia's exposure to external shocks, expressing particular concern about the pace and implementation of monetary policy normalization in the U.S. and its possible effects on global financial markets and economic growth in emerging markets. They also underlined the risks of a slowdown in China, with possible adverse implications for oil prices, and agreed with staff that shocks in the region could have a significant impact on Colombia.

Colombia: Risk Assessment Matrix ¹

	<i>Likelihood</i>	<i>Impact</i>	<i>Policy Advice</i>
Side-effects from global financial conditions: surges in global financial market volatility, triggered by geopolitical tensions or revised market expectations on UMP exit/emerging market fundamentals.	High	High	Use the exchange rate and international reserves as shock absorber.
Protracted period of slower growth in emerging economies: maturing of the cycle, misallocation of investment, and incomplete structural reforms leading to prolonged slower growth.	High	Medium	Use monetary policy to support growth; speed up execution of capital projects in the public sector.
Growth slowdown in China:			
Significant slowdown of growth in 2014. Growth may fall significantly below the authorities' target, with the slowdown caused by a variety of possible reasons and absent offsetting stimulus measures	Low	High	Use the exchange rate and international reserves as shock absorber; tighten fiscal policy.
Continued buildup and eventual unwinding of excess capacity, eventually resulting in a sharp growth slowdown and large financial and fiscal losses (medium-term).	Medium	High	Use the exchange rate and international reserves as shock absorber; tighten fiscal policy.
Geopolitical risks (financial flows, commodity prices, and supply chains): a sharp increase in geopolitical tensions surrounding Russia/Ukraine that creates significant disruptions in global financial, trade and commodity markets.	Medium	Low	Use the exchange rate and international reserves as shock absorber.
Sustained decline in commodity prices, triggered by deceleration of global demand and coming-on-stream of excess capacity (medium-term)	Medium	High	Use the exchange rate and international reserves as shock absorber; tighten fiscal policy.
Bond market stress from a reassessment in sovereign risk:			
Euro area: Sovereign stress re-emerges due to incomplete reforms, unanticipated outcomes from the asset quality review and stress tests in the absence of a fiscal backstop	Low	Low	Use the exchange rate and international reserves as shock absorber.
United States: protracted failure to agree on a credible plan to ensure medium-term fiscal sustainability	Low	High	Use the exchange rate and international reserves as shock absorber.
Political or economic distress in Venezuela	High	Medium	Use the exchange rate and international reserves as shock absorber.
Contingent liabilities from PPPs	Medium	Medium	Standardize PPP contracts to lower risk of litigation, strengthen the role of the Ministry of Finance in the gateway process; boost project evaluation.
Continued high growth of credit and house prices	Medium	Low	Adopt prudential measures tailored to the risk profile of financial institutions.

¹ 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 of risks listed 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 of 30 percent or more). 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.

16. Possible outward spillovers from Colombia are estimated to be limited. The main channel through which shocks in Colombia could transmit to other countries is through the financial sector via cross-border bank lending and foreign direct investment links. In the event of a shock in the Colombian banking system, this channel could be significant for some Central American countries (in particular El Salvador and Panama), where Colombian banks have gained a significant share of the market. Shocks in Colombia could also transmit through the trade channel. However, Colombia's share in total trade of individual trading partners is modest, suggesting that the potential for real spillovers to other countries in the region is small.

POLICY DISCUSSIONS

Discussions focused on the appropriate macroeconomic policy stance for 2014; policies to maintain fiscal, external, and financial sector stability; reforms to enhance the social security system; and actions to foster inclusive growth.

A. Near-Term Policy Stance

17. Economic policies supported growth in 2013. Staff and the authorities agreed that the central bank's decision to hold the policy interest rate at 3.25 percent from April 2013 to April 2014 was appropriate in light of soft growth during the first half of the year, a negative output gap, and inflation at or below the lower bound of the target range throughout the year. The reallocation of central government spending to provide targeted stimulus (e.g., through mortgage interest subsidies) and the use of royalties for investment spending by sub-national governments also supported growth. These policies helped economic activity rebound strongly during the second half of the year.

18. Staff supports the authorities' intention to move to a more neutral stance for demand policies as the recovery takes hold. The authorities reaffirmed their commitment to adjust the policy rate as necessary as conditions warrant to keep inflation within the target range.⁴ They indicated that fiscal policy would remain guided by the fiscal rule. With the latter mandating a slight improvement in the central government's structural balance, the fiscal policy stance is expected to be broadly neutral in 2014.

19. The authorities indicated that the flexible exchange rate would continue to serve as a shock absorber. Staff and the authorities agreed that the flexible exchange rate regime plays an important role in helping the economy adapt to shifts in global economic and financial conditions. The authorities noted that, after the U.S. Federal Reserve announced its intention to commence tapering, the exchange rate weakened significantly. At the same time, the central bank continued acquiring foreign exchange (with the intention of strengthening its international reserve buffer, ₱30),

⁴ The authorities increased the policy rate by 25 basis points to 3.50 percent at the end of April, 2014.

though at a slower pace. The authorities noted that the exchange rate adjustment did not lead to any important effects on balance sheets or inflation.

B. Preserving Fiscal Sustainability

20. The authorities reaffirmed their strong commitment to fiscal consolidation. Under the fiscal rule, the central government's structural deficit is set to decline to 1 percent of GDP by 2022, from an estimated deficit of 2.4 percent of GDP in 2013. In turn, the combined public sector balance is projected to shift into a small surplus, from an estimated deficit of 1 percent of GDP in 2013. This improvement in the fiscal balance would allow the public debt-to-GDP ratio to fall to 29 percent of GDP by 2019 from 35 percent at end-2013. Staff cautioned that the long-term oil price assumed in computing the structural balance may be too optimistic. If the long-term oil price is lower, reflecting market projections for a substantial decline over the medium-term, a larger fiscal adjustment would be required to meet the fiscal rule. The authorities responded that their assumption for oil production is conservative and the overall oil revenue projection over the medium-term is well balanced. Staff and the authorities concurred that the fiscal targets are prudent and appropriate on account of uncertainties related to oil revenues over the medium term, absent large new discoveries of oil reserves. In addition, the improvement in the non-resource primary balance projected in Colombia's medium term fiscal framework (1.9 percentage points of GDP by 2024) will allow a larger share of Colombia's natural resource wealth to be transferred to future generations (Box 4).⁵

21. Staff noted that achieving the medium-term fiscal consolidation goals would be challenging. The targeted reduction in the central government's deficit of 1.4 percentage points of GDP by 2022 will confront challenges both on the revenue and the expenditure sides. Fiscal revenues are expected to fall by up to 2.1 percentage points of GDP during the period, stemming from the planned phasing-out of the financial transactions tax (0.8 percent of GDP), the expiration of the wealth tax (0.4 percent of GDP), and a projected decline in oil revenues (0.9 percent of GDP). To attain the fiscal consolidation targets, the authorities' medium-term fiscal framework requires a significant decline in expenditure. Staff welcomed the authorities' intention to seek efficiency gains in current expenditure. At the same time, it noted that expenditure pressures may arise from developmental needs (e.g., infrastructure investment), social security, and any possible outlays related to a peace agreement. The authorities agreed that adhering to the fiscal plan would require exceptional discipline, but they expressed confidence that the targets would be met given broad consensus for the fiscal rule.

22. In this context, revenue mobilization will be key to accommodating expenditure needs while abiding by the fiscal consolidation path set out by the fiscal rule. Staff noted that non-commodity revenues in Colombia are low by international standards and should be the focus of mobilization efforts. At the same time, the mission supported the planned elimination of the financial transactions tax, given its distortionary effects. To enhance revenue, staff encouraged the

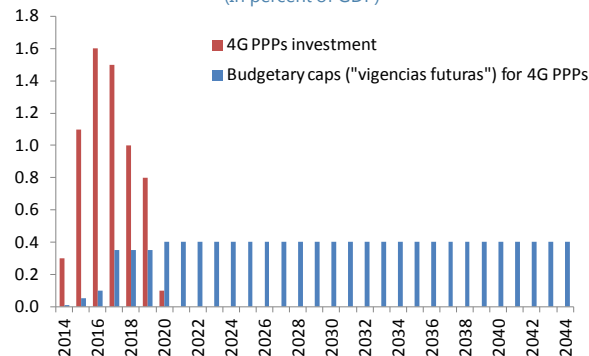
⁵ See the accompanying 2014 Selected Issues Paper—"Colombia's Fiscal Policy Framework and Risks."

authorities to broaden the tax base by lowering exemptions and fighting informality. Other options could include extending the wealth tax, taxing dividends, or increasing the value added tax rate. Staff highlighted that particular focus should be given to strengthening tax administration, by improving information technology, standardizing certification of accountants, and tightening sanctions for non-compliance. The authorities indicated that they would step up efforts to strengthen tax administration, including by implementing IMF technical assistance recommendations.

23. Staff welcomed the authorities' infrastructure program. Staff and the authorities agreed that the infrastructure program is essential for Colombia's sustained economic development. While infrastructure investment has been substantial in the past, its efficiency has been subpar, resulting in an inadequate road infrastructure. In 2013, Colombia ranked 126 out of 144 countries according to the Global Competitiveness report on the quality of transport infrastructure. The mission acknowledged that Colombia's road infrastructure deficit is a drag on competitiveness and growth, and supported the authorities' infrastructure program, including the fourth generation of road concessions (4G). The authorities indicated that the 4G would include projects valued at COP 47 trillion (about 7 percent of GDP) to be undertaken over the next 7 years through public-private partnerships (PPPs) under a revamped legal framework approved in 2012. The authorities expect the bidding process for the first 9 projects (for COP 11 trillion or about US\$5 billion) to be completed in 2014, with construction set to begin in 2015. To support these projects, the authorities created a national financial institution, *Financiera de Desarrollo Nacional (FDN)*, in charge of mobilizing long-term financing to infrastructure, primarily by developing standardized financing structures suitable for local institutional investors (banks and pension funds). FDN started its operations with a small initial capital (about US\$230 million) provided by the government, and is expected to receive capital injections by multilateral institutions, such as the International Finance Corporation (IFC) and the Andean Development Corporation. FDN is governed by a 7-member Executive Board, of which some are independent. The authorities are also planning to create a development fund with the proceeds of the sale of power company *Isagen*, which would be used to support infrastructure investment. Staff welcomed these initiatives.

24. The authorities are taking actions to minimize fiscal risks from PPPs. Colombia's government has a long history of inviting private sector participation in infrastructure and public services. Colombia was the first country to implement PPPs in the region and is the one with the largest share of projects financed through this arrangement. However, past experience with PPPs in Colombia has pointed to a high risk of contract renegotiations and the low effectiveness of contract monitoring. The authorities indicated that planned outlays for service and recuperation of costs after projects

4G PPPs projected investments and government outlays
(In percent of GDP)



Source: Ministry of Finance.

are completed (to be reflected as investment in the fiscal accounts) would not exceed the fiscal space available under the fiscal rule and would be limited to 0.4 percent of GDP per year. The outlays would be incorporated into the overall available capital expenditure envelope in the medium-term fiscal framework. To minimize any fiscal risks that could come on top of the outlays committed to the program, the authorities have added precautions by standardizing PPP contracts, supported by World Bank, IADB and IFC technical assistance. With regards to accounting and reporting practices, the mission encouraged the authorities to accelerate migration to accrual accounting under GFSM 2001, so that the budget implications of PPPs are better reflected. The authorities indicated that the adoption of GFSM 2001 is currently in progress, and that contingent liabilities would continue to be reported in the medium-term fiscal framework.

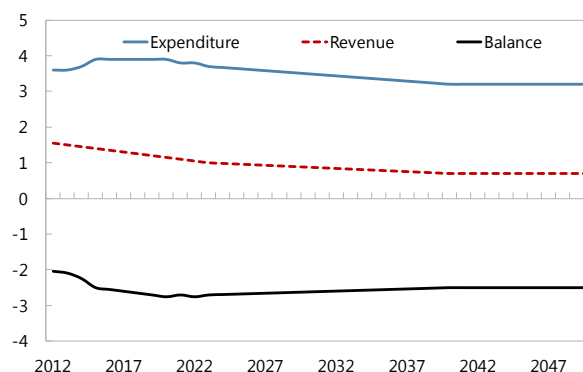
C. Enhancing the Social Security System

25. Colombia's pension system is fiscally sustainable but characterized by low coverage and high inequality. The share of the population receiving a pension in Colombia is low, especially among the poor, due to high informality.

Only about a third (about 7 million) of the employed population (about 21 million) contributes to a pension regime, with 4.7 million contributing to the private capitalization (defined-contribution) system and 2.5 million contributing to the pay-as-you-go (defined-benefit) public regime. Average benefits in the public regime are generous by international standards, with the replacement rate being among the highest in the world, implying a high overall cost given the low number of people covered. Also, the statutory retirement age, particularly for women, is low. Outlays by the public pension regime are projected at about 4 percent of GDP in the coming years, but are projected to decline to 3 percent of GDP by 2050.

Projected public pension balance, 2012-2050

(In percent of GDP)



Sources: Fund staff estimates.

26. The authorities expressed their intent to broaden the coverage of the pension system and make it more equitable. The mission welcomed the initiative and advised the authorities to consider creating space for expanded coverage by changing the benefit formula to reduce replacement rates for new retirees, equalizing retirement ages for men and women, and adjusting the retirement age in line with increases in life expectancy as part of the reform package. The implementation of recently-reinforced social security programs, including Beneficios Económicos Periódicos, Pensión Familiar, and Cotización por Semanas, is expected to foster savings and assist the population that does not qualify for a pension, without incentivizing informality. Staff also welcomed the authorities' intention to extend a non-contributory program for the elderly poor to cover the full amount of the eligible population (about 2.4 million), which would have a fiscal cost of 0.1 percent of GDP.

27. Colombia's health system has high coverage, but faces financial challenges. In contrast to the pension system, Colombia's health care system has nearly universal coverage, but cost control has been undermined by the system's complexity, high administrative costs and constitutional entitlements that have led to legal claims for expensive treatments. Public health spending, currently at over 7 percent of GDP, is expected to rise by about 1½ percentage points of GDP over the long term without any reforms, reflecting income growth, demographics and technological change. The authorities explained that a new statutory law, approved in June 2013, should reduce legal claims for expensive treatments, although this legislation is currently under review by the Constitutional Court. The mission encouraged the authorities to move forward with cost containment measures that can be implemented within the existing framework, in particular in the area of pharmaceutical prices, and to make efforts to clear arrears with hospitals.

D. Preserving External Stability

28. Staff and the authorities concurred that the current account deficit and the real exchange rate are broadly in line with fundamentals. According to the CGER external stability approach and the External Balance Assessment (EBA), the real exchange rate in 2013 was about 8 to 13 percent overvalued, respectively. However, staff estimates that the significant depreciation of the peso in real effective terms of the last few months has reduced the estimated misalignment. Staff's analysis based on the EBA methodology but adjusting for extremely conservative oil reserves assumptions suggests that the cyclically-adjusted current account deficit in 2013 (2.7 percent of GDP) was about 1 percent of GDP larger than its norm.⁶ However, accounting for profit remittances by foreign companies, which are not well captured in the EBA, would reduce this gap. Overall, the mission and the authorities agreed that Colombia's external position is strong, noting that the financing of the current account deficit largely through foreign direct investment, a relatively more stable source of financing, mitigates risks.

29. The exchange rate does not appear to have been an important driver of manufacturing sector weakness. Manufacturing output fell in the past two years, underperforming the rest of the economy. Some observers attributed the weak performance of the manufacturing sector to the real exchange rate appreciation of recent years. Analytical work conducted by staff based on firm-level data found no strong evidence that the exchange rate has negatively affected the manufacturing sector, especially given that the real appreciation of the peso vis-à-vis the

⁶ The EBA methodology estimated the current account norm in 2013 at +3.2 percent of GDP, compared to -2.6 percent of GDP in 2012. This pronounced change in the estimated norm was largely due to the introduction of oil wealth (as measured by proven oil reserves) as a new variable in the model. The estimate relied on a conservative assumption of Colombia's oil wealth. However, the Colombian authorities and the oil industry at large (including foreign multinational companies) share the view that the country's oil resources are substantially larger than indicated by the proven reserves measure. This is further supported by a high ratio of potential oil reserves to proven reserves. In addition, the substantial foreign investment of recent years and the incorporation of new technologies have allowed the industry to attain a high reserve replacement rate (of about 170 percent for Ecopetrol in the last 5 years), with the trend likely to continue. Using these higher oil wealth assumptions leads to a much lower estimate of the current account norm.

currencies of Colombia's manufacturing trade partners appears to have been more limited than the overall real appreciation (Box 5).⁷

30. International reserves appear adequate for precautionary purposes. Staff and the authorities concurred that Colombia has an adequate reserve buffer for normal times, though they might be insufficient to cope with tail risks (Box 6). The current stock of international reserves covers approximately 7 months of imports and over 100 percent of the short-term external debt amortizations and the projected current account deficit. Nonetheless, reserves measured relative to broad money, short-term external debt plus the current account deficit, and months of imports are still below the ratios prevailing prior to the global financial crisis of 2008–09. The authorities reiterated their intention to continue strengthening their international reserve position with the aim of returning to the pre-crisis reserve ratios, which proved to be an important buffer in confronting that large external shock. Staff and authorities concurred that the opportunity cost of accumulating reserves increases as they reach higher levels and that a careful cost-benefit-analysis is warranted.

31. The authorities are increasing their reserve buffers through foreign exchange purchases during periods of abundant external inflows. The authorities executed this policy by pre-announcing a minimum reserve accumulation amount (US\$3 billion between February and May, 2013, with a minimum daily purchase). At the end of May, the authorities reduced the size of the reserve accumulation program to US\$2.5 billion for June to September, and removed the minimum daily purchase. After significant depreciation of the peso, the authorities in October further slowed the pace and set a quarterly reserve accumulation ceiling (as opposed to a floor) of US\$1 billion. In the first quarter of 2014, the authorities maintained the quarterly US\$1 billion ceiling, but bought only US\$0.7 billion. Staff agreed that the implementation of the foreign exchange purchase program has been prudent and did not undermine exchange rate flexibility or the inflation-targeting regime, as reflected by significant exchange rate variability and well-anchored inflation expectations. In the past, the authorities have modified the foreign exchange intervention policy as necessary to preserve the credibility of the inflation-targeting regime, and are committed to continue doing it in the future.

E. Maintaining Financial Stability

32. Colombia has a broad financial system, dominated by complex conglomerates. The total assets of the financial system amounted to COP 963 trillion (143 percent of GDP) as of end-2013, with credit institutions (mainly banks) holding 44 percent of the system's assets or 62 percent of GDP, followed by trust companies (29 percent of the assets or 40 percent of GDP) and pension funds (16 percent of the assets or 22 percent of GDP). A small number of domestic conglomerates own a large share of the system's assets.

⁷ See the accompanying 2014 Selected Issues Paper—"Recent Performance of Colombia's Manufacturing Sector: Exchange Rate or Structural?"

33. Financial intermediation continued to deepen, with credit to the private sector

reaching 39.2 percent of GDP in 2013. In response to stronger consumer loan provisioning since mid-2012, growth in credit to the private sector continued to slow to 12.1 percent at end-2013, from over 20 percent in mid-2011. At end-2013, the credit portfolio was largely made up of commercial loans (24 percent of GDP) and consumer loans (11 percent of GDP), while the share of mortgages (3½ percent of GDP) and microcredit (1 percent of GDP) remained small, albeit growing. The domestic capital market continued to deepen and expand its product offerings, but remained dominated by government debt (Box 7).

34. The financial system appears sound. The financial sector has been stable, supported by favorable macroeconomic conditions. Financial soundness indicators remain robust (Table 7). In 2013, liquidity ratios were stable, profitability remained high (albeit somewhat lower than in 2012), and asset quality continued to be strong, with non-performing loans at 2.8 percent of total loans and high levels of provisions. The system's risk-weighted capitalization ratio fell to 15 percent as of February 2014,⁸ from 18 percent at end-2012, due to the introduction of an improved capital adequacy standard that focused more on loss-absorbing types of capital. Staff welcomed the introduction of an improved quality of capital measure.⁹

35. While asset quality is strong, the system remains exposed to concentration risk.

Commercial loans to the largest 1,000 borrowers stood at 42 percent of total in 2013, a fifth of which went to the manufacturing sector, followed by commerce and construction. Concentration of lending continues to expose banks to corporate credit risk. While regulatory limits to individual exposure exist, exceptions remain. Staff recommended the authorities to remove exceptions to large exposure limits and further simplify the number of separate limits in place, and require banks to hold more capital to reflect concentration risk in line with enhanced supervisory expectations. Staff and the authorities agreed that fostering financial inclusion (see ¶38, Box 9)¹⁰ would contribute to easing banks' exposure to concentration risk.

36. The supervisory framework is broadly effective, though there is scope for further improvement in some areas.

The strength of the supervisory framework relies on a unified approach to supervision which mitigates the scope for regulatory arbitrage. The SFC exercises effective oversight of the banking system and is strengthening supervision further to fully implement a comprehensive risk management framework, including for conglomerates. It enforces a robust framework for assessment of credit risk and asset classification and provisioning, and ensures

⁸ The issuance of equity shares by a large bank in March is likely to have boosted the system's capitalization ratio further.

⁹ The new requirements include a higher minimum of 4.5 percent for Tier 1 capital that now excludes newly generated goodwill; the recognition of voluntary reserves as part of Tier 2 capital up to 10 percent of total regulatory capital; and a deduction of deferred tax assets and pension liabilities from regulatory capital. See the accompanying 2014 Selected Issues Papers—"Selected Financial Sector Issues."

¹⁰ See the accompanying 2014 Selected Issues Paper—"Financial Inclusion, Growth, and Inequality: A Model Application to Colombia."

that banks adopt prudent management of market, liquidity and operational risks. The new capital regime represents an important step forward from the outgoing capital adequacy rules. IFRS implementation is on track and is expected to be fully applied by January 2015. The Financial Superintendence (SFC) received technical assistance from the Toronto Center on supervisory practice, including risk-based supervision. Staff and the authorities agreed that the SFC should be provided full supervisory powers over holding companies of financial institutions to broaden the scope of consolidated prudential requirements and resolution of conglomerates, and that capital ratios and buffers of banks that are part of financial and mixed groups should reflect their intra-group activities and future risks. This would mitigate the risks on regulated entities from the larger conglomerate structures they are part of. The authorities were receptive to staff's advice to consider implementing stress tests also on tail risks and consulting with the market over proposals in tackling the too-important-to-fail problem of systemically important banks and conglomerates. Staff and the authorities agreed that, going forward, it will be important to continue implementing risk-based supervisory enhancements to enable the supervisor to tailor prudential norms to the risk profile of institutions (especially systemic banks and conglomerates). Staff reiterated that a key priority remains enhancing the independence and legal protection of supervisory staff with regard to the execution of their duties. Authorities agreed and are looking into ways to provide legal protection to supervisors.

37. The expansion of the largest financial institutions across the region poses additional challenges for supervision. The retreat of some international banks from Central America opened up new opportunities for Colombian banks. Colombia's largest banking groups expanded rapidly across the region in recent years, as part of their strategy of market diversification. Operations of large Colombian bank conglomerates represent over half of banking system assets in El Salvador and over 20 percent in Panama, Nicaragua and Honduras.¹¹ In turn, the acquired assets in Central America account for about a third of the Colombian parent banks' assets. A significant share of the acquisitions was funded through debt issuance, implying some risk for the acquiring entities. Staff and the authorities concurred that the banks' efforts to diversify their operations are a welcome step. At the same time, they agreed that the regional expansion of the Colombian banks brings new challenges for supervision. Staff advised the authorities to adopt a deeper framework for monitoring tail risks, including cross-border risks, as part of stress testing and the banks' capital planning. The SFC indicated that it has made progress in enhancing cross-border supervision, by participating in supervisory colleges of Colombian banks' subsidiaries, signing memorandums of understanding with host supervisors in Central America, obtaining access to home-host supervisory data, and conducting on-site visits to Colombian banks' subsidiaries. In addition, the SFC is currently participating in a joint study with the Fund of financial interconnectedness in Central America and among Colombia and Central America.

¹¹ See the accompanying 2014 Selected Issues Papers—"Selected Financial Sector Issues" and "Colombia: Assessing Spillover Risks."

F. Fostering Inclusive Growth

38. Over the medium term, Colombia's main challenge will be to foster more inclusive growth. Despite significant progress in the past decade, Colombia's poverty, unemployment, inequality, and informality rates are still elevated (Box 8). At end-2012, Congress approved a comprehensive tax reform to improve tax progressivity and reduce non-wage labor costs, including a reduction in payroll and corporate income taxes, simplification of the VAT structure, introduction of a new tax on corporate profits, and an increase in progressivity of individual income tax. The reform was a positive step. However, at about 40 percent of total labor costs for average worker, non-wage labor costs remain high, compounding the effect of the minimum wage on informal employment. Efforts to address these challenges need to be sustained through structural reforms in the labor market, the fiscal area, and the financial sector. The mission encouraged the authorities to explore options for further reducing non-wage costs and contain the pace of growth of the minimum wage to fight informality.

39. Progress on financial sector deepening and inclusion is moving forward, albeit slowly. Investment and growth of firms in the informal sector is more constrained by insufficient finance than firms in the formal sector. Informal workers also earn and save less than their counterparts in the formal labor market, have lower access to financial services, and are more likely to find themselves in a difficult financial situation. Colombia has made important strides in fostering financial inclusion in recent years including through targeted transfers, subsidized bank accounts and mortgages, and expansion of physical infrastructure into rural areas. However, there is evidence that the widespread increase in accounts penetration hides low balances and low usage. The mission recommended fostering financial inclusion by lowering borrowing constraints and the cost of access to finance by improving the quality and transparency of public registries on movable property, promoting mobile banking, and enabling simplified financial licensing for electronic money issuers to foster competition. Efforts to promote financial literacy and develop products tailored to low-income households, such as micro insurance, are also key to expanding financial services to the most vulnerable population.

OTHER ISSUES

40. Staff has completed the safeguards procedures for Colombia's 2013 FCL arrangement. The authorities provided the necessary authorization for staff to communicate directly with Banco de la República's external auditor, PricewaterhouseCoopers (PwC) Colombia. PwC issued an unqualified audit opinion on Banco de la República's 2012 financial statements in February 2013. Staff reviewed the 2012 audit results and discussed these with PwC. No significant safeguards issues emerged from the conduct of these procedures. The financial statements and audit opinion are published in full on the bank's website.

STAFF APPRAISAL

41. Colombia continued to post a strong economic performance. Economic growth accelerated in recent quarters, averaging 4.3 percent in 2013. Inflation stood within the target range, job creation was robust, and unemployment fell to the lowest level in over a decade. The balance of payments posted a significant surplus, largely driven by strong foreign direct investment, which financed the current account deficit and strengthened international reserves. The financial system remained stable.

42. Economic prospects are favorable. Real GDP is projected to grow at around potential, estimated at 4½ percent over the forecast period, with inflation remaining within the 2–4 percent target range. The balance of payments is projected to remain in surplus, financing a broadly stable current account deficit. The authorities are committed to significant fiscal consolidation, which is expected to reduce the public debt ratio.

43. Risks to the outlook are tilted to the downside. Risks associated with emerging markets and geopolitical tensions have increased since the last Article IV consultation. Colombia is exposed to a sharp decline in commodity prices, especially oil, deterioration in global financial conditions, and negative growth shocks in key trading partners. The normalization of monetary policy in the U.S. could negatively impact Colombia if not accompanied by a corresponding increase in U.S. growth or if it led to higher global risk aversion, capital outflows, and weaker growth in emerging markets. Adverse shocks in China would affect Colombia directly through the trade channel, but most importantly through indirect channels via a decline in commodity prices and negative effects on financial markets and global growth. Negative spillovers could also come from the region, in the event of trade disruptions with neighboring countries, an increase in investor risk perception towards the region, or shocks affecting the balance sheets of Colombian banks operating in Central America.

44. Meeting the medium-term fiscal consolidation goals will require decisive policy action on the revenue side. The authorities' plan to reduce the central government's structural balance as set out in the fiscal rule is welcome. However, the medium-term fiscal framework envisages attaining this goal through expenditure reduction, which would be difficult in the case of current expenditure and undesirable in the case of investment spending. Fiscal consolidation will thus require increased revenue mobilization. There is scope to increase non-oil revenues, which are low by international standards, by broadening the tax base and reducing informality. In addition, particular focus should be given to strengthening tax administration.

45. Addressing the infrastructure deficit is key. The authorities' infrastructure program, including the fourth generation of road concessions to be executed through public-private partnerships (PPPs), is expected to help address Colombia's infrastructure deficit. The revamping of the legal framework for PPPs approved in 2012 and the standardization of contracts are positive steps and careful monitoring including of creation of contingent liabilities should help to contain fiscal risks. The creation of a national financial institution specialized in infrastructure financing (FDN)

and the efforts to establish a strong governance structure at the FDN are also positive initiatives that would help channel resources to infrastructure. Upgrading accounting and reporting practices, including by accelerating migration to accrual accounting under GFSM 2001, will be important to appropriately reflect the budget implications of PPPs.

46. It is important to address contingent fiscal pressures from the pension and health care systems. The implementation of programs to bring informal workers and the elderly poor into the social security system is an important step. However, the low coverage of the pension system remains a source of potential future fiscal pressure. A more comprehensive reform of the pension system will be required to broaden coverage and increase equity while maintaining the financial sustainability of the system. In health care, further efforts to contain costs within the current legal framework will also be important.

47. The external position of the economy is strong, and international reserves appear adequate for precautionary purposes. The current account deficit and the real exchange rate are broadly in line with fundamentals. Moreover, risks to external stability are mitigated by a stable financing of the current account deficit, largely through foreign direct investment. Most reserve ratio metrics suggest that Colombia has an adequate reserve buffer for normal times, though reserves might be insufficient to cope with tail risks. Efforts to further strengthen reserve buffers should remain consistent with exchange rate flexibility and the inflation-targeting regime. As reserves reach higher levels, the opportunity cost of accumulating reserves will warrant a careful cost-benefit-analysis.

48. Financial supervision is broadly effective, though there is scope for improvement in some areas. Financial soundness indicators are strong. However, supervision of complex financial conglomerates and mixed conglomerates and exposure to concentration risk continue to pose challenges. The recent expansion of the largest institutions across the region, primarily in Central America, will require a deeper framework to monitor and stress-test a wide variety of cross-border risks. It will also be important to implement the Basel II Pillar 2 supervisory framework, and strengthen the independence and legal protection of supervisors.

49. Fostering more inclusive growth remains a key medium-term challenge. Further reducing poverty, unemployment, inequality, and informality will require structural reforms in the labor market, and the fiscal and financial sectors. It will be important to further reduce non-wage costs and contain the growth of the minimum wage to fight informality. Financial inclusion could be fostered by lowering borrowing constraints, reducing the cost of access to finance, promoting financial literacy, and developing products tailored to low-income households.

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

51. 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.

Box 1. Foreign Exchange, Bond and Equity Market Developments Since Mid-2013

The announcement by Federal Reserve Chairman Bernanke on May 22, 2013 that tapering could commence triggered a sharp re-pricing of risk across emerging markets. Despite its strong fundamentals, Colombia did not escape this general trend. Financial asset prices fell, price volatility increased, traded volumes and market liquidity declined, and government debt spreads rose, especially between end-May and August, at the height of the market turbulence.

The peso depreciated and exchange rate volatility increased. The peso (COP) depreciated by about 7 percent vis-à-vis the U.S. dollar from May 22 until April 4. Daily exchange rate volatility tripled to 1 percent in June, returning to the pre-May 22 level by the end of 2013. Trading volumes remained broadly stable, while bid-ask spreads increased slightly. The central bank slowed the pace of its foreign exchange purchases.

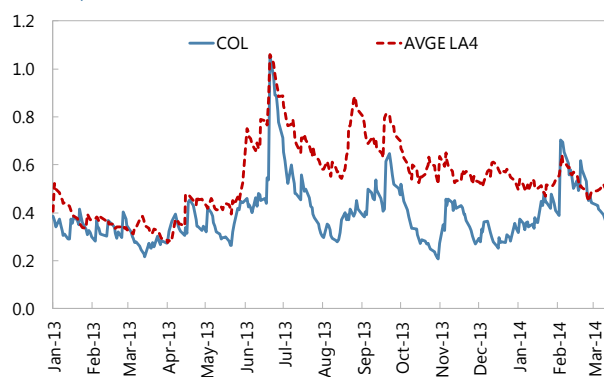
Local government bond prices declined sharply. The domestic government bond (TES) market was the most affected asset class during the market turbulence. TES yields rose initially by over 200 basis points, posting the second largest increase among emerging markets after Turkey. Bid-ask spreads and volatility increased, and traded volumes declined, reflecting some market dislocation. In turn, the yield curve steepened significantly. In subsequent months, yields fell somewhat, with 10-year TES yields stabilizing at about 7 percent, about 200 basis points above pre-tapering levels, by end-2013 (See charts).

External debt spreads widened. Yields on external (USD-denominated) bonds also rose, and spreads over U.S. Treasuries, at about 140 basis points on May 22, widened initially by up to 70 basis points, recovering somewhat in subsequent months and stabilizing at about 35 basis points over the May 22 level. Similarly, spreads on 5-year credit default swaps, at 90 basis points on May 22, rose initially by over 80 basis points, later recovering and stabilizing at about 20 basis points above pre-May 22 levels.

Money market funds suffered important redemptions. The decline in TES prices triggered redemptions in money market funds, which must mark to market their holdings of TES, during June–August, raising concerns about liquidity risks for these entities. In response, the authorities have begun working on a more robust and comprehensive liquidity regulation for these entities.

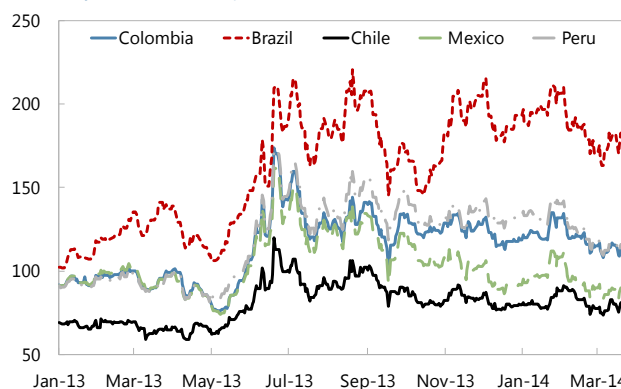
Stock prices fell initially but recovered in subsequent months. Stock prices posted two episodes of weaknesses since May 22, both coinciding with periods of global volatility in emerging markets: in June 2013 when they fell by up to 7 percent, and January 2014 when they fell by up to 10 percent. In both cases, prices recovered their losses in subsequent months. As of early 2014, stock prices were about 5 percent above their May 22 level.

Daily exchange rate volatility
(in percent)



Source: Central Bank.

Credit Default Swap spreads increased
(5-years CDS, in basis points)

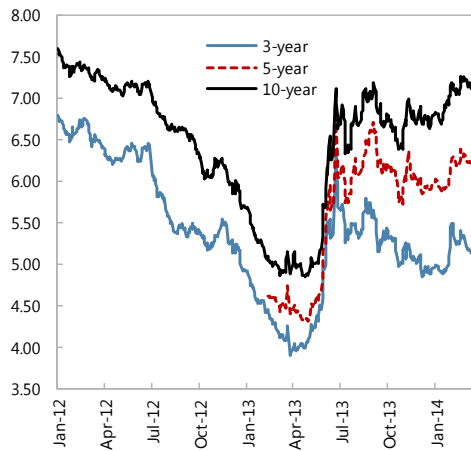


Source: Bloomberg.

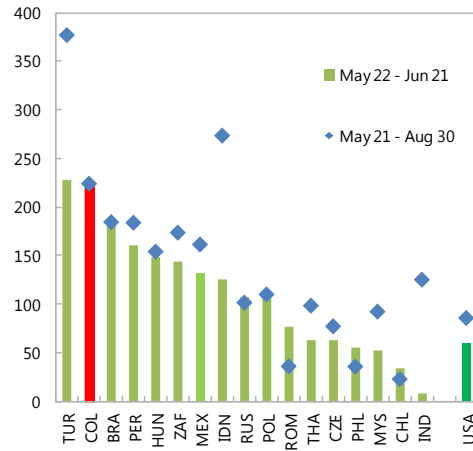
Box 1. Foreign Exchange, Bond and Equity Market Developments Since Mid-2013 (concluded)

Colombia. Developments in the TES market after May 22

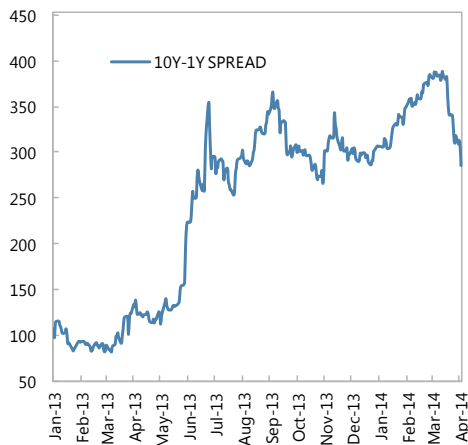
TES yields increased after May 22
(In percent per annum)



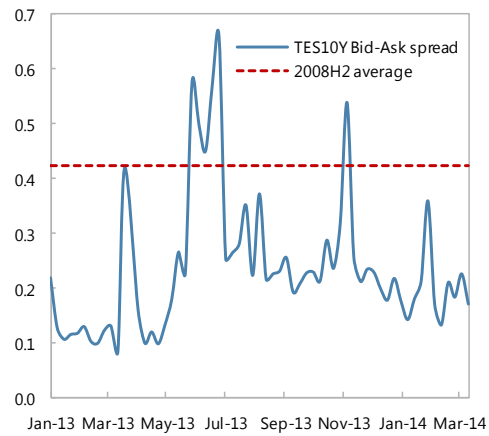
... by more than in most emerging markets
(Change in 10-year local currency bonds, in basis points)



The yield curve steepened
(In basis points)



... and bid-ask spreads increased.
(In percent of the price)



Source: Central Bank and Bloomberg.

Box 2. Savings and Investment in Colombia

Colombia benefited from the commodity price boom of the past decade. Driven by higher oil prices, Colombia's terms of trade rose by 69 percent since 2004. According to Adler and Magud (2013)¹, the income windfall associated with such increase in the terms of trade amounted to 5.3 percent of GDP a year on average between 2004 and 2012.

A significant portion of the commodity windfall was saved. Colombia's national saving rate rose by about 4 percentage points of GDP over the past decade to 21 percent of GDP in 2013, driven primarily by the public sector. According to Adler and Magud (2013), the economy saved about 90 percent of the commodity windfall, the highest share in the region. This behavior was underpinned by a prudent macroeconomic policy framework that prevented excess expenditure and promoted fiscal discipline.

Terms of trade booms, income windfall, and saving rates in Latin America 1/

Countries	First Year	Length (years)		Terms-of-Trade Shock 4/		Income Windfall (IW, price effect) 5/		Savings rates	
		Up-swing 2/	Cycle 3/	Cum. (%)	Annual Avg. (%)	Cum.	Avg	Average 6/	Marginal (percent of IW) 7/
Bolivia	2003	10	10	131.1	13.1	190.1	19.0	21.7	74.6
Brazil	2006	6	7	37.2	6.2	17.1	2.9	18.0	29.8
Chile	2003	9	10	90.2	10.0	184.7	20.5	23.4	27.1
Colombia	2004	9	9	68.7	7.6	47.7	5.3	19.9	91.5
Ecuador	2002	10	11	74.9	7.5	116.8	11.7	22.4	42.8
Paraguay 8/	2002	3	3	89.2	29.7	55.6	18.5	17.9	36.9
Paraguay 8/	2008	5	5	38.8	7.8	95.3	19.1	13.6	-10.2
Peru	2003	10	10	61.9	6.2	84.6	8.5	21.2	74.6
Venezuela	2003	10	10	233.3	23.3	303.9	30.4	33.6	47.5

Source: Fund staff estimates.

1/ For episodes with at least 15 percent cumulative and 3 percent annual average terms-of-trade shock (from start to peak).

2/ From start to peak.

3/ Start to end, with end identified as year when at least 1/3 of the shock is reverted (or 2012 if the latter is not met).

4/ Of goods and services, for upswing period (start to peak).

5/ In percent of income under the counterfactual (i.e., real income at pre-boom terms-of-trade).

6/ Average rates (in percent of GDP).

7/ Marginal rates, in percent of the income windfall (computed on the basis of average saving and investment rates of 3 years prior to the terms-of-trade boom).

8/ Paraguay had two terms-of-trade booms during the analyzed period.

The rise in savings helped financed a significant increase in investment. Higher investment was one of the drivers of Colombia's strong economic performance of the past decade. Gross investment rose by over 5½ percentage points of GDP over the past decade to over 24 percent of GDP (measured at current prices) in 2013, driven by the private sector. Measured at constant prices, investment rose even faster, by almost 10 percentage points of GDP, during the same period, reaching 28 percent of GDP in 2013, one of the highest investment ratios in the region. Investment was undertaken primarily by the private sector, and directed mainly to oil and mining, electricity, telecommunications, and the financial sector. Public investment lagged behind, as a result of which Colombia continues facing a significant infrastructure deficit, in particular in roads.

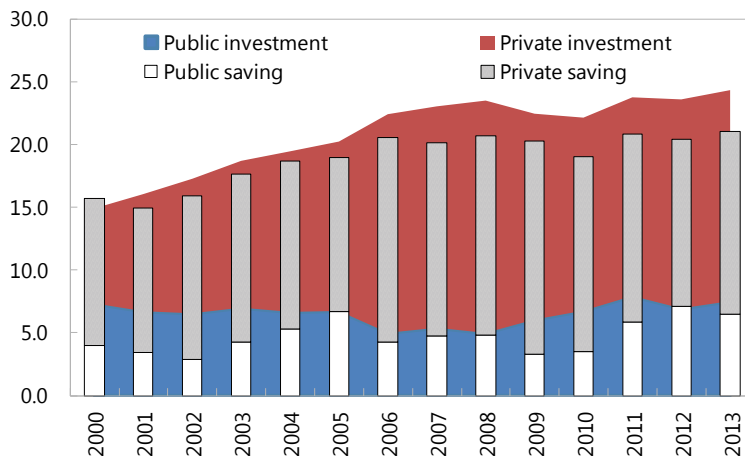
1/ "Four decades of Terms-of-Trade Booms: Saving-Investment Patterns and a New Metric of Income Windfall," IMF Working Paper No. 13/103 (Washington, D.C.).

Box 2. Savings and Investment in Colombia (concluded)

Savings and investment are projected to continue rising over the forecast period. The projected fiscal consolidation would lead to an increase in the savings ratio, while investment would be driven by continued strong economic growth prospects and the authorities' ambitious road infrastructure program, to be executed through PPPs (123).

Savings and Investment in Colombia

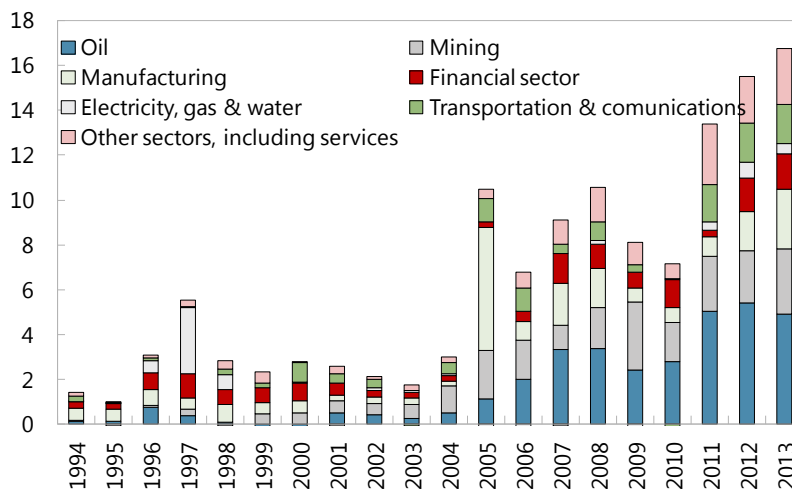
(In percent of GDP)



Sources: Fund staff estimates based on Central Bank.

Foreign Direct Investment by Sector

(In billions of US\$)



Source: Central Bank.

Box 3. Spillover Effects of the Normalization of Monetary Policy in the U.S.

The normalization of monetary policy in the U.S. will likely affect the Colombian economy through several channels. As policy normalization proceeds, the rise in U.S. interest rates will push up domestic interest rates (as already happened with government bond yields since mid-2013), possibly curtailing consumption, investment and growth. However, stronger U.S. growth, which is expected to drive the pace of policy normalization, will increase the demand for Colombian exports, supporting growth. The net effect on the Colombian economy will depend on the relative pace of U.S. rate increases and growth acceleration. At the same time, Colombia could be affected through the effect of U.S. policy normalization on the rest of the world. To assess these effects, staff has developed a model of 10-year government bond (TES) yields and a macroeconomic model to analyze the broader impact on the economy.

Effects on government bond yields

Staff estimates suggest that changes in U.S. Treasury yields have a significant impact on Colombian government bond yields. A vector error correction model (VECM) shows that a 100 basis point increase in 10-year U.S. Treasury yields translates into an increase of 91 to 123 basis points in 10-year TES yields after six months.

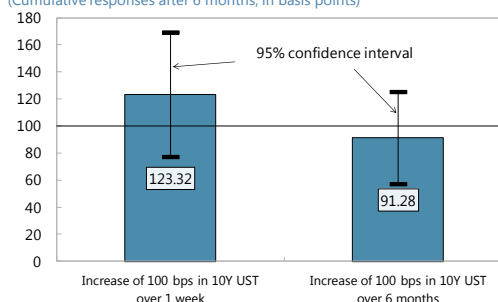
The model also suggests that, after an initial overshooting in June and July of 2013 following the announcement of possible Fed tapering, 10-year TES yields have converged to levels that are broadly in line with fundamentals.

Effects on the economy

The IMF Research Department constructed a set of three scenarios to analyze the impact of U.S. monetary policy normalization. They were developed using the Western Hemisphere module of its Flexible System of Global Models (FSGM). The scenarios are all presented relative to the baseline:

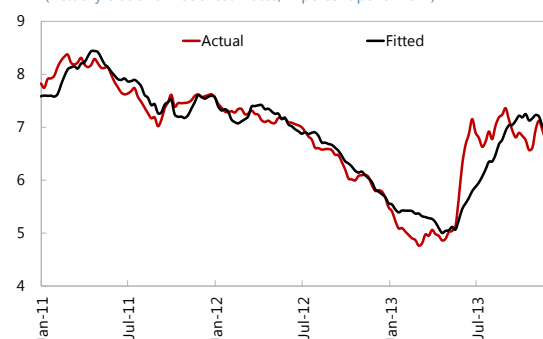
- In the first scenario (black line), a faster-than-baseline U.S. recovery leads the Federal Reserve to withdraw monetary stimulus faster than in the baseline.
- In the second scenario (dotted line), in addition to tighter U.S. monetary conditions, financial conditions are assumed to tighten outside the U.S. as well. In vulnerable emerging market economies, market interest rates tighten by roughly 25 basis points more than in the U.S. In less vulnerable emerging market economies, market interest rates tighten by about $\frac{3}{4}$ as much as in the U.S. In advanced economies, market interest rates tighten by about $\frac{1}{2}$ as much as in the U.S.
- In the third scenario (gray line), it is assumed that market participants perceive the Federal Reserve to be less tolerant of inflation overshooting the target rate, and further tighten financial conditions. Market interest rates rise by roughly an additional 40 basis points in the United States at the peak, 50 basis points in vulnerable emerging market economies, 20 basis points in less vulnerable emerging market economies, and 10 basis points in other advanced economies.

Response of Colombian 10-year Government Bond Yields to a 100-Basis Point Increase in 10-year U.S. Treasury Yields
(Cumulative responses after 6 months, in basis points)



Source: Fund staff estimates.

Colombian 10-year Government Bond Yields
(Actual yields and model estimates, in percent per annum)



Source: Fund staff estimates.

Box 3. Spillover Effects of the Normalization of Monetary Policy in the U.S. (concluded)

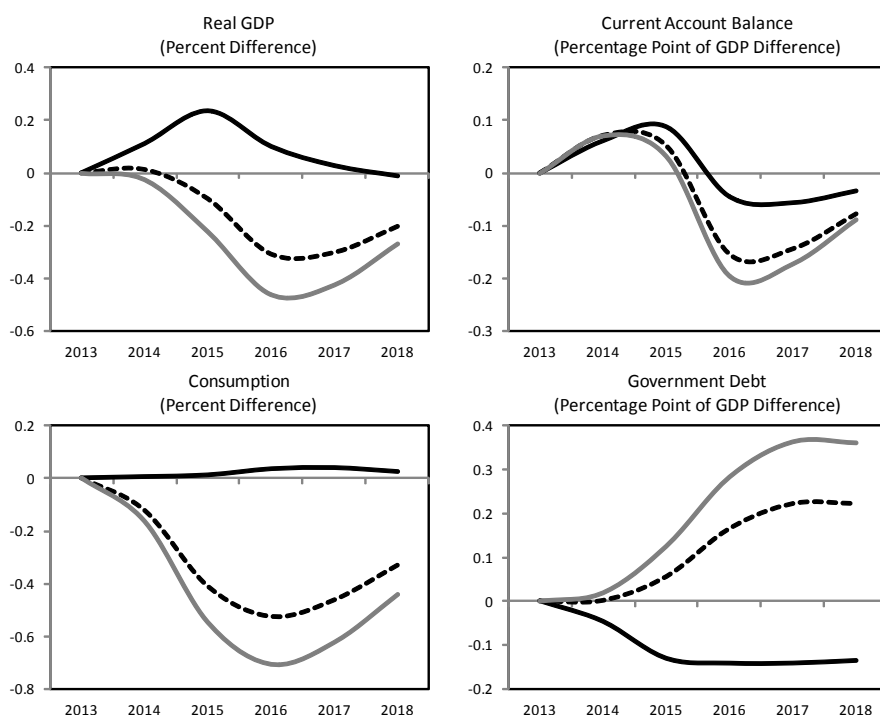
The results show a positive impact on Colombia in the first scenario, and adverse effects in the second and third scenarios.

In the first scenario, faster U.S. growth has positive spillovers on Colombia, resulting in stronger growth and better trends in the external and fiscal variables, as a stronger demand for Colombian exports outweighs the adverse impact of higher interest rates. In the second scenario, tighter financial conditions outside the U.S. slow growth and deteriorate external and fiscal sector performance. In the third scenario, the additional tightening in financial conditions further reduces growth and produces additional negative effects on the external and fiscal variables. In these two scenarios, the higher cost of capital resulting from the increase in risk premium reduces investment and the capital stock, lowering potential output. In addition, increased risk premia also reduce growth in Colombian trading partners, lowering the demand for Colombian exports. These negative effects more than offset the benefits of stronger U.S. growth.

Key Assumptions Under Simulated Scenarios
(Differences relative to baseline scenario)

	2014	2015	2016	2017
First scenario:				
U.S. growth (percentage points)	0.5	0.7	-0.4	-0.3
U.S. short-term rate (in basis points)	32	84	64	33
Second scenario:				
U.S. growth (percentage points)	0.5	0.6	-0.4	-0.2
U.S. short-term rate (in basis points)	31	79	58	28
Sovereign risk premium shocks (in basis points)				
Vulnerable EMEs	75	188	150	75
Less vulnerable EMEs	38	94	75	38
Advanced economies	19	47	38	19
Third scenario:				
U.S. growth (percentage points)	0.5	0.5	-0.5	-0.2
U.S. short-term rate (in basis points)	45	110	87	41
Sovereign risk premium shocks (in basis points)				
U.S.	16	38	40	25
Vulnerable EMEs	100	250	200	100
Less vulnerable EMEs	50	125	100	50
Advanced economies	25	63	50	25

Source: Fund staff.



Source: Fund staff estimates.

Box 4. Colombia's Fiscal Rule and Implementation in the Context of Resource Wealth

Colombia's non-resource primary balance (NRPB) is estimated to be below benchmarks for resource-rich countries. Common benchmarks for the NRPB are those that maintain net public wealth constant as a percent of non-resource GDP, in real per capita terms, or in real terms.¹ The central government's non-oil balance for 2013, estimated at -3 percent of GDP, was below the least restrictive of the NRPB benchmarks (i.e., keeping wealth constant in real terms), even under an assumption of 120 years of natural resource production.

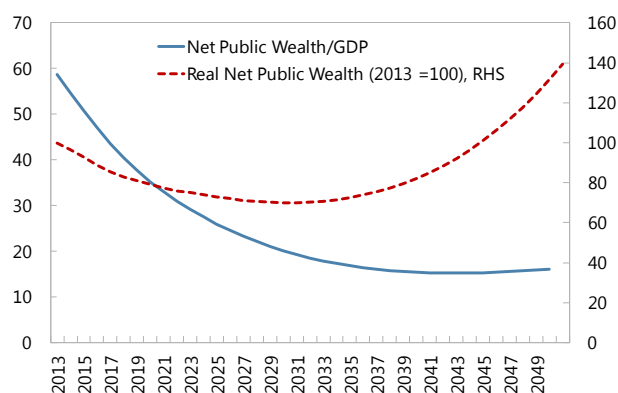
Non-Resource Primary Balance (NRPB) Necessary to Keep Net Public Wealth Constant

Years of production	30	60	90	120
	(Percent of GDP)			
2013 Net Public Wealth / GDP	34.6	58.7	67.3	70.3
2013 NRPB, constant wealth in real terms	-0.9	-1.5	-1.7	-1.8
2013 NRPB, constant wealth in real per capita terms	-0.6	-1.0	-1.1	-1.2
2013 NRPB, constant wealth as a share of NR GDP	0.9	1.5	1.7	1.8

Source: Fund staff estimates.

However, the fiscal consolidation prescribed by Colombia's fiscal rule could stabilize the net public wealth to GDP ratio. The rule mandates the central government to reduce its structural deficit to 1 percent of GDP by 2022. The authorities' medium term fiscal framework (MTFF) projects an additional decline to 0.8 percent of GDP by 2024. Considering that oil and mineral-revenues and interest payments are projected to decline by 0.9 and 0.6 percentage points of GDP during the same period, the NRPB would improve by 1.9 percentage points of GDP by 2024. Starting from an estimated central government net public wealth of 58.7 percent of GDP in 2013, adherence to the fiscal plan in the MTFF would imply that real net public wealth bottoms out at 70 percent of its 2013 value in 2030, and starts increasing after that (assuming the 2024 primary balance is maintained).²

Colombia. Net Public Wealth



Source: Fund staff estimates.

Achieving the authorities' required fiscal consolidation plan will be challenging. Such a consolidation is projected to be achieved primarily through expenditure restraint. Staff has estimated for illustrative purposes the fiscal effort that would be required to adhere to the MTFF goals under more adverse fiscal scenarios than assumed in the MTFF. The scenarios considered were a larger decline in oil and mining revenues (of 1.8 percentage points of GDP over the forecast period compared to 0.9 in the MTFF), and constant levels of

1/ IMF (2012), Macroeconomic Policy Frameworks for Resource-Rich Developing Countries-Analytic Frameworks and Applications-Supplement 2.

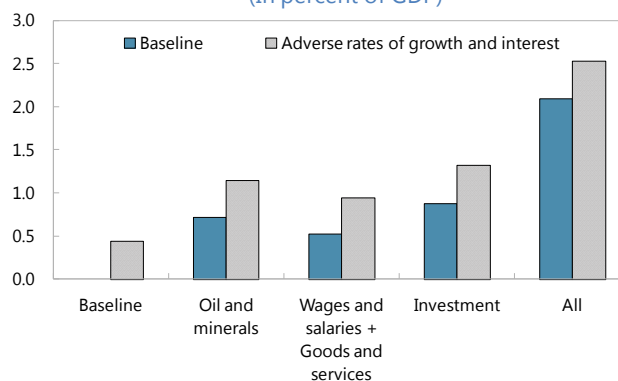
2/ Since Colombia's GDP growth is projected to be higher than the likely rate of return of financial wealth, net public wealth as a percentage of GDP decreases more abruptly, bottoming out in 2042 at 15.2 percent. However, because high projected GDP growth would make future generations richer than the current generation, it would not be necessary to increase current savings to establish intergenerational real income parity.

Box 4. Colombia's Fiscal Rule and Implementation in the Context of Resource Wealth (concluded)

spending in wages and salaries, goods and services, and investment as a share of GDP (compared to the significant declines projected in the MTFF). These scenarios were simulated under the baseline growth and interest rate projections utilized in the MTFF ("baseline") as well as under a more adverse growth and interest rate environment ("adverse rates of growth and interest").

The required fiscal effort was estimated as the permanent improvement in the central government's primary balance required starting in 2015 to achieve the central government's debt reduction projected in the MTFF by 2024 (the MTFF projects that the central government's debt will decline from 33.6 percent of GDP in 2013 to 25.3 percent of GDP in 2024). The analysis shows that compensating for a larger decline in oil and mining revenue would require a fiscal effort of 0.7 percentage points of GDP, maintaining stable ratios of current and investment spending would imply fiscal efforts of 0.5 and 0.9 percentage points of GDP respectively, while a more adverse growth and interest rate environment could cost 0.4 percentage points of GDP. The analysis suggests that the authorities may face a total fiscal effort of about 2 to 2½ percentage points of GDP to meet their fiscal consolidation goals if the adverse scenarios considered materialized.

Fiscal Effort Under Alternative Scenarios
(In percent of GDP)



Source: Fund staff estimates.

Box 5. The Recent Performance of Colombia's Manufacturing Sector

Colombia's manufacturing sector has performed relatively poorly since 2008. Real GDP grew, on average, by 4 percent between 2008 and 2013 despite the global financial turmoil of 2008–09, due to favorable commodity prices and Colombia's strong economic policy framework. At the same time, Colombia's manufacturing sector output grew only by 0.1 percent on average. As a result, the share of manufacturing in percent of real GDP has declined from 14 percent at the end of 2007 to 11 percent in 2013. The weakness of the manufacturing sector has raised concerns that the Colombian peso is overvalued.

Colombia's real exchange rate remained fairly competitive against most major trading partners of manufacturing goods except for the U.S. and Mexico. Despite the real appreciation of the Colombian peso against the U.S. dollar, the appreciation of the bilateral real exchange rate since 2008 against most major trading partners has been fairly modest, with the exception of Mexico.

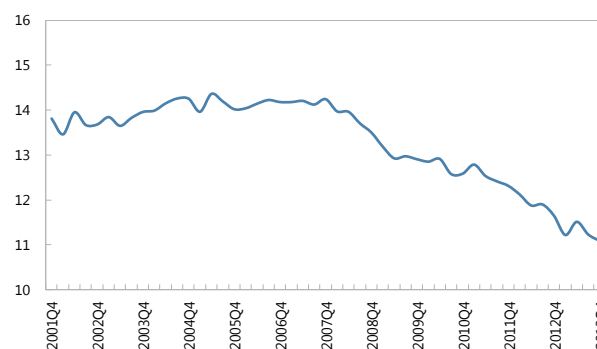
The results of a firm-level analysis show that, on average, real exchange rate appreciation did not negatively affect manufacturing firms' profitability.¹ In contrast, on average,

real exchange rate appreciation has contributed positively to manufacturing firms' profitability. The positive correlation between real appreciation and profit growth may be caused by the presence of imported intermediate inputs, to the extent that the export-weighted real effective exchange rate used in the analysis is correlated with the real effective exchange rate for imported intermediate goods. At the same time, the regression results show that export intensive companies suffered greater losses with real exchange rate appreciation compared to the companies that exported less.

Structural changes in trade seem to have affected firms' profit growth. Two structural trade dummies were included in the regressions in order to capture the effects of the trade disruption with Venezuela and increased trade competition from China. Both dummies have negative and significant coefficients. In particular, the profit growth after 2008 was, on average, 12 percent lower for those industries that were affected by trade disruption with Venezuela. Similarly, the profit growth after 2008 was, on average, 7 percent lower for those industries that faced higher competition from Chinese imports.

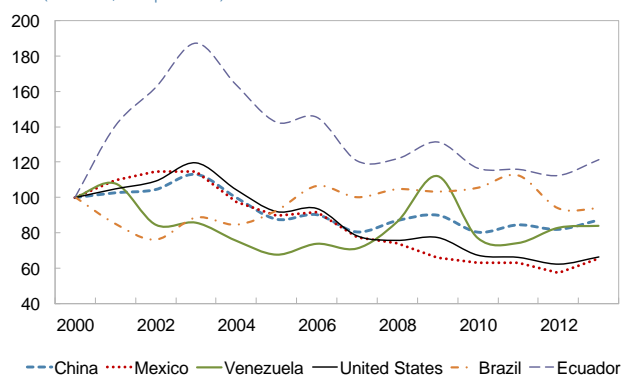
1/ A firm-level analysis is conducted using a large number of manufacturing companies compiled by the Colombian Superintendence of Corporations (Superintendencia de Sociedades). For more information on the results of the firm-level analysis, see the accompanying 2014 Selected Issues Paper—"Recent Performance of Colombia's Manufacturing Sector: Exchange Rate or Structural?"

Manufacturing Sector
(In percent of real GDP)



Source: Departamento Administrativo Nacional de Estadística (DANE)

Bilateral Real Exchange Rate
(2000=100, + depreciation)



Sources: WEO and Fund staff estimates.

Box 6. Colombia's International Reserve Adequacy

Colombia's international reserve indicators have improved in recent years after deteriorating during the global financial crisis. During the global financial crisis, the ratio of reserves relative to broad money, short-term external debt plus the projected current account deficit, imports, nominal GDP, and the reserve adequacy metric deteriorated. Recently, these indicators have improved as the authorities took advantage of strong capital inflows (primarily FDI) to rebuild their international reserve position. Capital inflows mostly in the form of foreign direct investment have been attracted by Colombia's strong fundamentals and policy frameworks and its proven track record of sound macroeconomic policies.

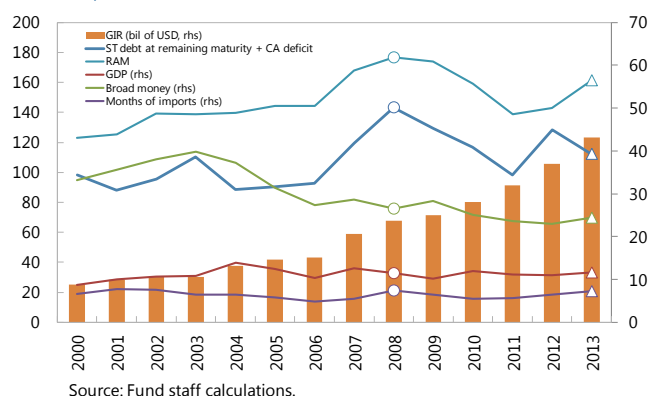
However, the majority of reserve indicators are still below their pre-crisis levels. The ratio of reserves to GDP is the only indicator that has returned to its pre-crisis level. The authorities consider the pre-crisis reserve ratios as benchmarks, as these ratios proved invaluable in coping with the global financial crisis as a large external shock by maintaining market confidence and the policy space to adjust to balance of payments pressures. The authorities' intention is to restore the reserve indicators to their pre-crisis levels and ensure that the nominal level of international reserves continues to increase in line with the growing size of the economy and international transactions.

Overall, Colombia holds a comfortable level of reserves and they appear adequate for precautionary purposes. Colombia's reserve indicators as of end-2013 are all above the levels suggested by the "rule of thumb." While the rebound in reserves to nominal GDP has remained somewhat muted, the ratio of reserves to months of imports is more than double the indicative guide of 3-months, and other traditional ratios are also back to a relatively comfortable level. Reserves to reserve adequacy metric in 2013 stands at 162 percent compared to the range of 100 to 150 percent considered adequate for precautionary purposes. However, as noted in the Board paper "Assessing Reserve Adequacy—Further Considerations," the metric needs to be carefully assessed as it may not appropriately capture vulnerabilities to trade shocks for countries heavily reliant commodity exports. An adjusted metric in an attempt to address Colombia-specific BOP vulnerabilities stood at 144 percent and the authorities' metric at 123 percent in 2013 (see below).

The reserve adequacy metric (RAM) does not appropriately capture Colombia's specific external vulnerabilities. Although financial account vulnerabilities are also present, balance of payments vulnerabilities are primarily concentrated in the current account, especially the vulnerability of export receipts to a decline in commodity prices.¹ An alternative export component specifically for commodity exporters in the RAM showed marginally higher losses from trade shocks. To that end, "most Executive Directors endorsed the staff's suggestions to alter the computation of the reserve adequacy metric for countries highly dependent on commodity trade" at the Executive Board meeting on "Assessing Reserve Adequacy—Further Considerations."

1/ Colombia is a large commodity exporter, having more than 50 percent of total exports related to petroleum products and about 20 percent related to non-oil commodities (coal, coffee, and nickel). The current account deficit is more than financed by capital flows, mostly in the form of foreign direct investment.

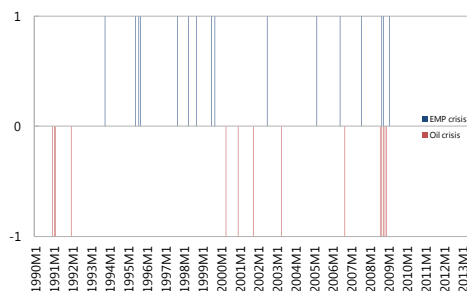
Reserve Indicators
(In percent)



Box 6. Colombia’s International Reserve Adequacy (concluded)

Colombia’s Exchange Market Pressure (EMP) events used in the RAM do not sufficiently coincide with episodes of weak commodity prices. “Oil crisis events” (identified as episodes of large declines in oil prices) and Colombia’s EMP crisis events (taken from the standard RAM analysis) only overlap in September and October 2008. Differences in the timing of crisis events identified under the two crisis measures lead to substantially different estimates of export losses (or gains). Colombia’s exports declined in 6 out of 7 oil crisis years at an average change of -10 percent, whereas its exports increased in 5 out of 6 EMP crisis years at an average change of +13 percent. This difference implies that EMP crisis events are somewhat irrelevant in identifying pressures on Colombia’s current account. Moreover, the average loss of 10 percent is twice as large as the change in exports at the 10th percentile during EMP events in the RAM for all countries. Incorporating a higher weight of 10 on Colombia’s export vulnerability would alter the ratio of reserves to RAM to 144 percent in 2013. In line with the Board’s endorsement, additional work is underway to come up with a RAM more suitable for commodity exporters.

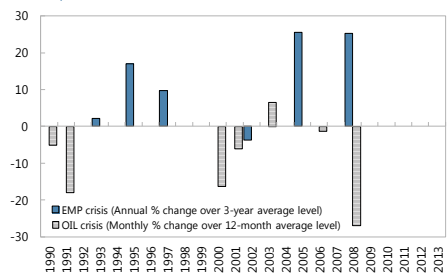
EMP Crisis in Colombia and OIL Crisis Events
(EMP crisis if =1, OIL crisis if =-1)



Sources: Fund staff calculations.

The authorities’ RAM estimate, based on the Fund’s methodology but using only Colombia data (as opposed to data for a set of emerging markets), suggests that Colombia is more vulnerable to export losses.² The authorities’ RAM also shows that the magnitude of potential losses from capital account vulnerabilities (i.e. short-term debt and other portfolio liabilities) are lower than the average of other countries in the Fund’s RAM, consistent with the structure of Colombia’s balance of payments. Combining all vulnerabilities, the authorities’ reserves to RAM stood at 123 percent in 2013, about 40 percent lower than the level suggested by the Fund’s standard metric.

Export Gain/loss in Crisis Years
(In percent)



Sources: Haver; Fund staff calculations.

EMP crisis in Colombia and OIL crisis events

(In percent)

	Reserves to RAM	Weights under the RAM			
		Export loss	Broad money	ST debt	Other portfolio liabilities
IMF RAM	162	5	5	30	10
Weight for export: average export loss during oil crisis events	144	10	5	30	10
Colombia RAM	123	19	9	13	3

Source: Fund staff estimates.

The reserves might be insufficient to cope with tail risks. The RAM is intended to assess reserves for precautionary purposes and not for covering tail risks. The RAM measures potential outflows at the 10th percentile of the distribution experienced during EMP events. Furthermore, while cost-benefit analyses on crisis probability and the fall of consumption suggest that the range of 100 to 150 percent might be regarded as adequate, “it does not preclude countries from wanting to hold more depending on the circumstances and their degree of risk aversion.”³

2/ Gómez. R. J., and J. S. Rojas. B, 2013, “Assessing Reserve Adequacy: The Colombia Case,” Borradores de Economía, Núm. 781, Banco Central de Colombia.

3/ IMF (2011), “Assessing Reserve Adequacy.”

Box 7. Colombia's Domestic Capital Market

Colombia's domestic capital market grew significantly in the past decade. Market activity is dominated by government debt securities (TES), followed by equity issuance, while the non-government fixed income market is small. The investor base comprises mainly domestic participants, primarily banks, trust companies and pension funds. The presence of foreign investors is still small, but is rising rapidly, particularly in government debt.

Colombia has the third largest local currency government bond market in Latin America, after Brazil and Mexico. Over 70 percent of outstanding TES are at a fixed rate, and about a quarter are linked to inflation (the UVR index). Maturities go up to 15 years for fixed-rate TES and 20 years for TES UVR. The average maturity of outstanding TES was 5 years as of end-2013. About 80 percent of TES issuance is channeled through competitive auctions, held weekly, alternating between fixed rate and UVR bonds each week. Non-competitive sales of TES comprise pre-arranged placements ("convenidas") targeted to state-owned companies and mandatory placements ("forzosas") targeted to public institutions that have to invest part of their resources in government bonds. Daily turnover in the secondary market is about COP 5 trillion for fixed rate TES and COP 1 trillion for TES UVR, equivalent to 3½ and 2½ percent of the amount outstanding, respectively. Liquidity is uneven across the curve, with bid-offer spreads at 1 to 5 basis points.

The equity market is concentrated in a small number of issuers. The main issuers are Ecopetrol, financial groups and utility companies. Initial public offerings and secondary offerings totaled US\$10.3 billion in 2010–13. The market capitalization of the companies listed in the stock exchange (BVC) grew rapidly in recent years, totaling US\$215 billion in 2013 (56 percent of GDP). Ecopetrol accounts for about half and the financial groups for about 20 percent of the total market capitalization. The average daily trading volume was US\$108 million in 2013.

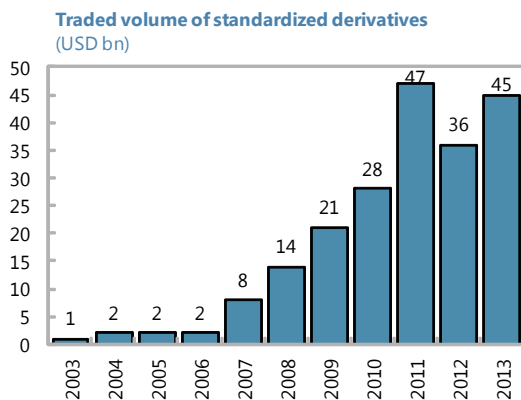
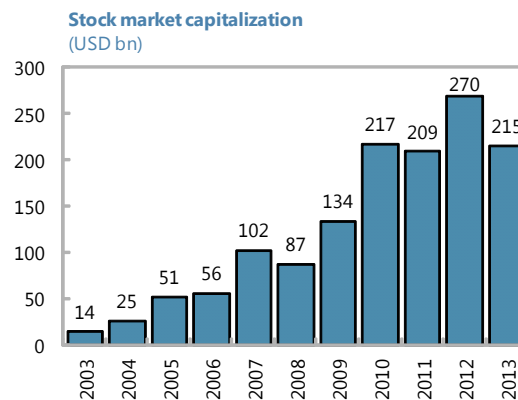
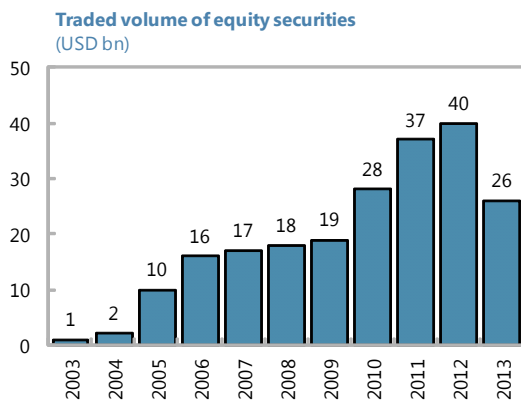
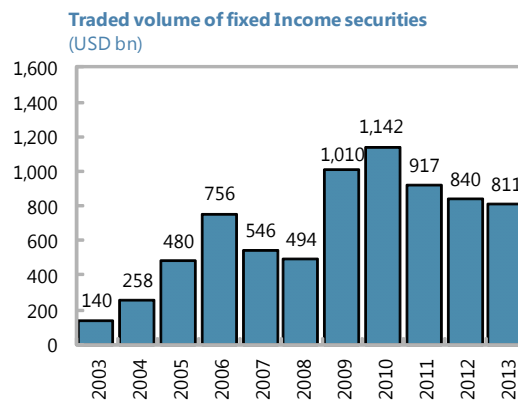
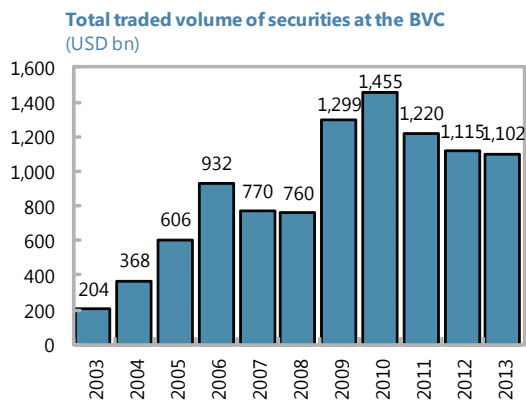
The corporate bond market is small and dominated by financial institutions. Issues are concentrated in highly-rated institutions, primarily banks and utility companies. The demand for smaller and lower rated securities is scarce. Maturities generally go up to 10 years, though some issuers were able to issue at up to 40 years. Most issues are indexed to inflation. Issuance totaled US\$22.6 billion in 2010–13 (of which US\$5 billion were issued in 2013).

An incipient derivatives market is developing. There are standardized futures for TES of different maturities, the stock market index Colcap, some equity issues, and energy contracts. There are also interest rate swaps and cross-currency swaps. Foreign exchange forwards (non-deliverable forwards or NDFs) trade mostly over the counter, with an average daily turnover of about US\$1 billion. Liquidity is concentrated in short-term contracts.

The investor base is dominated by locals, but the presence of foreign investors is rising. The investor base comprises primarily banks, trust funds and pension funds. The participation of foreign investors is higher in the equity market at about 20 percent of the average market volume in 2013. Foreign investors' ownership of TES rose to 7 percent of the total amount outstanding at end-2013, up from 3 percent at end-2012, fuelled by a reduction in early 2013 from 33 to 14 percent in the withholding tax charged on foreign investors' income and capital gains income tax. The authorities intend to raise foreign investors' participation in the TES market to 15–20 percent to diversify the investor base.

Box 7. Colombia's Domestic Capital Market (concluded)

Colombia: Selected Annual Capital Market Indicators, 2003-2013



Source: Bolsa de Valores de Colombia (BVC).

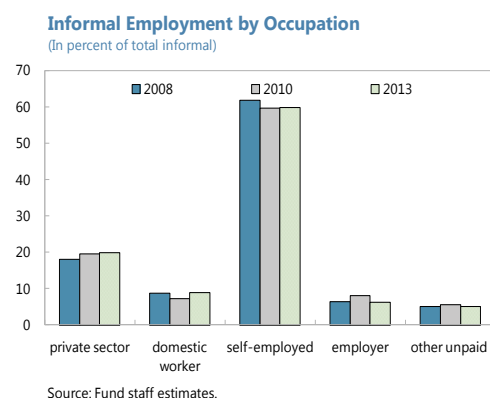
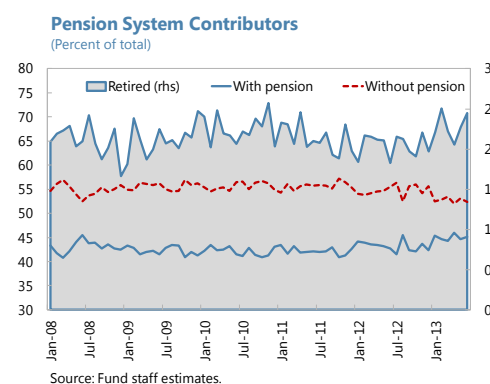
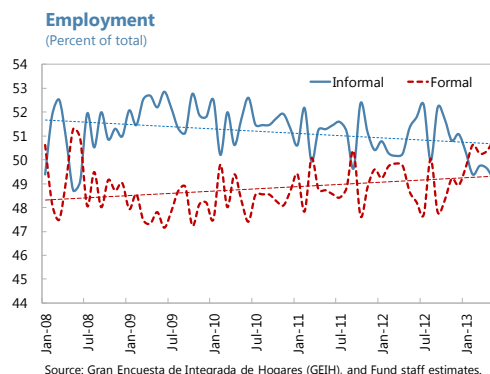
Box 8. Informality in Colombia

Informal work in Colombia has been declining in recent years, but remains stubbornly high. In 2010, the share of persons employed in the informal sector in total non-agricultural employment was almost 60 percent.¹ Fund staff estimates suggest that informality has been declining in recent years, but still remains about half of total employment. Statistics on pension contributions give a similar estimate of the magnitude of informality, with over 50 percent of non-retired respondents to the households' survey (GEIH) declaring not to have been contributing to the pension system.

Informality poses a number of disadvantages to macroeconomic management. Informal work contributes to economic activity, but is less accurately measured, which distorts statistics on actual and potential GDP, and complicates macroeconomic policy analysis. Informal work increases tax evasion, reducing government revenues. The absence of accurate employment information hinders the effective targeting of social benefits to the vulnerable population. In addition, informality is tightly linked to inequality, although the direction of causality and the precise channels of impact are less well understood.

Informal workers in Colombia cut across all age, gender, and educational groups. Over 65 percent of informal workers in 2013 were in full working age (between 25 and 55 years old). A small share of informal workers, below 10 percent, were very young or beyond retirement age. Female informal workers comprised a slightly larger share (53 percent) than males. Education attainment of informal workers is varied, with only a small share of them, below 3 percent, with less than primary education, 29 percent with primary schooling, 23 percent reporting having a secondary school diploma and 29 percent with a high school degree. Some 17 percent of informal workers reported having tertiary education.

Informal workers are more likely to find themselves in precarious job situations. About 40 percent of the workers in the survey were interested in changing their job for a variety of physical and psychological reasons. Almost half of informal respondents perceived their jobs as temporary. Informal sector workers also earn less, exacerbating inequality. According to the most recent households' survey, the majority of informal workers were self-employed, followed by employees in small private sector companies and domestic workers.²



1/ Source: LABORSTA, ILO.

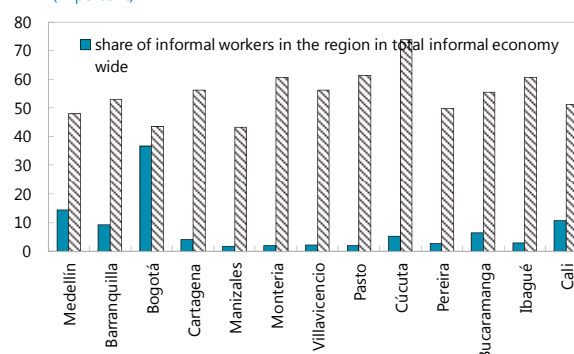
2/ The statistical institute's (DANE) definition of informality includes employees and owners of business with less than 5 workers, unpaid family members and housekeepers.

Box 8. Informality in Colombia (continued)

Informality is distributed across all regions.

The largest number of informal workers resides and/or works in Bogota (the capital region), mainly because it employs a large share of the population. The share of informal workers in total employment in each region is much more equally distributed. Yet, some pockets of above average informality exist: the Cucuta capital region bordering with Venezuela displays the highest share of informal workers, followed by agricultural areas of Monteria and Pasto, and Cartagena (which has a large share of the poor population).

Regional Distribution of Informal Work
(In percent)



Sources: Fund staff estimates.

While skill mismatches may play a role in the high rate of unemployment, very high labor costs are the main contributor to the large informal sector. In a recent survey, 30 percent of employers in Colombia reported having difficulty filling vacancies.³ Yet, real increases in the minimum wage outpaced productivity growth in the 1990s, spurring a movement from the formal to the informal sector. This trend particularly affected young and old workers, those with lower productivity, and those living in remote areas.⁴ The minimum wage remains a high relative to average value-added. For example, in mid-2013, the minimum wage for a 19-year old worker or an apprentice stood at \$310 per month, representing about 30 percent of value-added. In addition, non-wage costs constitute about 40 percent of total labor costs for the average worker, compounding the effect of the high minimum wage on informal employment. The tax reform of 2012 lowered non-wage compulsory payments by eliminating health, training, and child care contributions, and may have contributed to reduce informality since mid-2013.

3/The World Economic Forum, "Matching Skills and Labour Market Needs: Building Social Partnerships for Better Skills and Better Jobs", January 2014.

4/ Joumard, I. and J. Londoño Vélez (2013), "Income Inequality and Poverty in Colombia - Part 1. The Role of the Labour Market," OECD Economics Department Working Papers, No. 1036, OECD Publishing.

Box 9. Financial Inclusion in Colombia

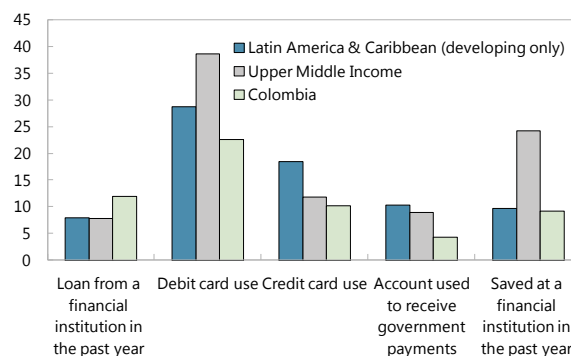
Financial inclusion of households in Colombia has not grown as rapidly as overall credit to the private sector in recent years.

Over the past decade, credit to the private sector has increased steadily, but this growth has mainly derived from an increase in the average size of loans, rather than the increase in the number of debtors (IMF, 2012). Colombia scores below upper-middle-income average and the average for LACs on financial inclusion indicators related to households. Fewer people in 2011 held debit and credit cards, less than 5 percent of the population received government payments through bank accounts, and less than 10 percent held savings in a formal financial institution. In contrast, informal finance was widespread, with a relatively larger share of adults declaring having received a loan from, or having saved through, informal channels.

Financial deepening was also not fully “shared” across enterprises. In 2010, a greater share of small firms claimed to have been affected by insufficient financing compared to 2006. Firms in the food industry were particularly affected. Over 50 percent of smaller-sized companies (with less than 20 employees) identified access to finance as a major constraint for their operations in 2010.

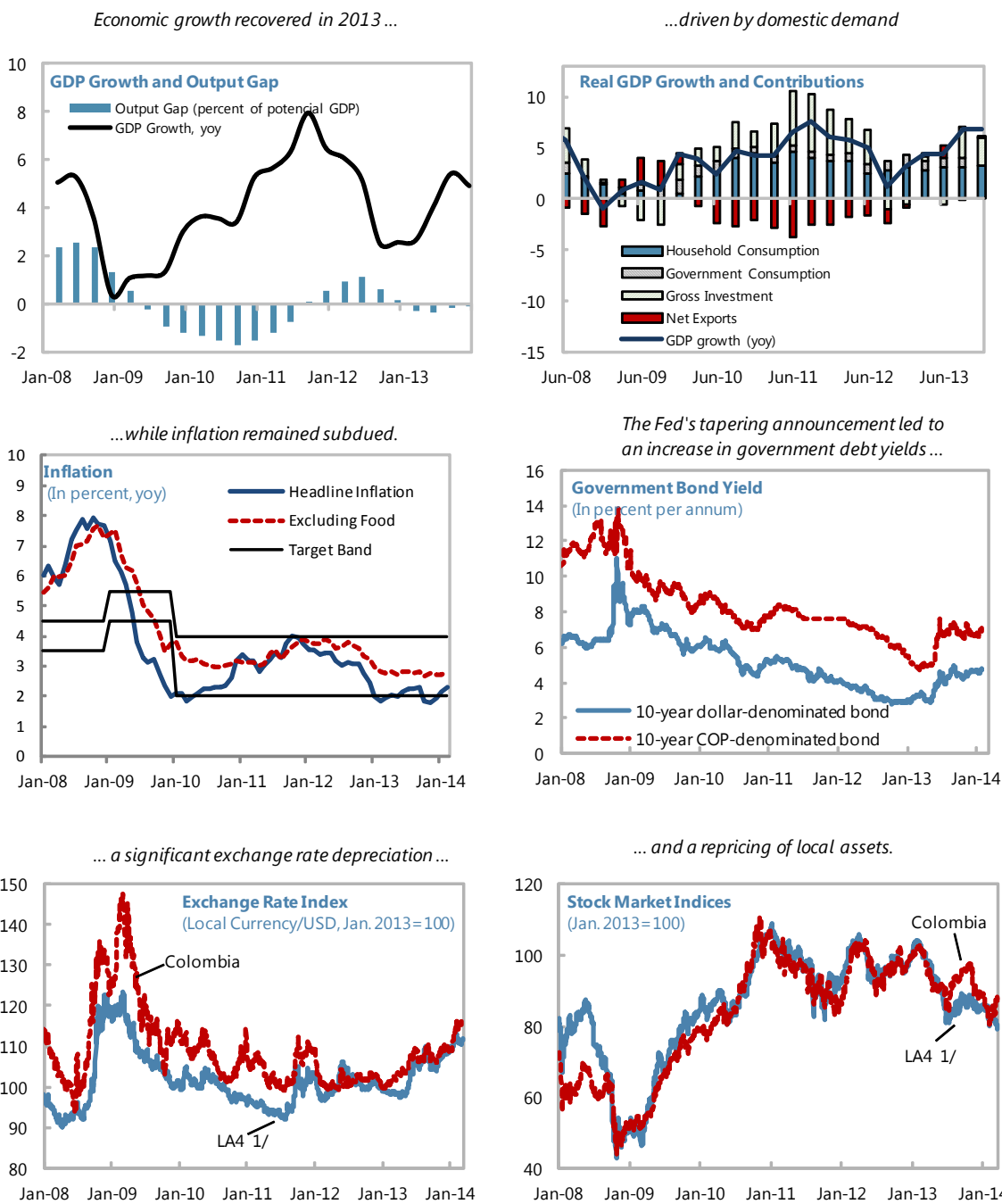
Colombia has implemented a number of improvements to reduce the costs of accessing financial services. Physical infrastructure has increased. Banks have been allowed to provide financial services through correspondents for social transfers programs since 2006 and over 38,000 correspondents were registered in 2013. The government has subsidized the opening of accounts for most Familias en Accion transfers recipients and lowered the financial transaction tax on low account balances. The program of interest subsidies on new mortgages granted to over 5,000 low income families since 2009 has been extended into 2014 and will cover up to 5 percentage points of the agreed interest rate for a 7-year period.

Formal Finance



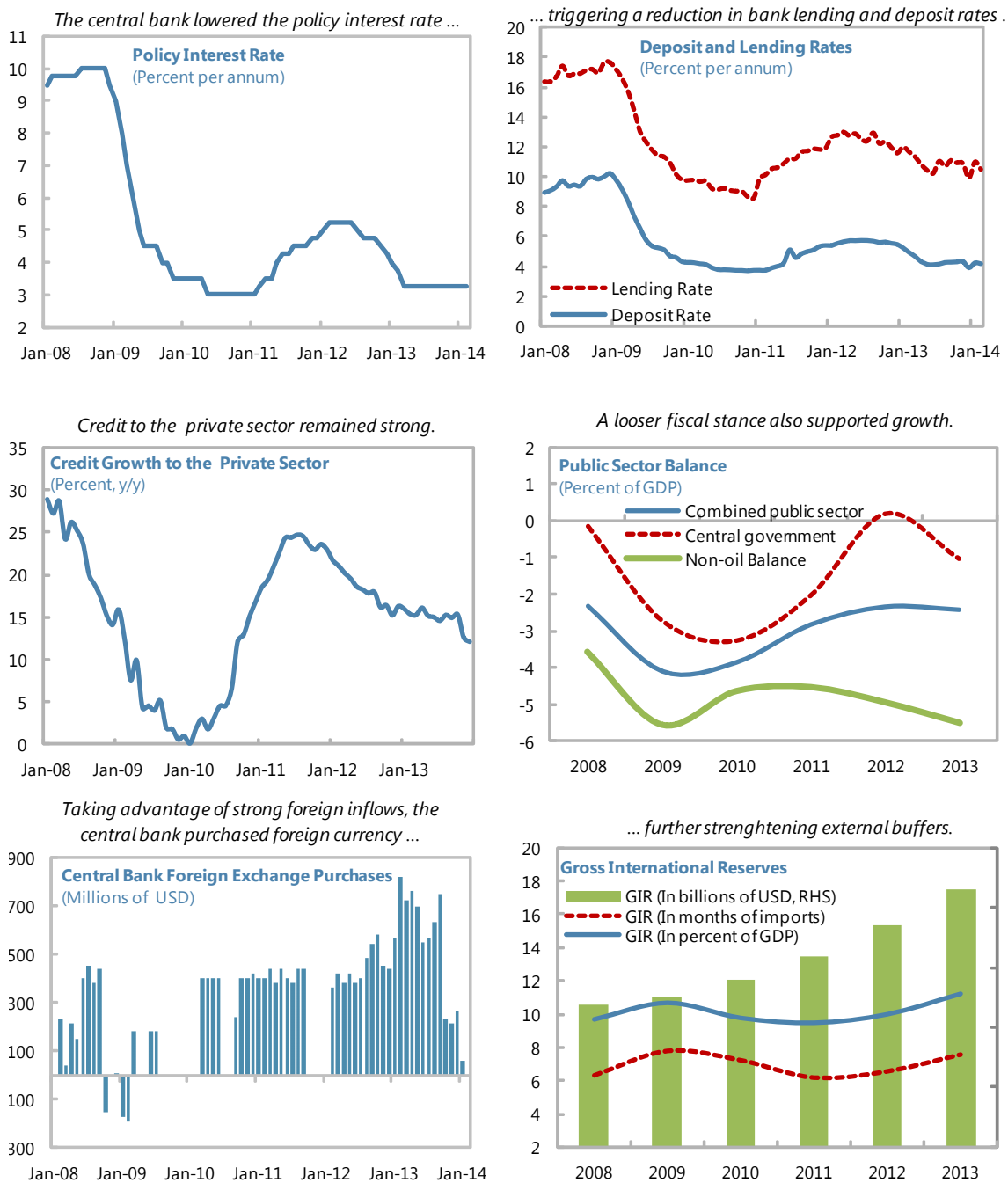
Source: Fund staff estimates.

Figure 1. Recent Economic and Financial Developments



Source: Banco de la República; DANE; Bloomberg; and Fund staff estimates.
 1/ LA4 corresponds to the average of Brazil, Colombia, Peru and Mexico.

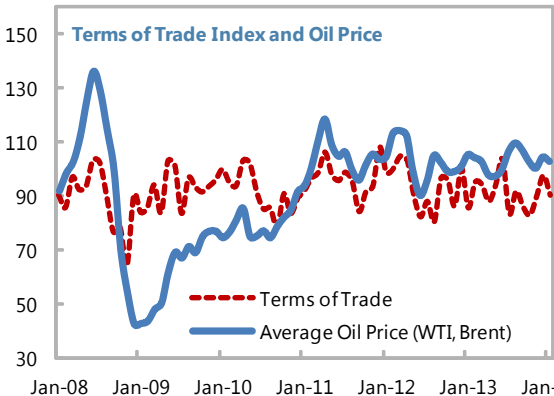
Figure 2. Macroeconomic Policies



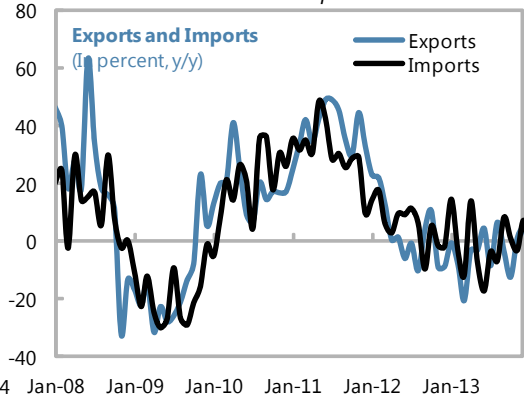
Sources: Banco de la República; and Fund staff estimates.

Figure 3. External Sector Developments

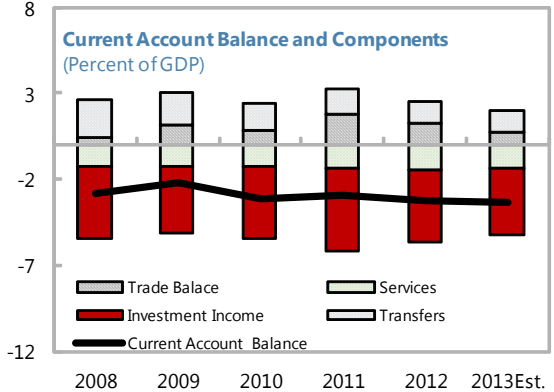
The terms of trade index was broadly stable in 2013...



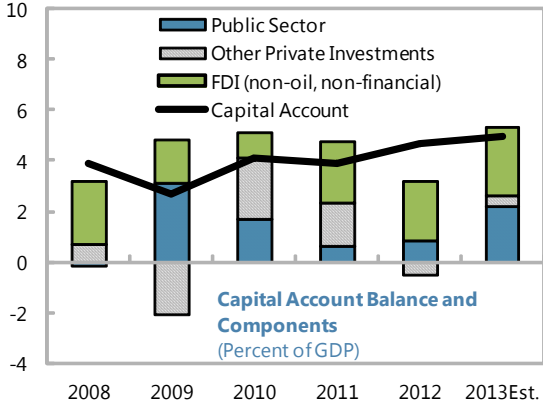
...contributing to relatively constant levels of exports and imports.



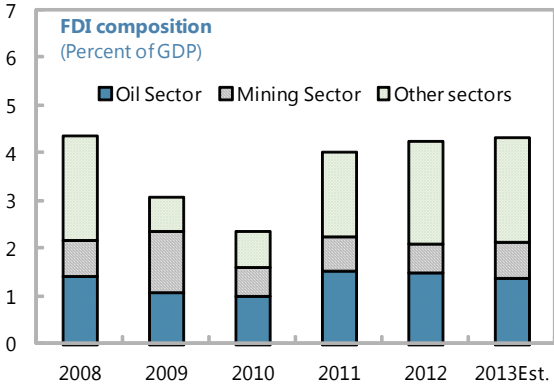
The current account deficit remained broadly unchanged ...



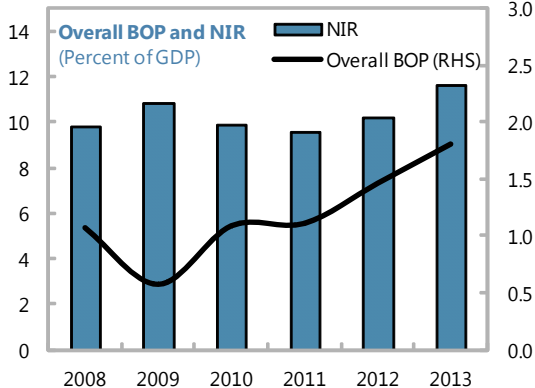
... and was financed mainly by strong FDI ...



... directed to many sectors.



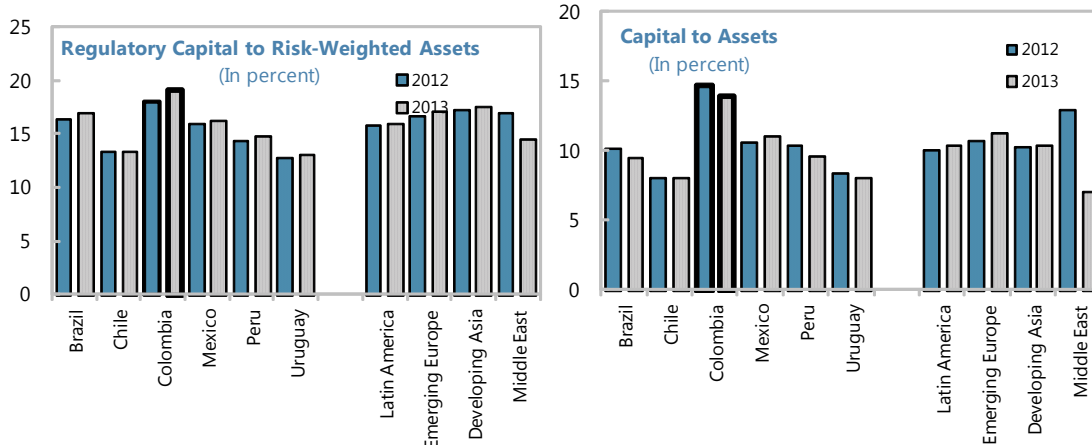
A continued BOP surplus strengthened reserves.



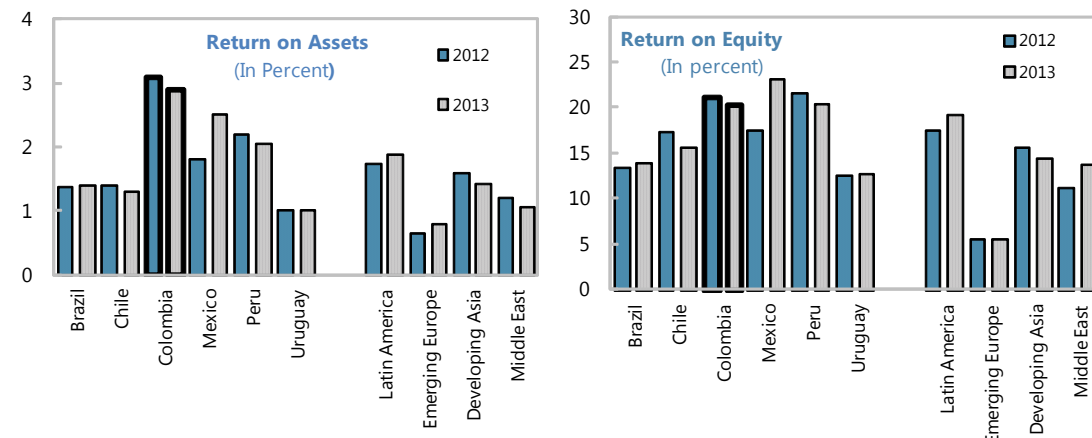
Sources: Banco de la República; Haver Analytics; and Fund staff estimates.

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

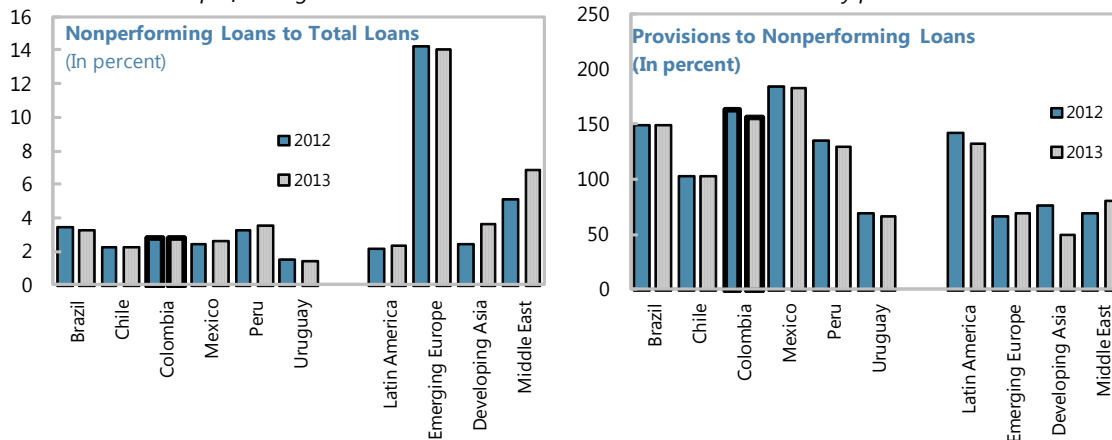
Colombian banks remained well capitalized ...



...and profitable.

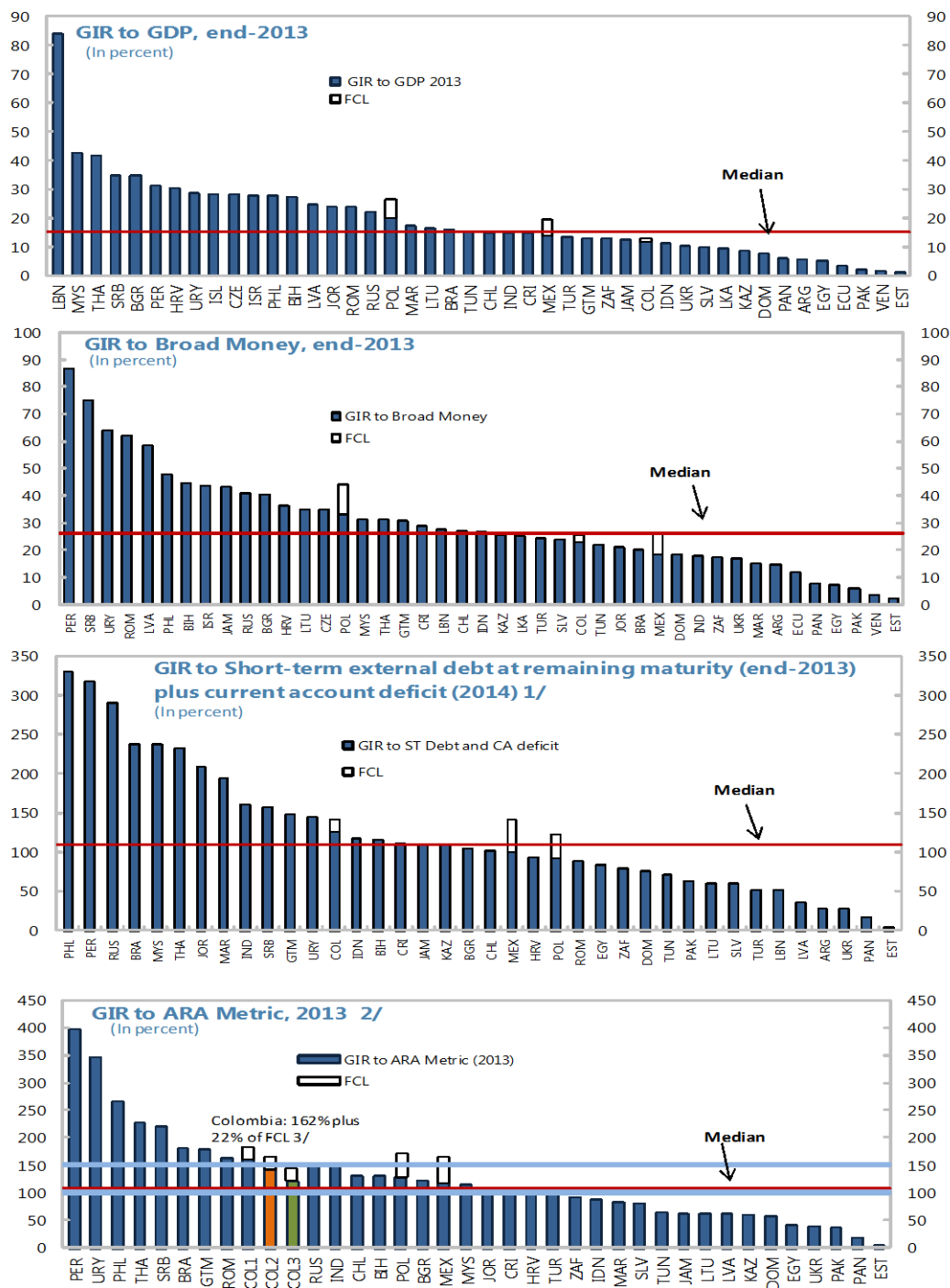


Nonperforming loans have remained moderate and are well covered by provisions.



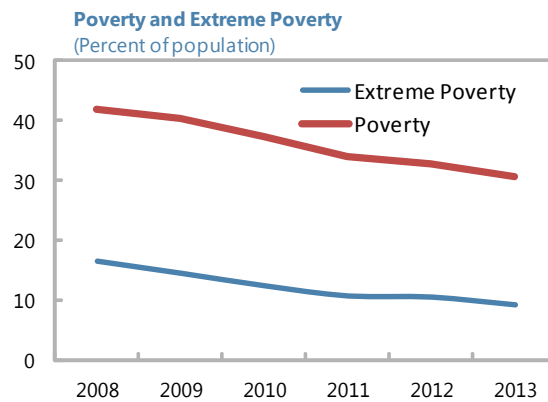
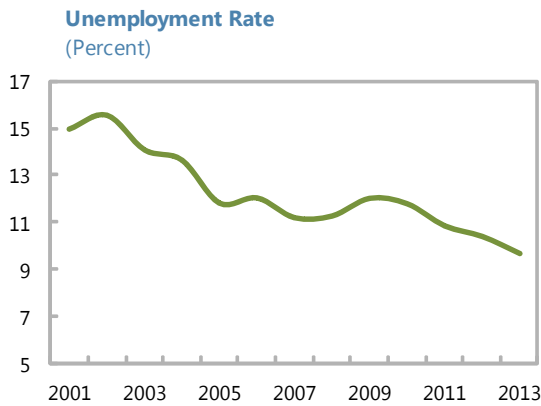
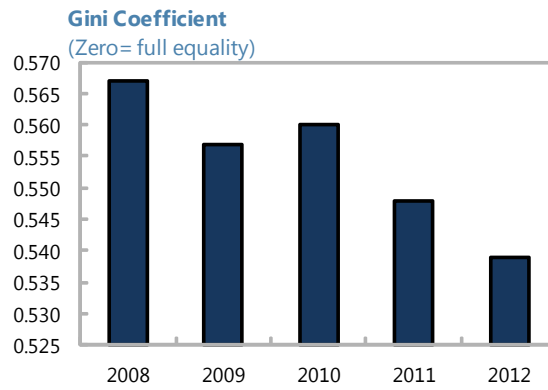
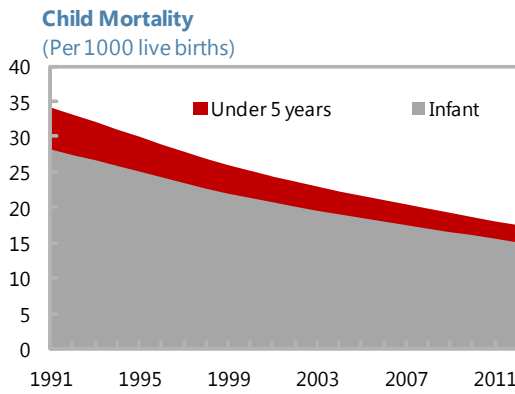
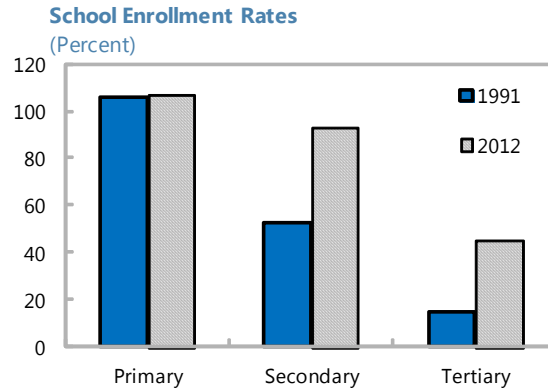
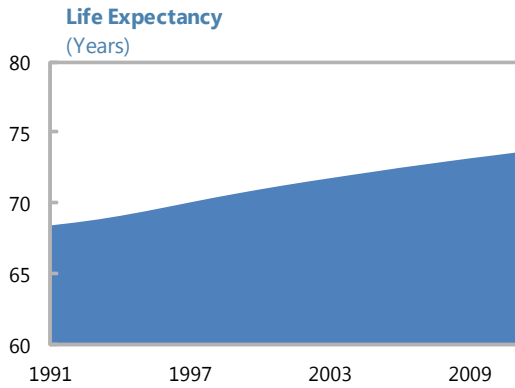
Source: October 2013 GFSR Statistical Appendix.

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/ Col1 is based on the IMF's RAM, Col2 is based on a metric using Colombia's average loss of exports during "oil crisis events," and Col3 is based on authorities' metric (Box 6).

Figure 6. Colombia: Social Indicators



Sources: World Development Indicators; and DANE.

Table 2. Colombia: Summary Balance of Payments

				Est	Projections					
	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
(In million of USD, unless otherwise indicated)										
Current account balance	-8,929	-9,854	-11,834	-12,722	-12,713	-13,588	-13,272	-13,944	-14,720	-15,267
Trade balance	2,341	6,090	4,744	2,832	5,445	3,474	3,815	3,053	2,701	2,747
Exports, f.o.b.	40,816	58,322	61,447	59,992	64,476	64,681	67,838	70,319	73,125	76,722
Coffee	1,884	2,608	1,910	1,884	2,756	3,089	3,293	3,288	3,288	3,288
Petroleum products	16,499	28,421	31,497	32,009	34,601	32,649	33,470	33,451	33,518	34,066
Non-traditional	14,137	16,413	17,730	16,769	17,906	19,539	21,257	23,307	25,568	28,096
Other	8,297	10,880	10,310	9,331	9,212	9,404	9,818	10,272	10,750	11,272
Imports, f.o.b.	38,475	52,232	56,703	57,160	59,031	61,207	64,022	67,266	70,424	73,975
Services (net)	-3,693	-4,737	-5,503	-5,470	-5,768	-6,131	-6,469	-6,858	-7,410	-8,029
Income (net)	-12,024	-16,042	-15,654	-14,656	-17,115	-15,849	-15,787	-15,584	-15,750	-15,760
Interest (net)	-2,816	-3,041	-2,804	-3,192	-4,540	-3,813	-3,082	-2,497	-1,677	-1,219
Of which: Public sector	-2,146	-2,143	-2,007	-2,126	-2,742	-2,286	-1,915	-1,715	-1,357	-1,116
Other Income (net)	-9,208	-13,001	-12,850	-11,462	-12,575	-12,036	-12,705	-13,088	-14,074	-14,541
Current transfers (net)	4,448	4,834	4,579	4,572	4,725	4,917	5,169	5,446	5,740	5,776
Financial account balance	11,763	12,976	17,396	19,175	14,719	15,371	15,101	15,769	16,255	16,799
Public sector (net)	4,813	2,143	3,085	8,346	3,140	3,063	3,058	3,372	3,496	3,867
Nonfinancial public sector	4,702	2,216	3,697	8,772	2,914	3,073	3,078	3,420	3,591	3,986
Medium- and long-term (net)	1,332	2,997	3,093	6,142	1,678	1,898	1,962	2,360	2,584	3,030
Disbursements	3,357	5,077	6,630	7,918	4,971	5,530	4,362	6,551	4,584	7,562
Amortization	2,019	2,039	3,482	1,651	3,175	3,519	2,293	4,090	1,903	4,440
Other long-term flows	-7	-41	-56	-125	-119	-113	-107	-102	-97	-92
Short term 1/	3,370	-781	604	2,631	1,237	1,175	1,116	1,060	1,007	956
Financial public sector	112	-73	-612	-427	226	-10	-19	-48	-95	-119
Private sector (net)	6,950	10,833	14,310	10,829	11,579	12,308	12,043	12,397	12,759	12,932
Nonfinancial private sector (net)	4,551	8,949	14,463	8,009	11,459	12,185	11,990	12,349	12,716	12,893
Direct investment	-147	5,101	16,135	9,120	11,242	11,348	11,464	11,579	11,699	11,834
Direct investment abroad	6,893	8,304	-606	7,652	3,884	3,954	4,030	4,113	4,199	4,286
Direct investment in Colombia	6,746	13,405	15,529	16,772	15,126	15,302	15,494	15,692	15,897	16,119
Leasing finance	22	541	257	186	30	64	106	154	198	248
Long-term loans	3,298	2,511	-3,503	505	134	460	95	101	469	250
Short term 2/	1,377	796	1,574	-1,802	54	312	324	516	350	562
Financial private sector (net)	2,398	1,884	-152	2,820	120	123	53	48	43	39
Valuation changes/Contribution to FLAR 3/	-50	89	-336	-797	0	0	0	0	0	0
Net errors and omissions	302	623	-139	505	0	0	0	0	0	0
Changes in GIR 4/	3,086	3,834	5,086	6,160	2,006	1,783	1,829	1,824	1,534	1,533
Memorandum Items:										
Current account balance (in percent of GDP)	-3.1	-2.9	-3.2	-3.3	-3.3	-3.3	-3.1	-3.0	-3.0	-2.9
Oil Price (Colombian mix US\$ per barrel)	73.1	99.3	104.2	100.3	100.4	94.3	89.6	86.7	84.9	83.5
Gross international reserves (in US\$ billion)	28.1	31.9	37.0	43.2	45.2	46.9	48.8	50.6	52.1	53.7
In percent of short-term external debt 5/	354.9	311.2	358.0	361.5	360.6	357.8	354.4	350.6	346.0	341.3
In percent of ST external debt plus CA deficit	117.0	98.1	128.2	110.7	111.2	124.0	118.2	126.0	117.9	127.6
Nominal GDP (US\$ billion)	287.0	336.3	369.8	384.3	388.4	410.0	435.1	462.9	492.8	526.2

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

1/ Deposit flows of public sector entities abroad.

2/ Includes net portfolio investment.

3/ FLAR is Fondo Latinoamericano de Reservas.

4/ IMF definition.

5/ Original maturity of less than 1 year. Stock at the end of the previous period.

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

	2010	2011	2012	Est	Projections					
				2013	2014	2015	2016	2017	2018	2019
	(In percent of GDP, unless otherwise indicated)									
Total revenue	13.8	15.2	16.1	16.9	17.0	16.5	16.5	16.4	16.5	16.3
Tax revenue	12.3	13.5	14.3	14.2	14.7	14.2	14.4	14.4	14.5	14.4
Net income tax and profits 2/	4.8	5.4	6.6	6.4	6.4	6.4	6.4	6.5	6.5	6.6
Goods and services	5.5	5.9	5.7	5.1	5.2	5.5	5.6	5.8	5.9	6.0
Value-added tax	5.3	5.6	5.5	5.1	5.2	5.5	5.6	5.8	5.9	6.0
Gasoline tax	0.3	0.3	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
International trade	0.9	0.7	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Financial transaction tax	0.6	0.8	0.8	0.8	0.8	0.4	0.4	0.2	0.2	0.0
Stamp and other taxes	0.5	0.7	0.7	1.4	1.8	1.4	1.4	1.4	1.4	1.4
Nontax revenue	1.5	1.7	1.8	2.6	2.3	2.3	2.1	2.0	2.0	1.9
Property income	0.1	0.1	0.2	0.2	0.1	0.2	0.2	0.2	0.2	0.2
Other	1.4	1.5	1.6	2.5	2.3	2.1	2.0	1.9	1.8	1.7
Total expenditure and net lending	17.6	18.0	18.4	19.3	19.3	18.7	18.7	18.5	18.5	18.2
Current expenditure	14.3	13.7	14.2	14.7	15.8	16.4	16.5	16.4	16.4	16.3
Wages and salaries	2.1	2.0	2.1	2.2	2.3	2.2	2.2	2.1	2.1	2.1
Goods and services	1.0	0.8	0.8	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Interest	2.7	2.7	2.6	2.5	2.3	2.4	2.3	2.3	2.3	2.2
External	0.7	0.6	0.5	0.6	0.6	0.5	0.5	0.5	0.5	0.5
Domestic	2.1	2.1	2.0	1.9	1.7	1.9	1.8	1.8	1.8	1.7
Current transfers	8.4	8.3	8.7	9.0	10.2	10.8	11.0	11.0	11.0	11.0
Capital expenditure	3.3	4.2	4.2	4.5	3.5	2.3	2.2	2.0	2.0	1.8
Fixed capital formation	1.9	2.8	2.9	3.1	2.1	1.0	0.9	0.8	0.8	0.6
Capital transfers	1.4	1.4	1.3	1.4	1.4	1.3	1.3	1.2	1.2	1.2
Overall balance	-3.9	-2.8	-2.3	-2.4	-2.3	-2.2	-2.2	-2.0	-2.0	-1.9
Memorandum items:										
Oil-related revenues 3/	0.8	1.7	2.6	3.1	3.2	3.1	2.8	2.7	2.5	2.3
Structural balance 4/	-3.6	-3.5	-2.9	-2.5	-2.3	-2.2	-2.2	-2.0	-2.0	-1.8
Non-oil balance	-4.6	-4.5	-4.9	-5.5	-5.5	-5.3	-5.0	-4.7	-4.5	-4.2
Primary balance	-1.1	-0.1	0.2	0.1	0.0	0.2	0.1	0.3	0.3	0.4
Nominal GDP (in COP trillion)	544.9	621.6	664.5	718.1	765.1	818.7	878.9	944.6	1,015.2	1,094.6

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 3B. Colombia: Operations of the Central Government 1/

	2010	2011	2012	Est	Projections					
				2013	2014	2015	2016	2017	2018	2019
(In trillion COP, unless otherwise indicated)										
Total revenue	75.0	94.2	107.1	121.1	130.1	134.9	144.8	155.3	167.2	178.6
Tax revenue	66.8	83.8	95.1	102.3	112.3	116.4	126.3	136.0	147.3	158.0
Net income tax and profits 2/	26.2	33.5	43.6	45.9	48.8	52.8	56.6	61.3	66.3	72.0
Goods and services	30.2	36.7	38.1	36.9	39.7	44.7	49.5	54.9	59.7	65.2
Value-added tax	28.8	35.1	36.3	36.8	39.7	44.7	49.5	54.9	59.7	65.2
Gasoline tax	1.4	1.6	1.7	0.1	0.0	0.0	0.0	0.0	0.0	0.0
International trade	4.7	4.1	3.5	3.4	3.6	4.3	4.5	4.8	5.1	5.5
Financial transaction tax	3.2	5.1	5.5	5.9	6.3	3.2	3.3	1.7	1.8	0.0
Stamp and other taxes	2.5	4.5	4.5	10.1	13.9	11.5	12.4	13.3	14.3	15.4
Nontax revenue	8.2	10.4	11.9	18.8	17.8	18.5	18.5	19.3	19.9	20.6
Property income	0.5	0.9	1.0	1.1	0.4	1.2	1.3	1.4	1.5	1.6
Other	7.7	9.5	10.9	17.7	17.4	17.2	17.2	17.9	18.4	18.9
Total expenditure and net lending	96.0	111.8	122.5	138.3	147.6	153.2	164.3	174.5	187.6	198.9
Current expenditure	77.8	85.2	94.2	105.6	120.7	134.5	145.3	155.2	166.8	178.7
Wages and salaries	11.6	12.4	14.0	15.8	17.6	18.0	19.3	19.8	21.3	23.0
Goods and services	5.6	4.7	5.4	7.1	7.6	8.1	8.7	9.3	10.0	10.8
Interest	14.8	16.8	17.1	18.0	17.5	20.0	20.6	22.1	23.8	24.5
External	3.7	3.6	3.5	4.0	4.5	4.5	4.8	5.1	5.5	5.9
Domestic	11.2	13.2	13.5	14.0	13.0	15.6	15.8	17.0	18.3	18.6
Current transfers	45.7	51.3	57.7	64.8	78.0	88.4	96.7	103.9	111.7	120.4
Capital expenditure	18.0	26.4	27.6	32.6	26.8	18.6	18.9	19.3	20.7	20.1
Fixed capital formation	10.5	17.7	19.2	22.3	16.1	8.2	7.9	7.6	8.1	6.6
Capital transfers	7.5	8.7	8.4	10.4	10.7	10.4	11.0	11.7	12.6	13.6
Overall balance	-21.0	-17.5	-15.4	-17.3	-17.5	-18.3	-19.5	-19.2	-20.4	-20.3
Memorandum items:										
Oil-related revenues 3/	4.2	10.6	17.4	22.2	24.5	25.4	24.5	25.1	25.3	25.4
Structural balance 4/	-19.4	-21.9	-19.4	-18.3	-17.8	-17.8	-19.4	-19.2	-20.1	-19.4
Non-oil balance	-25.2	-28.1	-32.8	-39.5	-42.0	-43.7	-44.0	-44.3	-45.7	-45.7
Primary balance	-6.2	-0.7	1.6	0.7	0.0	1.8	1.1	2.9	3.4	4.2

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

	2010	2011	2012	Est 2013	Projections					
					2014	2015	2016	2017	2018	2019
	(In percent of GDP, unless otherwise indicated)									
Total revenue	26.1	26.7	28.4	27.7	27.3	27.0	26.8	26.7	26.7	26.7
Tax revenue	18.7	19.1	20.0	19.9	20.2	20.2	20.8	20.8	21.0	21.0
Nontax revenue	7.4	7.6	8.3	7.8	7.1	6.7	6.0	5.9	5.7	5.7
Financial income	1.2	0.9	1.2	1.0	1.0	1.0	0.5	0.5	0.5	0.5
Operating surplus of public enterprises	0.1	0.2	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other 2/	6.1	6.5	7.0	6.8	6.1	5.7	5.5	5.4	5.2	5.2
Total expenditure and net lending 3/	29.2	28.5	27.9	28.7	28.2	27.7	27.5	27.4	27.4	27.3
Current expenditure	22.4	20.4	20.8	20.9	20.6	20.5	20.3	20.2	20.2	20.1
Wages and salaries	5.8	5.2	5.2	5.2	5.1	5.0	5.0	5.0	5.0	5.0
Goods and services	3.3	2.9	2.9	2.9	2.9	2.8	2.7	2.6	2.6	2.6
Interest	2.9	2.8	2.7	2.6	2.4	2.5	2.4	2.4	2.4	2.3
External	0.7	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Domestic	2.2	2.2	2.1	2.0	1.8	2.0	1.9	1.9	1.9	1.8
Transfers to private sector	8.1	7.4	7.3	7.6	7.6	7.6	7.6	7.6	7.6	7.6
Other 4/	2.4	2.2	2.7	2.6	2.6	2.6	2.6	2.6	2.6	2.6
Capital expenditure	6.8	8.1	7.2	7.8	7.6	7.2	7.2	7.2	7.2	7.2
Statistical discrepancy	-0.2	-0.2	-0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Nonfinancial public sector balance	-3.3	-2.0	0.1	-1.0	-0.9	-0.8	-0.7	-0.8	-0.7	-0.6
Quasi-fiscal balance (BR cash profits)	0.0	0.0	-0.1	-0.1	0.0	0.0	0.1	0.1	0.1	0.1
Fogafin balance	0.1	0.0	0.2	0.1	0.1	0.1	0.1	0.0	0.0	0.0
Net cost of financial restructuring 5/	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Combined public sector balance	-3.3	-2.0	0.2	-1.0	-0.8	-0.6	-0.6	-0.7	-0.6	-0.6
Overall financing	3.3	2.0	-0.2	1.0	0.8	0.6	0.6	0.7	0.6	0.6
Foreign, net	1.7	0.9	0.7	2.1	0.8	0.8	0.8	0.8	0.8	1.1
Domestic, net	1.5	1.1	-1.0	-1.1	0.1	-0.2	-0.2	-0.2	-0.1	-0.5
Privatization (including concessions)	0.1	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:										
Overall structural balance 6/	-2.8	-3.5	-0.9	-1.2	-0.9	-0.5	-0.6	-0.7	-0.6	-0.4
Non-oil balance	-5.5	-5.6	-4.7	-5.5	-5.6	-5.3	-4.9	-4.7	-4.5	-4.1
Primary balance 7/	-0.4	0.7	2.9	1.6	1.5	1.9	1.8	1.8	1.8	1.8
Oil-related revenues 8/	2.3	3.6	4.4	4.8	5.0	4.7	4.3	4.1	3.8	3.5
Total public debt 9/	37.0	35.7	32.0	35.2	34.7	33.5	32.2	31.0	29.8	28.6
Nominal GDP (In trillion COP)	544.9	621.6	664.5	718.1	765.1	818.7	878.9	944.6	1,015.2	1,094.6

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.

7/ Includes statistical discrepancy.

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

	2010	2011	2012	Est 2013	Projection					
					2014	2015	2016	2017	2018	2019
	(In trillion COP)									
Total revenue	142.2	165.7	188.6	198.6	208.6	220.9	235.6	251.9	271.1	292.4
Tax revenue	101.7	118.7	133.1	142.6	154.5	165.7	182.7	196.6	213.4	230.4
Nontax revenue	40.5	47.0	55.5	56.0	54.2	55.2	52.9	55.4	57.7	62.0
Financial income	6.4	5.6	8.1	7.2	7.7	8.2	4.4	4.7	5.1	5.5
Operating surplus of public enterprises	0.6	1.0	0.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other 2/	33.5	40.4	46.5	48.8	46.5	47.0	48.5	50.6	52.6	56.5
Total expenditure and net lending 3/	159.1	177.0	185.6	206.0	215.6	227.1	242.0	259.1	278.5	299.2
Current expenditure	121.9	126.9	137.9	150.0	157.5	168.1	178.8	191.1	205.4	220.4
Wages and salaries	31.3	32.2	34.4	37.3	39.0	40.9	43.9	47.2	50.8	54.7
Goods and services	17.9	17.9	19.5	20.8	22.2	22.9	23.7	24.6	26.4	28.5
Interest	15.6	17.2	17.7	18.6	18.2	20.8	21.4	23.0	24.7	25.5
External	3.9	3.8	3.8	4.3	4.8	4.8	5.1	5.5	5.9	6.3
Domestic	11.7	13.4	13.9	14.3	13.4	16.0	16.3	17.5	18.8	19.2
Transfers to private sector	43.9	45.8	48.3	54.6	58.2	62.2	66.8	71.8	77.2	83.2
Other 4/	13.1	13.8	18.1	18.7	19.9	21.3	22.9	24.6	26.4	28.5
Capital expenditure	37.2	50.1	47.6	56.0	58.2	58.9	63.3	68.0	73.1	78.8
Statistical discrepancy	-1.0	-1.0	-2.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Nonfinancial public sector balance	-18.0	-12.3	0.8	-7.5	-7.0	-6.2	-6.5	-7.2	-7.4	-6.8
Quasi-fiscal balance (BR cash profits)	0.2	0.0	-0.6	-0.4	-0.1	0.4	0.5	0.8	0.8	0.9
Fogafin balance	0.4	0.1	1.0	0.6	0.7	0.7	0.5	0.3	0.0	-0.3
Net cost of financial restructuring 5/	-0.4	-0.3	0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Combined public sector balance	-17.7	-12.6	1.3	-7.3	-6.5	-5.1	-5.4	-6.1	-6.6	-6.3
Overall financing	17.7	12.6	-1.3	7.3	6.5	5.1	5.4	6.1	6.6	6.3
Foreign, net	9.0	5.8	4.4	15.0	6.1	6.8	6.8	7.6	7.7	11.7
Domestic, net	8.2	6.8	-6.6	-7.6	0.4	-1.7	-1.4	-1.4	-1.1	-5.4
Privatization (including concessions)	0.5	0.0	0.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:										
CPS overall structural balance 6/	-15.1	-21.5	-6.0	-8.8	-7.0	-4.4	-5.3	-6.1	-6.1	-4.8
Non-oil balance	-30.1	-34.8	-31.5	-39.7	-43.0	-43.7	-43.4	-44.8	-45.5	-44.8
Primary balance 7/	-2.1	4.6	19.0	11.3	11.8	15.7	16.0	16.8	18.1	19.3
Oil-related revenues 8/	12.4	22.2	29.0	34.5	38.2	38.6	38.0	38.7	39.0	38.5
Total public debt 9/	201.7	222.1	212.8	252.8	265.4	274.1	283.1	292.5	303.0	313.4

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.

7/ Includes statistical discrepancy.

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

	2010	2011	2012	2013	Proj 2014
(In billions of COP, unless otherwise indicated)					
Central Bank					
Net Foreign Assets	53,265	61,750	65,356	83,092	87,683
Gross official reserve assets	54,583	63,566	65,824	88,928	87,746
in billions of US\$	27.4	32.7	37.2	46.3	44.2
Short-term foreign liabilities	844	1,575	403	5,770	2,583
Other net foreign assets	1,865	2,117	2,096	2,298	2,519
Net domestic assets	-8,388	-10,408	-8,892	-17,993	-16,837
Net credit to the public sector	-2,098	-4,624	-8,008	-14,526	-13,593
Net credit to the financial system	1,516	3,078	1,831	3,732	3,492
Other	-7,806	-8,863	-2,715	-7,199	-6,737
Monetary base	44,878	51,342	56,464	65,099	70,846
Currency in circulation	29,674	33,367	35,063	39,751	44,378
Deposit money banks reserves	15,157	17,946	21,374	25,254	20,393
Other deposits	47	29	27	94	94
Financial system					
Net foreign assets	44,392	47,389	53,145	67,826	71,417
in billions of US\$	22.3	24.4	30.0	35.3	36.0
Net domestic assets	168,288	202,773	237,166	261,480	376,484
Net credit to public sector	33,782	32,455	34,824	33,151	35,151
Credit to private sector	175,863	216,234	251,410	281,747	317,113
Other net	-41,357	-45,916	-49,068	-53,417	-70,846
Broad money	212,680	250,162	290,310	329,307	377,056
(Annual percentage change)					
Credit to private sector	16.8	23.0	16.3	12.1	12.6
Currency	15.6	12.4	5.1	13.4	11.6
Monetary base	13.5	14.4	10.0	15.3	8.8
Broad money	11.4	17.6	16.0	13.4	14.5
(In percent of GDP)					
Credit to private sector	32.3	34.8	37.8	39.2	41.4
Currency	5.4	5.4	5.3	5.5	5.8
Monetary base	8.2	8.3	8.5	9.1	9.3
Broad money	39.0	40.2	43.7	45.9	49.3
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
CPI inflation, eop	3.2	3.7	2.4	1.9	2.7
Nominal GDP (In billion COP)	544,924	621,615	664,473	718,081	765,133

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

Table 6. Colombia: Medium-Term Outlook

	2010	2011	2012	Est	Projections					
				2013	2014	2015	2016	2017	2018	2019
(In percent of GDP, unless otherwise indicated)										
Real GDP	4.0	6.6	4.0	4.3	4.5	4.5	4.5	4.5	4.5	4.5
Consumer prices (end of period)	3.2	3.7	2.4	1.9	2.7	3.0	3.0	3.0	3.0	3.0
Gross national savings	19.0	20.8	20.4	21.0	21.7	21.7	22.2	22.4	22.7	23.1
Private sector	15.5	14.9	13.3	14.5	15.2	15.3	15.8	16.0	16.3	16.7
Public sector	3.5	5.9	7.1	6.5	6.6	6.4	6.4	6.3	6.4	6.4
Gross domestic investment	22.1	23.7	23.6	24.3	25.0	25.0	25.2	25.4	25.7	26.0
Private sector	15.5	16.0	16.9	17.1	17.8	18.2	18.4	18.6	18.9	19.2
Public sector	6.6	7.8	6.7	7.2	7.2	6.8	6.8	6.8	6.8	6.8
External current account balance	-3.1	-2.9	-3.2	-3.3	-3.3	-3.3	-3.1	-3.0	-3.0	-2.9
Nonfinancial public sector 1/										
Revenue	26.1	26.7	28.4	27.7	27.3	27.0	26.8	26.7	26.7	26.7
Expenditure	29.2	28.5	27.9	28.7	28.2	27.7	27.5	27.4	27.4	27.3
Current expenditure	22.4	20.4	20.8	20.9	20.6	20.5	20.3	20.2	20.2	20.1
Capital expenditure	6.8	8.1	7.2	7.8	7.6	7.2	7.2	7.2	7.2	7.2
Primary balance 2/	-0.4	0.8	2.8	1.6	1.5	1.8	1.7	1.7	1.7	1.7
Overall balance 2/	-3.3	-2.0	0.1	-1.0	-0.9	-0.8	-0.7	-0.8	-0.7	-0.6
Combined public sector balance	-3.3	-2.0	0.2	-1.0	-0.8	-0.6	-0.6	-0.7	-0.6	-0.6
External financing	1.7	0.9	0.7	2.1	0.8	0.8	0.8	0.8	0.8	1.1
Domestic financing	1.5	1.1	-1.0	-1.1	0.1	-0.2	-0.2	-0.2	-0.1	-0.5
Privatization	0.1	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
External current account balance	-3.1	-2.9	-3.2	-3.3	-3.3	-3.3	-3.1	-3.0	-3.0	-2.9
Trade balance	0.8	1.8	1.3	0.7	1.4	0.8	0.9	0.7	0.5	0.5
Exports	14.2	17.3	16.6	15.6	16.6	15.8	15.6	15.2	14.8	14.6
Imports	13.4	15.5	15.3	14.9	15.2	14.9	14.7	14.5	14.3	14.1
Capital and financial account balance	4.1	3.9	4.7	5.0	3.8	3.7	3.5	3.4	3.3	3.2
Public sector	1.7	0.6	0.8	2.2	0.8	0.7	0.7	0.7	0.7	0.7
Private sector	2.4	3.2	3.9	2.8	3.0	3.0	2.8	2.7	2.6	2.5
Net errors and omissions	0.1	0.2	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	1.1	1.1	1.5	1.8	0.5	0.4	0.4	0.4	0.3	0.3
Gross public sector debt 3/	37.0	35.7	32.0	35.2	34.7	33.5	32.2	31.0	29.8	28.6
Domestic debt	24.3	23.9	20.7	22.5	21.8	20.9	19.9	19.4	18.5	18.3
External debt	12.7	11.9	11.3	12.7	12.9	12.6	12.4	11.5	11.4	10.4
Gross public sector debt, excluding Ecopetrol	35.8	34.8	31.2	33.6	33.1	32.0	30.9	29.7	28.6	27.7
Memorandum items:										
Nominal GDP (in billion COP)	544,924	621,615	664,473	718,081	765,133	818,658	878,931	944,642	1,015,195	1,094,635
Crude oil, spot price (Colombian mix)	73.1	99.3	104.2	100.3	100.4	94.3	89.6	86.7	84.9	83.5

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.

Table 7. Colombia: Financial Soundness Indicators

Total Banking System 1/

	2007	2008	2009	2010	2011	2012	2013
	(In percent, unless otherwise indicated; end-of-period values)						
Capital Adequacy							
Regulatory capital to risk-weighted assets	16.0	15.4	17.2	17.3	16.9	18.1	17.0
Regulatory Tier 1 capital to risk-weighted assets	12.5	12.0	13.4	13.0	13.4	13.7	12.0
Capital (net worth) to assets	12.9	12.6	14.2	14.2	14.3	14.7	14.8
Asset Quality and Distribution							
Nonperforming loans to gross loans	3.2	3.9	4.0	2.9	2.5	2.8	2.8
Provisions to nonperforming loans	133.8	124.3	140.1	175.0	182.0	163.9	160.7
Gross loans to assets	70.3	71.2	64.3	67.9	70.4	69.6	68.2
Earnings and Profitability							
ROAA	3.8	3.6	3.5	3.4	3.3	3.1	2.8
ROAE	29.6	28.1	26.2	23.7	23.0	21.2	19.5
Interest margin to gross income	51.2	54.0	54.0	55.6	58.4	58.7	61.3
Noninterest expenses to gross income	45.9	46.1	43.2	47.0	49.3	47.2	47.0
Liquidity							
Liquid assets to total assets	7.5	8.2	9.2	7.5	8.6	8.5	8.8
Liquid assets to short-term liabilities	11.6	12.8	14.2	12.1	13.9	13.4	13.8
Deposit to loan ratio	94.7	94.9	98.8	93.5	91.4	94.7	96.3
Other							
Foreign-currency-denominated loans to total loans	6.3	6.6	4.2	6.9	7.7	7.5	7.3
Foreign-currency-denominated liabilities to total liabilities	8.5	8.9	6.6	11.2	15.3	2.8	9.5
Net open position in foreign exchange to capital	1.9	-0.1	1.7	-2.0	-4.7	-0.5	-1.5

Source: Superintendencia Financiera

1/ All deposit taking institutions.

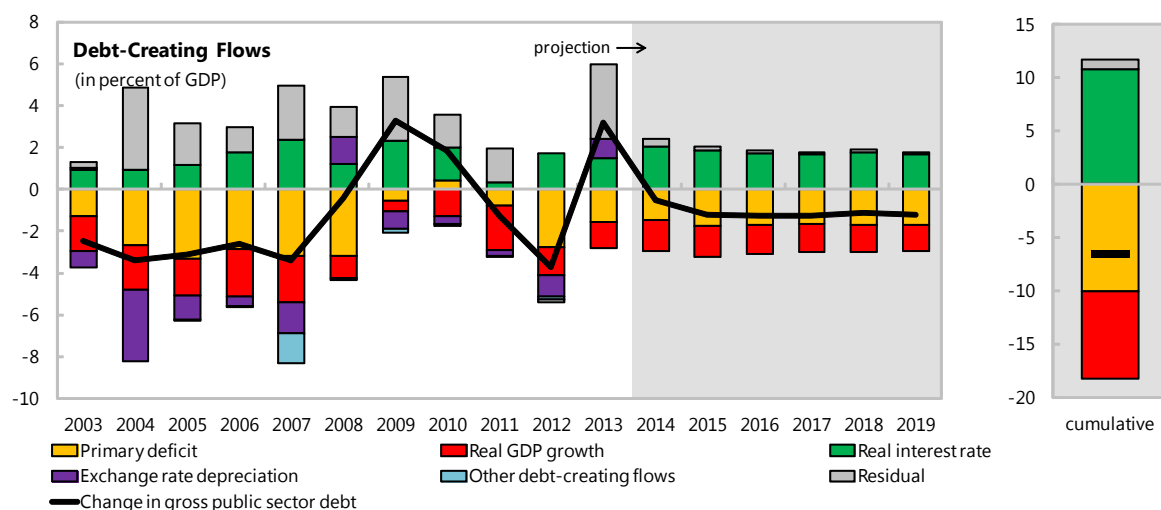
Table 8. Colombia Public Sector Debt Sustainability Analysis (DSA) - Baseline Scenario

(in percent of GDP unless otherwise indicated)

	Actual			Projections						As of March 31, 2014		
	2003-2011 ^{2/}	2012	2013	2014	2015	2016	2017	2018	2019			
Nominal gross public debt	36.9	32.0	35.2	34.7	33.5	32.2	31.0	29.9	28.6	Sovereign Spreads		
Public gross financing needs	8.4	3.2	4.5	6.0	5.4	4.6	3.8	5.2	3.8	EMBIG (bp) 3/ 171		
Real GDP growth (in percent)	4.8	4.0	4.3	4.5	4.5	4.5	4.5	4.5	4.5	5Y CDS (bp) 107		
Inflation (GDP deflator, in percent)	5.8	2.7	3.7	2.0	2.4	2.7	2.8	2.8	3.1	Ratings	Foreign	Local
Nominal GDP growth (in percent)	10.9	6.9	8.1	6.6	7.0	7.4	7.5	7.5	7.8	Moody's	Baa3	Baa3
Effective interest rate (in percent) ^{4/}	10.3	8.0	8.8	8.2	8.3	8.4	8.5	9.2	9.2	S&Ps	BBB	BBB+
										Fitch	BBB	BBB+

Contribution to Changes in Public Debt

	Actual			Projections						cumulative	debt-stabilizing primary balance ^{9/}
	2003-2011	2012	2013	2014	2015	2016	2017	2018	2019		
Change in gross public sector debt	-1.3	-3.7	3.2	-0.5	-1.2	-1.3	-1.3	-1.1	-1.2	-6.6	
Identified debt-creating flows	-3.2	-3.6	-0.4	-0.9	-1.4	-1.4	-1.4	-1.2	-1.3	-7.6	
Primary deficit	-1.9	-2.8	-1.6	-1.5	-1.8	-1.7	-1.7	-1.7	-1.7	-10.0	0.4
Primary (noninterest) revenue and grants	26.3	28.4	27.7	27.3	27.0	26.8	26.7	26.7	26.7	161.1	
Primary (noninterest) expenditure	24.3	25.6	26.1	25.8	25.2	25.1	25.0	25.0	25.0	151.1	
Automatic debt dynamics ^{5/}	-1.1	-0.7	1.1	0.6	0.4	0.3	0.3	0.5	0.4	2.5	
Interest rate/growth differential ^{6/}	-0.3	0.4	0.2	0.6	0.4	0.3	0.3	0.5	0.4	2.5	
Of which: real interest rate	1.4	1.7	1.5	2.0	1.9	1.7	1.7	1.8	1.6	10.7	
Of which: real GDP growth	-1.7	-1.4	-1.3	-1.5	-1.5	-1.4	-1.3	-1.3	-1.3	-8.2	
Exchange rate depreciation ^{7/}	-0.8	-1.0	0.9	...	...	...	...	...	...	...
Other identified debt-creating flows	-0.2	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Privatization proceeds (negative)	-0.2	-0.1	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	
Residual, including asset changes ^{8/}	2.0	-0.1	3.6	0.4	0.1	0.1	0.1	0.1	0.1	1.0	



Source: IMF staff.

1/ Public sector is defined as general government.

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; π = 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.

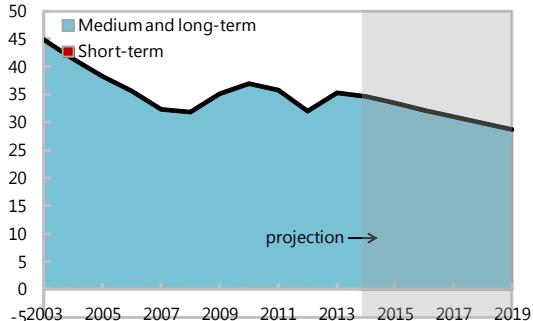
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Figure 7. Colombia Public DSA – Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

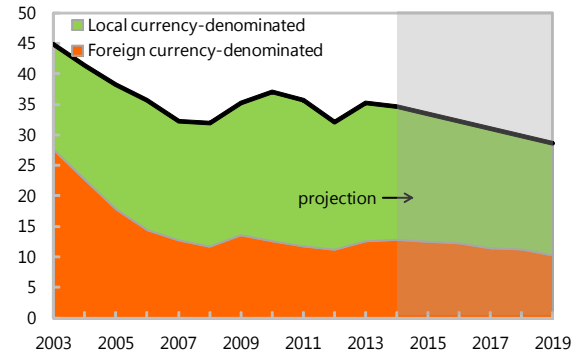
By Maturity

(in percent of GDP)



By Currency

(in percent of GDP)



Alternative Scenarios

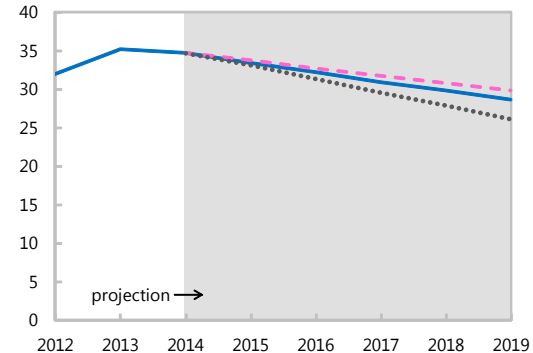
— Baseline

..... Historical

- - - Constant Primary Balance

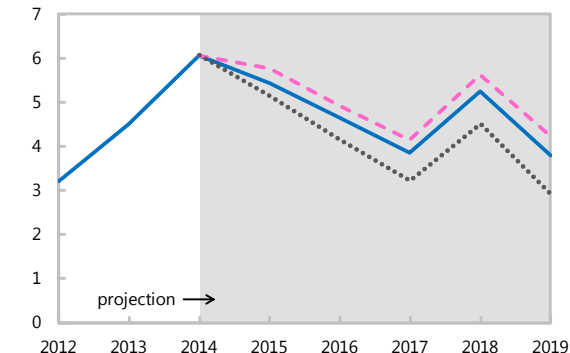
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

(in percent)

	2014	2015	2016	2017	2018	2019
Baseline Scenario						
Real GDP growth	4.5	4.5	4.5	4.5	4.5	4.5
Inflation	2.0	2.4	2.7	2.8	2.8	3.1
Primary Balance	1.5	1.8	1.7	1.7	1.7	1.7
Effective interest rate	8.2	8.3	8.4	8.5	9.2	9.2
Constant Primary Balance Scenario						
Real GDP growth	4.5	4.5	4.5	4.5	4.5	4.5
Inflation	2.0	2.4	2.7	2.8	2.8	3.1
Primary Balance	1.5	1.5	1.5	1.5	1.5	1.5
Effective interest rate	8.2	8.3	8.3	8.5	9.2	9.2

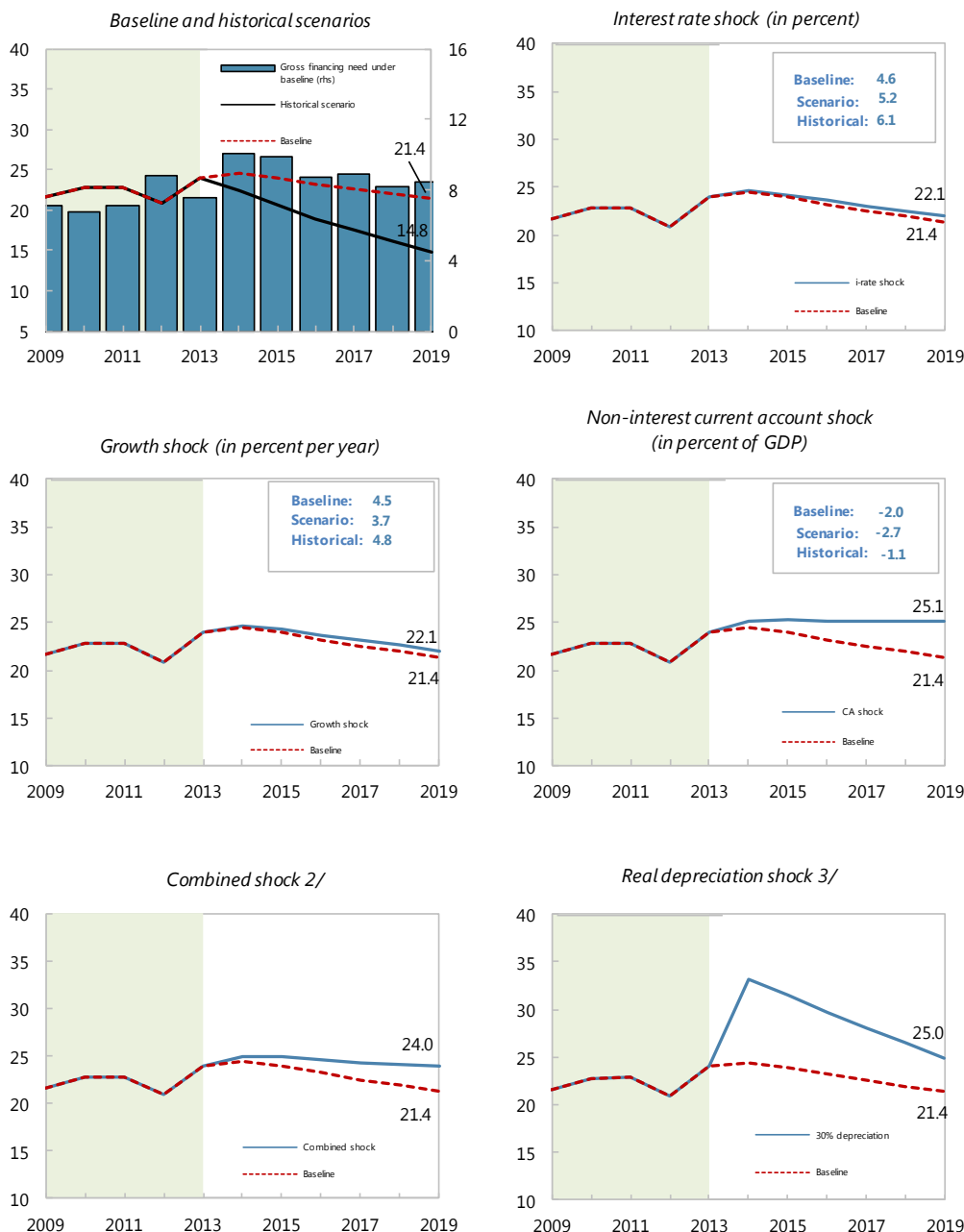
	2014	2015	2016	2017	2018	2019
Historical Scenario						
Real GDP growth	4.5	4.8	4.8	4.8	4.8	4.8
Inflation	2.0	2.4	2.7	2.8	2.8	3.1
Primary Balance	1.5	2.1	2.1	2.1	2.1	2.1
Effective interest rate	8.2	8.3	8.2	8.2	8.8	8.7

Source: Fund staff estimates.

Table 9. Colombia: External Debt Sustainability Framework, 2010-2019
(In percent of GDP, unless otherwise indicated)

	Actual			Projections 1/							Debt-stabilizing non-interest current account 7/
	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	
Baseline: External debt	22.8	22.8	20.9	24.0	24.5	23.9	23.2	22.5	22.0	21.4	-2.8
Change in external debt	1.1	0.1	-2.0	3.1	0.5	-0.5	-0.7	-0.7	-0.6	-0.6	
Identified external debt-creating flows (4+8+9)	-0.9	-1.9	-3.2	0.1	-0.1	-0.6	-0.7	-0.8	-0.7	-0.6	
Current account deficit, excluding interest payments	2.1	2.0	2.3	2.4	2.1	2.2	2.0	2.0	2.0	2.0	
Deficit in balance of goods and services	0.5	-0.4	0.2	0.7	0.1	0.6	0.6	0.8	1.0	1.0	
Exports	15.7	18.8	18.0	17.1	18.3	17.5	17.2	16.8	16.4	16.1	
Imports	16.2	18.4	18.2	17.8	18.4	18.1	17.8	17.6	17.3	17.1	
Net non-debt creating capital inflows (negative)	0.1	-1.5	-4.4	-2.4	-3.1	-2.6	-2.4	-2.4	-2.3	-2.2	
Automatic debt dynamics 2/	-3.0	-2.3	-1.1	0.1	0.9	-0.2	-0.3	-0.4	-0.4	-0.5	
Contribution from nominal interest rate	1.0	1.0	0.9	1.0	1.2	1.1	1.1	1.0	1.0	0.9	
Contribution from real GDP growth	-0.7	-1.3	-0.8	-0.9	-1.1	-1.0	-1.0	-1.0	-1.0	-0.9	
Contribution from price and exchange rate changes 3/	-3.3	-2.1	-1.2	0.1	...	...	...	...	...	...
Residual, incl. change in gross foreign assets (2-3) 4/	2.0	2.0	1.2	3.0	0.6	0.1	0.0	0.1	0.1	0.1	
External debt-to-exports ratio (in percent)	144.7	121.8	115.8	140.1	133.5	137.1	134.7	134.2	133.9	133.1	
Gross external financing need (in billions of U.S. dollars) 5/	19.3	24.0	32.5	28.9	39.0	40.6	37.9	41.3	40.2	44.2	
in percent of GDP	6.7	7.1	8.8	7.5	10.0	9.9	8.7	8.9	8.2	8.4	
Scenario with key variables at their historical averages 6/					22.4	20.7	19.0	17.5	16.1	14.8	-3.6
Key Macroeconomic Assumptions Underlying Baseline											
Real GDP growth (in percent)	4.0	6.6	4.0	4.3	4.5	4.5	4.5	4.5	4.5	4.5	
GDP deflator in US dollars (change in percent)	18.1	9.9	5.7	-0.3	-3.3	1.1	1.5	1.8	1.9	2.1	
Nominal external interest rate (in percent)	5.7	5.1	4.4	4.7	5.2	4.8	4.7	4.7	4.6	4.5	
Growth of exports (U.S. dollar terms, in percent)	18.5	39.6	5.7	-1.4	8.3	0.5	4.8	3.6	4.0	4.6	
Growth of imports (U.S. dollar terms, in percent)	20.9	32.6	9.3	1.4	4.6	3.8	4.6	5.0	4.9	5.0	
Current account balance, excluding interest payments	-2.1	-2.0	-2.3	-2.4	-2.1	-2.2	-2.0	-2.0	-2.0	-2.0	
Net non-debt creating capital inflows	-0.1	1.5	4.4	2.4	3.1	2.6	2.4	2.4	2.3	2.2	
Source: Fund staff estimates.											
1/ It does not assume any drawings under the Flexible Credit Line arrangement.											
2/ Derived as $[r - g - p(1+g) + ea(1+r)] / (1+g+p+gp)$ times previous period debt stock, with r = nominal effective interest rate on external debt; p = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency debt in total external debt.											
3/ The contribution from price and exchange rate changes is defined as $[-p(1+g) + ea(1+r)] / (1+g+p+gp)$ times previous period debt stock. p increases with an appreciating domestic currency ($e > 0$) and rising inflation (based on GDP deflator).											
4/ For projection, line includes the impact of price and exchange rate changes.											
5/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.											
6/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.											
7/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.											

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



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

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

3/ One-time real depreciation of 30 percent occurs in 2013, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).



COLOMBIA

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

May 2, 2014

Prepared By

The Western Hemisphere Department
(In collaboration with other Departments)

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FUND RELATIONS

(As of March 31, 2014)

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

General Resources Account:

	SDR million	Percent Quota
Quota	774.00	100.00
Fund holding of currency (Exchange rate)	492.66	63.65
Reserve position	281.35	36.35

SDR Department:

	SDR million	Percent Quota
Net cumulative allocation	738.32	100.00
Holdings	732.68	99.23

Outstanding Purchases and Loans: None

Latest Financial Arrangements

Type	Date of Arrangement	Expiration Date	In million of SDR	
			Amount Approved	Amount Drawn
FCL	Jun 24, 2013	Jun 23, 2015	3,870.00	0.00
FCL	May 6, 2011	May 5, 2013	3,870.00	0.00
FCL	May 7, 2010	May 5, 2011	2,322.00	0.00
FCL	May 11, 2009	May 6, 2010	6,966.00	0.00
Stand-by	May 2, 2005	Nov 2, 2006	405.00	0.00
Stand-by	Jan 15, 2003	May 2, 2005	1,548.00	0.00

Projected Payments to the Fund (in SDR million):

	forthcoming				
	2014	2015	2016	2017	2018
Principal					
Charges/interest	0.01	0.01	0.01	0.01	0.01
Total	0.01	0.01	0.01	0.01	0.01

Implementation of HIPC Initiative: Not applicable

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

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 January 23, 2013 (Country Report No.13/35).

Implementation of Past Fund Recommendations. The authorities have been receptive to Fund advice. On the fiscal front, they are implementing Fund recommendations to strengthen revenue administration. The Fund welcomed the tax reform approved by Congress in late 2012, which replaced payroll taxes with a corporate income tax, and appears to be having a positive effect in fostering formal employment. Staff has also supported plans to increase coverage and fairness in the pension system as well as efforts to contain health care costs, two areas in which the authorities are currently working. On the financial front, the authorities are working on improving risk-based supervision and enhancing cross-border supervision, in line with Fund advice. In the area of statistics, work is underway in the area of national accounts, price indices, and in the adoption of GFSM 2001.

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
FAD	Mar-13	Tax Administration
FAD	Apr-13	Budget General
FAD	Apr-13	Public Financial Management
FAD	May-13	Tax and Customs Administration
FAD	Jun-13	Tax Administration
FAD	Jun-13	Public Private Partnerships
FAD	Jul-13	Customs Administration
FAD	Sep-13	Public Financial Management
FAD	Oct-13	Tax Administration
FAD	Nov-13	Public Private Partnerships
FAD	Nov-13	Tax Administration
FAD	Nov-13	Revenue Administration
FAD	Dec-13	Public Financial Management
FAD	Feb-14	Revenue Administration
FAD	Feb-14	Tax Administration
FAD	Mar-14	Revenue Administration
FAD	Mar-14	Public Financial Management
STA	Apr-13	National Accounts Statistics
STA	Nov-13	Government Finance Statistics
STA	Dec-13	National Accounts Statistics
STA	Jan-14	Consumer Prices/Producer Price
STA	Jan-14	National Accounts Statistics

WORLD BANK RELATIONS¹

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

For FY 14–16 the lending program is expected to be US\$870–1,000 million per annum. Actual delivery of the lending program will depend on Colombia’s performance, IBRD lending capacity, demand from other borrowers, global economic developments, and disbursement profiles that keep exposure within the country limits. Trust funds have continued to be an integral part of the Bank’s engagement with Colombia. As trust fund resources are not predictable for the purpose of the CPS, the WBG is ensuring that activities financed by trust funds follow the thrust of this strategy in agreement with the government counterparts.

As of February 2014, Colombia is the 7th largest Bank borrower in terms of IBRD exposure, with US\$7.9 billion debt outstanding, representing about 7 percent of IBRD’s total portfolio. In December 2013, IBRD net commitments stood at US\$1.5 billion, of which US\$1.2 billion remained undisbursed. The active portfolio is composed of 18 IBRD and 2 GEF projects. More than 90 percent of the active IBRD commitment is in Sustainable Development, with the remainder split between Poverty Reduction (PREM) and Human Development (HD).

IFC committed US\$750 million in the last two fiscal years, including participants. Colombia represents 2.8 percent of IFC’s total outstanding portfolio. IFC’s committed portfolio includes participants from the financial, power and transportation sectors, which account for 87 percent of the total. Colombia also has a considerable Trust Fund portfolio with US\$17.3 million newly committed in RETF (Recipient Executed Trust Funds) over the period FY13–FY14 in 46 approved grant requests over the same period. Four of these grants are managed by IFC.

¹ Prepared by World Bank staff.

Operational Portfolio (IBRD/IDA and Grants) As of February 2014 (In millions of U.S. Dollars)	
Closed Projects	201
Active Projects	20
IBRD/IDA	
Total Disbursed (Active).	1.250
Of which has repaid	112.4
Total Disbursed (Closed)	4.769
Of which has been repaid	1.924.7
Total Disbursed (Active + Closed)	5.718
Of which has been repaid	2.036
Total Undisbursed (Active)	1.037.6

Loan Information (IBRD) As of February 2014 (In millions of U.S. Dollars)							
FY*	2008	2009	2010	2011	2012	2013	
Total Disbursements	638	1240	1592	488	396	780	
Repayment Amount	381	170	258	277	241	416	
Net Disbursements	257	1070	1334	211	155	364	

* Fiscal Year : July - June 30

International Finance Corporation (IFC) Portfolio As of February, 2014				
Debt (\$m)	Equity (\$m)	Quasi Equity (\$m)	Total (\$m)	Guarantee
455	422	125 (Loan + Equity)	1002	4
Investment Business – Top sectors and Clients				
Sector 1	Finance & Insurance			
Sector 2	Transportation & Warehousing			
Sector 3	Electric Power			
Sector 4	Chemicals			
Sector 5	Collective Investment Vehicles			
Top client	DAVIVIENDA I			

INTER-AMERICAN DEVELOPMENT BANK RELATIONS²

The Bank's ongoing country strategy with Colombia (2012–2014) identifies the main targets of engagement in the areas of Transportation, Science, Technology, and Innovation, Trade and Integration, Access to Financial Services, Education and Vocational Training, Social Protection, Health, Water Supply and Sanitation, Housing and Urban Development, Risk Management.

These areas are part of a comprehensive vision for the development process of the country, aimed at creating a “virtuous circle” between the objectives of increased growth, and reducing poverty and inequality. There are cross-cutting requirements associated with these areas, in order to overcome conditions of poverty and inequity, which are: (i) targeting actions and resources to a balanced, multidimensional approach to regional development in relation to public management and competitiveness, and (ii) recognizing both infrastructure development, and human and social capital development as necessary factors for greater competitiveness, stronger institutions, and better governance.

The sovereign guarantee lending envelope under the current Strategy was estimated at US\$852 million per year, which total US\$3.4 billion for the years 2012 to 2014. In 2013, the Bank approved 10 operations for US\$1023 million in sovereign guarantee operations.

The Bank portfolio is currently composed of 23 sovereign guarantee operations, totaling US\$1.6 billion, with a disbursed percentage of 23 percent. Operations are concentrated in competitiveness (70 percent), governance (17 percent) and social development (13 percent). The non-reimbursable technical cooperation portfolio includes 126 operations, with an approved value of US\$95 million. This includes the Multilateral Investment Fund, whose portfolio has 48 operations for US\$48million.

The current portfolio of private sector initiatives (non-sovereign guarantee) in Colombia consists of 3 loans, totaling US\$205 million. The Inter-American Investment Corporation has a portfolio of US\$87 million.

Colombia Sovereign Loan Portfolio			
As of February 28, 2014			
	Number of Operations	Current Approved US\$M	Disbursement (percent)
Competitiveness	4	1452	55
Governance	16	49	20
Social Development	3	116	35
TOTAL	23	1,617	23

² Prepared by Inter-American Development Bank staff.

STATISTICAL ISSUES

(As of March 31, 2014)

A. Assessment of Data Adequacy for Surveillance

Data provision is adequate for surveillance.

Real sector

The National Department of Statistics (DANE) is responsible for the compilation of the national accounts, although the Banco de la República (BdR) compiles the financial accounts. Annual and quarterly estimates of GDP by the production and the expenditure approaches use 2005 as the reference year. GDP compilation conforms to the methodological recommendations of the System of National Accounts 1993 (1993 SNA) and some recommendations of the 2008 SNA. The rebasing of the national accounts' base year included a methodological change regarding the volume measures from a fixed-base Laspeyres index to a Laspeyres chain index with 2005 as the reference year. The main implications of the rebasing are that the 2000 and 2005 series are not comparable and the chain index is associated with non-additivity of the components. The rebasing also resulted in an upward revision of the nominal GDP, reflecting improvements in source data. DANE currently compiles a monthly indicator of economic activity for internal purposes, but has decided to start disseminating it to the general public during the third quarter of 2014.

DANE is also responsible for price statistics. It currently compiles and disseminates the consumer price index (CPI) and the producer price index (PPI). The basket and weights of the CPI were updated in 2008 according to the latest Income-Expenditure Survey (2006–2007), which resulted in an increase in the number of products collected. DANE is currently updating the PPI, which is expected to be available during the third quarter of 2014.

Government finance statistics

The Ministry of Finance and Public Credit (MFPC) is responsible for the compilation of public revenue, expenditure, and financing data. The Colombian authorities have reaffirmed their commitment to adopt the GFSM 2001 framework, enhance inter-institutional coordination, and increase the resources allocated to compiling government finance statistics. While significant progress has been made, there is still a need to take additional steps. In the short term, these include: adopting a common list of public sector entities, and disseminating high-frequency data on a national and international level. The General Accounting Office (GAO) has developed a single accounting 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, which are reported annually to the IMF's Statistics Department for publication in the Government Finance Statistics Yearbook.

Financial sector statistics

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

External Sector Statistics

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

The 2005 data ROSC mission recommended that the BdR, in consultation with the DANE, develop a methodology to include unrecorded trade in the balance of payments on a timely basis. Although DANE developed a methodology to estimate unrecorded trade, the BdR does not include these estimates in the balance of payments statistics. Also, the BdR has been working to identify government bonds issued abroad and held by residents, but the task has not been completed yet due to coverage issues. In line with the mission's recommendations, the BdR reclassified some FDI equity transactions to portfolio equity, and adjusted the related investment income series accordingly.

The BdR also compiles and disseminates data on International Investment Position statistics, External Debt statistics, and the Data Template on International Reserves and Foreign Currency Liquidity. Colombia reports data to the Coordinated Portfolio Investment Survey (CPIS).

B. 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.

C. Reporting to STA (optional)

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

Colombia: Table of Common Indicators Required for Surveillance
As of April 7, 2014

	Date of Latest Observation	Date Received	Frequency of Data ¹	Frequency of Reporting ¹	Frequency of Publication ¹	Memo Items:	
						Data Quality – Methodological Soundness ⁸	Data Quality – Accuracy and Reliability ⁹
Exchange Rates	Apr. 7, 2014	Apr. 7, 2014	D	W	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities ²	Feb. 2014	Mar. 20, 2014	M	M	M		
Reserve/Base Money	Mar. 21, 2014	Apr. 7, 2014	D	W	W	LO, O, LO, LO	O, O, O, O, O
Broad Money	Mar. 21, 2014	Apr. 7, 2014	D	W	W		
Central Bank Balance Sheet	Feb. 2014	Mar. 2014	M	M	M		
Consolidated Balance Sheet of the Banking System	Jan. 2014	Mar. 2014	M	M	M		
Interest Rates ³	Apr. 4, 2014	Apr. 7, 2014	D	W	D		
Consumer Price Index	Feb. 2014	Mar. 5, 2014	M	M	M		
Revenue, Expenditure, Balance and Financing Composition ⁴ – General Government (GG) ⁵	Q3 2013	Mar. 2014	Q	Q	Q	O, O, LO, O	LO, O, O, O, NO
Revenue, Expenditure, Balance and Composition of Financing ⁴ – Central Government	Feb. 2014	Mar. 2014	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt ⁶	Q4 2013	Mar. 2014	Q	Q	Q		
External Current Account Balance	Q4 2013	Mar. 31, 2014	Q	Q	Q	O, LO, LO, LO	O, O, O, O, LO
Exports and Imports of Goods and Services	Q4 2013	Mar. 31, 2014	Q	Q	Q		
GDP/GNP	Q4 2013	Mar. 20, 2014	Q	Q	Q	O, LO, O, O	LO, O, LO, LO, NO
Gross External Debt	Dec. 2013	Apr. 2014	M	M	M		
International Investment Position ⁷	Q4 2013	Mar. 2014	Q	Q	Q		

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

² Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.

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

⁴ Foreign, domestic bank, and domestic nonbank financing.

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

⁶ Including currency and maturity composition.

⁷ Includes external gross financial asset and liability positions vis-à-vis nonresidents.

⁸ Reflects the assessment provided in the data ROSC published in October 2006 for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O); largely observed (LO); largely not observed (LNO); not observed (NO); and not available (NA).

⁹ Same as footnote 8, except referring to international standards concerning (respectively) source data, assessment of source data, statistical techniques, assessment and validation of intermediate data and statistical outputs, and revision studies.



INTERNATIONAL MONETARY FUND



Press Release No. 14/234
FOR IMMEDIATE RELEASE
May 19, 2014

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

IMF Executive Board Concludes Article IV Consultation with Colombia

On May 19, 2014, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation¹ with Colombia.

Colombia has maintained a robust economic performance in recent years. A strong policy framework—anchored by an inflation-targeting regime, a flexible exchange rate, a structural fiscal balance rule, and effective financial supervision and regulation—has allowed the authorities to respond adequately to shocks and pursue effective demand management. The authorities have continued to improve the policy framework in recent years, by including a fiscal sustainability principle in the constitution; introducing a structural fiscal balance rule; overhauling the oil and mining royalties system; and implementing a comprehensive tax reform that replaced payroll taxes with a corporate income tax. Amid increased volatility in financial markets, the Flexible Credit Line arrangement has also allowed Colombia to maintain orderly financial market conditions by providing a buffer against tail risks.

Real GDP growth rebounded strongly in the second half of 2013. After slowing down to 2.9 percent y/y in the second half of 2012 and the first half of 2013, growth accelerated to 5.2 percent y/y in the second half of 2013, driven by higher public investment and a solid expansion in private consumption. Overall, real GDP growth in 2013 as a whole averaged 4.3 percent, up from 4 percent in 2012. Employment also rose strongly, particularly in the formal sector of the economy, and unemployment declined to 9.7 percent in 2013, the lowest mark in the last decade. At the same time, inflation was subdued at 1.9 percent y/y at end-2013, slightly below the 2–4 percent target range.

¹ Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

Monetary and fiscal policies supported growth in 2013. The central bank held the policy interest rate constant at 3.25 percent between April 2013 and April 2014 in light of soft growth during the first half of the year and inflation at or below the lower bound of the target range throughout the year. The reallocation of central government spending to provide targeted stimulus (e.g., through mortgage interest subsidies) and the use of royalties for investment spending by sub-national governments also supported growth in 2013. In April 2014, the central bank increased the policy interest rate by 25 basis points to 3.5 percent. Going forward, the authorities have reaffirmed their commitment to adjust the policy rate as necessary as conditions warrant to keep inflation within the target range, to adhere to fiscal plans consistent with the medium-term fiscal framework, and to use the flexible exchange rate as a shock absorber.

The banking system remained stable. Financial soundness indicators remained strong, with low and well-provisioned non-performing loans, strong profitability, and adequate liquidity. New capital requirements became effective in August 2013, significantly enhancing the quality of banks' capital. The financial system is expected to continue deepening, and the participation of nonresidents in both the local government debt market and the equity market is also projected to rise in the near term.

Growth is projected to remain robust in 2014 and beyond, although risks are tilted to the downside. With the output gap nearly closed as of end-2013, real GDP is projected to grow at around potential (about 4½ percent) in 2014 and beyond, with inflation remaining within the target range. However, Colombia remains vulnerable to external risks, including: a sharp decline in commodity prices, especially oil; deterioration in global financial conditions; and volatility from the normalization of monetary policy in the U.S., especially if not accompanied by a corresponding increase in U.S. growth.

Executive Board Assessment²

Executive Directors commended the continued strong performance of the Colombian economy, with faster economic growth, low inflation, robust job creation, particularly in the formal sector of the economy, and declining unemployment. Nonetheless, while economic prospects are favorable, risks remain tilted to the downside. The uncertain global outlook, including the increase in geopolitical and emerging market risks, could present challenges even for strong and well-managed economies like Colombia. Directors stressed the importance of continued prudent policies to safeguard macroeconomic and financial stability and sustained structural reforms to promote more inclusive growth.

² 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>.

Directors commended the authorities' adherence to the fiscal rule and commitment to medium-term fiscal consolidation. They noted, however, that meeting the fiscal goals will require greater revenue mobilization, and called for decisive action to broaden the tax base, reduce informality, and strengthen tax administration. Adjustments on the expenditure side would also be needed to improve the efficiency of spending, including by reducing costs from healthcare provision. Directors considered the authorities' plans for a comprehensive reform of the pension system to broaden coverage and increase the equity of the pension system as a step in the right direction. Directors took note of the staff's assessment that the external position of the Colombian economy is strong, with the current account balance and the real exchange rate broadly in line with fundamentals. They emphasized that continued efforts to enhance productivity is crucial to raise competitiveness. Directors noted that risks to external stability are mitigated by a stable source of financing of the current account deficit, an adequate level of international reserves, and the additional line of defense offered by the Flexible Credit Line arrangement. Directors welcomed the authorities' recognition of the need to weigh the opportunity costs of further reserves accumulation vis-à-vis the benefits of ensuring sufficient buffers.

Directors noted that the financial system is sound and financial supervision broadly effective. Nonetheless, they saw room to enhance supervision of complex conglomerates and their exposure to concentration risk. They also highlighted that the expansion of the largest institutions across the region will require a deeper framework to monitor and stress-test cross-border risks.

Directors emphasized the need to foster more inclusive growth through structural reform. They encouraged the authorities to continue to reduce informality by further reducing non-wage costs and addressing labor market rigidities. They also recommended fostering financial inclusion by reducing the cost of access to finance and developing products tailored to low-income households. Directors noted that addressing infrastructure needs is critical to boosting competitiveness and growth and welcomed the authorities' infrastructure program.

Colombia: Selected Economic Indicators								
	2007	2008	2009	2010	2011	2012	Est 2013	Proj 2014
(Annual percentage changes, unless otherwise indicated)								
National Income and Prices								
Real GDP	6.9	3.5	1.7	4.0	6.6	4.0	4.3	4.5
Consumer price index (period average)	5.5	7.0	4.2	2.3	3.4	3.2	2.0	1.9
Consumer price index (end of period)	5.7	7.7	2.0	3.2	3.7	2.4	1.9	2.7
GDP deflator	5.0	7.6	3.4	3.9	7.0	2.7	3.7	2.0
Terms of trade (deterioration -)	3.3	9.9	-10.4	9.4	12.8	3.1	-4.7	1.3
Real effective exchange rate (depreciation -)	7.5	-2.7	4.7	5.1	3.0	6.2	-7.5	...
(In percent of GDP, unless otherwise indicated)								
Public finances								
Central government balance	-2.7	-2.3	-4.1	-3.9	-2.8	-2.3	-2.4	-2.3
Combined public sector balance	-0.7	-0.1	-2.7	-3.3	-2.0	0.2	-1.0	-0.8
Public debt 1/	32.3	31.9	35.2	37.0	35.7	32.0	35.2	34.7
External Sector								
Current account (deficit -)	-2.9	-2.8	-2.2	-3.1	-2.9	-3.2	-3.3	-3.3
External debt	20.8	20.4	21.6	22.8	22.8	20.9	24.0	24.5
of which: Public sector	12.8	11.8	13.7	12.7	11.9	11.3	12.7	12.9
GIR in percent of short-term debt	198.7	207.3	239.9	198.4	154.1	229.2	164.3	167.0
Savings and Investment								
Gross domestic investment	23.0	23.5	22.4	22.1	23.7	23.6	24.3	25.0
Gross national saving	20.1	20.7	20.3	19.0	20.8	20.4	21.0	21.7
(12-month percentage changes, unless otherwise indicated)								
Money and credit								
Broad money (M2)	14.8	17.4	8.8	11.4	17.6	16.0	13.4	14.5
Credit to the private sector	25.6	14.1	0.9	16.8	23.0	16.3	12.1	12.6
Interest rate (90-day time deposits; percent per year)								
Nominal	9.0	10.1	4.1	3.5	5.1	5.2	4.1	....
Sources: Colombian authorities; and Fund staff estimates and projections.								
1/ Includes Ecopetrol and Banco de la Republica's outstanding external debt.								

**Statement by Maria Angelica Arbelaez, Alternate Executive Director for Colombia
May 19, 2014**

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 continued to perform well. The growth rate was 4.3 percent in 2013, and is projected at 4.5 to 5 percent in 2014. Growth has been driven by strong consumption and investment with construction and agriculture as the leading sectors. Exports and manufacturing were subdued but started to recover bolstered by both the exchange rate depreciation and a more dynamic external demand. In the medium term, the four generation infrastructure project (4G) is estimated to add around 0.7 percentage points to the potential output, currently at 4.6 percent.

The authorities agree with staff that although the outlook is favorable, as other emerging markets (EMs) Colombia is also subject to a variety of shocks. One major risk is the uncertain and potentially disruptive process of monetary policy normalization pursued in the U.S. So far the "tapering" has produced an adjustment in asset prices throughout the EMs with diverse effects according to countries' fundamentals. The next step that involves raising policy interest rates could be more disruptive, as some past episodes suggest. Although these changes would come as a result of a stronger US economy and higher external demand for EMs, adverse shocks through world financial markets could overwhelm any positive effect stemming from real channels. In addition, Colombia could be affected by a Chinese slowdown not only directly, through decreases in prices and quantities of commodity exports, but also indirectly, through a declining export demand from regional markets that depend significantly on exports to China (e.g. Ecuador, Peru, Chile etc.)¹. Both policy normalization in the U.S. and a slowdown of the Chinese economy could trigger adverse reactions in other EMs and impact the Colombian economy via financial contagion. Finally, further deterioration in the Venezuelan economy (our second partner in manufacturing exports) and/or in other countries in Latin America could also impact the Colombian economy through different channels.

Colombia's strong policy framework, that has been its first line of defense, rests on three pillars: sustainable fiscal policy, a strong financial system, and an inflation targeting regime with exchange rate flexibility. This framework, well backed by the FCL, has provided the country with resilience and with the ability to pursue countercyclical policy responses. Indeed, economic policies supported last year's growth, while being prudent and keeping fundamentals strong. In 2013 inflation held in the lower bound of the target range; fiscal targets were met; the current account deficit remained relatively low and

¹ Colombian exports to China accounted for roughly 9 percent of total exports in 2013 and 24 percent of total Colombian exports were sold in 2013 to countries with significant trade links with China (excluding the US).

comfortably financed with FDI inflows; the level of international reserves increased and continue to be adequate; and the financial sector stayed sound and well capitalized.

Monetary and exchange rate policies

The central bank (Banco de Republica, BR) maintained an expansionary stance to support the economy while keeping inflation under control. As a response to slow growth in the first semester of 2013 and the negative output gap, and with the inflation rate in the lower bound of the target, the authorities have held the policy interest rate at 3.25 percent since April 2013. However, they began to move to a more neutral interest rate as the economy started to recover. In a context of inflation converging towards 3 percent, a more dynamic domestic demand (output gap close to zero) and rising employment, the BR raised the policy rate by 25 basis points at the end of April 2014. The objective of the BR is to achieve efficient monetary policy normalization by means of a timely and gradual adjustment of the policy stance. Delays in the start of this adjustment risked introducing sharper interest rate movements in the future with adverse effects on output and employment volatility.

The exchange rate has been the main shock absorber. After the announcement of the tapering by the U.S. Federal Reserve, the currency depreciated significantly with no negative consequences for the economy or inflation. Indeed, a credible long-term inflation target, a subdued exchange rate pass-through and low currency and FX term mismatches have been both consequences and conditions for the successful operation of the monetary and FX policy strategy.

The monetary authorities have continued to build-up reserves with the objective of keeping indicators at adequate levels. International reserves are accumulated through the program of pre-announced daily purchases in the FX market. The pace of accumulation is guided by a strategy that takes into account pre-crisis levels of several indicators (that proved to be an adequate buffer), and the average of levels of those indicators during the floating period. This strategy indicates the need for continued strengthening of the country's external liquidity position. It is worth noting, however, that the pursued level of international reserves is considered adequate for precautionary purposes but would be insufficient to cope with tail risks.

The external position continues to be strong and, according to the authorities, there is no evidence of a statistically significant exchange rate misalignment. In 2013 the current account deficit stood at 3.4 percent of GDP, similar to that of 2012, and comfortably financed with capital inflows (5.3 percent of GDP) of which FDI constitutes the largest fraction. The deficit is mainly associated with high imports in line with economic activity (related to FDI and to retail and industrial sectors) and high profit remittances from foreign companies. The authorities estimate that the current account deficit will slightly narrow in the coming years on account of higher exports.

Fiscal policy and stance

A strong framework, both at the central and subnational governments (SNGs), has supported fiscal consolidation, and helps to anchor fiscal discipline and promote savings². In 2013, the fiscal target dictated by the fiscal rule for the central government of 2.4 percent of GDP was met (0.9 percent for the combined public sector) with higher than envisaged revenues that allowed for higher public investment. The consolidation will continue gradually in the next years in order to reach a structural deficit of the central government of 1.9 percent of GDP in 2018 and levels below 1 percent in 2022 onwards—which in turn will bring down public debt to 26 percent of GDP.

The authorities welcome the selected issues paper on the fiscal rule. The main finding is that, even in a very adverse scenario (much more pessimistic than that assumed by the government) the adjustment would be at most 2 to 2.5 percent of GDP. The authorities are fully aware of the need for an adjustment based on raising revenues rather than cutting spending, but consider that the magnitude could be smaller as: GDP is expected to grow at least at the potential level or higher should positive effects on infrastructure materialize; oil and mining revenues might be larger (government's assumptions are rather conservative); and other revenues would become stronger as a result of the proceeds of the 2012 tax reform as well as envisaged tax administration improvements. Indeed, efforts in the latter front have been significant: tax revenue almost doubled in four years (COP 66 trillion in 2010 against 112 trillion in 2014). It is also important to reiterate that the fiscal rule enjoys broad support among key actors in Colombia and the government is fully committed to meeting its targets.

Financial sector

The financial sector continues to be sound, with healthy corporate and households balance sheets, strong credit quality and profitability. The solvency ratio of close to 15 percent is well above the regulatory minimum (9 percent) and, since August 2013, it complies with the quality of capital required by Basel III. Colombian credit institutions hold ample liquidity and are required to satisfy a liquidity indicator in line with the Liquidity Coverage Ratio of Basel III. Liquidity regulation for non-banking institutions is being evaluated and enacted. Currency and maturity mismatches of financial intermediaries are closely monitored and regulated.

The recent expansion of Colombian banks in Central America takes advantage of long-term business opportunities and diversifies some risks for financial conglomerates, although it poses challenges for regulators and the Central Bank. The authorities have acknowledged this new source of risk, and have undertaken mitigating actions. Firstly, closer ties with monetary and financial supervision authorities in Central America have

² Fiscal Transparency and Responsibility Law, Fiscal Rule, Traffic Lights and Fiscal Responsibility Law for SNGs, fiscal sustainability added as a principle in the Constitution and Royalties Reforms.

been established with the purpose of obtaining and sharing more and better information; secondly, Colombia's international reserves position has been reinforced.

Medium-term challenges

The Colombian authorities concur with staff on the important challenges ahead, and want to underscore the progress achieved in deepening inclusive growth and addressing infrastructure gaps.

Unemployment has continued to decrease, and reached in 2013 a historically low level of 9.6 percent. More importantly, job creation has been mainly in the formal sector (bolstered by the 2012 tax reform which significantly reduced labor costs) representing an enormous change in the Colombian labor market. In addition, poverty and extreme poverty have constantly declined and income inequality has improved. A further substantial reduction of inequality is envisaged in the next years as result of the full effect of the 2012 tax reform, whose main purpose was redistributive. In addition, the programs adopted by the government to broaden pension's coverage for the population that does not qualify for a pension as well as to strengthen financial inclusion will also contribute to reduce inequality. Finally, the government has put in place an ambitious infrastructure project (four generation) through APPs that is expected to boost competitiveness and growth.