



Colombia: Potential and Challenges for Future Growth

OECD Seminar
Beyond the Crisis - Returning to Sustainable
Growth in Latin America

Paris, November 2010

María Paola Figueroa | Economist BBVA
Research Colombia |

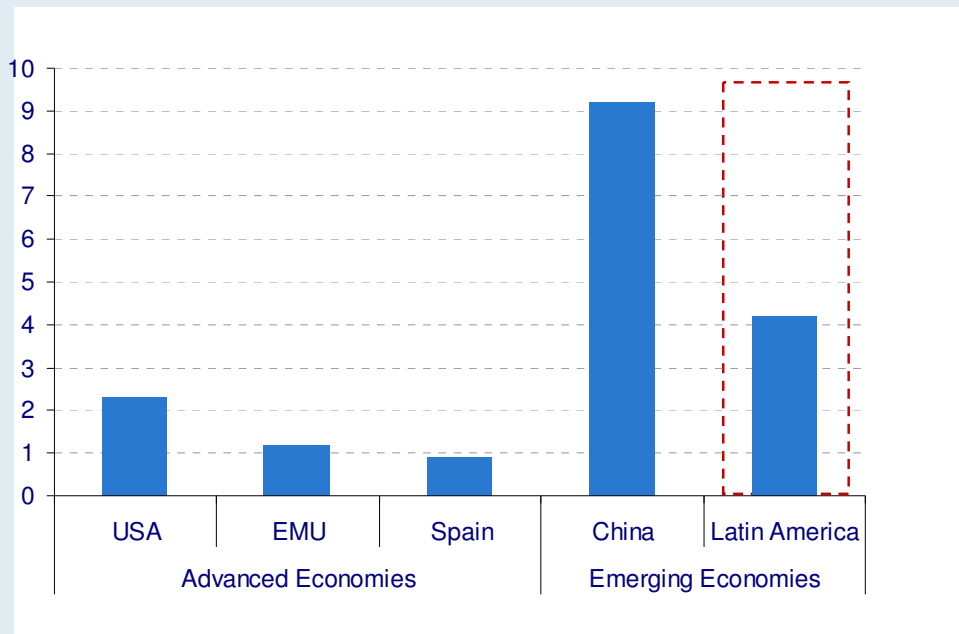
Global Outlook

Global Outlook

Economic growth in 2010 across key geographical areas will be above expected one year ago. Significantly higher in Emerging Markets.

2011 GDP growth revision

Source: BBVA Research Forecasts. *Latin America: Arg, Bra, Chi, Col, Mex, Per and Ven.



Latin America Economic Growth:

- **Breaks with the past**
- **Passes the “stress test”**
- **A bright future:**
 - Capital inflows
 - Commodity Prices
 - Asian Dynamism
 - Potential Growth

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Colombia breaks with the past

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A bright future, if the right road is taken...

Colombia breaks with the past

Colombia made substantial economic and institutional reforms. There have been important improvements in economic fundamentals. Proof of this is the relatively mild impact of the recent economic crisis.

Positive performance in the last 10 years

- Colombia exhibited relatively high growth rates over the last ten years.
- This process has been characterized by a strong increase in the investment rate.
- Colombia exhibits strong macroeconomic stability; fundamentals have improved.
- Both domestic and external factors have contributed to the recovery of investment.

Progress on macroeconomic fundamentals

- Low and stable inflation
- Exchange rate flexibility
- Current account financed mainly by long-term flows
- Improvements in financial regulation and supervision
- Progress on fiscal institutions with positive, albeit insufficient, results

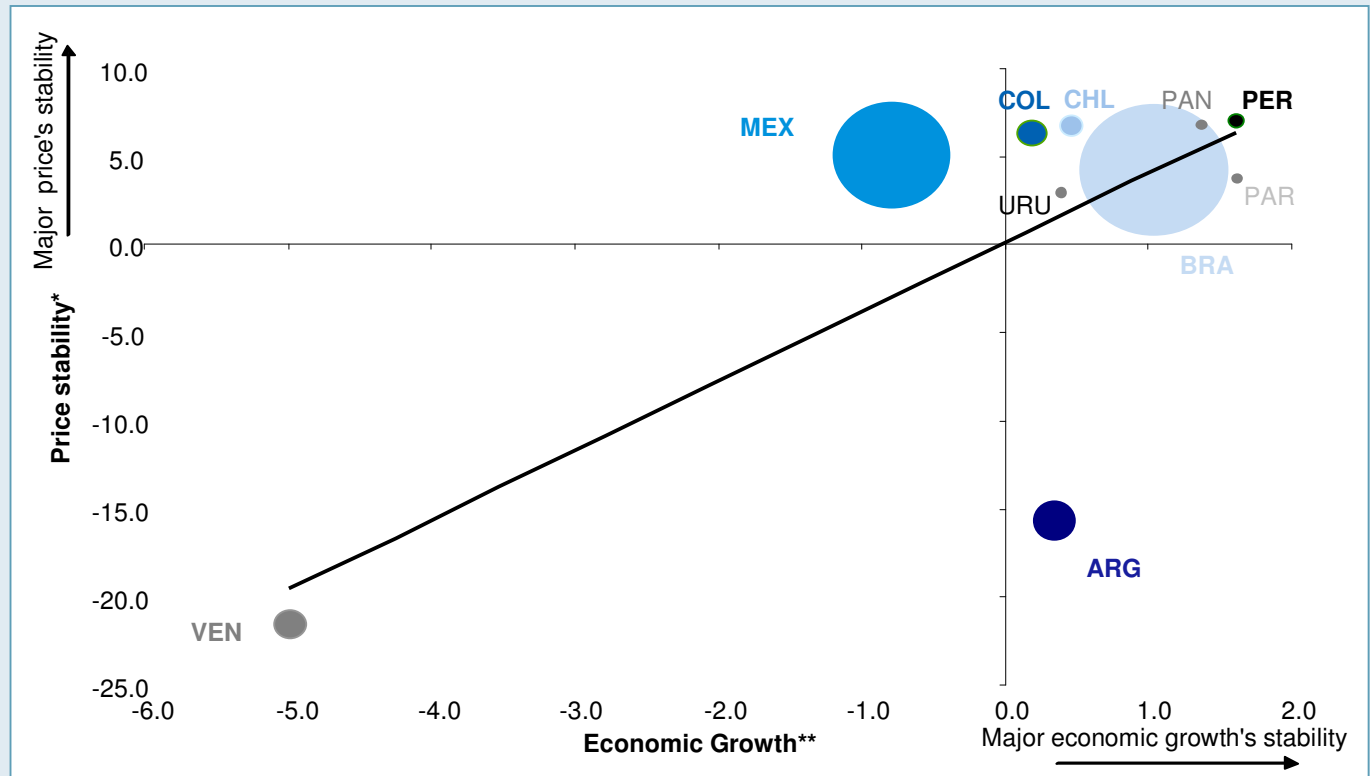
Colombia breaks with the past

Macroeconomic stability

Diversity in the region (GDP and CPI forecast)

Source: BBVA Research. *Price Stability: CPI 2010-2012 (spread % y/y average latam vs. average country). **Economic Growth: GDP 2010-2012 (spread % y/y average country vs. average latam) Bubble size: Total GDP based on purchasing-power-parity (PPP).

- **The “two giants”** (BRA, MEX)
- **Medium Size Emerging South America:** medium size countries combine good performance both in inflation and growth (CHL, COL, PER)
- **The “heterodox” countries:** most countries have achieved low inflation, but it remains a problem in ARG and VEN



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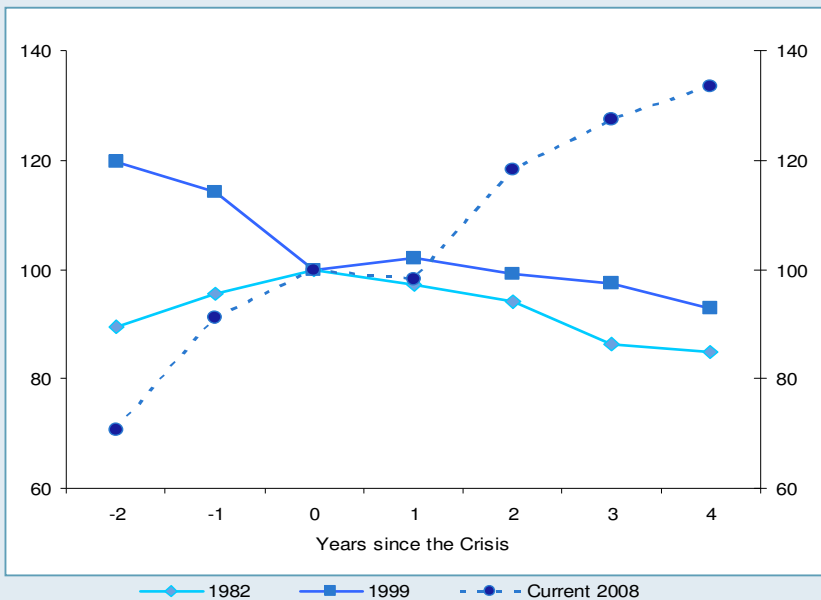
A bright future if the right road is taken

Colombia passes the “stress test”

Strength of the recovery

In the past, recessions meant long periods of divergence

Colombian performance during past crises



Source: DANE and BBVA Research.

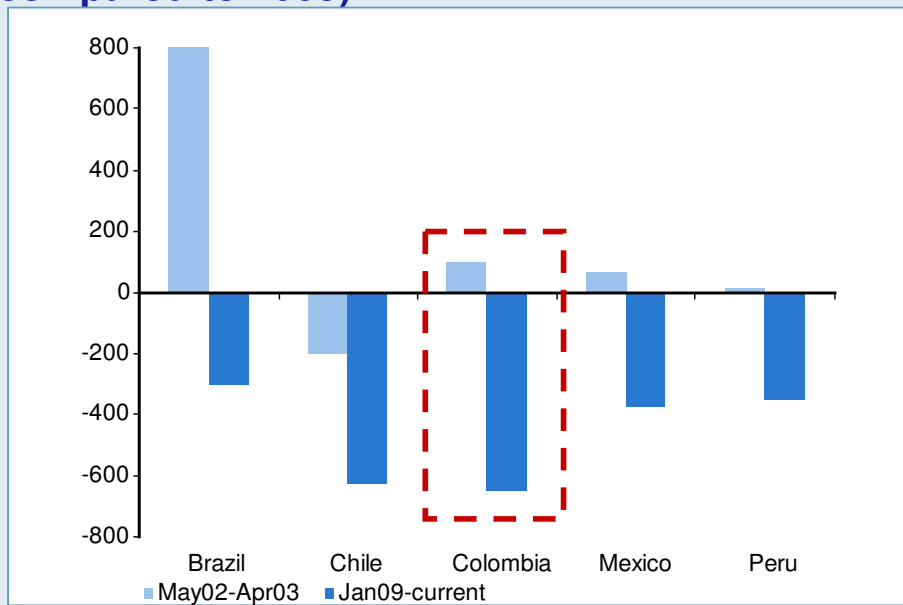
Resilience during the crisis

- Countercyclical monetary and fiscal policies
- Availability of funds in the financial system was not interrupted
- Government maintained access to international capital markets
- Healthy financial system indicators

Colombia passes the “stress test”

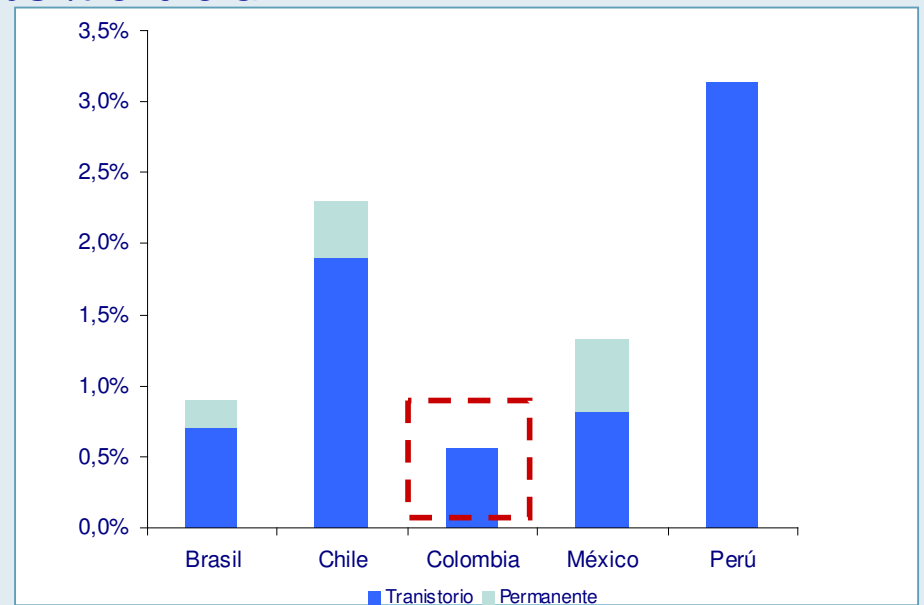
In this cycle fiscal and monetary policies were expansionary, marking a major break with previous cycles when financial constraints did not allow them.

Interest Rate changes during crises (2002 compared to 2009)



Source: BBVA Research, central banks

LatAm, Fiscal Stimulus as % of the GDP



Source: BBVA Research based on official data

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A bright future, if the right road is taken...

The concept of BBVA EAGLES

BRICs (GS)



Based on absolute size

- Bigger does not necessarily determine market potential



Static concept

- Allows no anticipation: too much inertia
- Too long horizon: at least 20-25 years
- Why four countries? Subjective



No clear cut-off

BBVA EAGLEs definition



Based on absolute growth

- Large enough size plus...
- Fast enough growth



Dynamic concept

- Anticipation: dynamic concept
- Shorter horizon: next 10 years
- Flexible number of countries: "Club admission" depends on performance



Defined Cut-off: the G6

BBVA EAGLEs is the set of countries whose contribution to World GDP growth is expected to be larger than that of the average G6 economy

EAGLEs “Nest”: other economies to watch

- Additional 11 economies are expected to add to global growth somewhere between the G6 average and Italy’s figure
- Some of the EAGLEs could fall from the list, some of these countries could make it into it

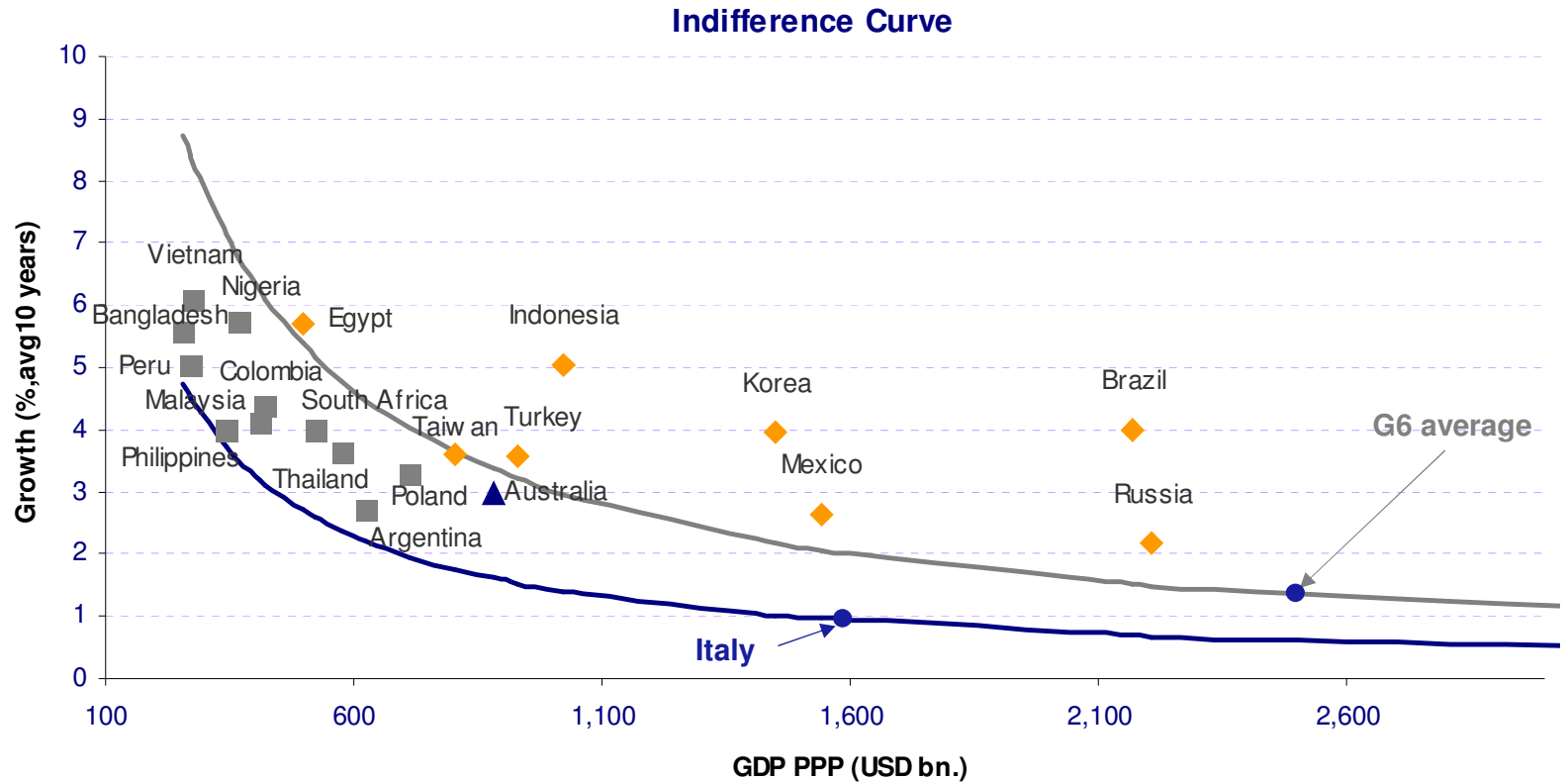
The “EAGLEs nest”

Source: BBVA Research

- Nigeria
- Poland
- South Africa
- Thailand
- Colombia**
- Vietnam
- Bangladesh
- Malaysia
- Argentina
- Peru
- Philippines

Indifference Curve: Growth and size in the watch list countries

Source: BBVA Research



Colombia: An “EAGLEs Nest”

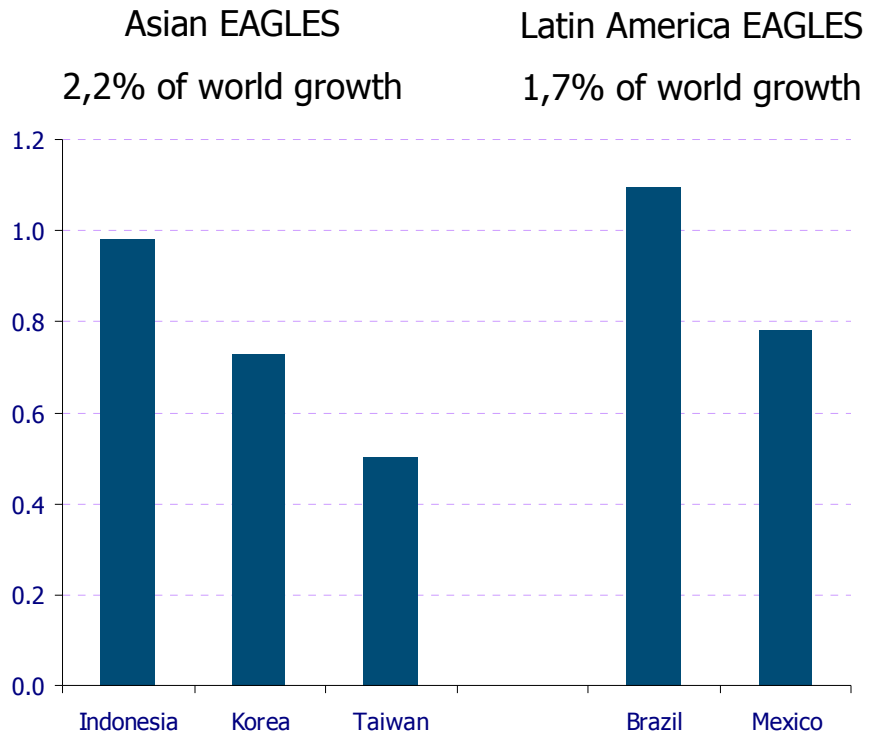
BBVA EAGLEs : Latin America compares with Asia in terms of its role for global growth in this decade

- 1) Latin American EAGLEs similar to Asian (ex China-India)
- 2) Latin American NEST countries close to Asian. Andinos region would make it into EAGLE status

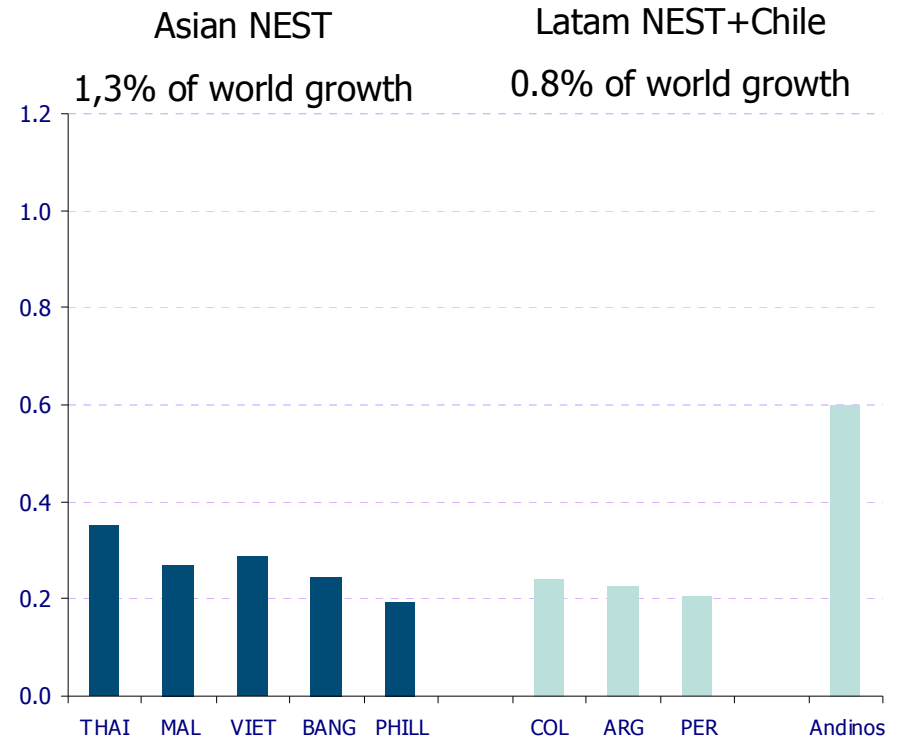
Contributions to World GDP growth: 2010-2020

Source: BBVA Research

EAGLE countries



NEST countries



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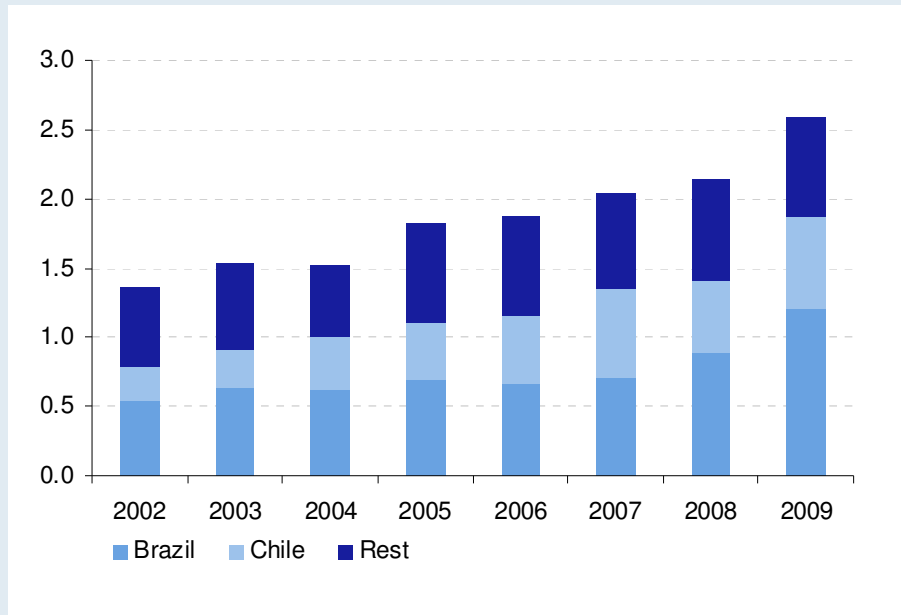
A bright future, if the right road is taken

The region has increased significantly its trade integration with Emerging Asia during the last decade, mainly at the expense of traditional trade partners (U.S.).

Initially Latam's exports to Asia have been biased towards commodities and are benefiting from high prices

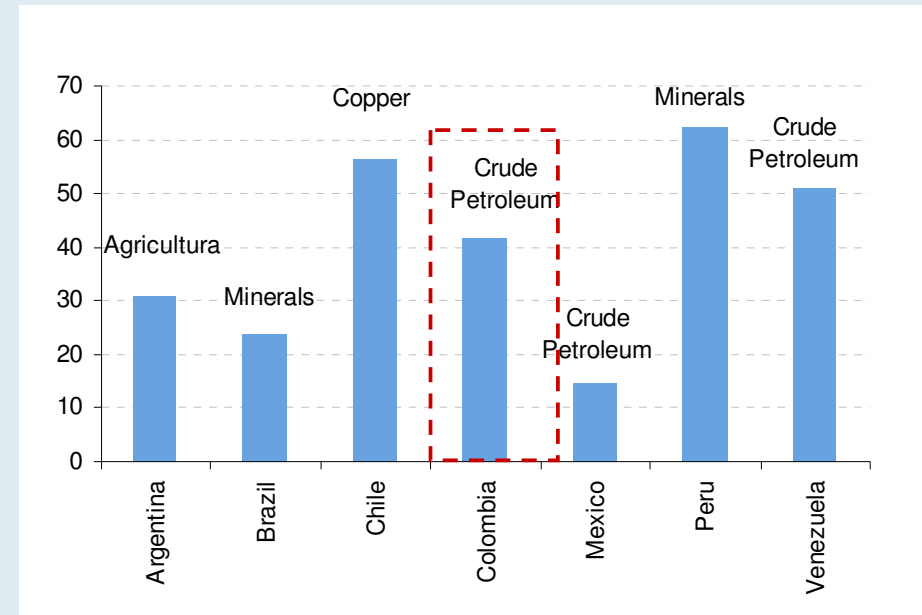
Asian imports from Latin America (% over total Asian imports)

Source: MF and BBVA Research



Concentration of the main product's exports to Asia from Latin America (% over total exports in each country)

Source: BBVA Research.

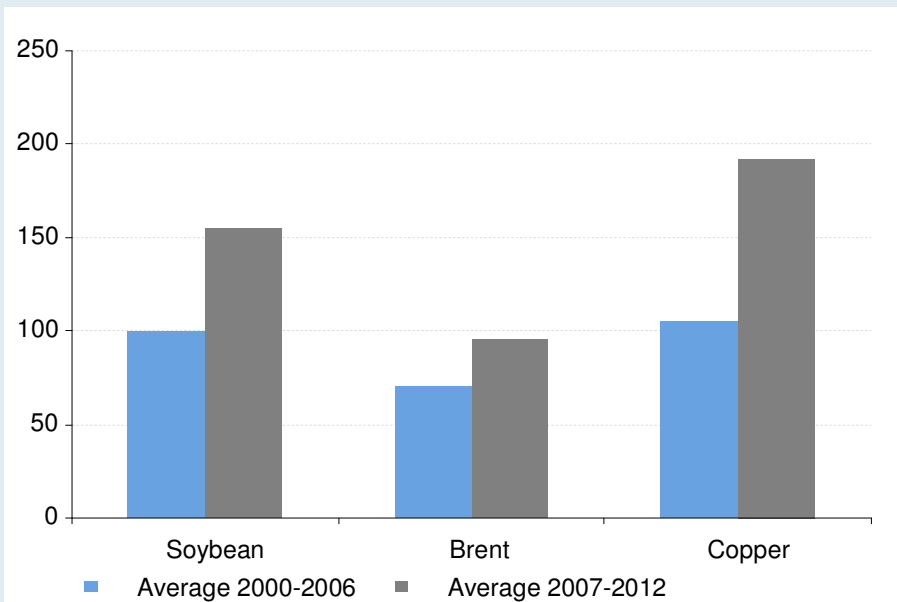


A bright future, if the right road is taken

Some new policy dilemmas: Stronger fundamentals means more appreciated currencies – in real terms – over the long – run

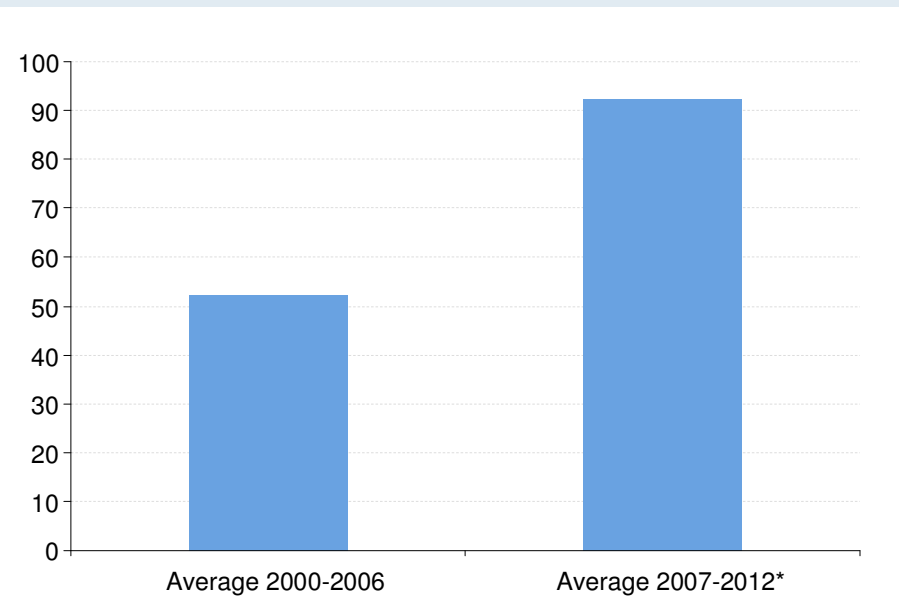
Real Commodities Price (Respect US CPI, base 2005=100)

Source: IMF and BBVA Research.



Foreign Direct Investment to the region (US\$ bn)

Source: BBVA Research. *Forecast BBVA Research.



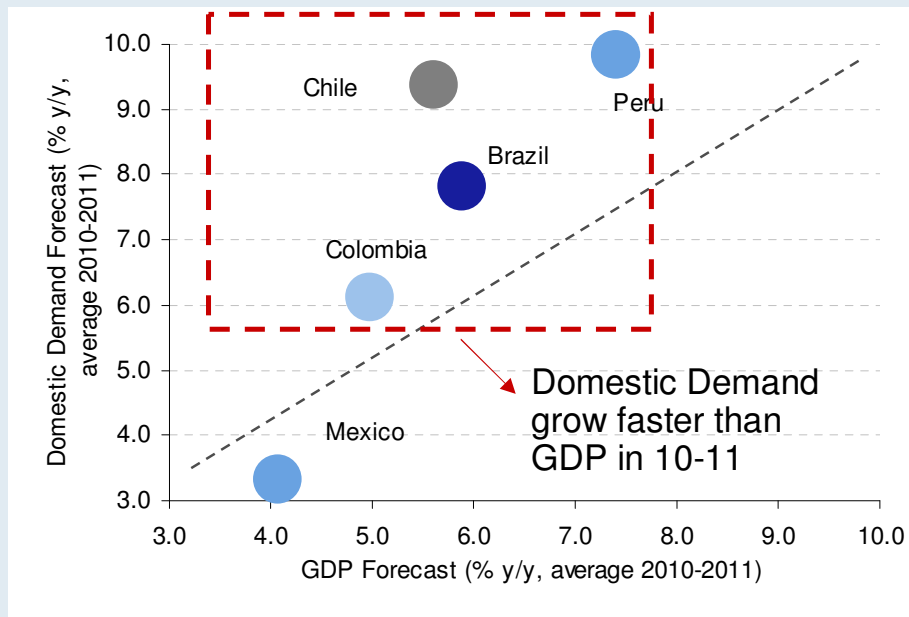
A bright future, if the right road is taken

Short term dilemmas: Domestic demand growth is outperforming GDP growth in almost all countries (Mexico is the exception) with significant risks of overheating, while policy interest rates are well below neutral levels in most countries

GDP and Domestic Demand Forecast

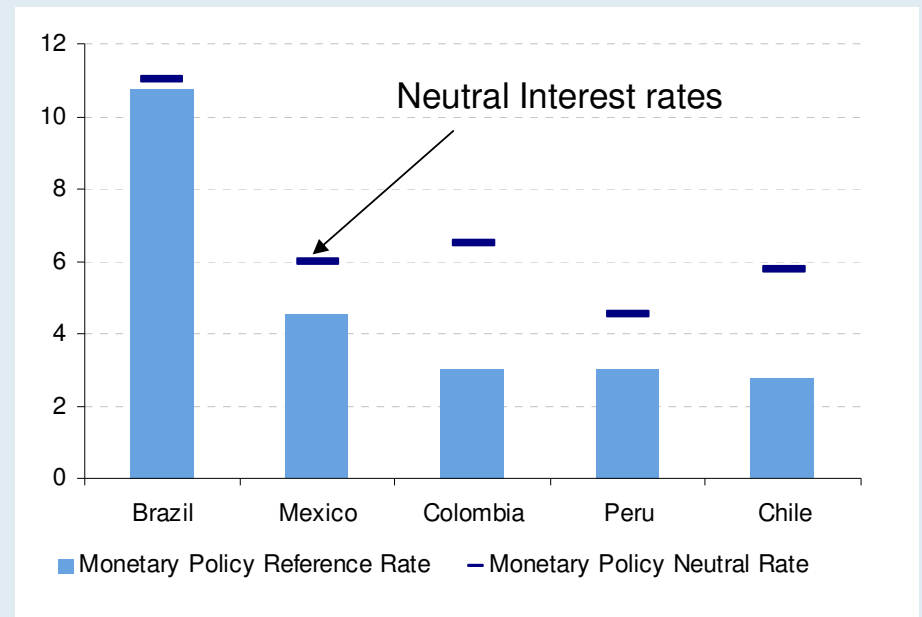
(% y/y, average 2010-2011)

Source: BBVA Research



Monetary Policy Rates (%)

Source: BBVA Research

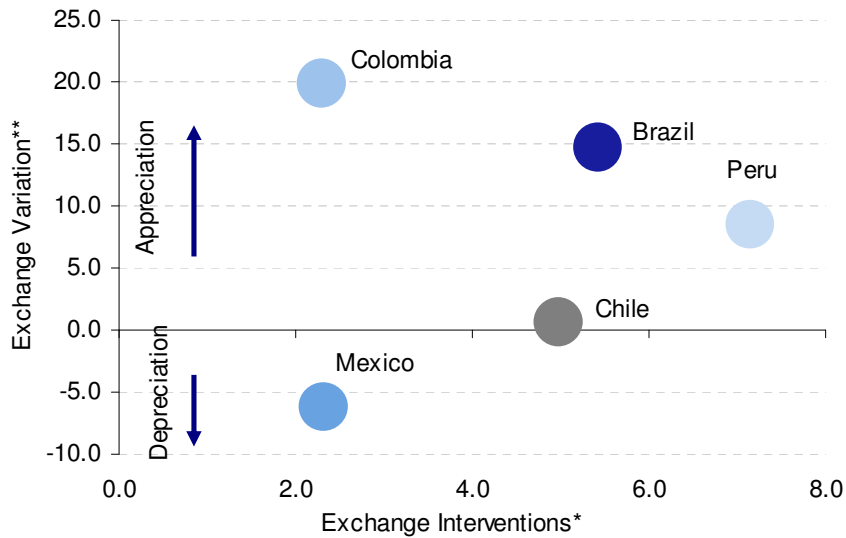


A bright future, if the right road is taken

Short term dilemmas: FX interventions have failed to prevent excessive appreciations in most countries, and policy makers are increasingly tilting towards capital controls. However, if these measures prove effective, there is a risk they will backfire through high inflation

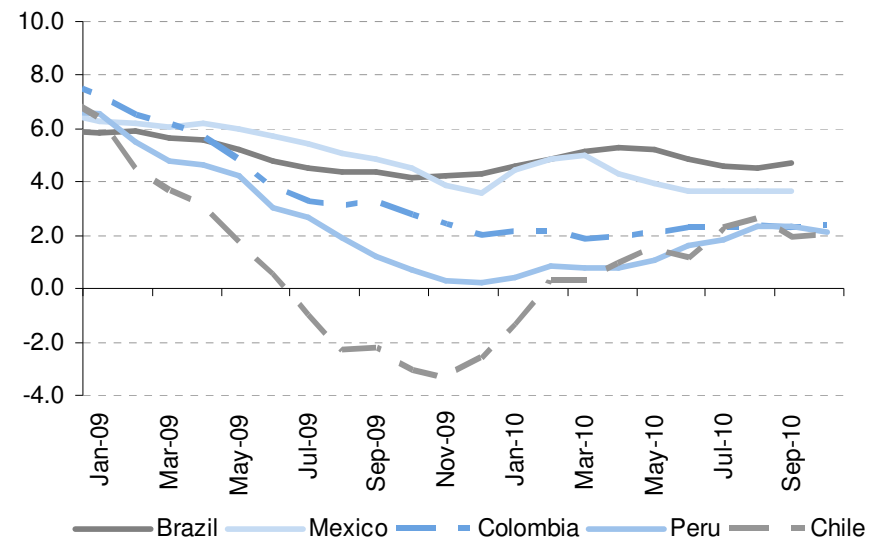
Exchange Rate: Appreciations and Interventions

Source: BBVA Research. *Exchange intervention: International Reserves: net purchase between Jan08-Sep10 (% GDP). **Exchange variation: Appreciation/Depreciation in Real Effective Exchange Rate between Jan08-Sep10



Inflation (% y/y)

Source: BBVA Research



Perspectives of a positive oil and mining cycle

Steps need to be taken to underpin the sustainability of public finances and macroeconomic stability, particularly in view of a potential boom in the mining-energy sector.

Risks:

- Commodity international prices are volatile.
- Fluctuations in prices lead to volatility in revenues and Government rents.
- Also lead to fluctuations in the real exchange rate, which discourage diversification and lead to the concentration of exports and production.

Opportunities:

- The trends in productivity are as positive for commodities as for other sectors of economic activity.
- The production of commodities provides positive “spillover effects” and links to other sectors, similarly to manufacturing.
- **Importance of well designed funds, oriented towards stabilization and saving in the long run.**

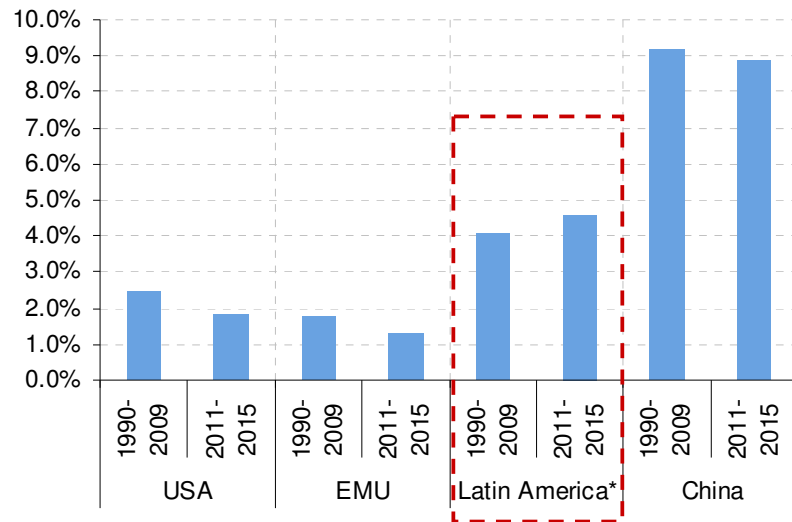
Source: World Bank (2010) and BBVA Research

A bright future, if the right road is taken

There is room for further increases in potential growth in the case extra microeconomic reforms and more investments in infra-structure and education materialize

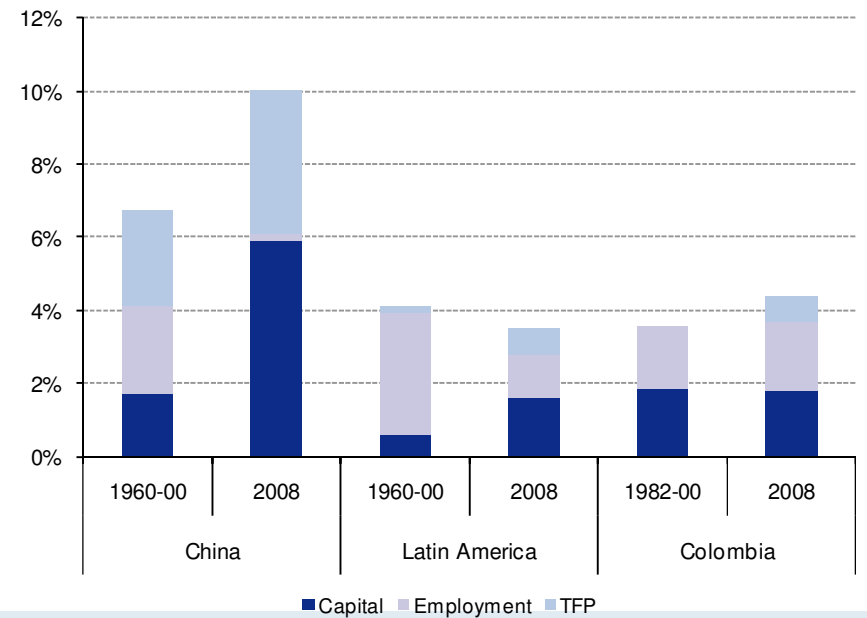
Potential Output Growth (% yoy change)

Source: BBVA Research. *Latin America: Arg, Bra, Chi, Col, Mex, Per and Ven.



Growth sources

Source: BBVA Research. *Latin America: Arg, Bra, Chi, Col, Mex, Per and Ven.



A bright future is the right road is taken...

There is room for further increases in potential growth in the case extra microeconomic reforms and more investments in infra-structure and education materialize...

Measures to strengthen growth in Colombia

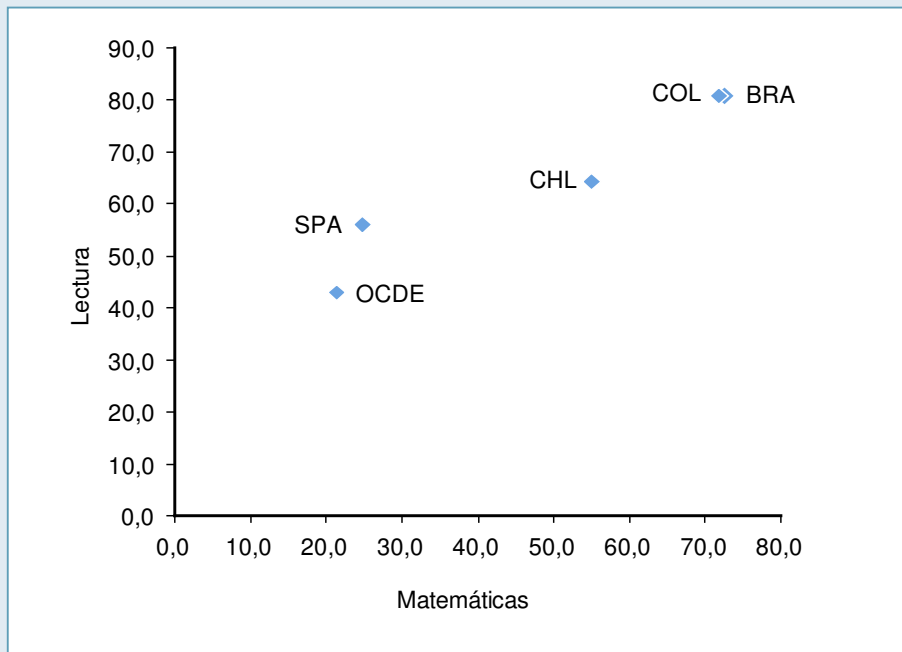
- Infrastructure
- Formalization and labor market reforms
- Increased internationalization
- Education
- Bancarization and financial deepening

A bright future is the right road is taken

Education is a challenge

More scarce labor requires better trained workers to interact with more capital and improve TFP. PISA results show a gap with the OECD

Results Test Pisa (% below Level 3)



Promote innovation and training for work

- The progress in coverage has not been proportional to improvements in quality
- Improve the adjustment between labor supply and demand to respond effectively to the needs of expansion and development

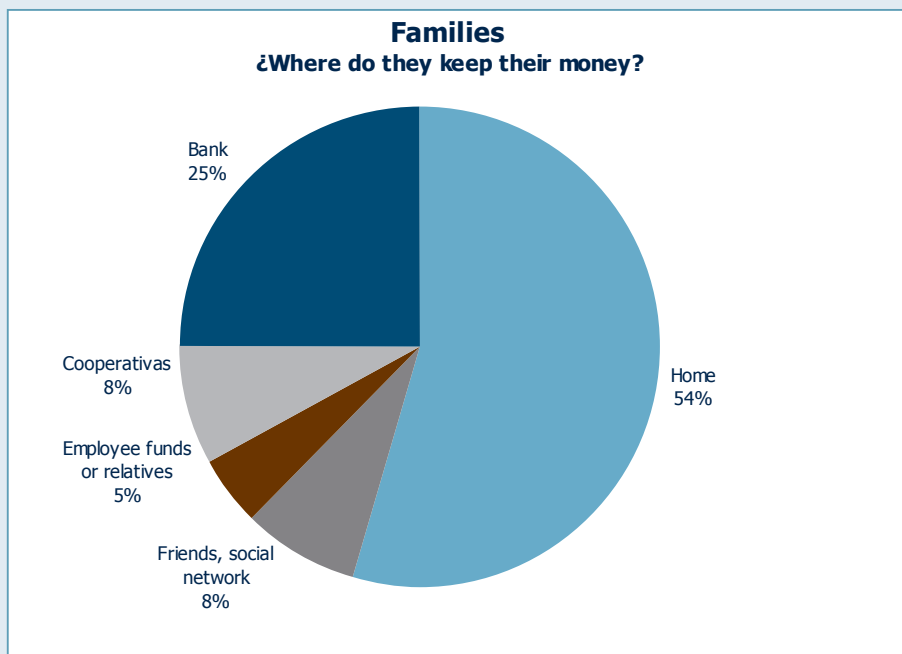
Source: World Economic Forum 2007

A bright future if the right road is taken...

Bancarization and financial deepening

Colombia has made clear efforts over the last years to consolidate and strengthen the financial system. However, in comparison to Latin America, indicators remain relatively low.

Where do families keep their money?



Source: Ecometria.

Strengthen financial development

- The percentage of adults with access to financial services is lower than 60%; credit is only 31% of GDP.
- The lack of protection for the compliance of financial contracts is one of the main barriers for the extension of credit.

Ambitious set of economic reforms

Government Budget 2011

- \$52,6 billions, 2,5% growth rate.
- Implicit Central Government Deficit 3.9%
- Public investment will diminish as % GDP (0.1 pp)
- Modified by increasing investment into strategic growth sectors

Formalization and First Job Law

- Goal: To create 3 million formal jobs and reduce the unemployment rate to 9% (aprox).
- It motivates entrepreneurial formalization, formal first jobs, red carpet simplification and control mechanisms
- Incentives based on tax exemptions

Fiscal Rule

- Target on Structural Fiscal Balance: 1.5% of GDP
- Transition period until 2015
- Long run goal for public debt of central government below 20% of GDP
- Macroeconomic and fiscal Stabilization Fund

Measures to contain currency appreciation

- Possible Forward operations until US\$ 3.700 millions
- Less external debt issues for 2011.
- Abolish tax exemption for interest payments over external debt.
- Tariff reduction for some capital goods and inputs (requires Congress Reform)

July

August

September

October

November

Fiscal Sustainability

- Constitutional Right and State duty.
- Fiscal criteria harmonization through all public powers
- Coordination y coherence of economic and budgeting process

Royalties Reforms

- It creates a Royalties National System
- Competitive and fairness principles
- Resources for more underdeveloped regions
- Investment in science, technology and innovation

Health Reform

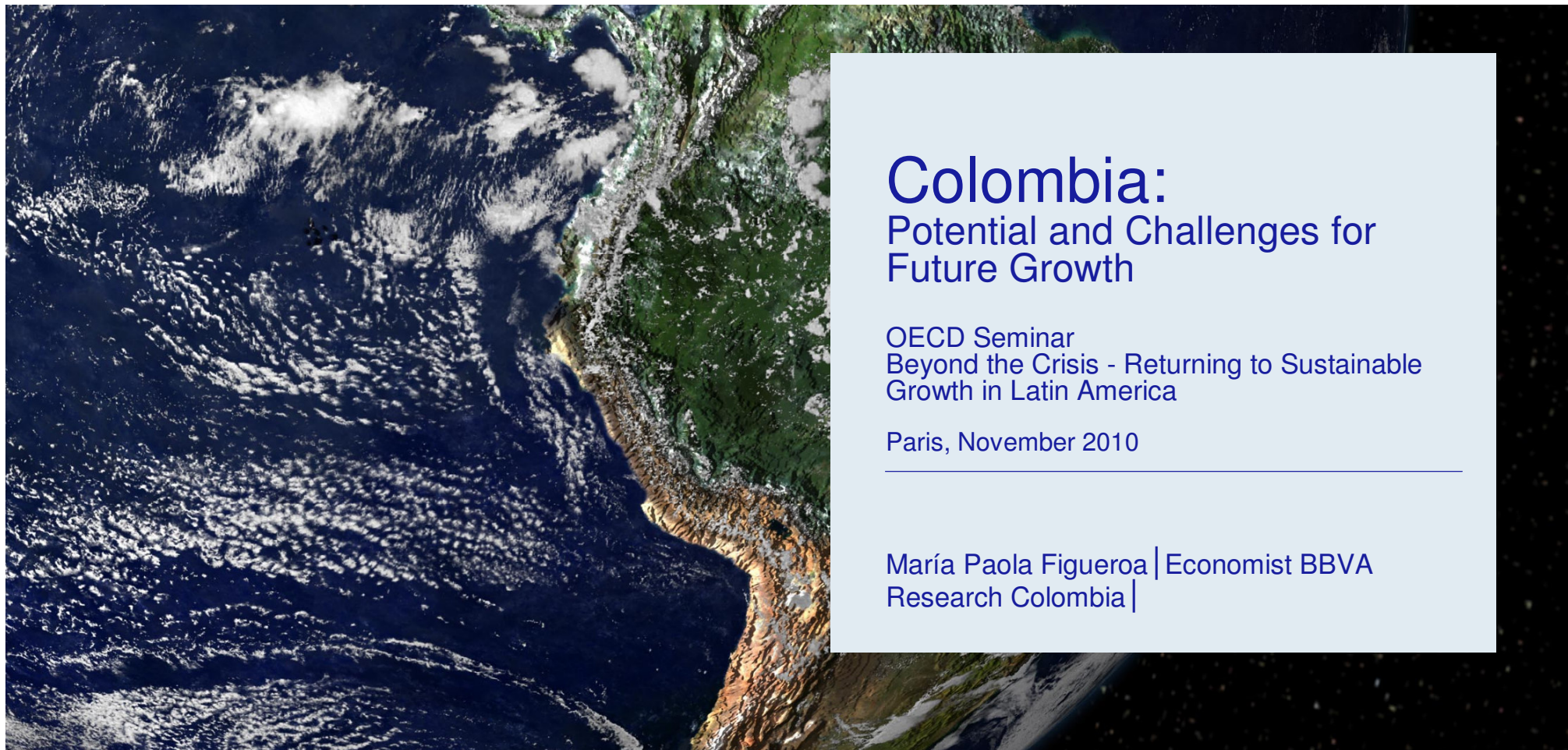
- Statutory Law: Criteria definition for a wide and inclusive mandatory health plan
- General Law: Defines quality, promotion and prevention and primary attention.
- Control of health cost for fiscal sustainability

Mini Tax Reform

- Unilateral tariff reduction for inputs and capital goods (Average tariff changed from 12% to 8%)
- Elimination of the energy over cost for industry
- Adjustment of Financial Transactions Tax's coverage

Coming:

- National Development Plan
- Elimination of Financial Transactions Tax (2011)



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