



GDP Observatory

March 30, 2009

Both domestic and external factors had a negative impact on the economy of Colombia in 2008

- September to December 2008 saw the first year over year reduction in growth in the last 6 years.
- Industry and construction presented a yoy drop of 8.0% in the fourth quarter, while gross investment stagnated and total consumption continued to fall.
- Imports continue at a good pace but will have to be corrected in the future in view of the slow growth of domestic demand.
- We expect an increase in the economic slowdown in 2009, although there are better perspectives for 2010.

According to the information published by the DANE for the fourth quarter of 2008, internal production of Colombia's economy grew 2.5% for the year, but fell by 0.7% yoy in the fourth quarter of 2008. This result was lower than expected by the BBVA ERD and the consensus of economists (3.1% and 1.0%, respectively) and demonstrated greater unravelling than expected of growth factors that worsened at the end of the year.

The lower rate of economic growth in 2008 is the result of contagion of the foreign crisis and the end of the expansive cycle of domestic demand, reflected in the progressive unravelling of export volume, industrial setback and lower trade sales. Moreover, household consumption dropped as a result of lack of confidence, high level of debt and lower available income due to the impact on food and fuel prices. On the other hand, investment conditions were not favorable, which affected this type of expense. Finally, growth of government consumption also fell due to delays in the execution of the national budget.

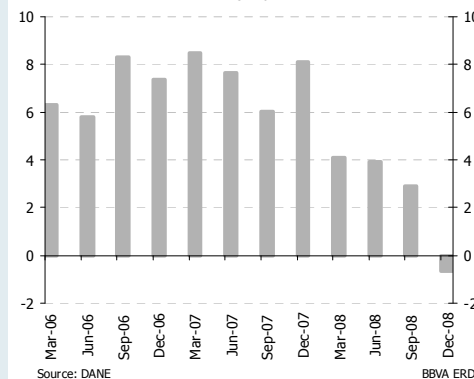
Balance sheet of the production sectors and demand

The production of economic sectors that were pioneers in growth during 2007 – industry, trade and construction – fell in 2008. YOY industrial production fell for two consecutive quarters; 2.0% for the year and 8.0% yoy for 4Q08. Trade grew 1.3% in 2008; in 4Q08 sales of durable goods (motor vehicles and household appliances), drinks, cigarettes, textiles and household goods showed negative results. Lastly, the growth in aggregate construction value for 2008 was a mere 2.8% and fell 8.0% in 4Q08; specifically, civil engineering, which represents 58.7% of the sector, fell 7.1% during the year and 12.6% in this quarter.

Total consumption in the economy, on the other hand, is progressively declining. Household purchase of durable goods fell by 3.9% in 2008, while the remaining categories (non-durable goods, semidurable goods and services) presented modest increases (1.5%, 2.1% and 4.1%, respectively). Total household consumption increased by 2.5% in 2008

Mauricio Hernández Monsalve
mauricio.hernandez@bbva.com.co
 Mario Nigrinis Ospina
mario.nigrinis@bbva.com.co

Gross Domestic Product
YoY %



GDP per supply

Change yoy, %	2007	2008	4Q08
Agriculture	3.9	2.7	-0.6
Mining	2.9	7.3	6.6
Energy	3.7	1.2	1.0
Industry	9.5	-2.0	-8.0
Construction	11.5	2.8	-8.0
Trade	8.7	1.3	-0.1
Transportation	11.0	4.0	0.8
Financial	7.3	5.6	4.0
Social Security	4.7	2.1	0.5
Taxes	11.5	3.3	-1.7
GDP	7.5	2.5	-0.7

Source: DANE

BBVA ERD

and only 1.6% yoy in 4Q08. In turn, government spending fell by 0.1% yoy in 4Q08 and grew only 1.3% in 2008.

Investment last year grew by 7.7%, but fell by 0.02% yoy in the last quarter. Gross capital formation decreased by 4.1% yoy in 4Q08, especially due to falling investment in civil engineering projects (-12.7% yoy) and in transportation equipment (-28.8% yoy). Overall domestic demand of the economy grew 1.0% yoy for the fourth quarter and 3.5% for the entire year.

On the other hand, low export volume and lower exchange conditions were more than compensated by currency exchange devaluation, in view of the increase in foreign trade in 4Q08 (6.3% yoy) which resulted in a variation of 8.1% in 2008. In addition, these good results affected Colombia's mining sector, which presented highly satisfactory results; growth was 7.3% in 2008 and 6.6% yoy from September to December. Finally, imports grew 10.3% in 4Q08 and 10.1% during 2008.

In sum, with the exception of the mining, quarry and financial services sectors, the rest of the sectors presented a slowdown in production. This slowdown translated into loss of employment and household income which, in turn, led to a reduction in household spending and lower growth in investment. All this compounded with lower than expected budget execution by the government and low progress in civil engineering projects needed to counter the slowdown cycle.

What are the reasons behind the economic slowdown?

Although the decrease in gross domestic product in the fourth quarter was not expected by the consensus of economists, this quarter was expected to have the slowest growth of the entire year, which confirms the reduction in economic activity. Various indicators pointed to an unraveling of the conditions required for high growth rates. Consumer, industry and trade confidence fell throughout the year, especially in the last quarter, in view of poor sectorial results, lower expectations regarding income and the detriment of the business environment due to involuntary accumulation of inventory and a decrease in orders. Therefore, households became less inclined to spend in durable goods and savings, industry reduced production and outlets reduced supplier orders considerably.

Moreover, available household income was also affected. Urban unemployment has been on the increase since May 2008, job creation has stopped growing in the trade sector and industrial employment fell by 1.3% last year. Employment quality also deteriorated, evidenced by a decrease in wage earners and an increase in self-employment. In turn, inflation for food products and fuel was higher than total inflation during the entire year, which reduced available household resources for other expenses. Finally, the high household debt contracted in the past increased the financial load on households and limited their capacity to acquire new credit.

On the other hand, lower growth of public spending was foreseeable due to the lower budget deficit achieved by the Central National Government, demonstrated by delays in the execution of expenses by decentralized institutions. In the midterm fiscal framework, the objective of the decentralized sector was to achieve a surplus of 1.7% of the GDP, but the final figure was 2.4%. Although government income was less than the fiscal target, lower deficit necessarily implied less expense than initially budgeted, both as regards to spending and to public investment project execution.

Finally, one item that stands out is the growth in imports, backed by the trade balance figures. However, this does not correspond with the results in domestic demand, spending and investment in 4Q08. As an example, the category of purchase of capital goods in FOB imports has shown active growth (12.4% interannual in 4Q08), while national gross fixed capital fell (-4.1% yoy in 4Q08).

GDP per demand			
Change yoy, %	2007	2008	4T08
Total consumption	6.9	2.3	1.3
Private spending	7.6	2.5	1.7
Public spending	4.5	1.3	-0.1
Gross investment	13.7	7.7	0.0
Domestic demand	8.5	3.5	1.0
Exports	11.4	8.1	6.3
Imports	13.9	10.1	10.3
GDP	7.5	2.5	-0.7

Source: DANE

BBVA ERD

End household spending			
Change yoy, %	2007	2008	4T08
Household spending	7.5	2.3	1.6
Durable goods	12.9	-3.9	-1.2
Non-durable goods	6.7	1.5	0.6
Semidurables goods	8.9	2.1	1.2
Services	7.0	4.1	2.9

Source: DANE

BBVA ERD

Gross fixed capital formation			
Change yoy, %	2007	2008	4T08
Gross fixed capital formation	15.2	4.7	-4.1
Agriculture	1.6	3.5	2.7
Machinery and equipment	19.1	9.4	6.8
Transportation	16.0	-14.9	-28.8
Edifications	3.7	19.1	-1.0
Civil engineering	21.5	-3.7	-12.7
Services	6.7	1.9	0.9

Source: DANE

BBVA ERD

Given this situation, the BBVA ERD considers that the forecast of economic growth could be revised in the future by the DANE and that this could imply rate changes for the components of domestic demand different than those presented at this time. However, total variation of the GDP should not vary considerably as regards the most recent report, which is coherent with the evident slowdown of the economy.

Towards the future: trend of the economy depends on countercyclical policies

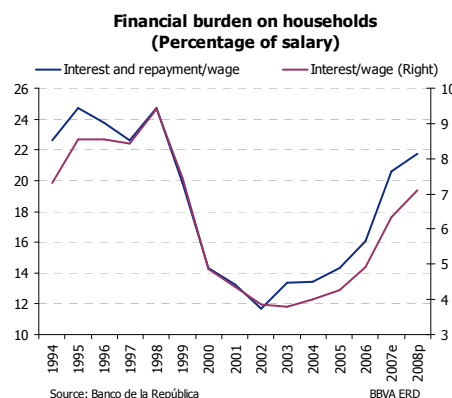
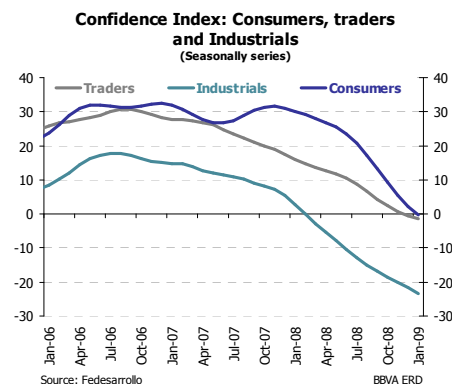
The forward economic indicators and our forecast show that the quarter-over-quarter decline in national production could extend to the first half of 2009, requiring economic policies to buffer the impact from abroad that it is currently faced with. In December 2008, monetary policy began to lower reference rates. However, the countercyclical effects of these measures take time to have an impact on the rest of the interest rates of the market, and will have their greatest effect at the end of this year.

In turn, effective fulfillment of the commitments of the Central and Local Governments is essential. The evolution of the unemployment rate, especially of non-qualified workers, and the generation of links with other sectors to motivate production will depend on the progress in bidding-related programs and execution of public works programmed for 2009 and carried over from 2008. However, historical evidence shows that execution of national and local government investment projects has generally been at a low level and delays in bidding processes and public works execution are a constant factor.

In addition, building construction does not appear to have a positive outlook either. Construction and new project permits fell during all of 2008, while the number of completed and paralyzed building projects grew. Therefore, savings in the sector may have come to an end, building projects that are underway may have reached their maximum expansion in December and we would be seeing the beginning of a new cycle.

But there are certain strengths in the economy that support public policy to eventually come out of the slowdown in growth. The financial system, which continues to be solid and was the sector that provided the highest growth in 2008, is prepared to transfer the reduction in interest rates to the Bank of the Republic. In turn, the devaluation of the exchange rate should improve export company balance sheets and compensate family incomes, in part. In addition, specific sectors such as the coffee sector are facing a trend of high international prices. These elements will contribute to relieve household and company cash flow in the coming months.

The BBVA ERD expects a new economic slowdown in 2009, within an adverse international scenario. However, in spite of this, the rate of growth of the Colombian economy during 2009 will be one of the highest in the region. While many countries show significant reduction in domestic production, Colombia's economy will pass through a soft adjustment phase, as long as the measures taken by the government are successful and combined with the strengths mentioned above.



Leading construction indicators			
Change yoy, %	2008	3T08	4T08
Building permits	-11.7	-3.7	-24.8
Civil Engineering projects	-7.1	9.2	-12.9
New projects started	-19.0	-16.4	-48.5
Projects underway	12.4	9.7	-4.1
Projects completed	19.3	22.3	20.0
Projects paralyzed	4.1	0.6	12.3

Source: DANE BBVA ERD