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# Colombia: A Macroeconomic Equilibrium

Luis Fernando Mejía  
General Director of Macroeconomic Policy  
Ministry of Finance and Public Credit  
February 2013



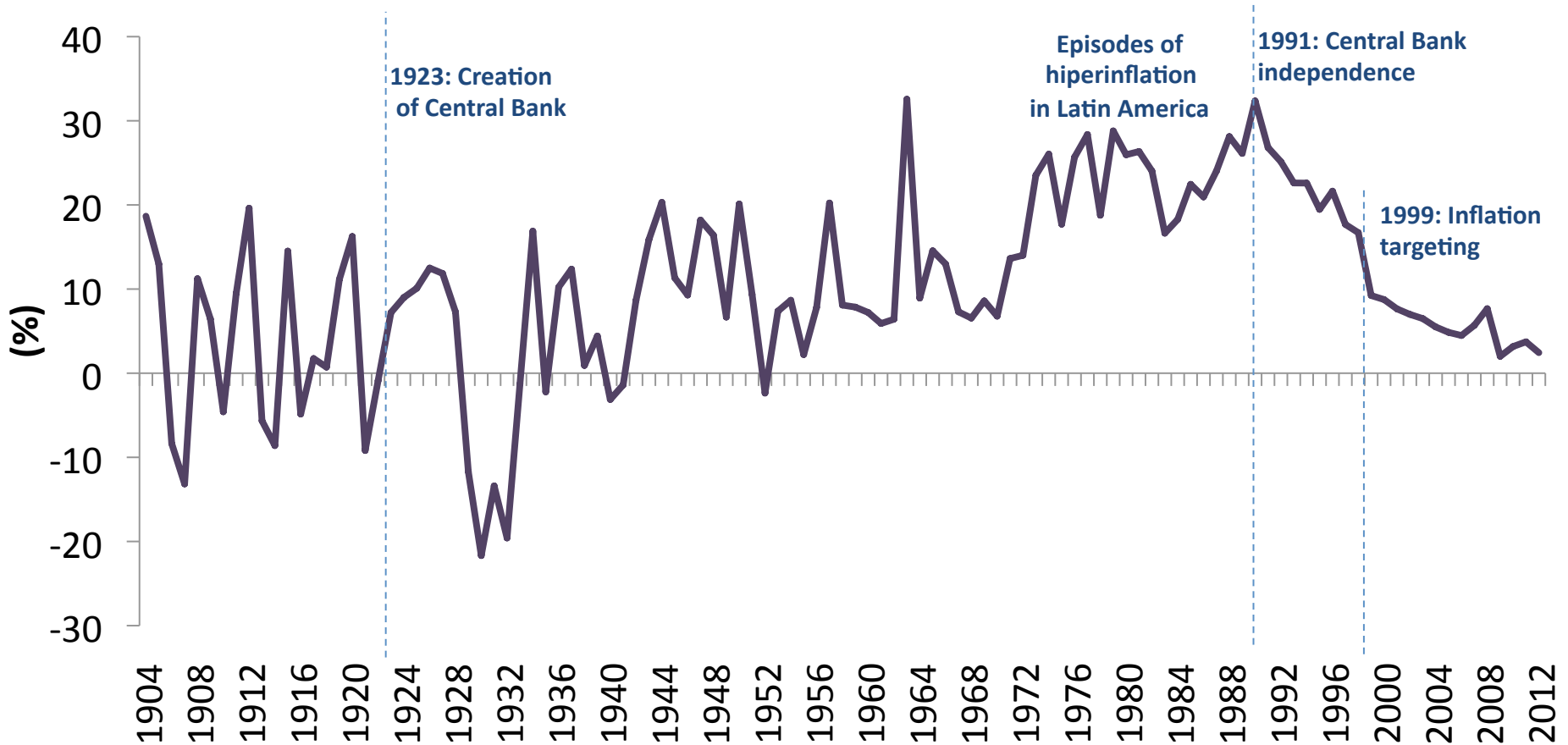
# Agenda

- 1. A History of Macroeconomic Stability**
- 2. Structural Reforms and Fiscal Sustainability**
- 3. How is the economy today?**



# A history of monetary stability: Colombian success in a turbulent neighborhood

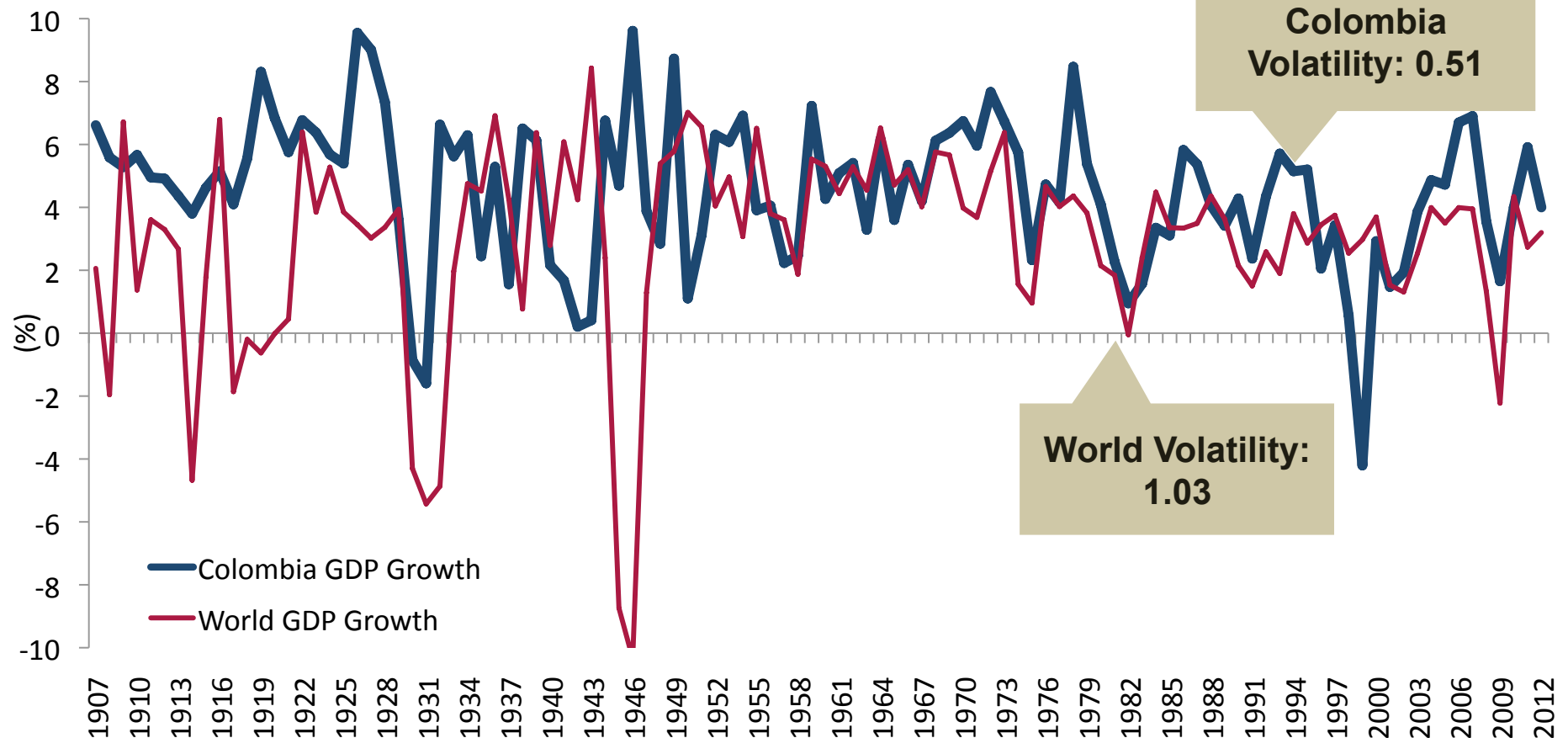
Inflation rate (1904-2012)





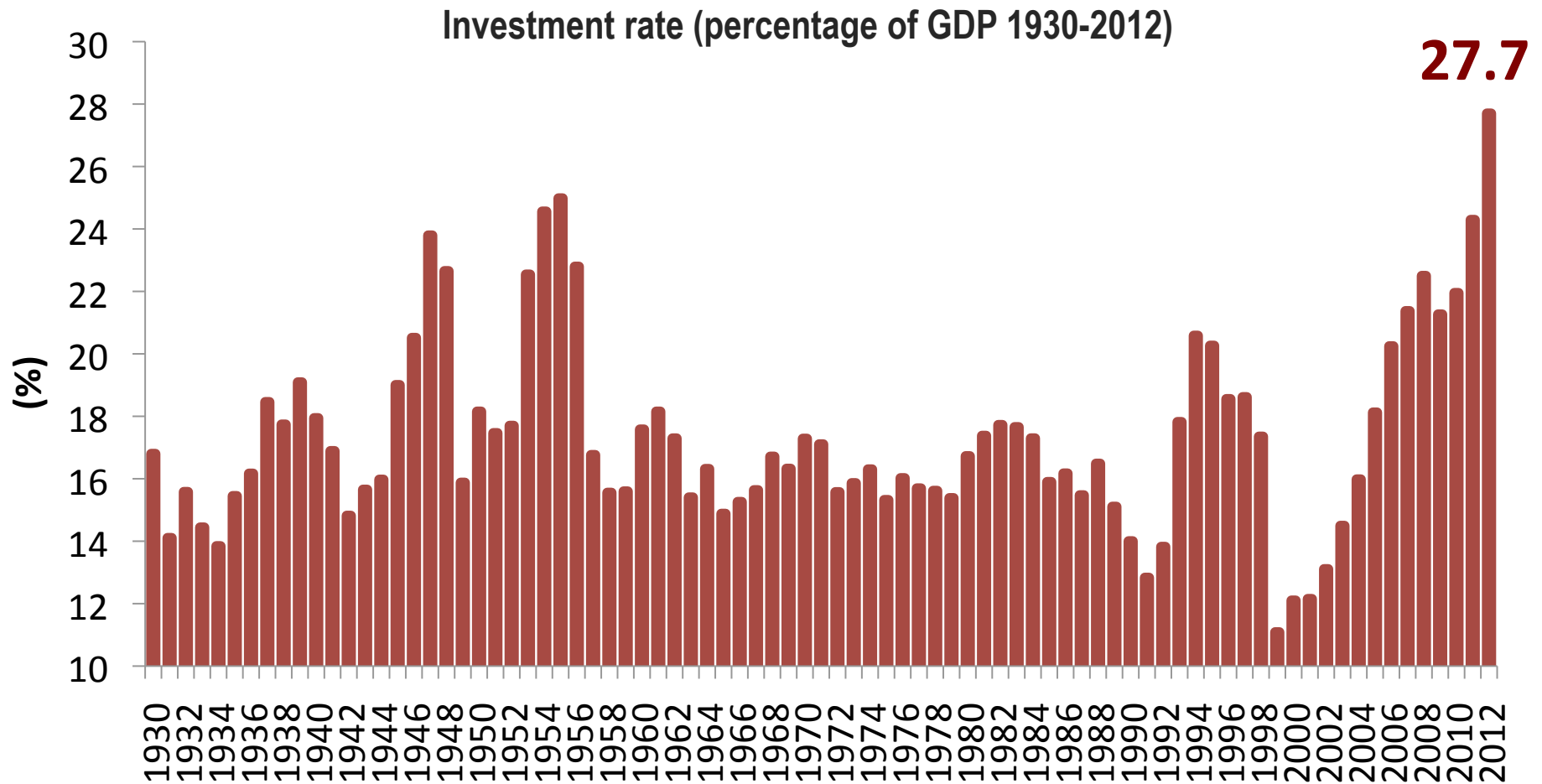
# A history of resilience and continuous growth

Economic Growth (World vs. Colombia, 1906-2012)





# The trend of Colombian investment rate has changed in XXI century





# Agenda

1. A History of Macroeconomic Stability
2. **Structural Reforms and Fiscal Sustainability**
  - 2.1 Fiscal Sustainability Reform
  - 2.2 Fiscal Rule
  - 2.3 Royalty's System Reform
  - 2.4 Tax Reform
3. How is the economy today?



# Fiscal Sustainability Constitutional Reform

The Fiscal Sustainability bill amends Article 334 of the Colombian Constitution, adding the concept of Fiscal Sustainability as a *criterion that should guide the branches and institutions of government.*

## Objectives of the Fiscal Sustainability Reform

- Guarantee the effective access to social, economic and cultural rights

1



- Promote productivity and competitiveness

2



- Support the development of all regions

3





# Agenda

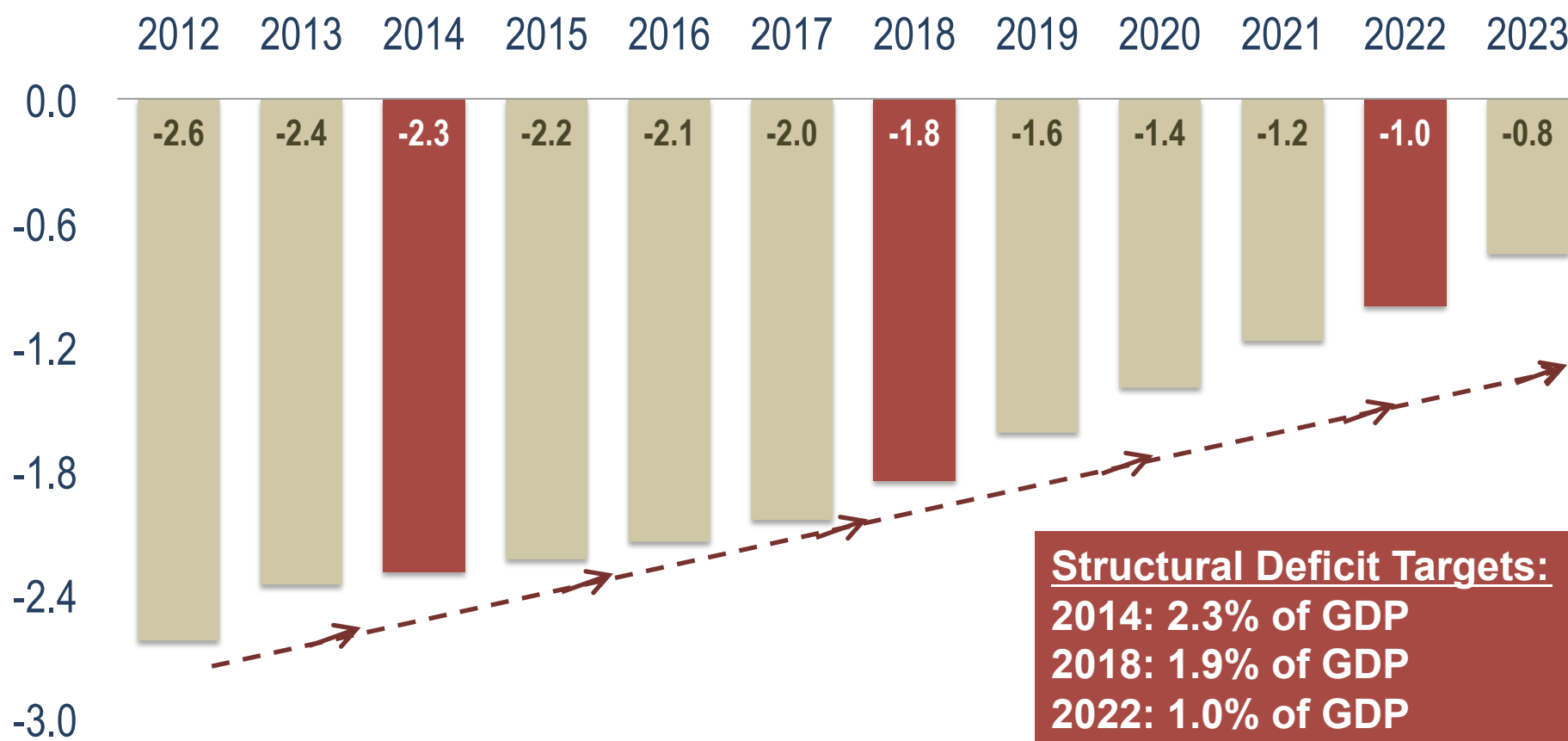
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# Fiscal Rule: Fiscal discipline for the CG

Fiscal Rule: structural deficit limit, counter-cyclical policy and savings fund





# Agenda

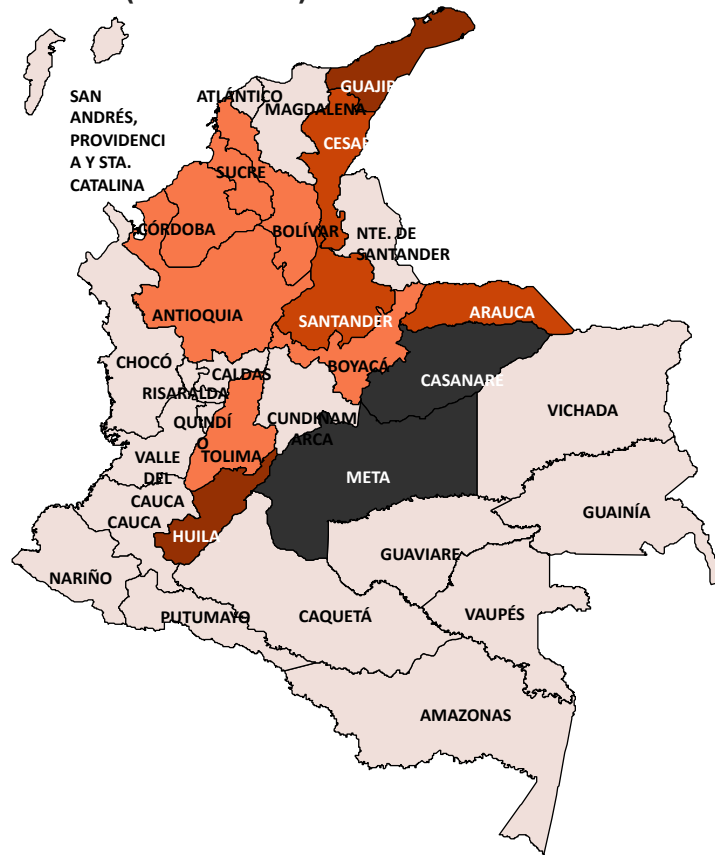
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  - 2.3 **Royalty's System Reform**
  - 2.4 Tax Reform
3. How is the economy today?
4. Challenges of the Colombian Economy



# Royalties reform: large impact on inequality

Before (2002-2011)\*: Resources were concentrated

Today (2012 – 2020)\*: Resources are distributed equitably



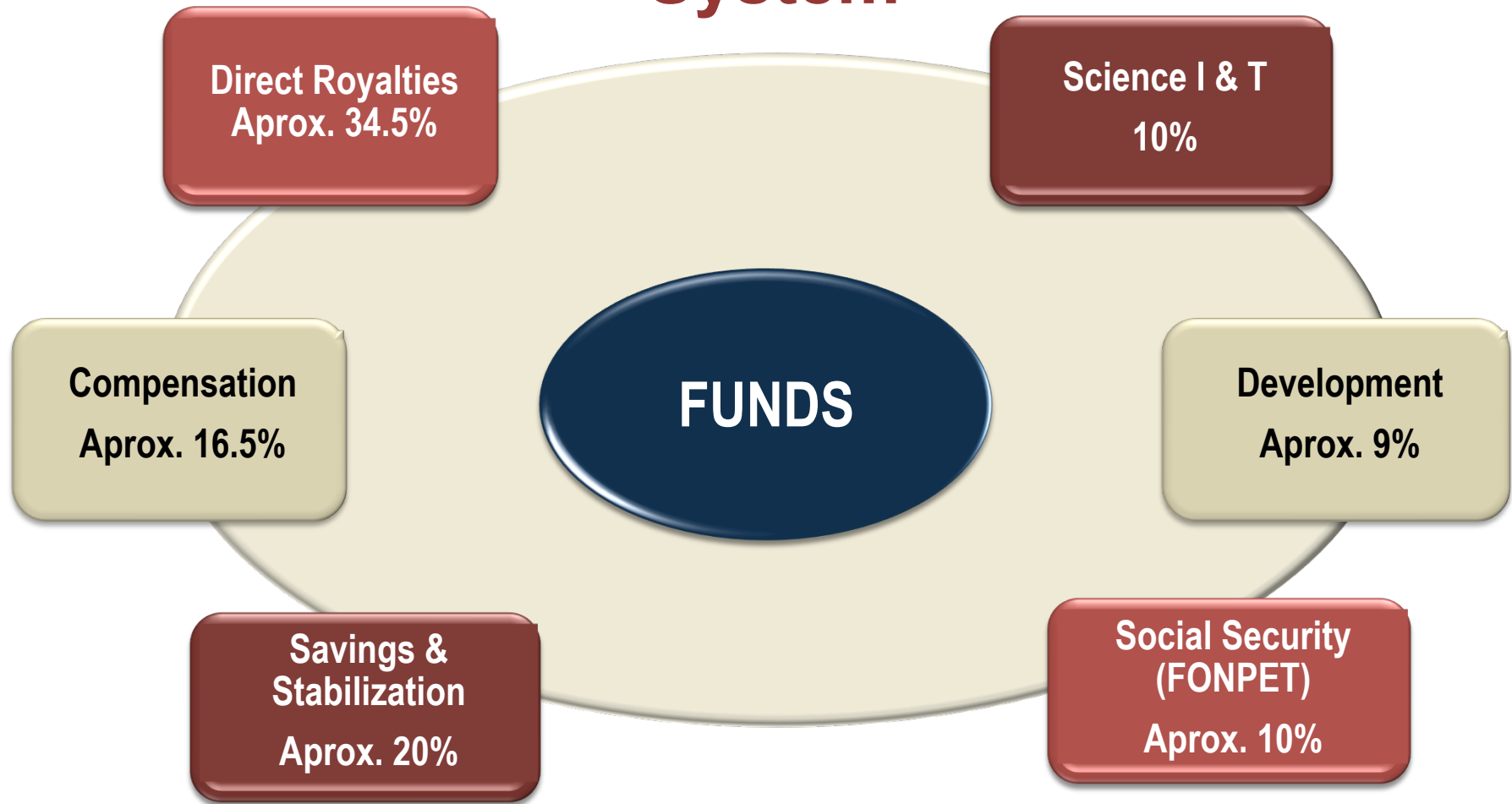
Total royalties by department  
(figures in COP trillion)

- Above \$4
- From \$3,2 to \$4
- From \$2,4 to \$3,2
- From \$1,6 to \$2,4
- From \$0,8 to \$1,6
- From \$0 to \$0,8

\* Annual average for the period



# Extra budgetary funds: Royalties General System





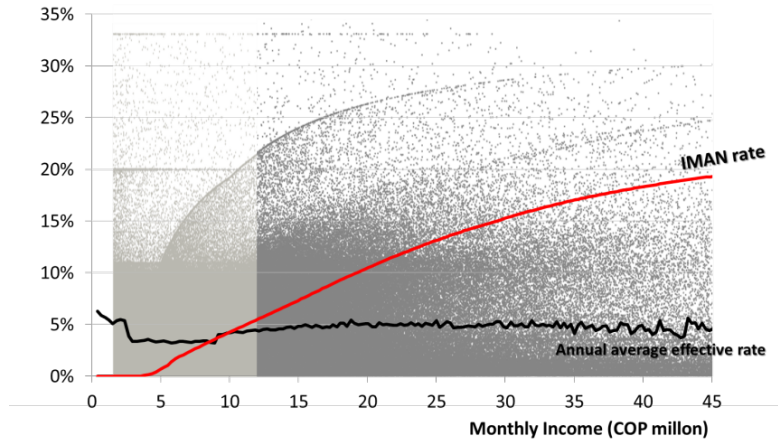
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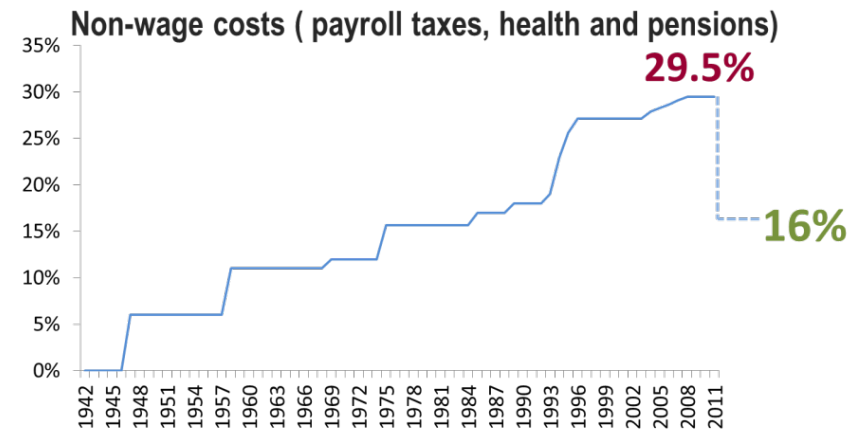
# Tax Reform



## 1. Modification of Income Tax - IMAN

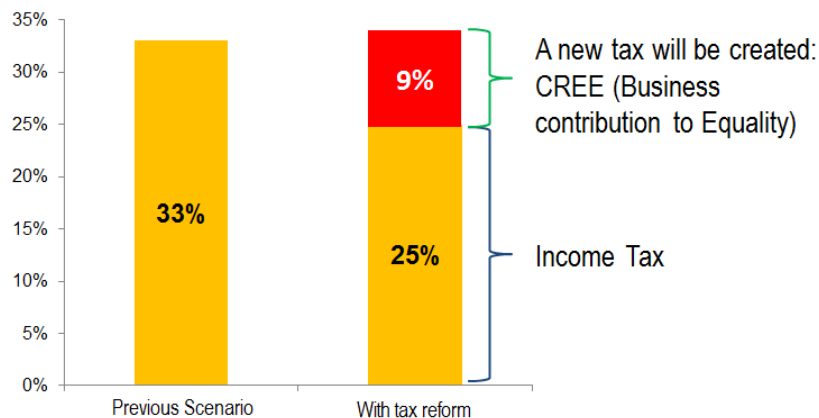


## 2. Reduction in non-wage costs



# Main Components of the Tax Reform

## 3. Creation of CREE



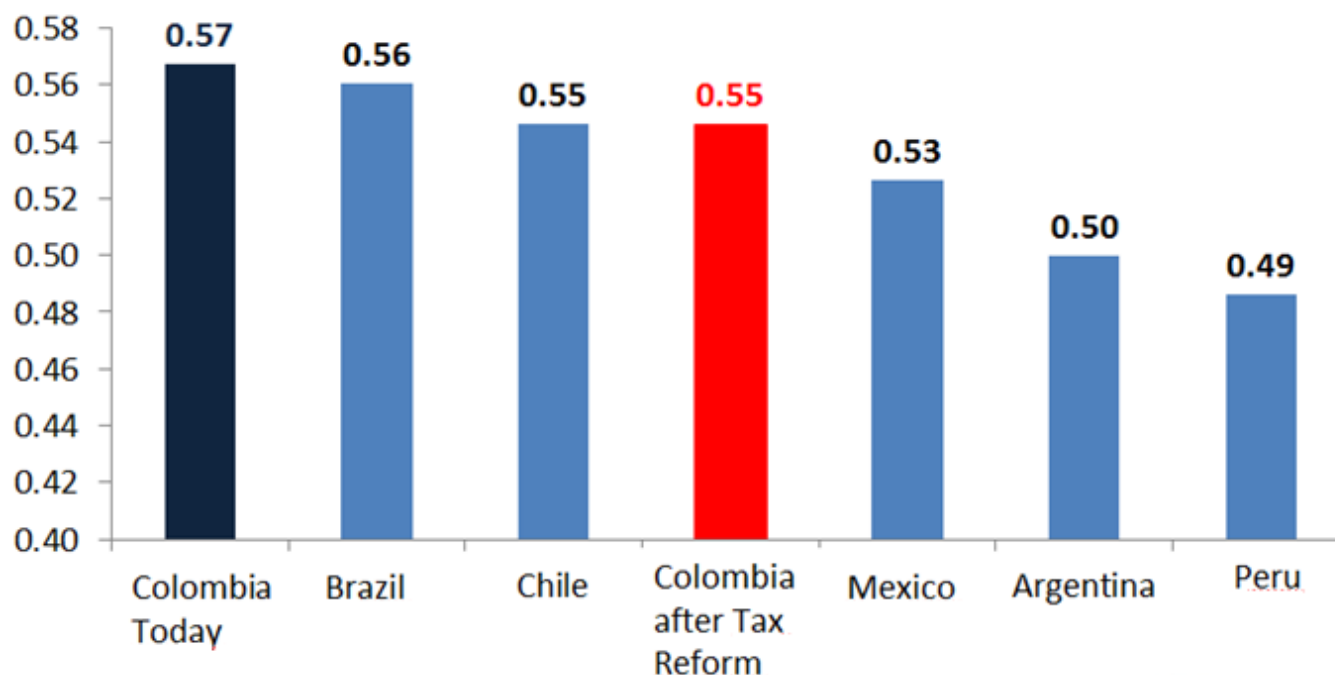
## 4. Reduction of VAT rates and consumption tax

- VAT rates are reduced from 7 to 3
- Creation of a consumption tax



# Expected Effects on Inequality

Gini Index – Latin America



Gini with current  
tax system

-

Gini with IMAN

=

1,9  
Less inequality



# Expected Effects on Informality

Reform: Reduction of 13.5 percentage points in non-wage costs (from 29.5% to 16%)

Formal employment will increase

↑ 11%

From 400.000 to 1 million new formal jobs

Source : Bernal y Cárdenas (2003), Kugler y Kugler (2009) y Mondragón, Peña y Wills (2010).

Increase in the relative size of the formal sector

↑ 10% - 15%

Source : Hamann & Mejía (2011)





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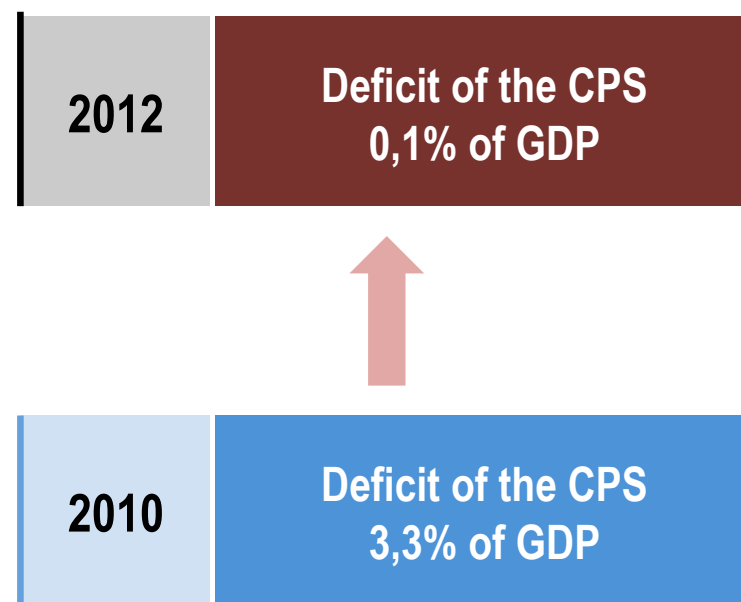
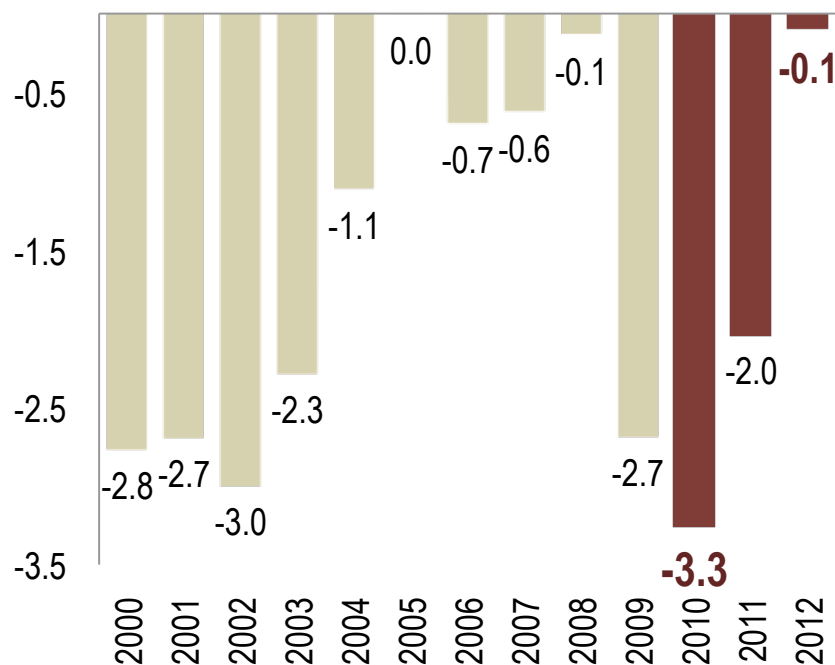
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# Colombia has experienced a quick convergence to fiscal equilibrium

## Balance of the Consolidated Public Sector

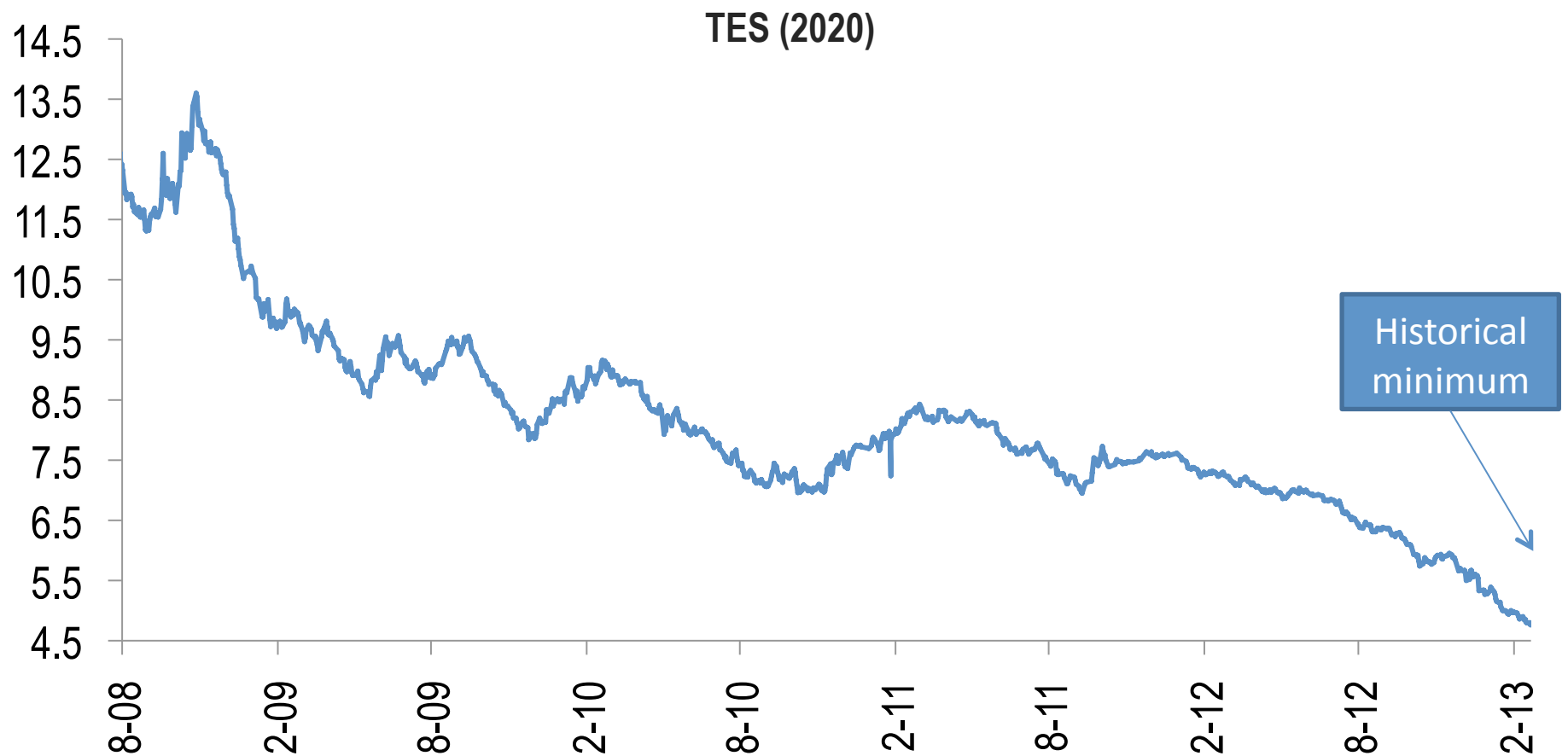
(% of GDP)



Balance of the CPS = Macroeconomic stability

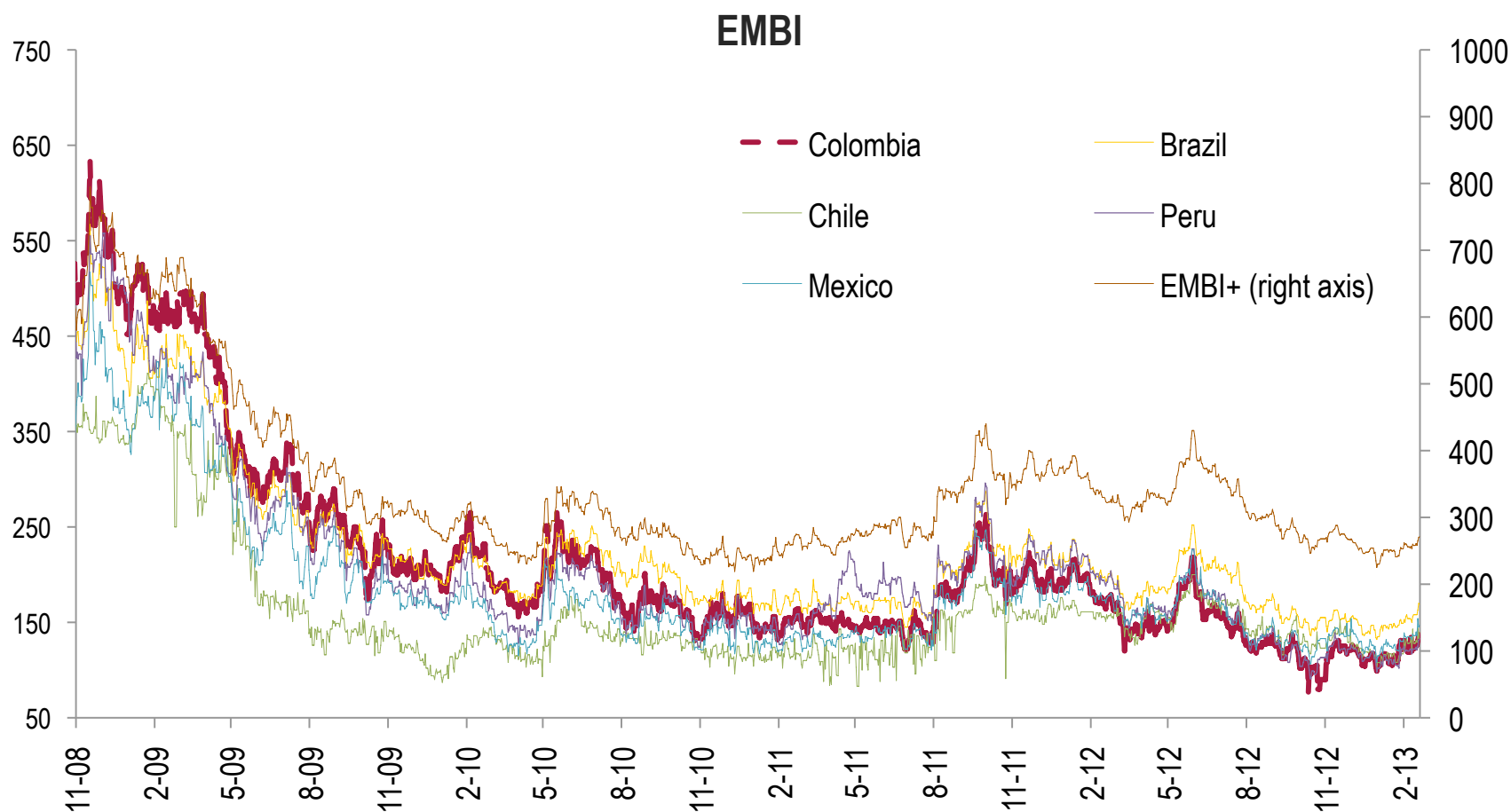


# Our fiscal responsibility has resulted in lower domestic borrowing costs...





# ...and lower external borrowing costs, even relative to our peers

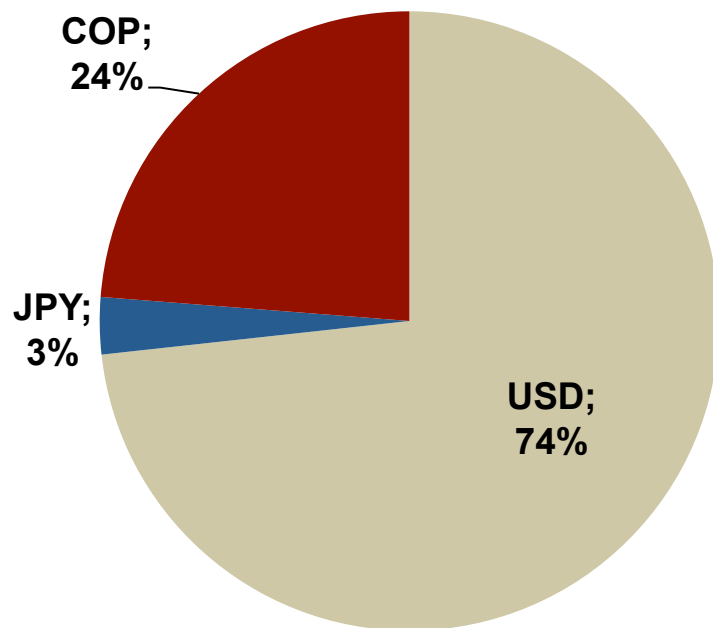




# This has allowed us to issue external debt in USD at historical low rates

## External Debt by Currency

Dec 2012

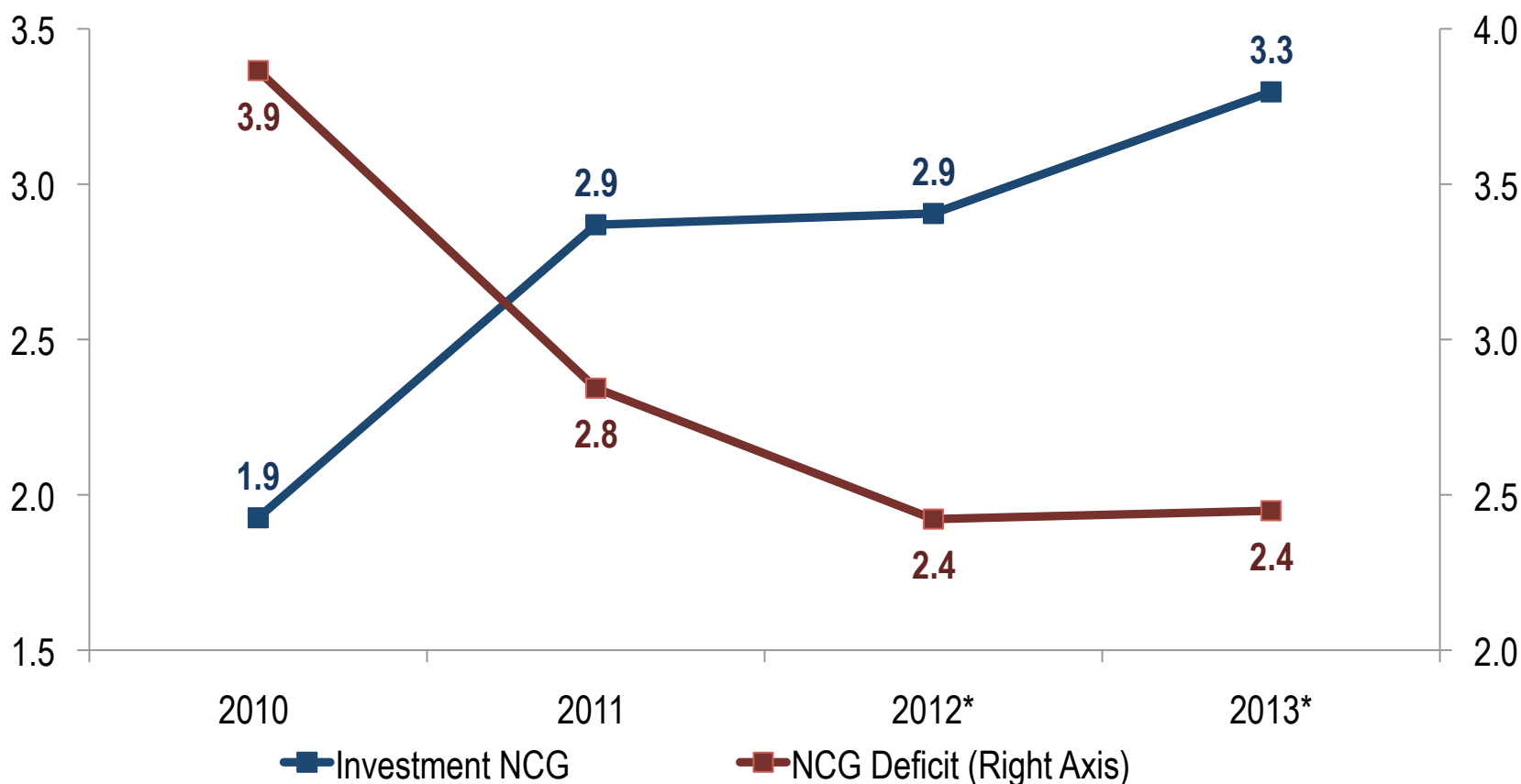


- On January 22<sup>nd</sup>, Colombia issued a 10 year global bond in the international markets, with **the lowest rate (2.718%) in history.**
- The differential with US Treasury Bonds was the lowest in history (0.88%).



# Fiscal equilibrium has been reached with increases in public investment

Fiscal deficit and investment NCG (% of GDP)

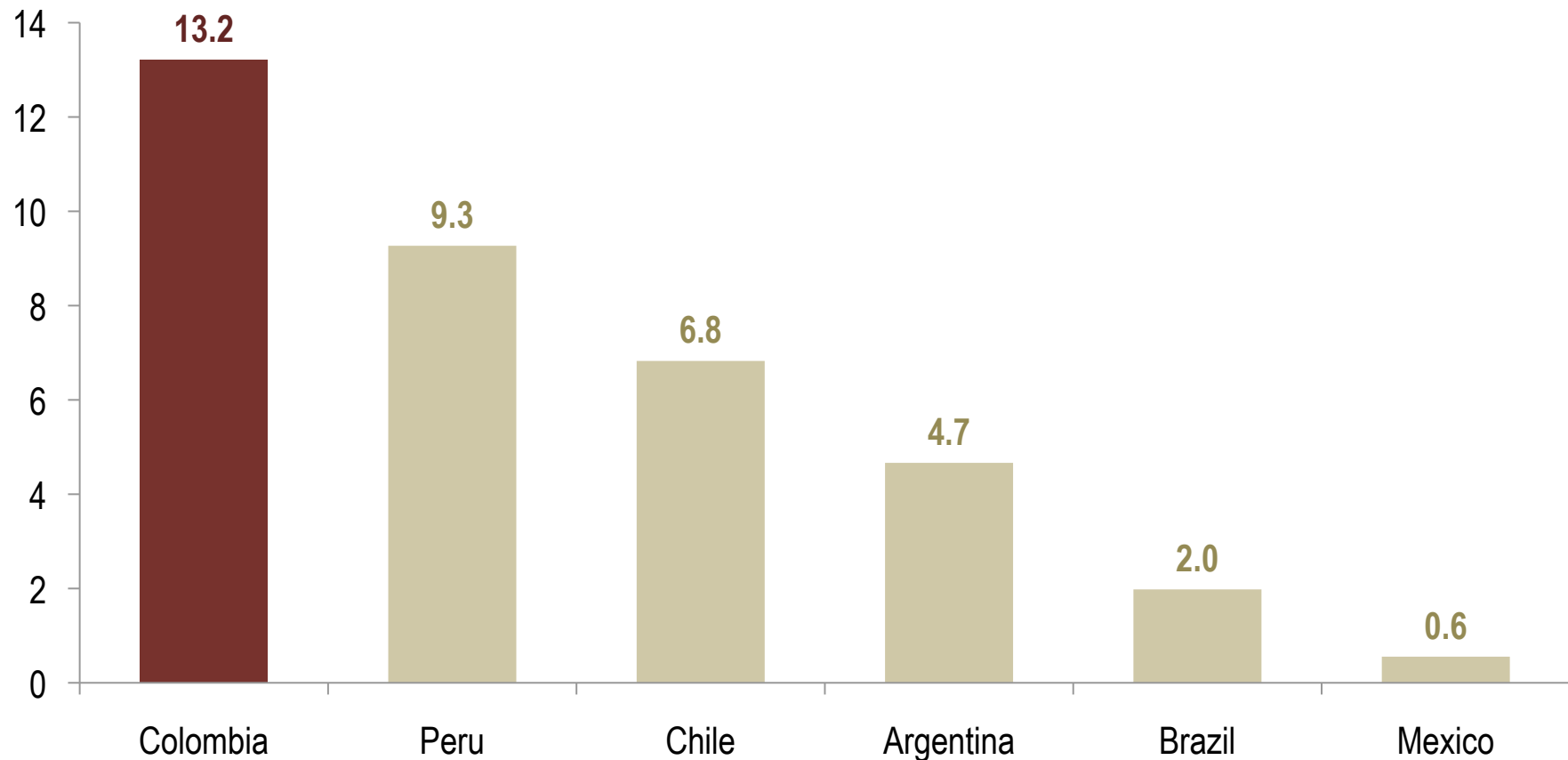


Source: Ministry of Finance and Public Credit. \* Projected



# Investment growth has been the highest in Latin America

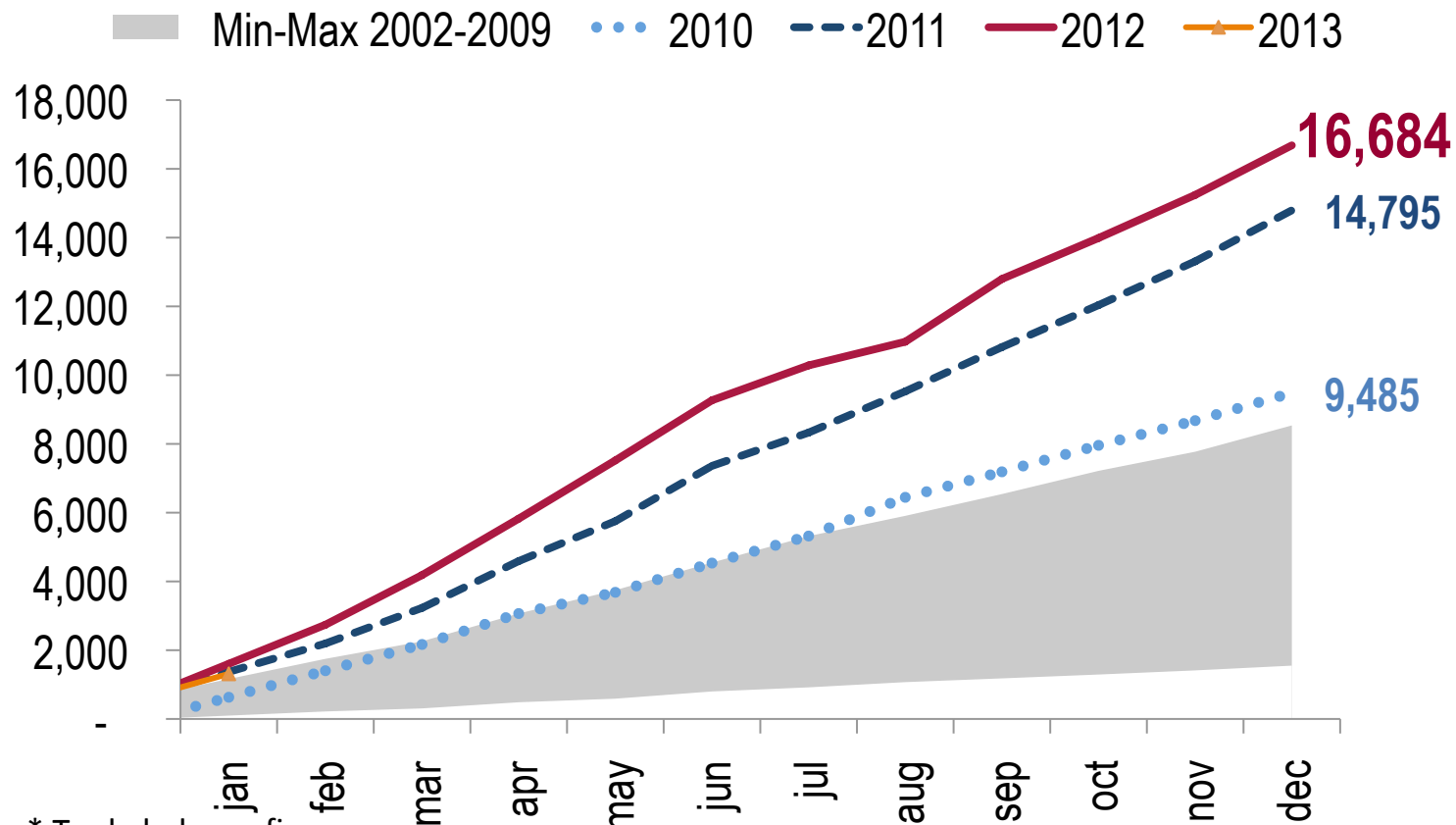
Investment rate change, 2000-2012 (% of GDP)





# Investor confidence has been evidenced by a record high FDI

FDI in Colombia throughout the year (US\$ million)



In 2013 FDI is expected to reach a level of **US\$16,271 million**

\* Trade balance figures

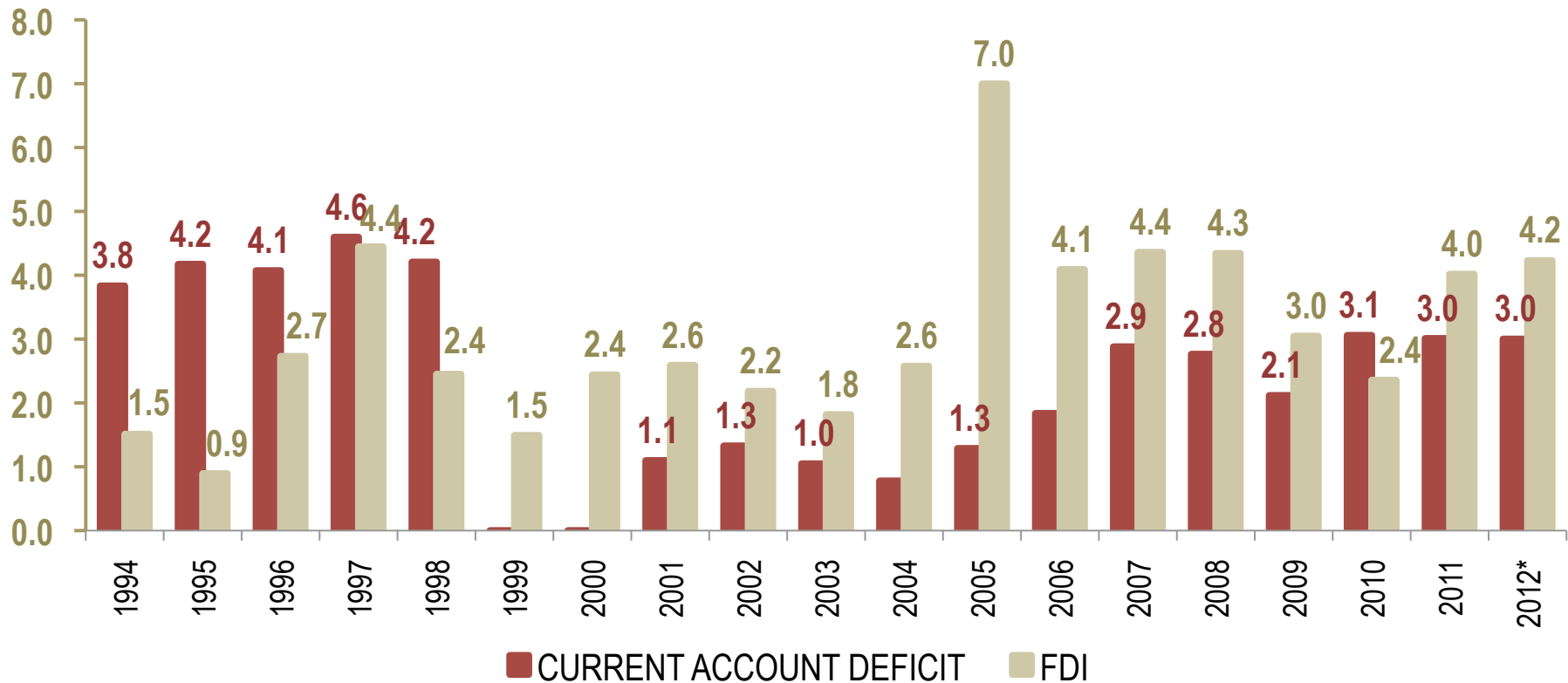




# External Equilibrium

Current account deficit is currently at reasonable levels

Current Account Balance and FDI (% of GDP)



\* Forecast

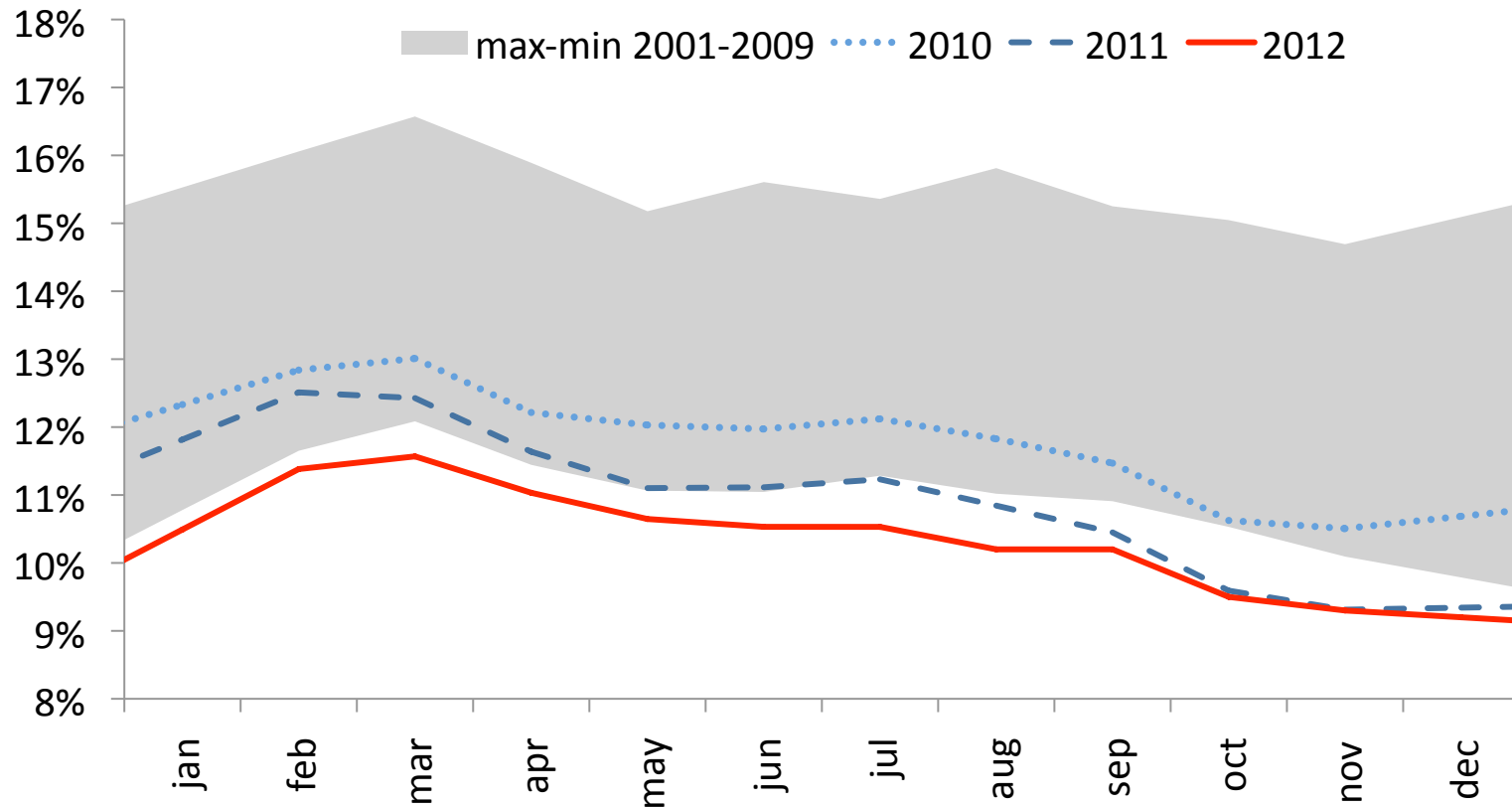
Source: Banco de la República



# Although still high, unemployment has dropped consistently

It currently locates at single digit levels

Unemployment rate – National total (Moving average 3 months)

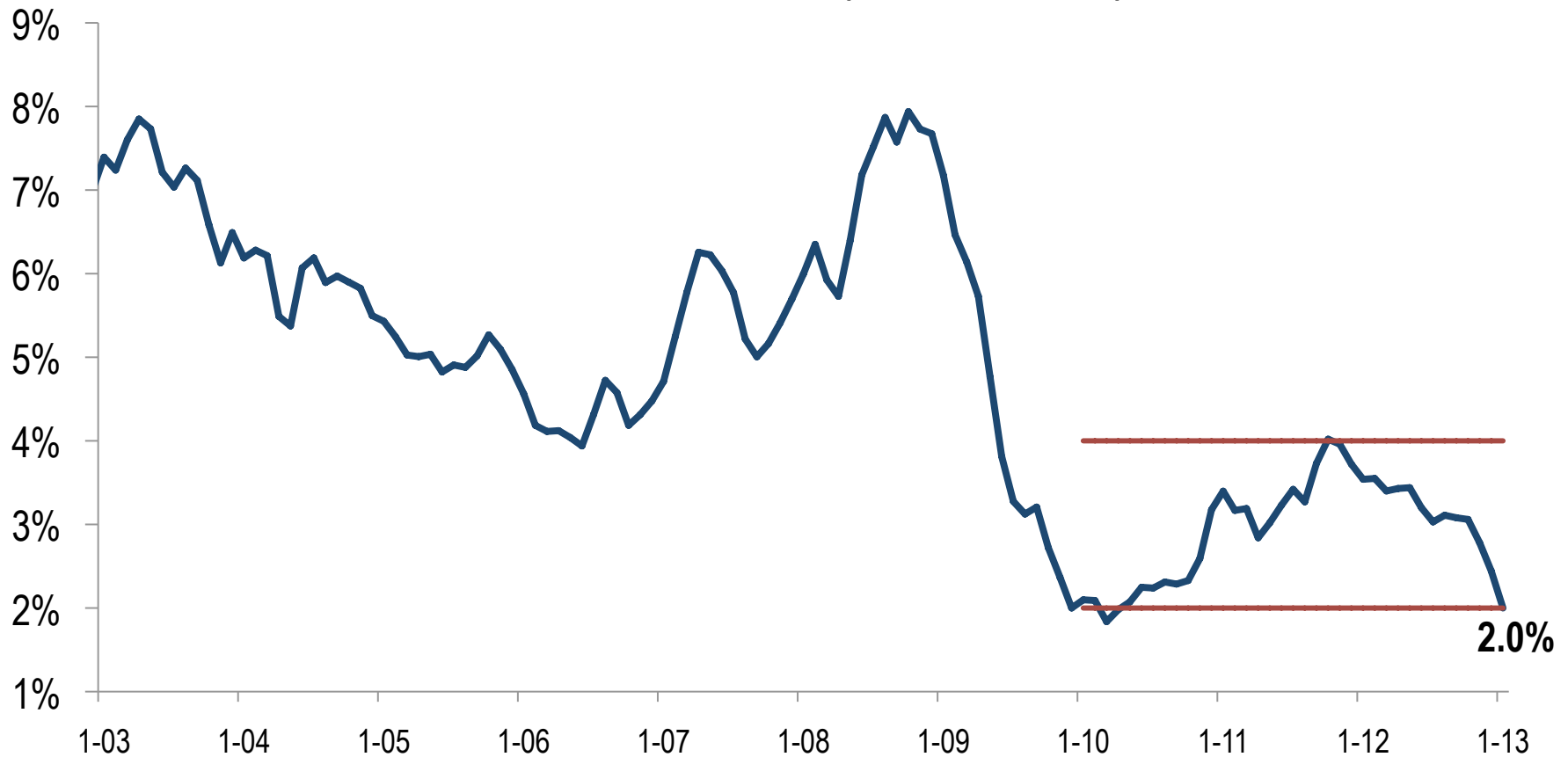




# Prices stand below the long term target (3%)

There are no evident inflation pressures, there is space for expansive monetary policy

Consumer Price Index (annual variation)





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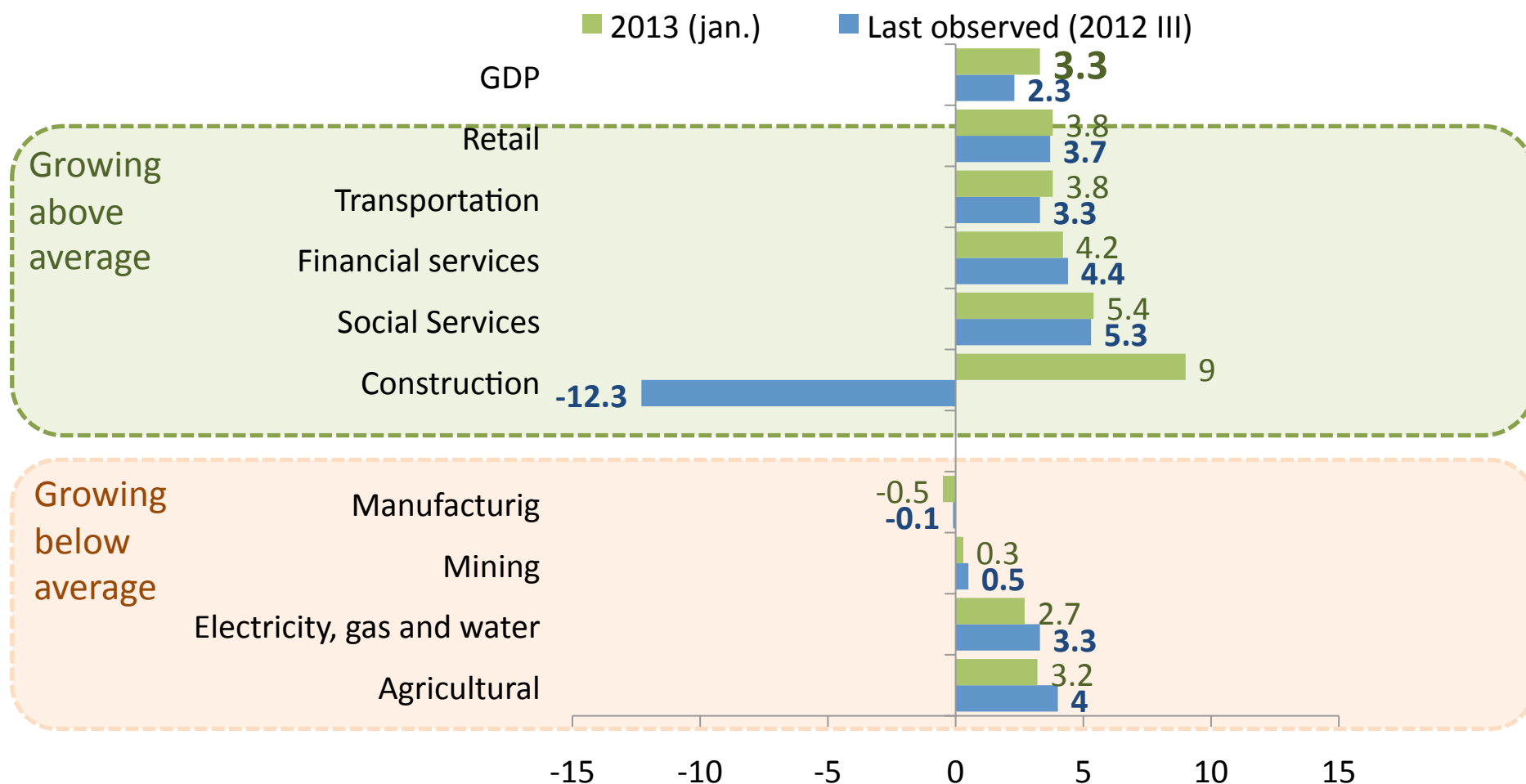
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# Economy activity as of January 2013

“Nowcast” exercise with *Google Trends* (2013 (January) vs. last observation)



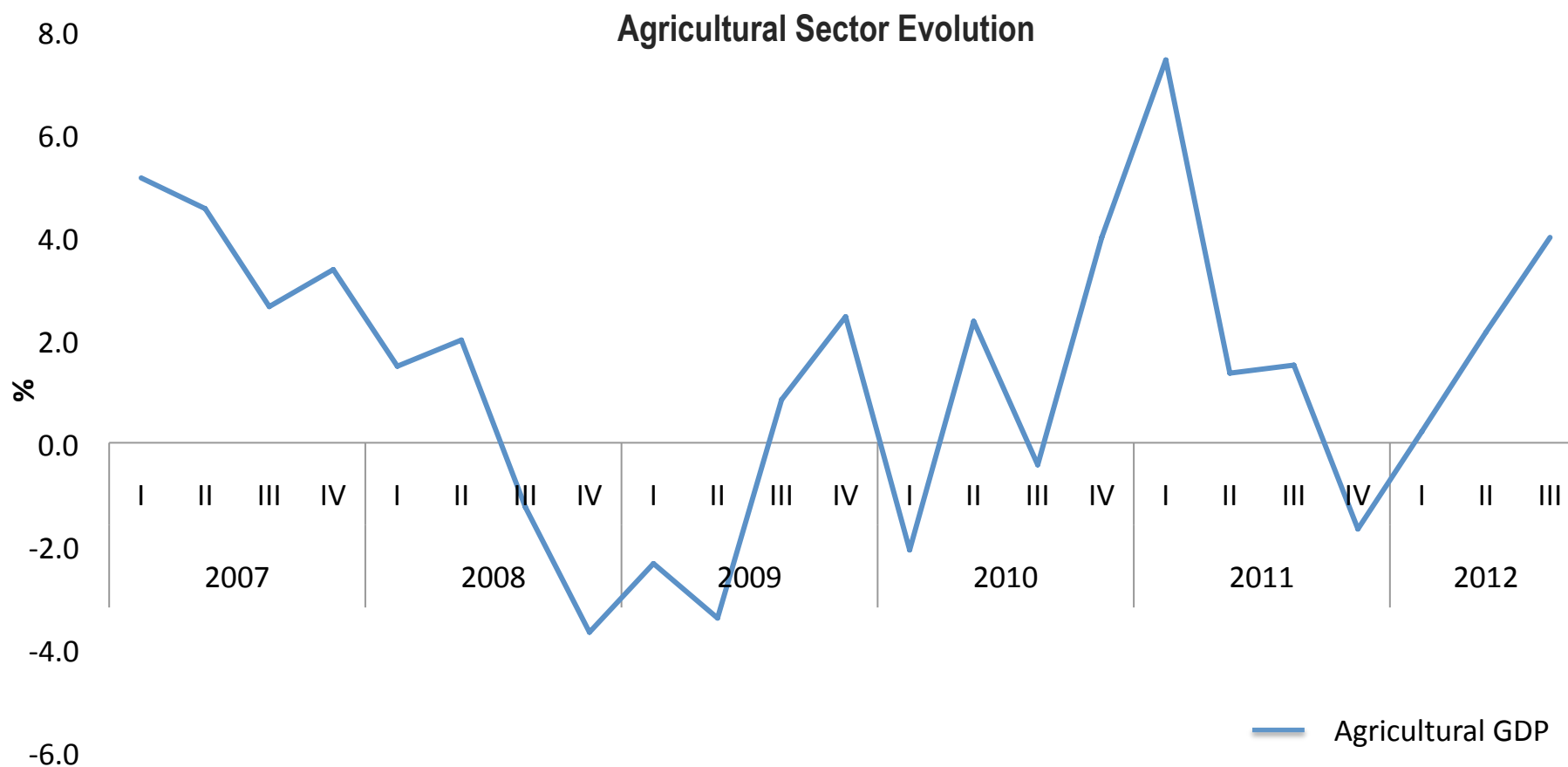


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    - a. **Agriculture**
    - b. Mining
    - c. Industry
    - d. Construction
    - e. Demand
  - 3.3 Economic Policy



# The agricultural sector has showed a strong recovery in 2012





# Agenda

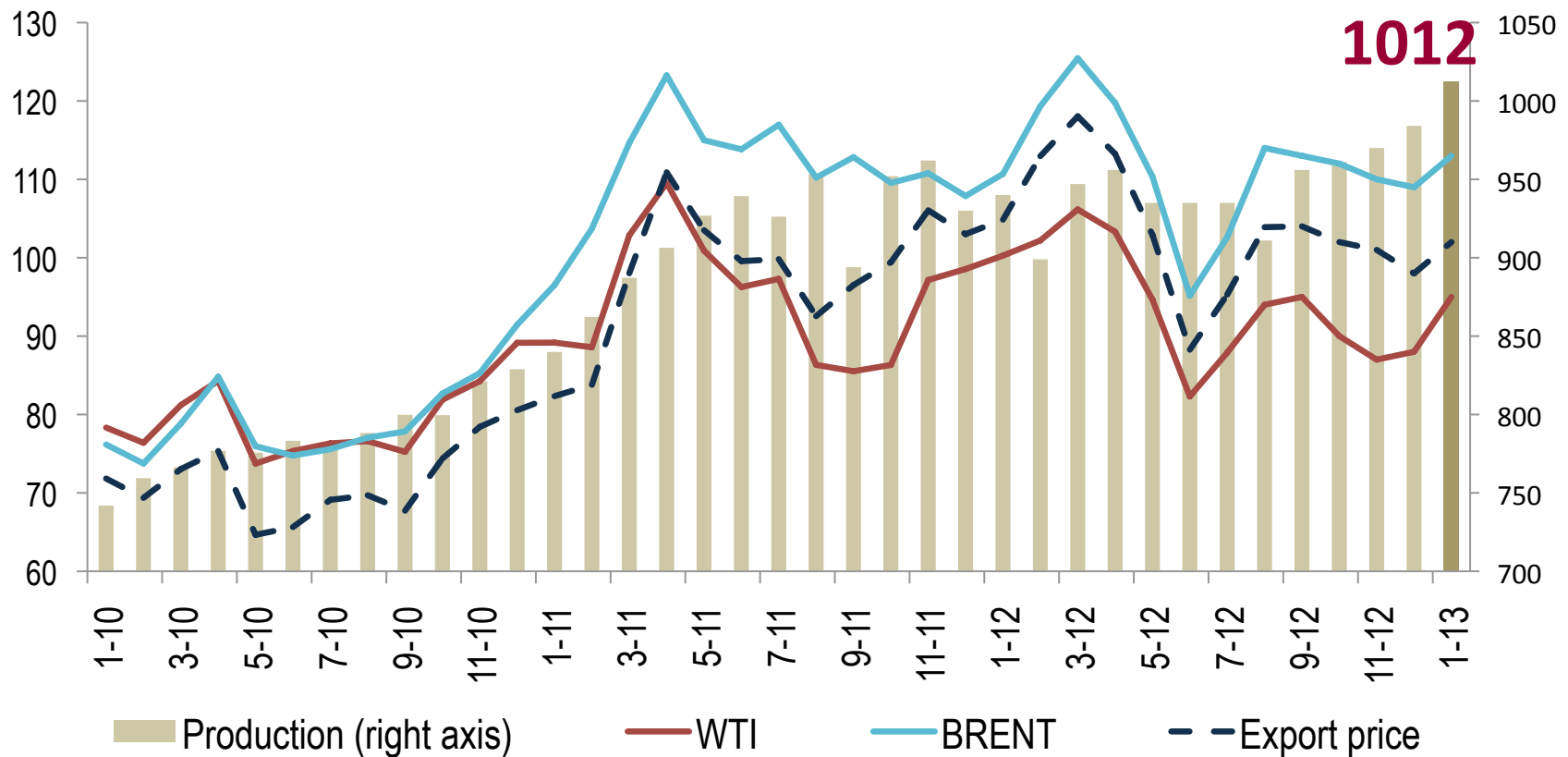
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# In January oil production surpassed 1 million barrels per day

Oil production (Thousand barrels per day) and oil prices (USD per barrel)





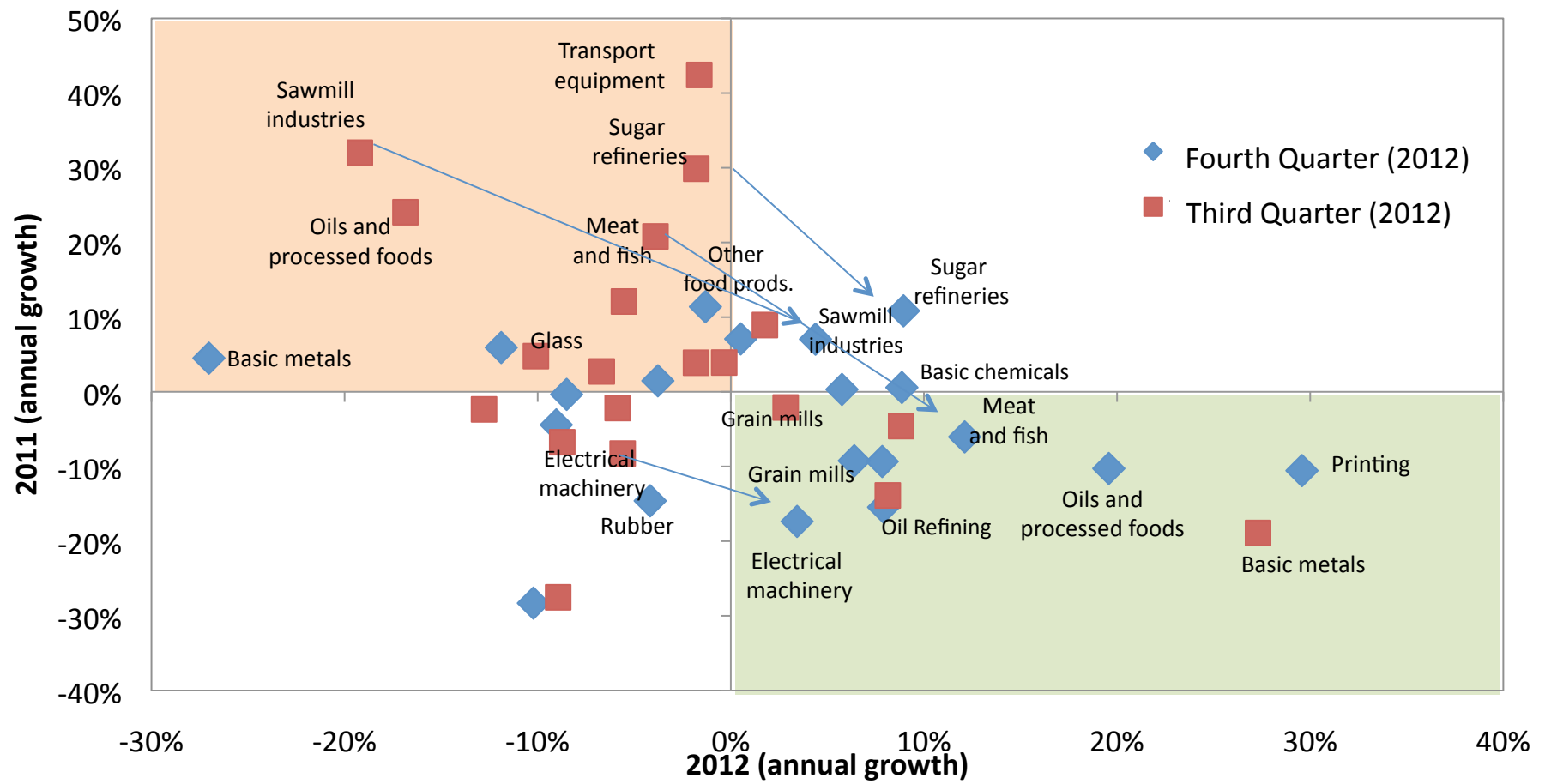
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# Manufacturing has shown a recovery in the last quarter of 2012

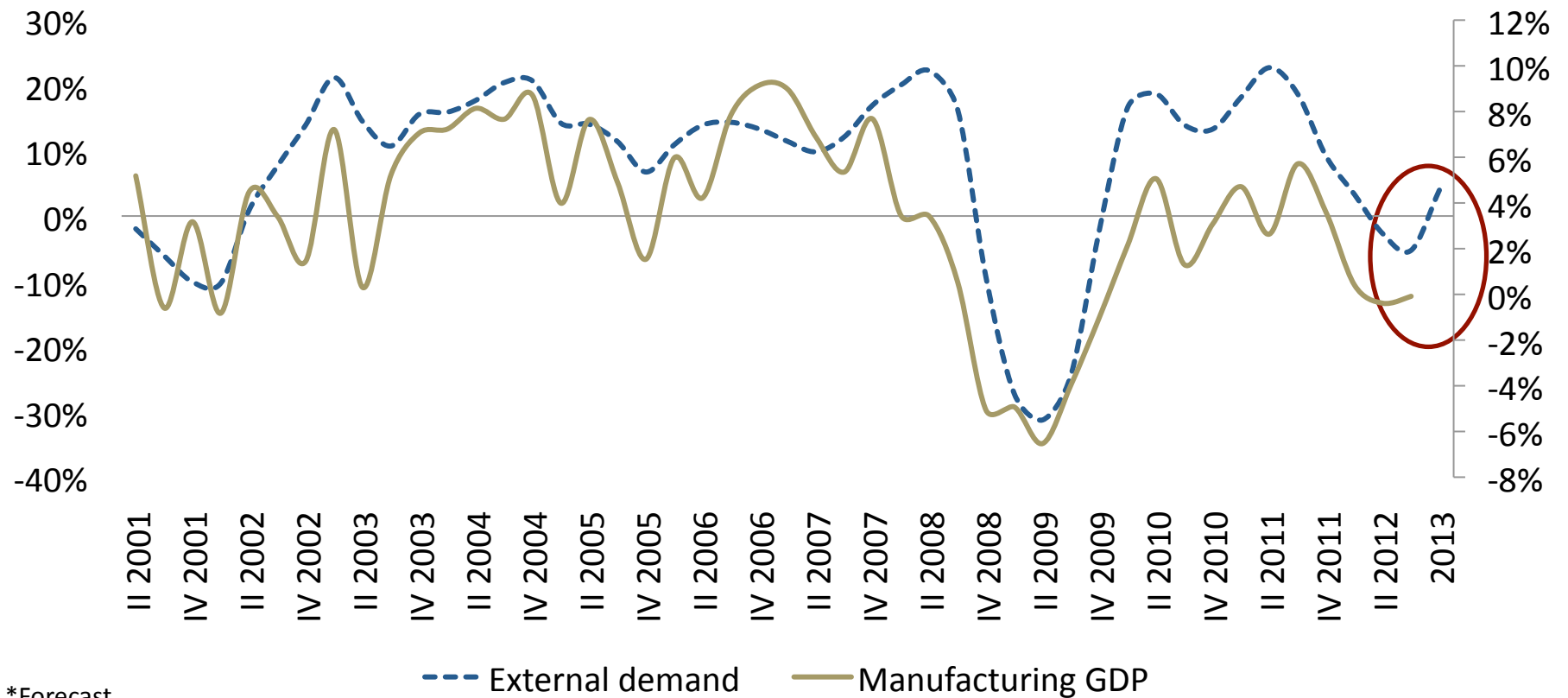
Industrial activities 2011-2011 (fourth quarter vs. third quarter)





# External demand and industrial activity are expected to recover during 2013

### External demand (G-20) and manufacturing (Annual variation)



\*Forecast



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# Why do we think that construction will improve in 2013?



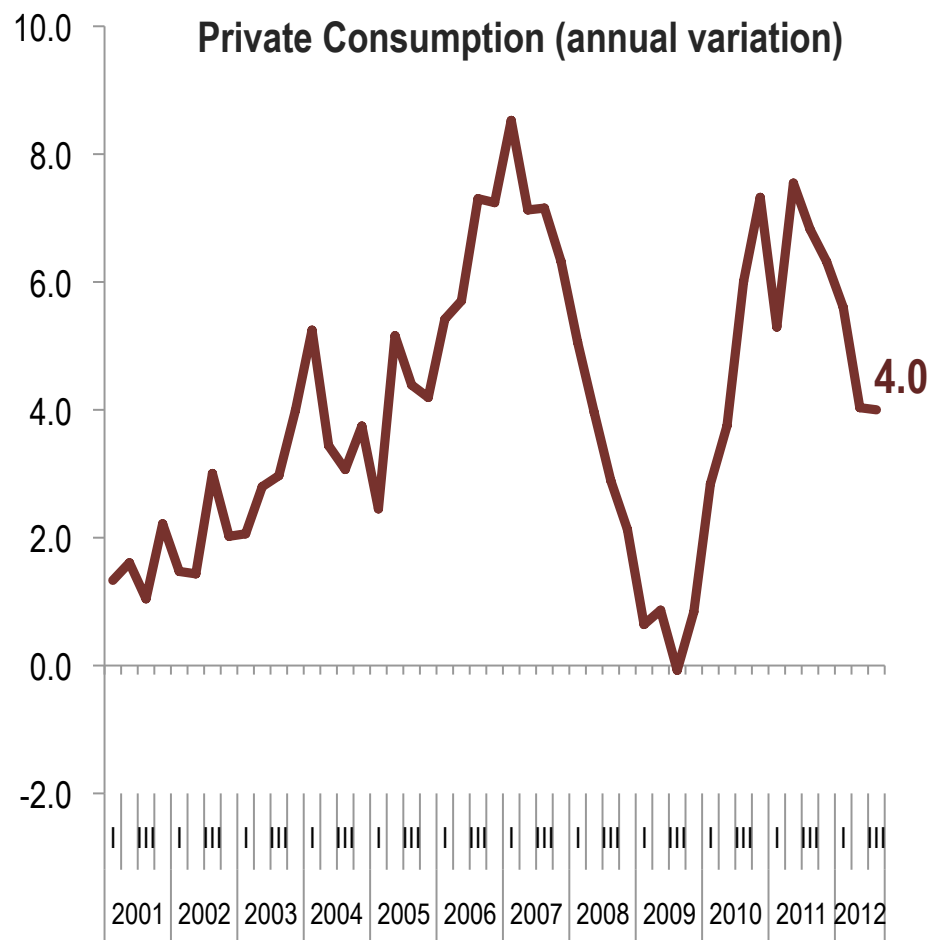
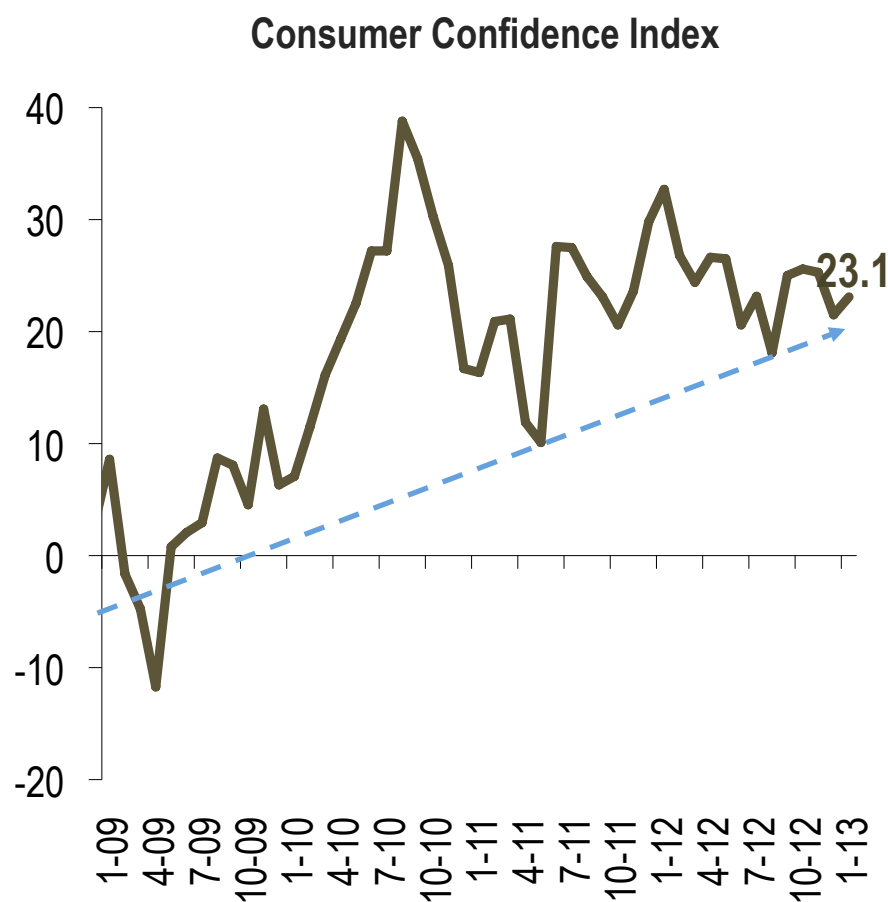


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# Private consumption maintains a positive dynamic

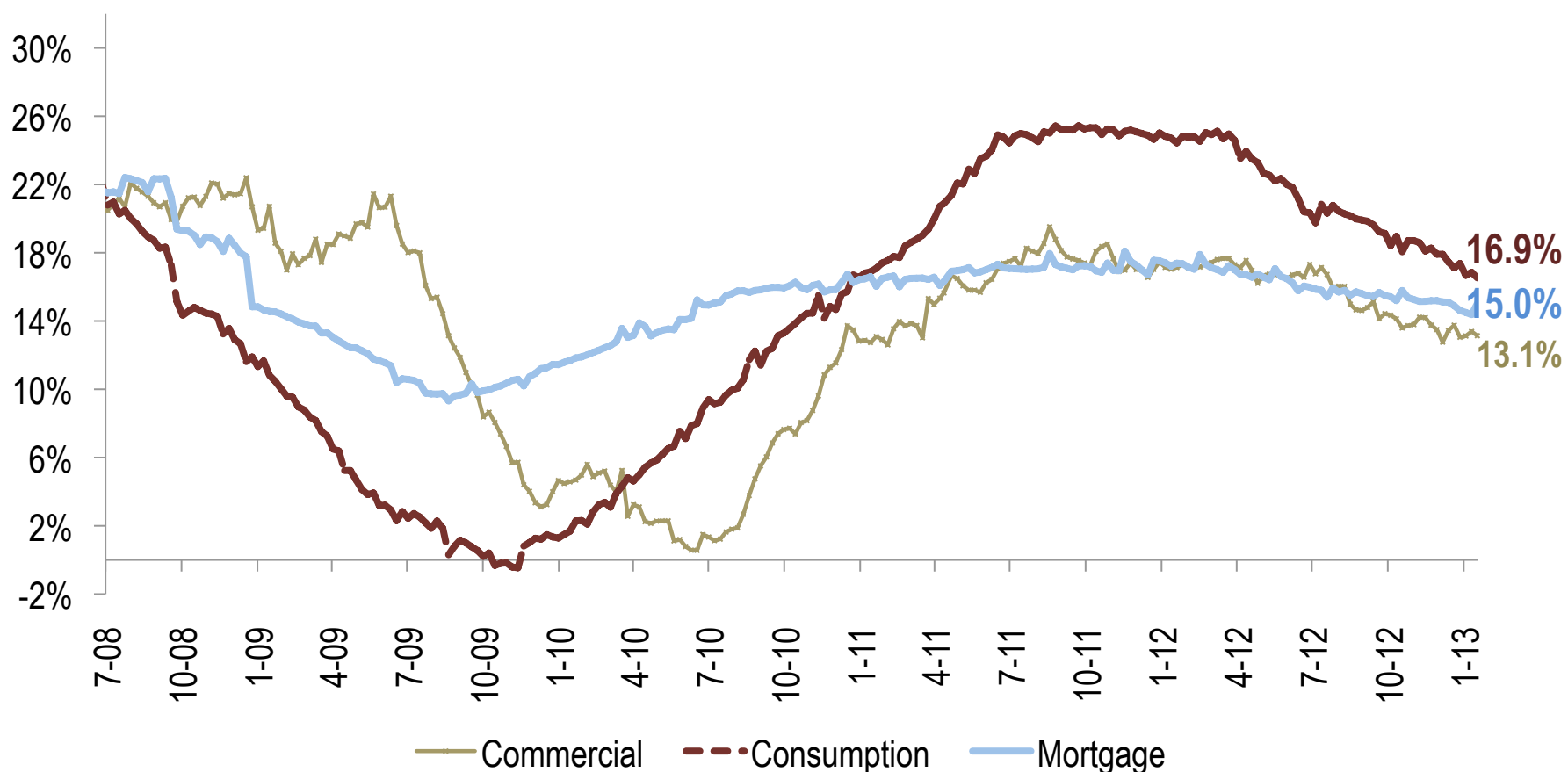






# Credit is still growing at healthy rates

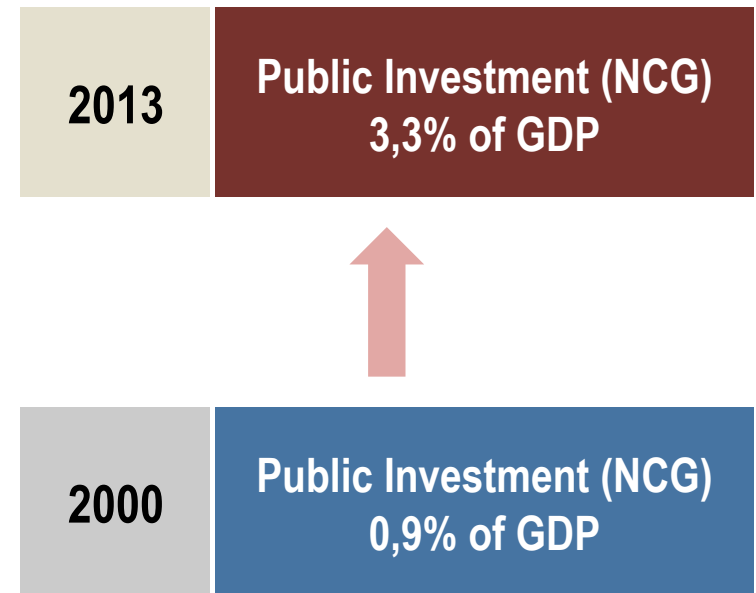
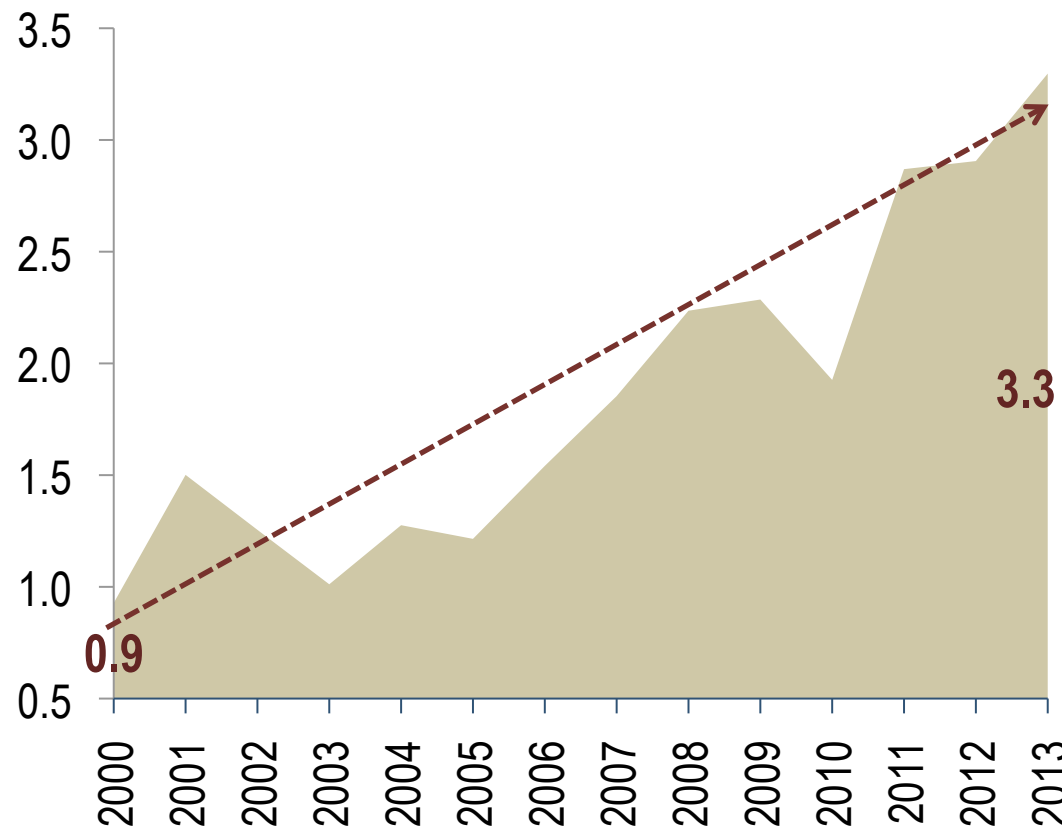
Credit by type (annual variation)





# Public investment has reached historically high levels

National Central Government Investment (% of GDP)





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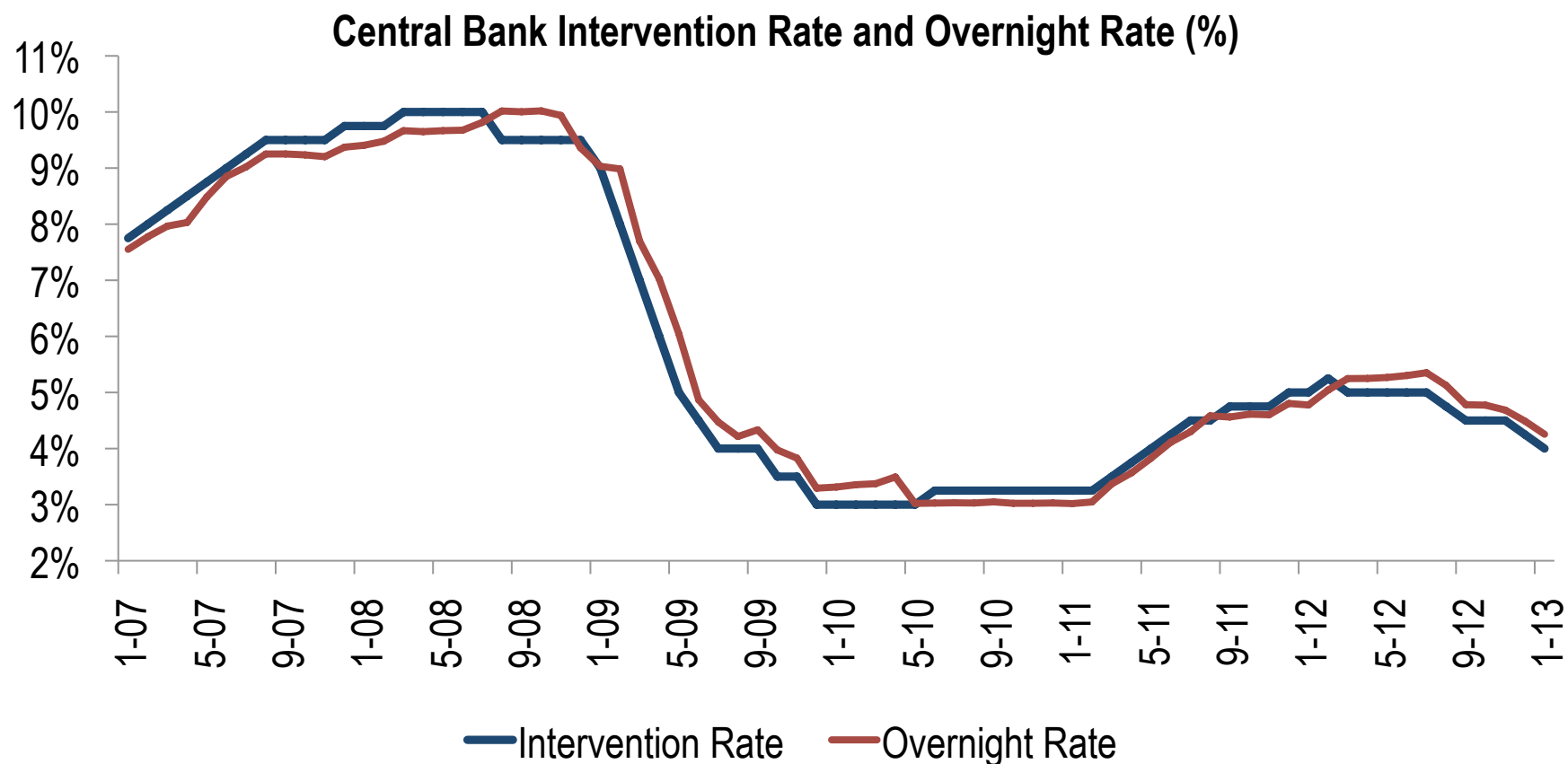
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# The monetary policy reacted promptly

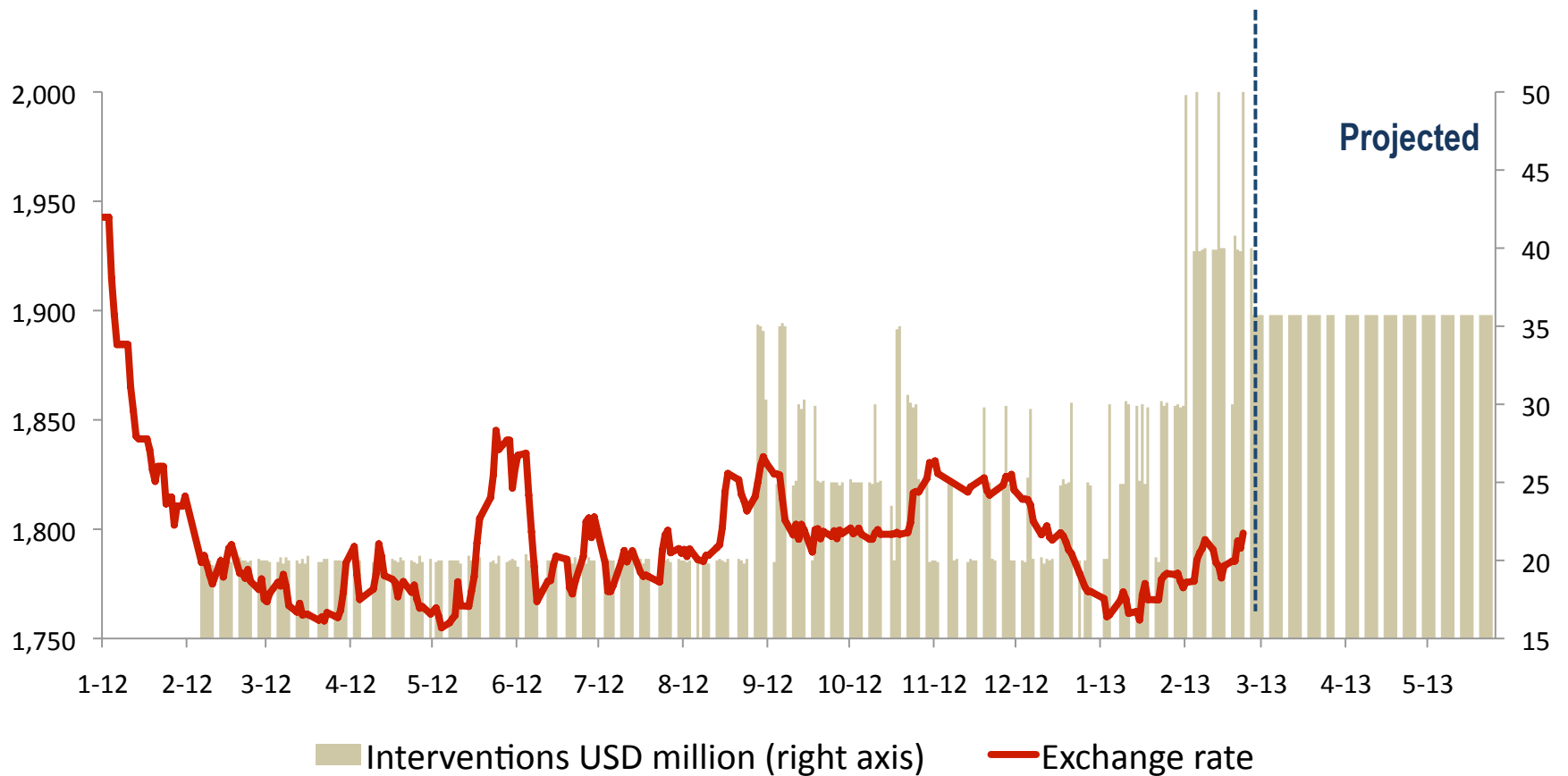
The reduction in the interest rate has been transmitted efficiently to interest rates in the financial system





# Interventions in the market have stabilized the exchange rate

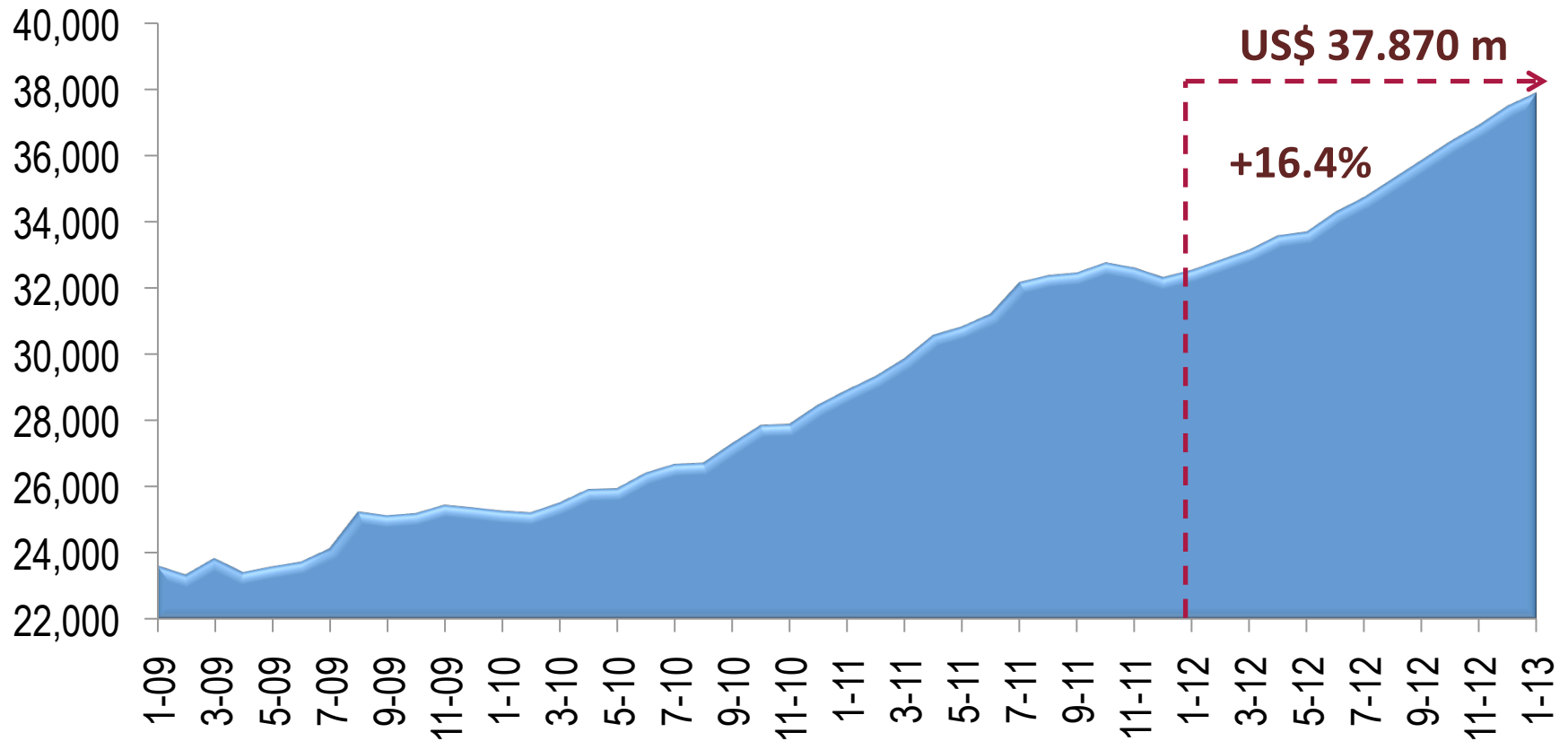
Exchange rate and interventions in the exchange market (US Million)





# International reserves have grown due to the interventions

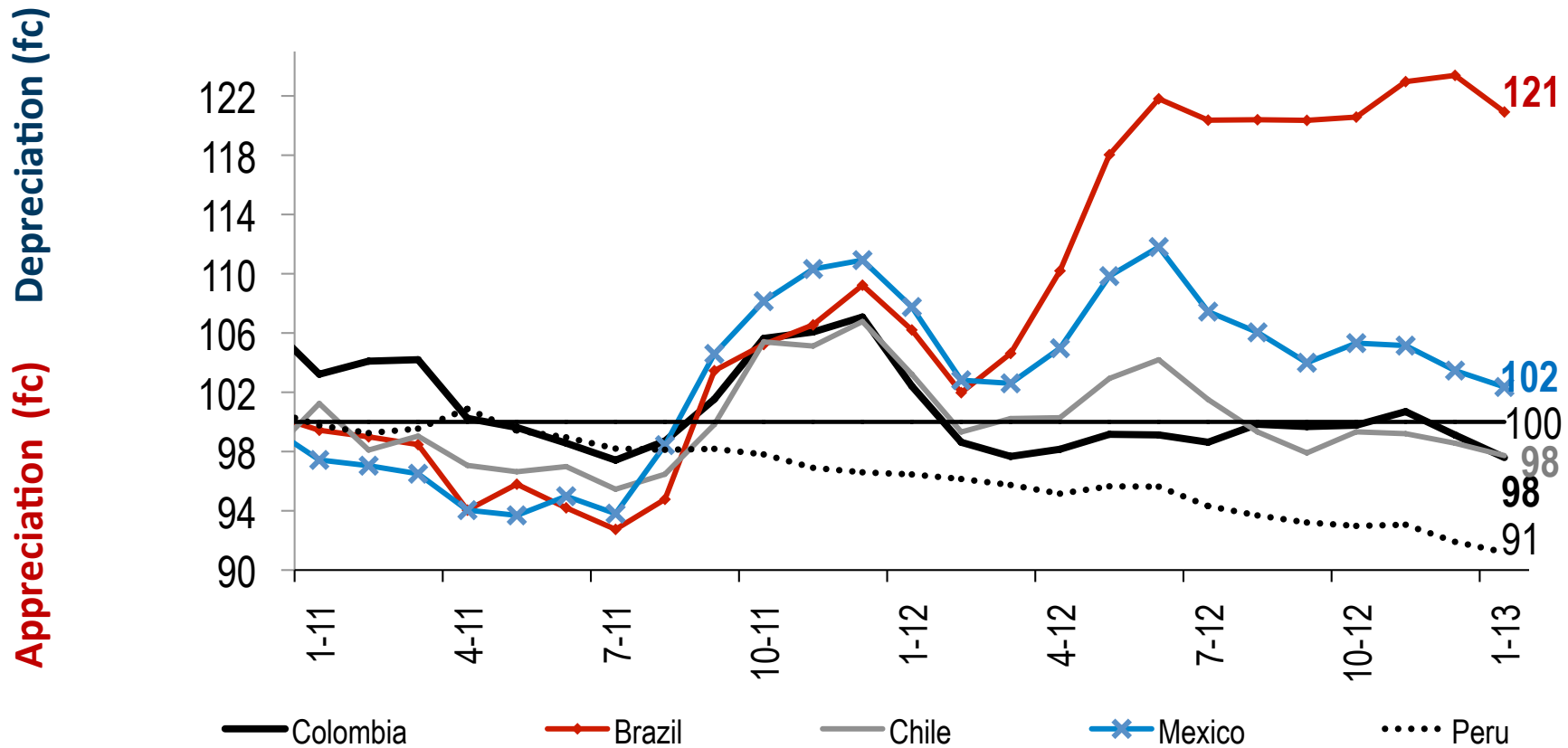
International Reserves (US\$ million)





# The Colombian Peso variations are in line with those of its peers

LATAM, Exchange rate index (foreign currency (fc)/dollar) (october 2010=100)





# Why are we optimistic about the future?



External demand is recovering



In 2013 we will have the **highest infrastructure investment** in history



About two-year worth of **royalty resources** for investment



Historically **high investment budget**



Consumer **confidence** remains in high levels



Therefore, we expect the economy to **grow in 2013 at its potential (4.5% - 4.8%)**





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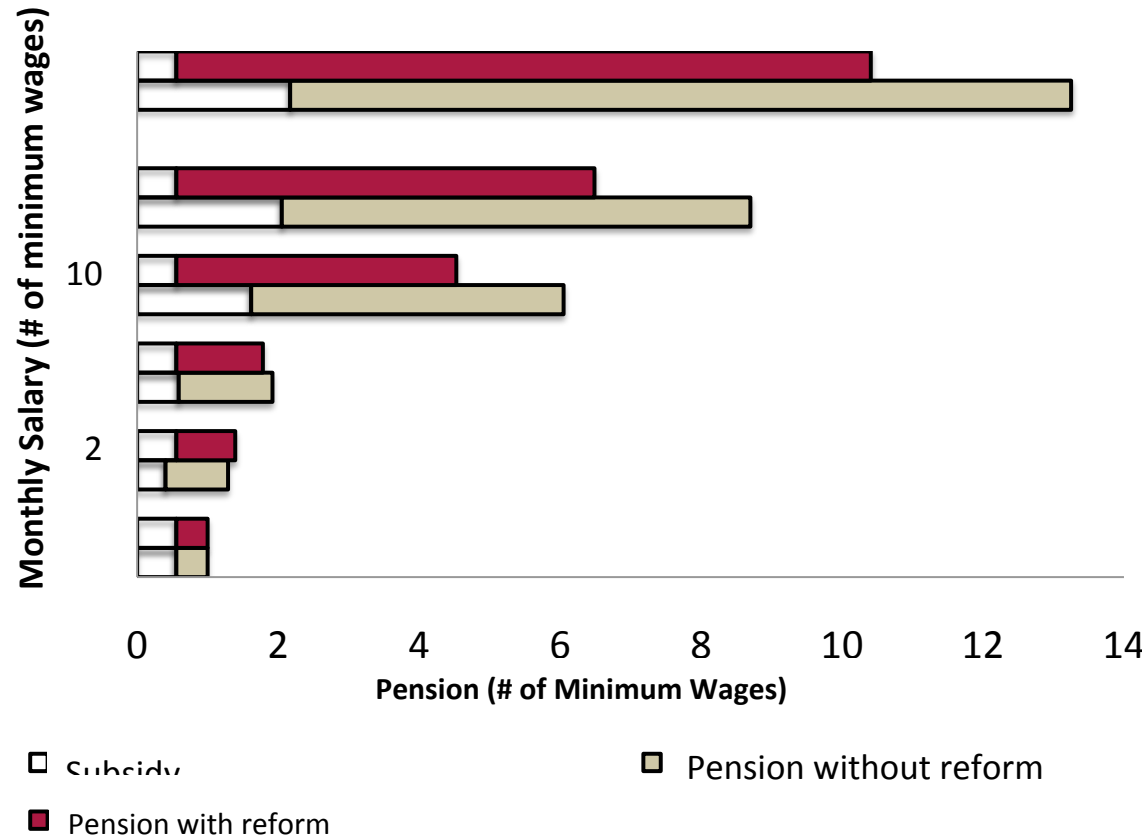
# ADDENDUM

- 1. Pension reform**
- 2. Health Reform**



# Pension Reform aims to reduce inequality

Pensions with and without the reform (# of minimum wages)



- Contributions of up to 1 Minimum Salary will be made in a pay-as-you-go scheme (Colpensiones)
- Contributions above 1 Minimum Salary will be made in Individual Retirement Accounts (AFPs)
- With the reform, government subsidies will be the same for every income level



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2. Health Reform



# Health Reform will change dramatically the way health services are offered

## 6 Main Aspects of the Reform:

**1.** The Government (Misalud) will be in charge of affiliations, collection and payments.  
(Fosyga will disappear)

**2.** The EPS will stop receiving funds. With the reform, they will be in charge of administrating risks and organizing the networks of health services.

**3.** Hospitals and health institutions will receive their payments directly from the Government (Misalud).

**4.** The POS as a list of medications and procedures will be eliminated and will be replaced with a benefit plan with defined exclusions.

**5.** The country will be divided in 10 to 12 districts, each of them with several networks of health services. These regions will be defined by the Ministry of Health.

**6.** Municipalities and Local Governments will be able to administrate directly the subsidized regime, only if they fulfill several requirements.