

SITUACIÓN COLOMBIA: EXECUTIVE SUMMARY Second Quarter 2008

2007 was an excellent year for the Colombian economy. Growth (7.5%) was higher than expected, completing a phase of economic expansion not seen since the start of the 1970s. The confidence in the country, and the high prices for its main export products, enabled the economy to overcome an adverse international environment in the second half of the year, when international financial markets began to suffer the consequences of the collapse of the prices of assets supported by real estate loans in the United States.

Recent data show that the economy has entered a period of a slight slowdown in growth, towards a more sustainable rate, as had been expected for some months, due to lower global growth and to internal factors such as the measures implemented by the Banco de la República. We interpret this favourably, as it is expected to serve to reduce the macroeconomic imbalances in the Colombian economy.

In this regard, inflationary pressure shows no sign of relenting in the first months of the year. In addition to the global phenomenon of rising inflation due to high raw material and food prices, in Colombia there is pressure from the excess spending in the economy. Basic inflation indicators have increased, and it will be hard to meet the inflation goals that have been set for 2008 and 2009. In this context, we believe that the Banco de la República will maintain a restrictive monetary policy, increasing interest rates again in the second quarter, and maintaining them thereafter until inflationary pressure begins to decrease.

In 2007, the current account deficit widened, reflecting the excess spending in the economy. This was comfortably financed by the record level of foreign direct investment (FDI), a sign of the confidence of international investors in the economy. For this year, we expect an additional deterioration in the external accounts, in spite of the moderation in domestic demand. We think that capital flows, particularly FDI, will continue to finance this deficit. In addition, due to the high international prices for raw materials, some of them with a high weight in the Colombian export basket, and the lax monetary stance of the FED, we expect the Colombian peso to appreciate.

The financial system performed well in 2007, despite eight rises in interest rates (from 7.5% to 9.5%) from the Banco de la República, and despite the imposition of marginal reserve requirements on deposits. The slowdown in lending growth reflects the effect of monetary policy decisions and points to a slowdown in economic activity. For this year, we expect lending growth of close to 10% in real terms.