

Colombia

GDP Observatory

July 7, 2009

Growth during the first quarter of the year was affected by greater deterioration of domestic demand

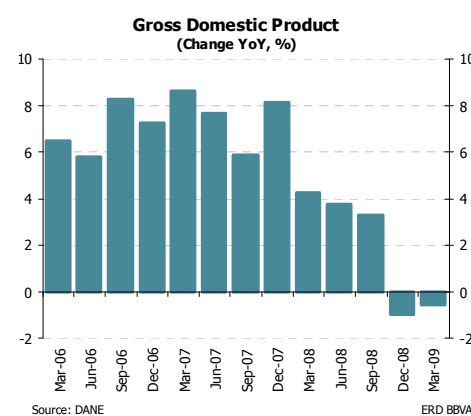
- In the first quarter of the year, the Colombian economy fell by 0.6% YoY, but posted a 0.2% QoQ growth. This result was higher than the consensus of economists and the ERD BBVA forecast.
- The contribution of external demand to growth was zero, reversing the trend shown since 2004 with negative contributions.
- Falls in investment and consumption spending and stagnation of real public spending resulted in a negative contribution of domestic demand, unseen since 1999.
- The adjustment of domestic demand in the quarter was also evidenced by a lower current account deficit, which shows major adjustments in imports and fewer dividend payments abroad.
- The economic sectors that led this growth were mining, financial services and construction, thanks to the dynamic foreign investment flows shown until March and the country's continuing bank solvency.
- ERD BBVA maintains its growth forecast for the whole year at a 0.5% fall, owing to the greater adjustment expected in domestic demand and the irregular effect of the Holy Week, two factors which may result in a second quarter with a year-on-year fall higher than the one reported in March.

Growth in the first quarter of the year positively surprised the consensus opinion among the country's economists, showing a 0.6% fall YoY, 7 bp above the ERD BBVA forecast and the Bloomberg survey. This performance coincides with a higher than expected deterioration of domestic demand in December, when it was believed that the main impact on the economy would derive from the international crisis. Instead, the figures published by DANE show that the contribution of the economy's foreign demand to growth was zero. Exports fell less than expected, thanks to the good results in mining sales and increased Venezuelan demand up to March, while domestic demand was responsible for the entire fall in GDP during the quarter.

The internal driving forces for growth have been slowing down since the beginning of 2008, when the economy embarked on a new growth path. However, global uncertainty generated by the financial crisis accelerated this normalization of the economy, and the trend in both consumption and investment spending has changed dramatically since then.

The effect on expectations and the deterioration of the labor market resulted in negative year-on-year growth of private consumption in March (-0.5% YoY), especially owing to the heavy decline in the purchase of durable goods (-6.2% YoY). Moreover, the economy's gross investment fell by 1.3% YoY, although with growing investment (basically foreign) in mining and hydrocarbons, and with the execution of more public works for fluvial transport. These two components partially offset the adjustment in capital goods made by industrialists and builders in response to the lower orders.

Mauricio Hernández Monsalve
mauricio.hernandez@bbva.com.co



| | GDP per demand (Year-on-year percentage change) | | |
|-------------------|--|------------|-------------|
| | 2007 | 2008 | Q109 |
| Final consumption | 6.9 | 2.1 | -0.3 |
| Private consumpt. | 7.6 | 2.3 | -0.5 |
| Public consumpt. | 4.5 | 1.3 | 0.2 |
| Gross investment | 13.7 | 8.8 | -1.3 |
| Fixed investment | 15.2 | 3.2 | -0.1 |
| Domestic demand | 8.9 | 4.1 | -0.5 |
| Exports | 11.4 | 7.0 | -0.5 |
| Imports | 13.9 | 9.8 | -0.5 |
| GDP | 7.5 | 2.5 | -0.6 |

Source: DANE ERD BBVA

| | GDP per supply (Year-on-year percentage change) | | |
|----------------------|--|------------|-------------|
| | 2007 | 2008 | Q109 |
| Agriculture | 3.9 | 2.7 | -0.8 |
| Mining | 2.9 | 7.3 | 10.6 |
| Energy | 3.7 | 1.2 | 1.9 |
| Manufacturing sector | 9.5 | -1.8 | -7.9 |
| Construction | 11.5 | 1.7 | 4.1 |
| Trade | 8.7 | 1.7 | -2.7 |
| Transportation | 11.0 | 4.0 | -2.0 |
| Financial | 7.3 | 5.6 | 4.7 |
| Social services | 4.7 | 2.1 | -0.2 |
| Taxes | 11.5 | 3.2 | -4.2 |
| GDP | 7.5 | 2.5 | -0.6 |

Source: DANE ERD BBVA

Gross fixed capital formation during the period fell by 0.1% YoY, causing a drop in the economy's rate of investment from 27.4% to 26.7% of GDP and reflecting a de-accumulation of inventories during the period, since gross investment fell with greater intensity. Finally, public spending grew modestly up to March, reflecting the government's reduction of expenditure (especially operating) in the new financial plan for 2009.

Performance of domestic demand affected the results of the balance of payments at the closing of the first quarter. The internal adjustment, the reduced transfer of profits abroad and an acceptable rate of remittances resulted in a closing of the current account deficit from 4.9% of GDP in December 2008 to 1.9% of GDP in March of this year. This closing was achieved despite the fact that the financing sources continued to contribute to the economy, mainly those corresponding to direct foreign investment (which reached USD 2.528 million as of March) and credit to the public sector.

Furthermore, the worst performing production sectors during the first quarter were industry, trade and transport. In industry, only 3 of 25 activities posted growth, with an increase in meat products, whose exports to Venezuela were 52% higher as of March of this year. The fall in trade, in turn, was a result of the steep decline in retail sales, which were not offset by the better performance of wholesale trade. Moreover, the reduction in foreign trade and the slowing down of domestic activity adversely affected the provision of transportation services, both by road and waterway.

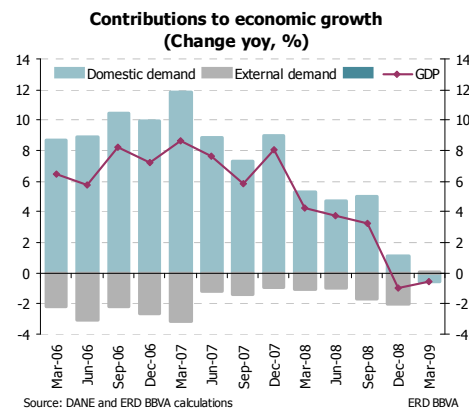
However, it is important to highlight the positive trend in mining activity, especially oil production, which represents nearly 70% of the sector's total and grew by 11.5% year-on-year as of March.

The country's labor outlook has also deteriorated over the last few quarters as a result of poor economic growth. The unemployment rate continues to grow, according to DANE data up to May. Lower family income caused by the deterioration of the labor market has generated an increase in job supply in the country, where more members of each family are now seeking employment in order to guarantee a greater flow of income. Thus, and even though the economy does not yet show signs of job destruction, with more than 265,000 jobs created over the last year, the increase in the economically active population (something characteristic of crises) does not allow the unemployment rate to be reduced.

Even so, performance of the Colombian economy within the context of Latin America has been positive. It is the only country with quarter-on-quarter growth in March, which has generated some institutional controversy over the existence of a recession in the country. And although technically there should be no recession, the negative data regarding the economic activity as a whole, together with the crisis in the country's industrial sector, make it difficult to rule out the existence of a recession in Colombia, although it has proved to be milder compared with previous episodes.

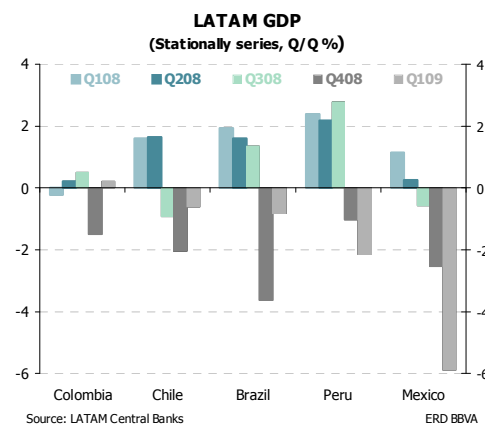
Finally, economic policy has reacted in different ways to the current economic crisis. Monetary policy, foreseeing this slowdown, has acted promptly and BanRep has cut its benchmark rate by 550 bp since December, as well as adjusting some policies related to reserves. This reduction is being transmitted quickly to market rates. For example, the maximum interest rate that credit institutions can charge for loans, between July and September, is 273 bp lower than the one implemented in December.

Moreover, fiscal policy does not have enough room to guarantee a countercyclical policy, partly because it did not adapt its spending in the higher end of the cycle to generate saving, and also because the negative growth of the last two quarters reduced the government's revenue significantly. Specifically, the infrastructure plan announced by the government, where private participation plays a key role, is being carried out satisfactorily thanks to the latter component.



| Consumption and investment (Year-on-year percentage change) | | | |
|---|-------------|------------|-------------|
| | 2007 | 2008 | Q109 |
| Final Household consumption | 7,5 | 2,2 | -0,6 |
| Nondurable goods | 6,7 | 1,5 | -1,3 |
| Semi durable goods | 8,9 | 1,3 | -2,5 |
| Services | 7,0 | 4,0 | 1,2 |
| Durable goods | 12,9 | -4,3 | -6,2 |
| Gross fixed capital formation | 15,2 | 3,2 | -0,1 |
| Machinery and equipment | 19,1 | 11,4 | 2,0 |
| Transportation equipment | 16,0 | -22,2 | -22,4 |
| Residential | 3,7 | 18,5 | -14,8 |
| Civil Engineering | 21,5 | -8,7 | 21,2 |
| Others | 4,6 | 3,0 | 2,1 |

Fuente: DANE SEE BBVA



This is proved by the figures for the first quarter, which indicate that works in mining (mainly oil, probably) and ports mark out this type of construction, namely works from private companies with direct foreign investment and port concessions granted to non-governmental companies. By contrast, works funded predominantly with public capital, such as railroads and highways, continued to fall as of March.

At BBVA ERD we are maintaining our growth forecast for 2009

The economic indicators known for the second quarter suggest new negative data as regards economic growth, worse even than that recorded in the two previous periods. The effect of the Holy Week in April drastically undermined industrial performance in the month, which is unlikely to be reversed by the sector's performance in May and June.

In addition, the pronounced decline in private consumption, which was reflected in the downward trend in retail sales and the reduction in consumer credit, confirms that recovery in this sector, as well as consumption recovery, will have to wait until year end. Moreover, growing unemployment and impairment of some financial assets during the crisis have resulted in reduced household income and real wealth, which will take some time to be restored under present circumstances.

Likewise, growth in the mining sector in the first quarter was due partly to a statistical factor, owing to the problems that occurred one year ago in the Cerratos mine. Also, the increase in the level of investment for mining works, which gained significant momentum compared with one year ago, makes it less plausible to confirm other growth rates similar to those recorded in March (93.5% YoY). The second quarter will probably yield positive results for this sector, but to a considerably lower extent. The profit growth rate is also slowing down in the financial sector, and its real growth will probably stabilize at a figure nearer its average historical quarterly growth (1.4% YoY).

Finally, the capacity rate utilization by the companies has been declining since September 2008 (according to ANDI figures), from usage levels close to 80% to 73% in April of this year. This idle capacity in the companies, as a result of falling orders, will limit the investment decisions of businesses and reduce this type of spending even further. Likewise, this negative gap in production will limit the existence of inflationary pressures during 2010 arising from demand.

These sources of uncertainty, combined with the risk on future performance of civil engineering, will continue for the rest of the year. Therefore, ERD BBVA maintains its growth forecast for 2009 at a 0.5% drop for the whole year, despite the fact that many analysts are revising their forecasts upward, carried by the euphoria of a good first quarter.

At ERD BBVA we believe that growth in the second quarter may be lower than in the first three-month period, and positive growth data, even moderate, will only be possible in the second half of the year.

