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COLOMBIA
COUNTRY RISK ANALYSIS

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Executive Summary

Transfer Risk

Colombian authorities have chosen to run down external reserves rather than substantially boost external borrowing to cover recent balance-of-payments deficits. As a result, foreign exchange has fallen from a peak of $4.8 billion in 1981 to an estimated $800 million by the end of 1984. A crack down on the illicit drug trade has also reduced the amount of funds flowing into the country and has driven some funds offshore to avoid possible confiscation by government authorities.

Colombia's public sector remains current on external debt payments with all foreign creditors. However, in the past year, private sector debt problems and bank scandals have shaken investor confidence. Regional U.S. banks, as a result, which account for about 15% of all bank credits to Colombia, have recently become reluctant to refinance principal payments of the Colombian private sector, and this has hurt the country's liquidity. This situation has generated occasional rumors within the international banking community of a possible private sector rescheduling. It now appears likely that the government will become more involved in the intervention or restructuring of foreign debt of domestic banks, financial and industrial corporations. Public sector repayments, however, should be unaffected by a private sector rescheduling.

This deterioration in liquidity has worsened Colombia's near-term transfer risk. The country, however, still enjoys considerable access to eurocurrency markets and has substantial unused borrowing capacity at the IMF. Colombia may request a formal IMF stabilization program to obtain new money which should bridge its present tight liquidity until the external accounts begin to improve in 1984 and beyond.

Economic Risk

Colombia's medium-term prospects are brighter than its near-term outlook. Real GDP growth should begin to recover in 1985 and beyond with consumer price inflation moderating to an acceptable level. The structure of the economy will change significantly as new mining (including petroleum) and manufacturing activity come on stream which will also help to diversify the export base. Agriculture, which has been the mainstay of the economy, will continue to grow at a healthy rate but inevitably decline in relative importance.

Colombia's current account deficit is expected to average $2.0 billion over the 1985-89 period which is sustainable and financiable assuming the country continues with its present effective economic policy that has brought about a strong improvement in the external accounts. The anticipated level of deficit financing over the 1985-89 period will result in moderate growth of external debt, but debt service is expected to remain manageable throughout the period.

Colombia's external debt, including undisbursed, is expected to reach $12.3 billion by the end of 1984 or about 36% of GDP and is moderate compared with other LDC debtor nations. Colombia's economic managers have been able to avoid the difficult external debt problems that have plagued its Latin American neighbors. The country has managed external shocks reasonably well through currency devaluation and tight import control. Efficient investments in the recent past have set the stage for new sources of growth, and there is reasonable expectation that the country will retain a good degree of creditworthiness for the foreseeable future.

AID's Loan to Colombia

AID's housing loan to Colombia will have no discernable impact on the level of Colombia's overall external debt or its service. However, debt-service will be moderately higher in the 1985-87 period and grace periods on interest, as well as principal repayments, while not necessary, would be helpful.

AID's housing loan to Colombia will result in measurable savings over the terms the country receives in eurocurrency markets. In recent borrowings, Colombia has paid 1 5/8% over six month Libor for 8 year borrowings which is about 150 basis points higher than HIG's six month U.S. Treasury Bills plus a spread of up to 100 basis points.

Table 1

Key Economic Indicators

	1982	1983	1984E	1985E	Average 1985-89E
Real GDP (% change)	1.4	1.3	1.6	3.0	3.5
Inflation (% Change)	24.0	17.0	16.0	18.0	21.0
Trade balance ($US bil., fob-cif)	-2.0	-1.9	-1.5	-1.3	-0.6
Current account ($US bil.)	-2.9	-2.5	-2.1	-2.0	-2.0

E - estimated

Prepared by: Jesse Wright
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Current Economic Developments

Colombia's recession is continuing into a third year, with real GDP expected to grow by only 1.6% in 1984. A number of conditions have recently combined to slow domestic economic growth. The agricultural sector, especially coffee, has been hit by low prices and growing world inventories while investment in Colombia's construction sector has been lagging. A significant portion of the government budget is allocated to housing, but other major public works projects have been slowed due to the budget shortfall. Higher taxes and user charges on government services will dampen aggregate demand this year as the government seeks to reduce persistent budget deficits. One of the few bright spots in the economy has been moderate growth in Colombia's industrial sector which is principally the result of the containment of manufacturing imports and the clamp down on contraband. Manufacturing output should recover to nearly 3% growth in 1984 after three years of decline. Due to investments already in place, industrial growth over the 1985-89 period should be able to achieve an average 4% annually.

Consumer price inflation is expected to moderate at about 16% in 1984 due to a declining growth rate in the money supply and slower economic activity. Better progress on inflation has been achieved despite an aggressive exchange rate devaluation policy that is raising import costs. In 1985 and beyond, however, inflationary pressures will increase as international reserves increase and a limited amount of monetization of budget deficits occurs. By Latin American standards, Colombian authorities have been fairly successful in moderating inflation and an approximate 21% inflation rate over the 1985-89 period is both achievable and appropriate. Real wages may rise by a moderate 5-6% in 1984 and have been held down by a fairly substantial 14% unemployment rate. High unemployment is likely to linger for a couple more years which should hold real wage increases to about 2-3% annually.

Gross business investment has been depressed in the last two years but is expected to increase by 3.0% or better in 1984, providing most of the stimulus to this year's economic growth. However, capacity utilization in the industrial sector, because of the recessionary environment, is still comparatively low at 67% and until excess capacity is absorbed will prevent a substantial rise in investment. The bulk of Colombia's investment continues in manufacturing, mining (including petroleum) and the services sector and is gradually shifting the structure of the economy toward industry and services.

The Colombian authorities' recent crack down on illicit drug trafficking has had an adverse affect on domestic investment. Formerly, drug money was laundered through Colombia shell companies that would bring the money into the Colombian banking system to be used in legal domestic investment. The law enforcement campaign, however, has cut heavily into the amount of new money available and has driven some funds offshore to safer havens. This undoubtedly has had a depressive effect on investment, but even so investment as measured in the national accounts is expected to rise an average 3.7% annually in the 1985-89 period.

Petroleum and Mining Sectors

Colombia is still a net petroleum importer, spending about $500 million in 1983 for light fuel oils and petroleum derivatives. The national goal is to become petroleum self-sufficient by the end of this decade. The country has proven reserves of 600 million barrels and probable reserves of 1.5 billion barrels or approximately 11 and 27 years, respectively, of production at current rates. Exploration activity is brisk with 160 exploratory wells expected to be drilled in 1984 compared with 147 wells last year. Most of Colombia's oil exploration is carried out by major oil companies that are reimbursed for 50% of exploration costs and receive 40% oil equity participation. These are attractive terms in the industry and mostly explain Columbia's rising oil investment and production activity.

Despite the intensive exploration activity, official forecasts suggest that oil production in 1990 will decline slightly from present levels owing to a sharp drop in the production from older wells. Colombia, however, will continue to enjoy near self-sufficiency in oil for many years to come and will realize significant foreign exchange savings.

Over the 1985-89 period, Colombia's economy will expand into the mining sector, helping to diversify the export base. Coal exports are expected to begin in early 1985, initially earning about $150 million of foreign exchange annually and rising to about $1.2 billion by 1989, making coal exports second to coffee. Nickel exports of about $150 million are also expected to begin in 1984 although they will rise more slowly to about $230 million by 1989. The structural changes anticipated in Colombia's economy over the 1985-89 period should raise the percentage of petroleum and mining export earnings from 10% of total exports in 1983 to 31% by 1989.

Table 2

Petroleum Balance
(Barrels/Day)

	1980	1981	1982	1983 a)	1986 (forecast)	1990 (forecast)
Domestic crude output	125,800	134,200	141,700	152,245	149,600	147,200
Imports						
Crude oil	20,052	20,953	20,041	37,700	68,600	94,200
Refined products b)	35,341	30,386	30,259	13,200	1,800	3,800
Total imports	55,393	51,339	50,300	50,900	70,400	98,000
Exports c)	25,970	28,578	32,928	36,700	41,600	46,900
Net imports	29,423	22,761	17,372	14,200	28,800	51,100
Apparent domestic demand d)	155,223	156,961	159,072	166,445	178,400	198,300

Notes: a) Preliminary estimates. b) Mainly motor gasoline and gas oil. c) Mainly heavy fuel oil. d) Domestic crude production plus net imports. No stock change assumed.

Sources: Centro de Information de la Industria Petrolera

Recent Changes in Economic Policy

The next two or three years for Colombia will be a period of adjustment and accommodation to stringent new economic policies. Fiscal and current account deficits have forced an increasingly austere fiscal policy that is coupled with new measures to deal with external imbalance.

A new 10% Value Added Tax (VAT) went into effect in April, 1984 and is expected to boost tax revenues well above the former ineffectual sales tax. Many basic consumer items such as food, drugs, housing, etc. are exempted, but luxury items are subject to a stiffer 20-35% VAT rate. Domestic petroleum prices were raised 16% in early 1984 to conserve rising oil production for export markets. Minimum wages were raised 22% for urban workers and 29% for rural workers. This represents respective real income increases of 6% and 13% after inflation, but income increases are probably nil when new taxes and subsidy reduction are taken into account.

Despite new taxes and a 10% spending cut, the Finance Ministry recently announced that the 1984 fiscal deficit will rise to 5% of GDP from 4% last year. As a result, further fiscal austerity is in store. The 1985 budget caps government wage increases and cuts government spending further with the objective of bringing down the fiscal deficit to 3.0-3.5% of GDP. If the government can achieve these goals in 1985, they may be able to avoid an IMF stand-by program.

With respect to the external sector, Colombia's most important policy has been its rapid exchange rate devaluation. Over the 1984-89 period Colombia's consumer price index is projected to increase about 21% annually while peso devaluation may average 24% against the U.S. dollar in the same period. The peso is thus expected to increase its real competitiveness with respect to the U.S. dollar and even more so on a trade-weighted basis with respect to other Latin American trading partners. Moreover, a small increase in import taxes has recently been introduced that will further boost domestic sales of Colombian industry.

A 20% decline in foreign direct investment in 1983 may force the government to drop some of the harsher provisions of the Andean Pact's Decision 24 which limits foreign direct investment. The authorities are contemplating reducing minimum requirements on the percentage of locally sourced raw materials and export sales that foreign firms must meet, as well as introducing more liberal profit remittance rules. These measures, if adopted, will represent a significant attempt by Colombia to attract foreign business investment and further open its economy.

The overall thrust of Colombia's economic policies has been that of conservative economic management. Similar to most LDCs, Colombia has been buffeted by external conditions mostly beyond its control, but unlike many countries the authorities have responded with appropriate policy changes. Thus in the recent past, there have been tax increases, government spending cuts, caps on wage increases, limits on import spending and foreign borrowing and accelerated currency depreciation. Moreover, it is notable that these difficult measures have been adopted in the absence of IMF prodding.

Balance-of-Payments

Over the 1985-89 period, Colombia's huge mining and petroleum projects are expected to increase export revenues by nearly 15% annually. Rapid currency depreciation should also boost the growth rate of agricultural and manufacturing export receipts by about 6% annually. Import growth is expected to recover from its current low level, but subdued government spending and the near completion of major mining investments should keep the growth rate near 6% annually over the period. External trade deficits, as a result, are expected to experience a significant decline throughout the period rising to trade surpluses by 1989.

Colombia's service balance suffers from the continued reduction of workers' remittances from Venezuela, declines of inflows from contraband and drugs and rising interest payments on project loans. Over the 1985-89 period, the net service balance is expected to deteriorate to a $1.8 billion deficit from an anticipated $800 million deficit in 1984. As a result, the improvement in the current account deficit will be slow beyond 1985. The current account deficit should rise from $2.1 billion in 1984 to a peak of $2.3 billion in 1985 and gradually decline to $1.7 billion by 1989.

Colombia's total financing requirement, including gross short and long-term capital inflows, over the 1985-89 period is expected to rise to about $6 billion annually. However, two-thirds of the $6 billion annual refinancing is amortization which can be rolled-over so long as Colombia remains creditworthy. Thus, Colombia is not expected to experience any sharp balance-of-payments difficulties in the next five years.

Colombia has experienced a considerable loss of reserves over the last three years, falling from a high of $4.8 billion in 1981 to an estimated $800 billion by the end of 1984. The country has an additional 4.1 million ounces of gold with a current market value of $1.4 billion. The authorities choose to run down international reserves to finance external deficits rather than resort to greatly accelerated international borrowing. This has given the country a near-term liquidity problem that may require an IMF assistance program, but the country has also avoided massive debt accumulation.

Table 3

Balance-of-Payments Summary
($ billions)

	1981	1982	1983	1984	1985	Average 1985-89
Trade balance	-1.6	-2.0	-1.9	-1.5	-1.3	-0.6
Exports (fob)	3.2	3.2	2.9	3.3	3.6	5.0
Imports (cif)	-4.8	-5.2	-4.8	-4.8	-4.9	-5.6
Service balance (net)	-0.5	-1.1	-0.7	-0.8	-0.9	-1.5
Transfers (net)	0.2	0.2	0.1	0.2	0.2	0.1
Current account	-1.9	-2.9	-2.5	-2.1	-2.0	-2.0
Capital account (net)	1.9	2.3	0.5	1.0	2.3	1.9
Change in reserves	0.0	-0.6	-2.0	-1.1	+0.3	-0.1

External Debt Profile

Although Colombia has not experienced the extreme debt problems of its South American neighbors, it has to some extent been painted with the same brush as troubled Latin American debtor nations. As a consequence, Colombia's external debt is not likely to grow as fast in the future as occurred in the five years prior to 1982 when Colombia's public and publicly guaranteed debt grew at an annual average of 22% and private non-guaranteed debt at 28%. As an example of reduced borrowing, in 1983 Colombia borrowed $618 million in syndicated euroloans compared with $1.1 billion in 1982. In the first half of 1984, the rate of euroborrowing was down still further at $285 million. Colombia has been able to slow its borrowing because of the completion of major mining projects, but also because of deliberate policy to reduce its dependence on external loans. The country has also been affected by the general malaise affecting most Latin American debtor nations and the slowing of lending to these countries.

In the period between 1982 and 1989, Colombia's external debt outstanding will nearly double (see Table 5). In relative terms, however, the average annual increase in debt should be slightly over 10% which is well under the nearly 15% average annual increase in export earnings. Thus, Colombia should see some relative improvement in its ability to service external obligations. The accumulation of debt is relatively smooth over the period with the exception of 1985 and 1986 when the increase in external debt will be moderately higher due to planned borrowing for completion of already-started projects.

The debt service profile that results closely mirrors the time profile of gross debt. In general the rise in total debt service is expected to be gradual except in the 1986-88 period when a bulge of non-guaranteed private debt service rises measurably but subsequently levels off to a more gradual growth rate.

The debt service ratio reaches a peak of 46% in 1986 and probably will not fall below the 32% mark anticipated in 1989. Even so, the country is not expected to reach the extremes of indebtedness or the repayment problems experienced by some nations on the South American continent. Colombia's creditworthiness is expected to remain high and thus continue to encourage commercial banks to rollover a portion of medium and long-term amortization payments.

Private Sector Debt

There have been no difficulties with public and publicly guaranteed debt-service, but Colombia's non-guaranteed private sector repayment is beginning to show signs of strain. Approximately one-half of the Colombian banking sector's $5.9 billion of external debt (see Table 4 below) is medium and long-term loans. Colombian banks in turn have on-lent these funds to companies--cement, textile, transport and steel--that has been squeezed by a drop in sales, price controls and the real devaluation of the peso. It is estimated that perhaps 25% of private sector domestic debt must be rescheduled. The Colombian banking sector thus may be hit with a high level of past due loans. It is likely that the Colombian government will have to step in and provide liquidity to the banking system and assist in the restructuring of private sector external loans. This will undoubtedly increase the burden on the Colombian government, but not to the point where it disrupts the Colombian government's external debt service.

Table 4

External Position of Colombian Banking System with International Commercial Banks
($ millions)

	Dec '79	Dec '80	Dec '81	June '82	Dec '82	June '83	Dec '83
Liabilities	3,463	4,261	4,868	4,930	5,541	5,862	5,926
Assets	3,132	2,956	3,571	3,492	3,686	2,987	2,570

Source: Bank for International Settlements, Basle, Switzerland, April, 1984.

Net foreign assets with all foreign entities	3,431	4,537	4,648	3,629	3,811	2,348	N/A

Table 5

Public/Publicly Guaranteed and Private Non-Guaranteed External Debt
($ millions)

	1982	1983	1984	1985	1986	1987	1988	1989
Public/Publicly Guar.*	9,712	10,198	11,400	13,400	15,600	17,800	19,300	20,200
Private Non-Guar.**	1,216	900	875	1,600	1,900	1,200	700	800
Total Debt Outstanding	10,928	11,098	12,275	15,000	17,500	19,000	20,000	21,000

Sources: 1982 base year IBRD, World Debt Tables; projections as per assumptions discussed above.

* Includes undisbursement commitments.
** Disbursed debt only.

Table 6

Total Debt Service*
($ millions)

	1983	1984	1985	1986	1987	1988	1989	1990
Official creditors	432	450	510	655	660	800	880	920
Private creditors	545	580	650	830	840	1,000	1,120	1,180
Guaranteed debt service	977	1,030	1,160	1,485	1,500	1,800	2,000	2,100
Non-guaranteed debt service	129	100	90	400	400	400	100	200
Total debt service	1,106	1,130	1,250	1,885	1,900	2,200	2,100	2,300
Minus: Net private rollovers	(218)	(360)	(400)	(700)	(700)	(700)	(660)	(700)
Equals Net debt service	888	770	850	1,185	1,200	1,500	1,440	1,600
Total debt service ratio (%)	38	34	35	46	40	40	32	34

Source: 1983 base year IBRD, World Debt Tables; projections as discussed above.

* Projected debt service assumes the following: Official credit terms are 9% interest, 5 year grace period and 17 year maturity; private creditor terms are 13% interest, 2 year grace period and 7 year maturity. Net debt service acknowledges that commercial banks customarily rollover principal repayments on medium and long term debt as long as the country maintain creditworthiness. The debt service ratio above, however, is based on the debt service before rollovers.