



QUARTERLY REPORT: COLOMBIA WILL GROW IN 2009

- **Growth perspectives for Colombia improve in the second half of 2009.**
- **The Central Bank may keep its interest rates unchanged until the end of 2009.**
- **Appetite for financial assets in Colombia continues thanks to a lower risk perception for the Region and a positive growth outlook for developed economies.**

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I. Introduction: Growth Perspectives for Colombia Improve

Ending June, the Departamento Administrativo Nacional de Estadística (DANE – National Statistics Office) announced that GDP dropped 0.55 percent in the first quarter of 2009. The decrease was less than expected and came as a positive surprise for analysts, who expected a 1.3 percent contraction. However, GDP growth has moved in negative territory for two quarters in a row (Q4-2008, -0.97 percent), which means that the economy is in recession.

This information is not news due to the marked impact felt on commerce, industry and consumption. What indeed came as a shock was that the Ministry of Finance, eager to disclose positive numbers, stated that the Colombian economy was not in recession. This announcement was based upon well built calculations from DANE, yet not thorough enough to deny reality.

There are different definitions of economic recession. One of the most popular ones denotes two consecutive decreasing quarters, although some economists stick with three quarters. Others include additional variables such as unemployment, industrial output or trade. Some economists even believe that despite showing two or three consecutive trimesters of economic downturn, the economy may not be in a recession if such drops are minimal. This matter could be more subjective than what it appears to be.

The discussion at present in Colombia, which seeks to determine if we are or not in a recession, proves that the Government must adopt one of the numerous definitions and appoint an entity the job of stating and delimiting the expansion and contraction economic cycles. We agree with the Minister when he says that the relevant discussion is not whether we are or not in a recession. Nonetheless we find quite important to establish a methodology that allows us all to speak the same language.

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In the midst of this debate we deem important to underline that Colombia performed better than expected and it may be in better shape than most of the economies in the Region. While the variation in Colombia was -0.55 percent in the first quarter, other countries in Latin America exhibited deeper falls like México (-8.2 percent), Chile (-2.1 percent) or Argentina (-2 percent). Outperforming Colombia are Peru (+1.8 percent) – which has been an outstanding economy in the past years – and Venezuela, whose numbers are still dubious.

On the demand side, Colombia’s performance was better than forecast due to the price climb of commodities and the aggressive cut in interest rates. However, for the first time in a decade we saw consumption fall (-0.31 percent for the quarter) as investment dropped 1.26 percent.

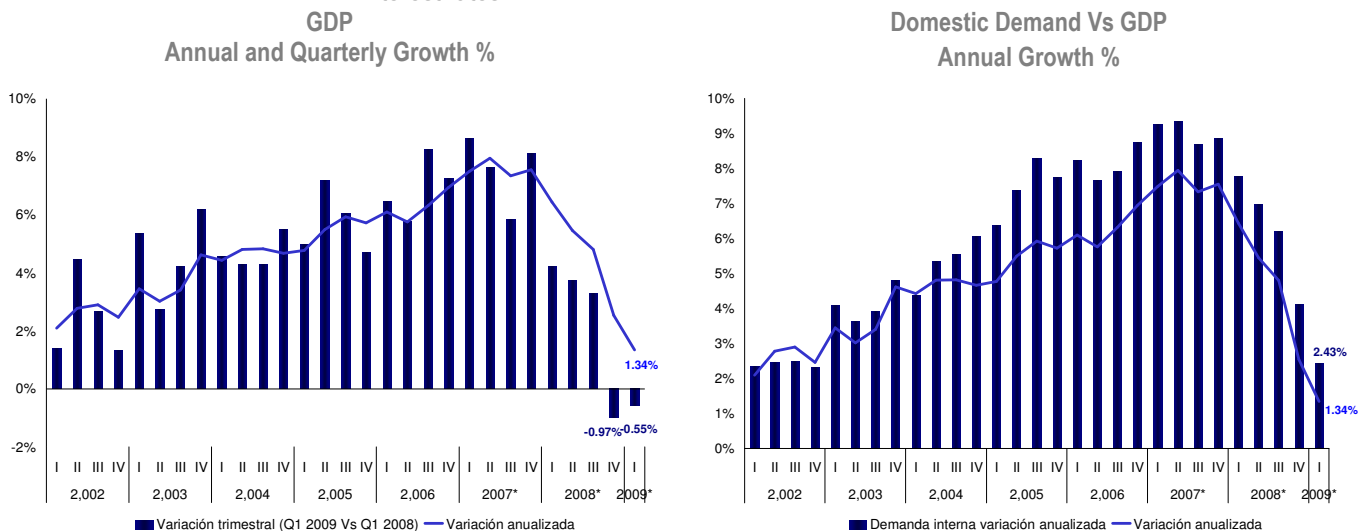
As for offer, the 0.48 percent fall on exports had its match on the manufacture industry (-7.88 percent). Meanwhile, trade decreased 2.7 percent and added two consecutive quarters in negative territory. In spite of this, a counterbalance was found in some groups like construction (+4.1 percent) and financial institutions (+4.68 percent).

Looking at the figures released by DANE, while considering the upshot of the Central Bank’s rate cuts and the smaller-than-expected economic decline, at Corredores Asociados we have revised our 2009 growth target from -0.1 percent to 0.4 percent.

II. Economic Growth: The Numbers in Detail.

The Colombian economy shrank 0.55 percent in the first three months of 2009, below last year’s first quarter figure of 4.23 percent. Taking into account that in the last trimester of 2008 the contraction rate was 0.97%, the economy has now moved two consecutive quarters into negative territory. Thus, annual growth sits on 1.34 percent, while at the end of the first three months of 2008 it reached 6.43%. Annual growth also stands below domestic demand, which increased 2.43%.

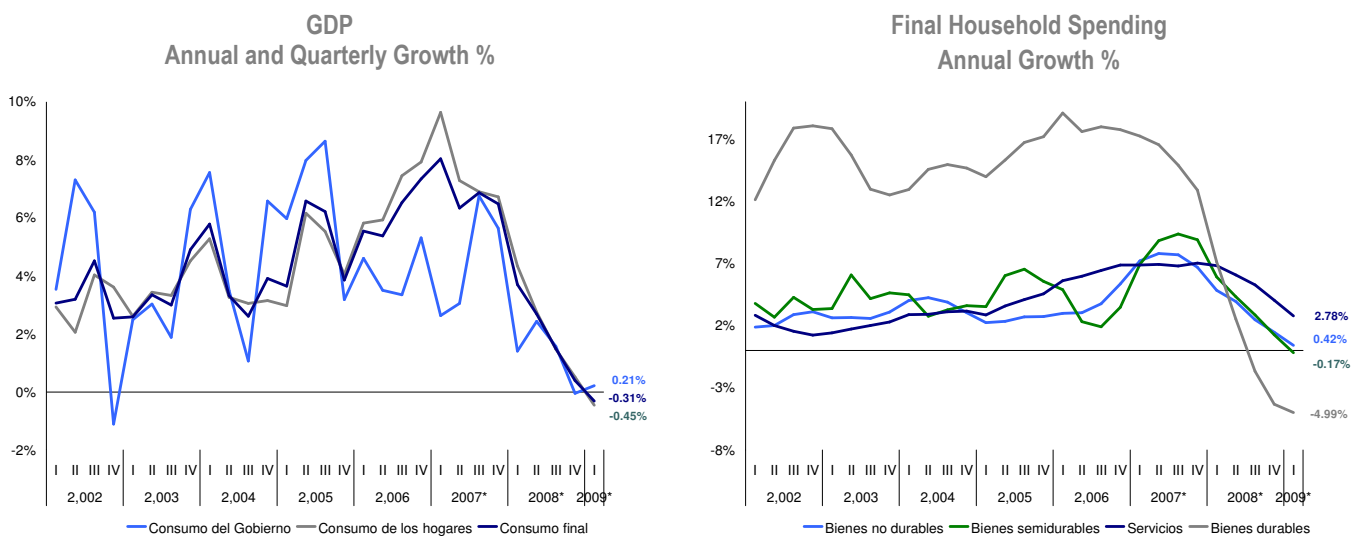
The performance of the Colombian economy on the demand side was better than expected due to the price climb of commodities and the stimulus arising from the aggressive slice in interest rates.



Source: DANE

According to the data released by DANE, the economy contracted on the demand side due to a drop in final consumption of 0.31 percent and a fall in investment of 1.26 percent.

The decrease in consumption is explained mainly by a 0.45 percent negative variation in household spending (78 percent of total consumption), while Government expenditures rose 0.21 percent. Within household consumption, the hardest drops were on non-durable goods, which fell 1.34 percent, and semi-durable goods (-2.51 percent). Although durables make up for just 8 percent of total household spending, its 6.17 percent plunge had a significant effect on the quarter results. The former were offset by a 1.16 percent increase in services, which represent 48% of total home consumption.



Source: DANE

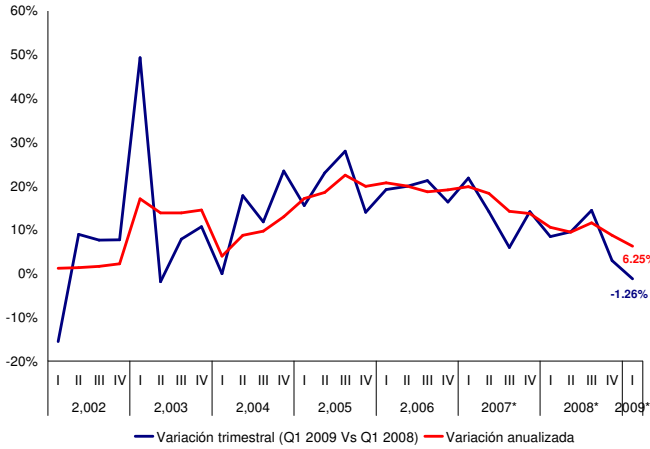
In the last quarter, imports rose 10.33 percent, while at year-end 2007 the growth rate reached 15.84 percent. According to DANE's figures, imports grew 20.6 percent in 2008 from the previous year, when the annual increase was 25.7 percent. Still, imports continue to be intensive in productivity enhancing goods. The main lines that sustained the performance of imports during 2008 were Industrial Sector (20.4 percent), Chemical Products (20.8 percent) and Machinery and Equipment (24.3 percent). Then again, imports were negatively affected by a drop from the Mining Sector (-10.3 percent) and Motor Vehicles (-14.9 percent).

Investment showed a -1.26 percent variation, thus standing below the number from last year's first quarter (8.4 percent) and hitting negative territory for the first time since the beginning three months of 2004 (-0.05 percent). Consequently, the annual growth rate fell from 10.55 percent between January and March 2008 to 6.25 percent in the correspondent period of 2009.

Taking a closer look at gross fixed capital formation, we see that the drop in investment during the first quarter of 2009 is largely explained by a 14.82 contraction in Construction and Buildings and a 22.45 percent decrease in Transport Equipment. In the Farming and Services sectors the growth rates exceeded last year's numbers with 2.16 percent and 2 percent, respectively. During the first quarter of 2008 these sectors' respective figures were 1.21 percent and 0.68 percent. It is worth underlining the performance of Public Infrastructure, with

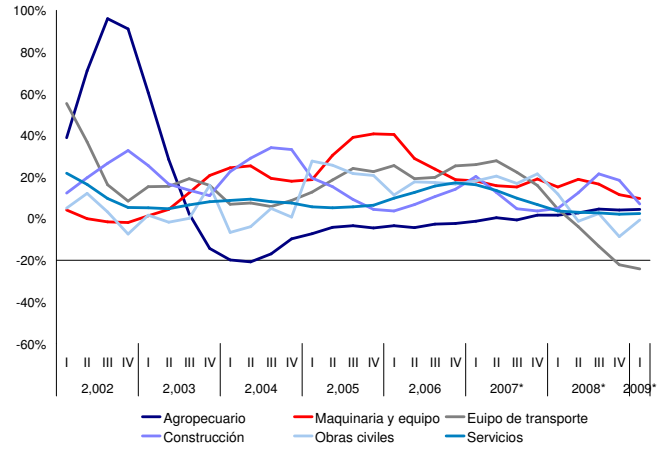
its rate soaring from -14.84% during the initial trimester of 2008 to 21.81 percent in the first three months of 2009.

Investment Annual and Quarterly Growth %



Source: DANE

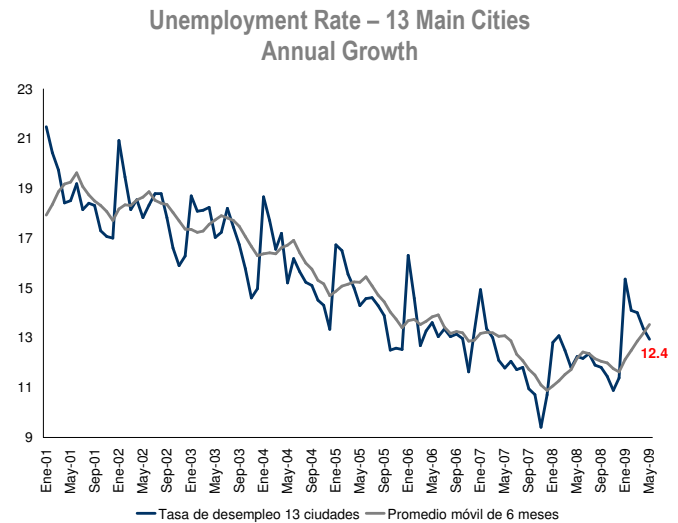
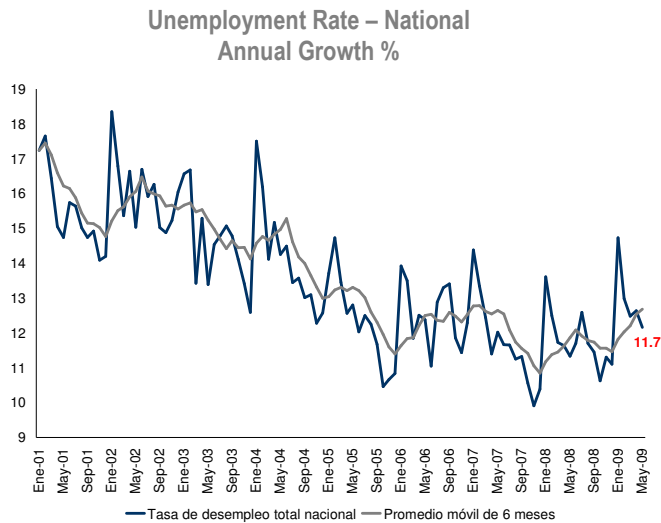
Investment by Group Annual Growth %



On the offer side, this first quarter's economic downturn was led by Manufacturing Industry (-7.88 percent), Trade (-2.7 percent) and Social, Community and Personal Services (-0.19 percent). These were followed by Transportation (-1.98%), Banking Institutions (-4.68 percent) and Farming (-0.84 percent). On the other hand, the sectors that showed a recovery against 2008 were Electricity (+1.87 percent), Construction (+4.1 percent) and Mining (10.59 percent).

Employment

The economic slowdown brought a decrease in labor demand in Colombia. The data released by DANE revealed that in June 2009 the jobless rate at a national level reached 11.4 percent. This figure stands slightly below the previous month, when it registered 11.7 percent, but is still 0.2 percent above June 2008. Focusing on the 13 main cities unemployment was 13 percent, which is 0.6 percent above May's number and sits substantially higher than a year back (11.7 percent).



Source: DANE

III. Inflation, Monetary and Foreign Exchange Policy

The Central Bank has kept a lax monetary policy in response to the deterioration of global markets and the angling domestic economic slowdown. The main interest rate has been sliced from 10 percent in December to 4.5 percent in June 19, but we are still suffering some of the consequences from the global economic crisis. However, Colombia stands out among other countries in the Region by delivering stable if not recovering numbers, to which the Central Bank has taken action ahead of their peers by maintaining interest stable.

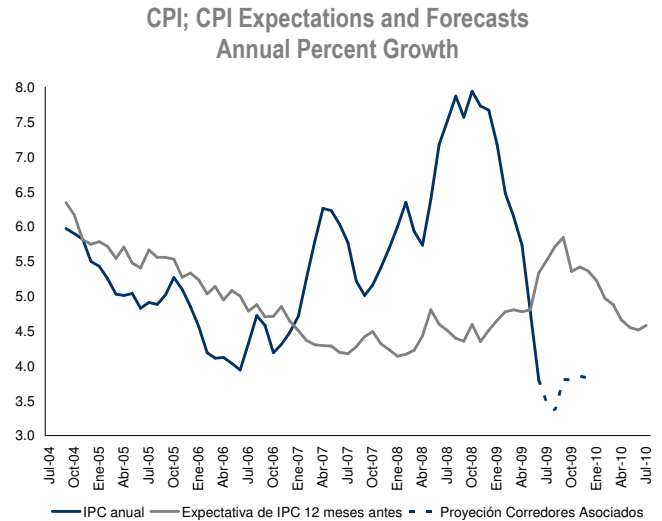
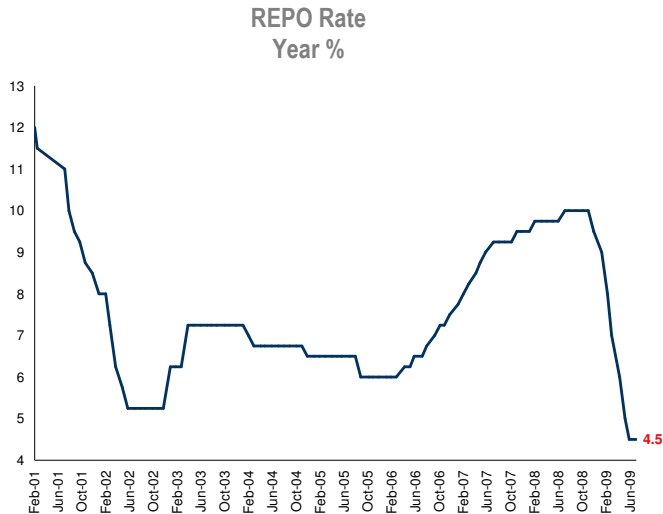
Just as foreseen by Corredores Asociados, in the meeting of July 24 the Board of Directors of *Banco de la República* kept the main interest rate unchanged (4.5 percent) and didn't take any specific measures regarding the valuation of the peso. This shows how the Board is aware that the twelve-month inflation expectations are above the long term target (3 percent +/- 1%), that the country's fundamentals are improving, that the other domestic interest rates have shown a remarkable development and that the numbers coming from the United States are stabilizing.

We applaud the Bank's decision to not interfere with the exchange rate. Preserving a floating exchange rate is valuable when executing a counter-cyclic monetary policy that tempers the risk of a financial crisis. Besides, Colombia meets most of the conditions to move onto a more open flotation scheme: Monetary stability, contained liabilities in U.S. dollars and a low contribution of foreign trade. Hence importers, exporters, investors and companies that have any link abroad will have to adjust to these circumstances and benefit from the foreign exchange rate hedging tools offered by the market today.

Additionally, the Central Bank has announced that it will not compensate for the regular mandatory deposits. This means that starting on August 5 the Central Bank will not pay for the balances that financial institutions hold in cash and in the mandatory deposit accounts. The objective is to lower these balances and forestall a possible decrease in secondary interest rates.

We also agree with the cautious decision of not cutting further the main interest rate in order to control inflationary pressures arising in 2010. The latter will result as a consequence of a

recovery in internal demand and the stabilization – even measured growth – of World demand that China and India will lead in the second half of 2009. Although we expect that annual inflation – which at present reaches 3.81 percent – will keep falling in July (3.46%) and August (3.36%), it is probable that at year-end 2009 it will near 4%. This estimate is confirmed by the results released after the July Expectations Survey that show that after seven months of consecutive drops, the year inflation outlook rose from 4.5 percent for June 2010 to 4.58 percent for July 2010.



Source: DANE

On the other hand we underline that the Colombian economy displayed a GDP contraction below the estimates and it is in better shape than most economies in the Region. While Colombia showed a -0.55 percent variation in the first quarter, some of Latin America's main economies suffered deeper plunges like Mexico (-8.2 percent), Chile (-2.1 percent) and Argentina (-2 percent).

At Corredores Asociados we believe that based upon presently available information, the Central Bank will maintain the main interest rate on 4.5% until December 2009 and most likely this will be the first country in the Region to begin tightening its monetary policy.

IV. Estimates

Gross Domestic Product and Unemployment Rate

Although some industry and trade numbers seem to be stabilizing, the labor market will keep deteriorating during the next 12 months. This is a result of the uncertainty in available fund adjustments amid a crisis environment. Besides, after the economy touched rock bottom new hires may still be slow and it is likely that some companies that are in trouble will have to lay off personnel as a last resort. In the midst of these circumstances we forecast that the unemployment will reach again 14 percent.

The most recent World crisis has proven that the fiscal policies aimed at reducing domestic and foreign sovereign debt helped the Colombian economy in reducing its vulnerability. And

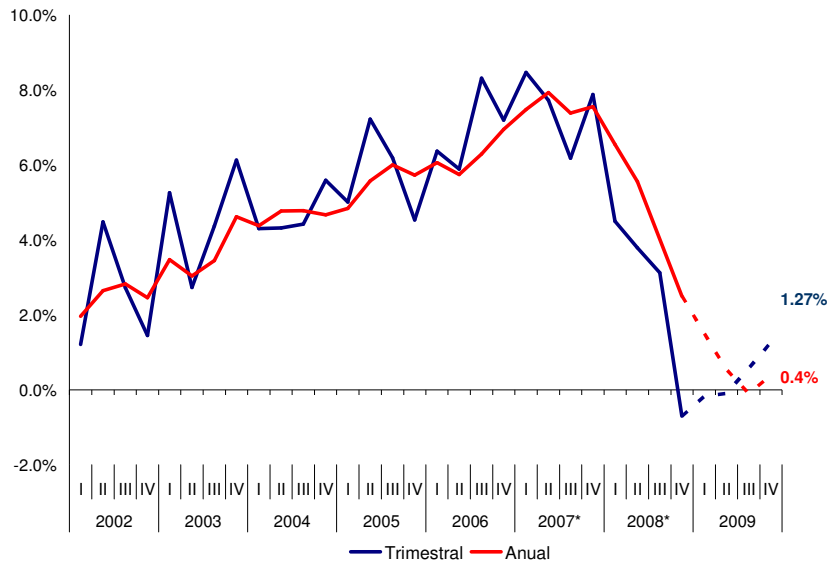
although investment plunged in the last quarter, the ratio-to-GDP reached in former years built a strong foundation for medium and long term growth.

We expect that in the second half of this year the trade and manufacturing industry sectors will evidence a slight recovery. And led by infrastructure, another sector with a positive outlook is construction. On the demand side, consumption may swerve after months of heading down and could improve in the second semester thanks to better interest rate conditions. With these recent numbers our growth estimate for 2009 has gone from -0.1 percent to 0.4 percent.

Inflation and Interest Rates

With the information currently available the Central Bank will keep the main interest rate in 4.5 percent until December 2009. This could level the domestic public debt yield curve in the next six months. On the other hand inflation may fall to near 3.4 percent in August and reach the end of the year close to 4 percent. We expect inflation to go up again in the second quarter of 2010.

Gross Domestic Product | Quarterly and Annual
Percent



Estimates

**Corredores Asociados - Resumen de proyecciones**

		2009	2010
Colombia			
PIB	PIB Real, % cambio	0.40%	3.50%
Inflación	YoY (%)	4.02%	4.50%
Deficit Fiscal	(% PIB)	-3.90%	-2.50%
Tasa de Interés (DTF)	Fin de año, DTF 90 días e.a. (%)	4.30%	7.00%
Tasa Repo	Tasa lombarda - Subasta OMAS	4.50%	7.25%
Tasa de cambio	Fin de año, (COP/USD)	2,050	2,200
Devaluación	Cambio fin de año (COP/USD)	-8.6%	7.3%
Tasa de desempleo	Fin de año, 13 ciudades (%)	14.00%	12.50%
Tasa de desempleo	Fin de año, Total nacional (%)	14.20%	10.00%
United States			
PIB	PIB Real, % cambio	-0.50%	1.00%
Inflación	YoY (%)	0.50%	1.50%
Tasa FED	Tasa de los fondos federales	0.25%	1.50%



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