

## **Miguel Urrutia Montoya: Extracts of a speech on the Colombian economy**

Extracts of a speech by Dr Miguel Urrutia Montoya, Governor of Banco de la República (Bank of the Republic), at the III Commission of the Senate of the Republic of Colombia, Bogotá, 24 August 2004.

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- Colombian peso appraised 10,8% against the dollar in February of 2003 and on August 17 of 2004. Real exchange rate index has been revaluated 5,7% and it is calculated that at present it has a level similar to the one observed in October of 2002.
- Appraisal (nominal and real) of the peso is explained by external and internal factors and by a partial revision of an "excessive" devaluation between May of 2002 and February of 2003.
- The devaluation of the peso during the second semester of 2002 and the first two months of 2003 was excessive in relation to the performance of fundamental determinants of the exchange rate due to two facts:
  1. As with other currencies in Latin America, the peso started its devaluation starting on May of 2002 following the strong devaluation of Brazilian real currency and the increment in the "spreads" of public external debt of the countries of the region. As the doubts of the markets regarding Brazil's economic politic resulted baseless, including the fear of the "infection" effect, the real as well as a good part of the currencies of Latin American economies began to appreciate in front of the dollar. In Colombia and Chile the appraisal was at first moderate and in Argentina, Brazil and Mexico it was strong.
  2. The devaluation in Colombia during the second semester of 2002 came along, with a residue, of acceleration in the inflation. This increase in the inflation contributed to the non-compliance of inflation target set for the year 2002 and made it mandatory that during the first quarter of the year 2003 the Board of Directors of the Banco de la República (JDBR) had to intervene the exchange market and elevate intervention interest rates in 100 basic points on two occasions. The target of this measure was to stabilize exchange rate and control inflation expectative, objectives that were achieved in a gradual manner but that did not avoid that in the year 2003, inflation target could not be met for a second consecutive year.
- Due to the fact that the devaluation described was originated partially in a baseless fear and was translated into an inflation rate and expectative incompatible with target compliance, devaluation during the second semester of the year 2002 and two first months of the year 2003 was unsustainable. Even more, though the appraisal of the peso in front of the dollar was not much until November of 2003, in part the appraisal of the peso at the end of that year and beginning of 2004 corresponds to the adjustment described in exchange rate.
- The external factors that have influenced in great manner the appraisal of the peso has its origins in the unbalanced and economic politics of the United States of America, in the higher dynamism of worldwide economy and the recovery of Colombian exportations to Venezuela. Also, for the fifth consecutive year, in 2003 the remittance of Colombians increased and during 2004 a significant increment in dollars in cash entrance has been had.
- Low interests rates and a strong unbalance in payment balance drawing account of the United States of America are an incentive for international investors to invest their capitals in countries with higher interests rates and diversify the currencies of their portfolio.
- The higher growth in worldwide economy increases the demand of the goods exported by emerging countries, including Colombia, and raises international prices of their basic products. This has occurred with a great force in 2004.
- Between December of 2003 and May of 2004, Colombian exportations to Venezuela have increased in relation to the same period of the year before, US\$ 220 millions (m). This is equivalent to an increment of 114%. Also, in the lapse of the year 2004 an increment in

dollars in cash entrance has occurred. These two factors contribute to explain the intensification of the peso revaluation process in the time elapsed during this year.

- The internal factors that have contributed a great deal to peso appraisal are the betterment of national and international investors confidence level and the central government deficit and its financing.
- Confidence incentives the inversion and consumption facilitates economy growth and attracts capitals from foreign countries of Colombians as well as foreigners.
- There are two channels by which the government deficit tends to appraise exchange rate. The first an obvious one is financing. Part of government deficit financing comes from external credit that appraises local currency. On the other hand high deficits elevate internal indebtedness costs of the government and open external and internal differential rates in favor of inversions of national public debt titles.
- Up to July of 2004, Colombian exchange market has presented a dollar offer excess for an amount of US\$ 1.400 m, in which the net demand of dollars by the Banco de la República has been of US\$ 900 m, that of the government of US\$ 407 m and of the financial system of US\$ 141 m. Additionally during this month of August, the Banco de la República has bought currency for an amount of US\$ 200 m.
- The appraisal of the peso that started on the second semester of 2003 and specially and with great force during the period of 2004 that has elapsed, is the result of three types of factors: i) a natural consequence of an economy that is strengthening and has an important betterment in terms of exchange, ii) the counterpart of the tendency of dollar devaluation in front of other currencies due to very low interests rates and the strong macroeconomic unbalances in the United States of America and iii) the limited action margin that economic politics (monetary and fiscal) has for offsetting in a sustained manner the forces towards the appraisal.
- The JDBR has moved its politics movements in order to avoid an excessive appraisal of the peso that may compromise the future of commercial goods productions sector (exportations and importations). Also he has taken advantage of the tendency of the exchange market for consolidating the position of international liquidity of the country and thus reducing the vulnerability of the economy if there are future external impacts and thus diminishing external public debt cost. In this manner a reversion of the factors that today explain peso revaluation and that generate a macroeconomic instability that would result costly in terms of production, employment and inflation, are avoided. Measures taken by the JDBR are the following:
  - First, the Banco de la República has purchased US\$ 1.400 m between December of 2003 and the time elapsed during this year 2004, taking care that the resulting effect of monetary expansion will not compromise the compliance of inflation targets.
  - Second, it has maintained low intervention interests rates, reducing them in two opportunities during this year for a total amount of 50 basic points and leaving them stable while Federal Reserve incremented them.
  - Third, it has taken measures that although did not have as a target, an exchange target, it incremented dollar demand or reduced it in some manner. In the first direction is the prohibition to financing intermediaries to maintain a negative cash position and the second the prohibition to travel to foreign countries with more than US\$ 10.000 in cash. Also, the Banco de la República decided not to render the service of cash currency of foreign exchange consignments to intermediaries in exchange market.
- Marginal diminishments on interests' rates of the Banco de la República in order to revert revaluation pressures would be ineffective. Higher reductions would have a significant effect over inflation.
- Massive reserves purchase may conduct to inflation acceleration or to that Banco de la República may suffer losses, if these are sterilized, this will worsen the fiscal situation.