FOR AGENDA

SM/07/397
Correction 1

January 11, 2008

To: Members of the Executive Board

From: The Secretary

Subject: **Colombia—Staff Report for the 2007 Article IV Consultation**

The attached correction to SM/07/397 (12/26/07) has been provided by the staff:

Factual Error Not Affecting the Presentation of Staff's Analysis or Views

Page 14, para. 13, line 3:
for "banks account for less than 10 percent of banking sector assets,"
read "banks account for about 20 percent of banking sector assets,"

Questions may be referred to Mr. Clements (ext. 36950) and Mr. Abrego (ext. 38754) in WHD.

This document will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities.

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output by about 1½ percent—more than the Latin American average of about 1 percent.[2] A sudden reduction in demand from Venezuela would particularly weaken growth and the external accounts. A reduction in exports to Venezuela to the 2005 level, for example, would reduce receipts by about 1½ percent of GDP.[3] Colombia compares well to the emerging market average on most vulnerability indicators, although external debt sustainability analysis indicates a relatively high degree of sensitivity to a real exchange rate shock (Table A1). Public debt is below the emerging market average, but higher than average for emerging market countries at investment grade.

Selected Vulnerability Indicators, 2007
(In percent of GDP, unless otherwise indicated)

	Colombia 1/	Median, sample of 48 emerging market countries 1/
External sector		
Gross reserves in percent of short-term debt at remaining maturity	159.3	139.7
Total gross external debt	25.0	45.8
Current account balance	-4.0	-3.3
Foreign direct investment	4.0	3.8
Gross external financing requirement 2/	10.8	15.1
Public sector		
Overall balance	-0.7	-1.8
Public sector gross debt	38.3	41.5
Of which: Exposed to exchange rate risk 3/	16.4	16.3
Exposed to rollover risk (ST debt, residual maturity) 4/	4.0	4.2
Financial system		
Capital adequacy ratio, in percent	10.4	13.8
Non-performing loans, in percent of total loans	3.2	3.8
Return on average assets, in percent	2.5	1.7
Change in credit-to-GDP ratio, in percentage points 5/	4.9	3.0

Source: Fund staff estimates.

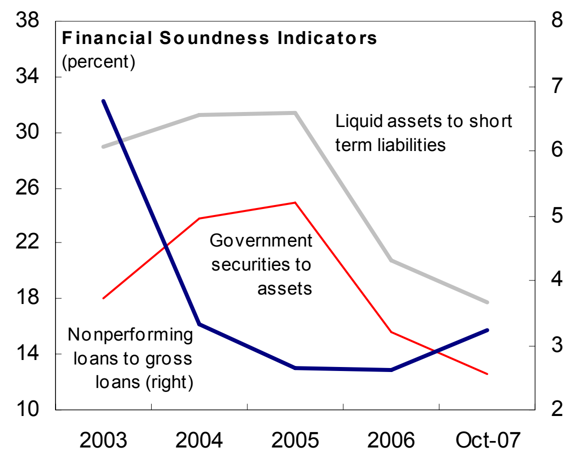
1/ For Colombia, data refer to 2007 where available. For other emerging markets, data refer to 2006 for stocks and mostly 2007 for flows.
2/ Current account balance plus maturing external debt.
3/ Debt in foreign currency or linked to the exchange rate, domestic and external.
4/ Short-term debt and maturing medium- and long-term debt, domestic and external, excluding external debt to official creditors.
5/ Credit to the private sector.

11. **Domestic risks are also important, including for inflation and the current account.** Staff views the risks for the projection for inflation and the current account as slanted to the upside. The economy may not slow as quickly as envisaged, resulting in higher inflation and a larger current account deficit than expected.

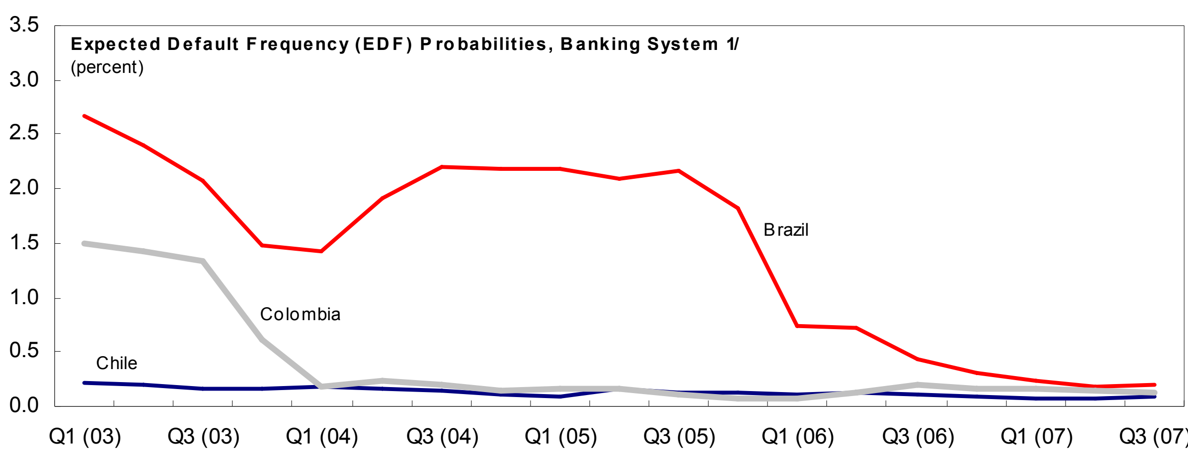
[2] See Chapter 2 of the Selected Issues paper for further examination of this issue.

[3] Manufactured goods comprise a large share of exports to Venezuela, and finding alternative markets for these products would be difficult in the short run.

12. **Financial sector indicators remain sound and point to relatively small chances of adverse macroeconomic spillovers in the near term.** While credit growth has been rapid, credit-to-GDP ratios are below their peak of the late 1990s and close to the emerging market average. The share of nonperforming loans has remained low, both on average and for the weakest performing banks. In light also of the high levels of provisioning, credit risk for the banking sector as a whole remains low. Liquidity ratios have declined, although liquidity remains sufficient to cover short-term maturity mismatches. Market risk remains the predominant risk to the financial system, with the BdR estimating that a 200 basis point increase in interest rates would reduce the profits of the banking system by 20 percent. Commercial banks appear resilient, with low estimated default probabilities.



Source: Superintendencia Financiera.



Sources: Creditedge (Moody's-KMV); and Fund staff estimates and projections.
1/ EDF refers to the probability that the banking system will default on non-equity obligations.This is based on the contingent claims approach, which uses equity market data to estimate risk indicators.

13. **The risk of contagion from a further worsening of problems in the subprime market, through its effect on parent banks in developed countries, is small.** Foreign banks account for about 20 percent of banking sector assets, compared with an average of over 30 percent in other large Latin American countries.