NEWS 02
April – June
2013

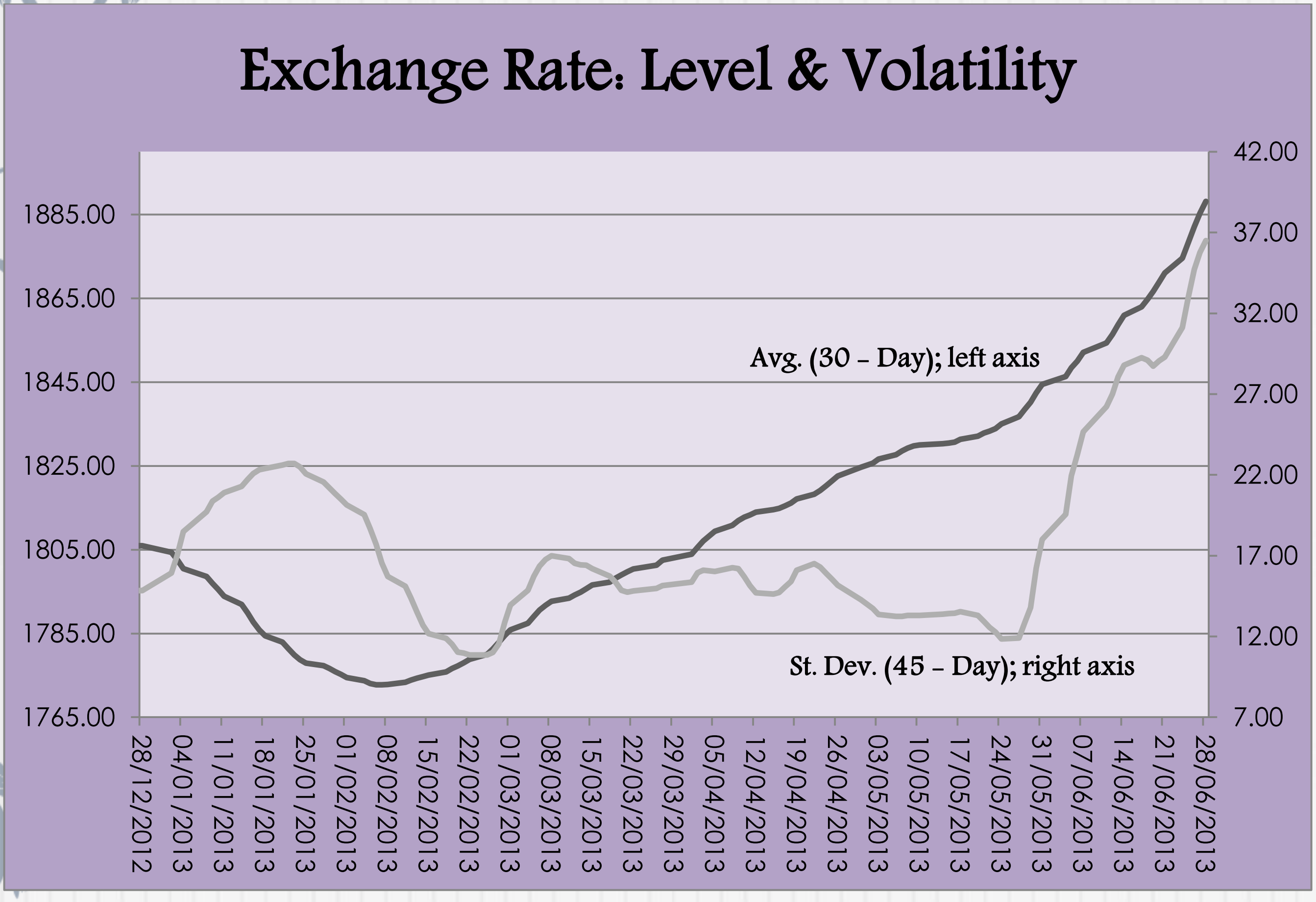
ESCUELA
DE ECONOMÍA

QUAESTOR
Universidad Sergio Arboleda

BUSINESS ENVIRONMENT WATCHDOGS

DATA

Peso – Dollar Exchange Rate (ER)



The plunge of the Colombian Peso (COP) has been severe.

After its strongest level on January 31, the COP has depreciated steadily and is now gravitating around the 1,900 COP per $US threshold:

$ER_{January\ 31} = \$1{,}773$
$ER_{June\ 4} = \$1{,}908$
$ER_{June\ 28} = \$1{,}923$

This is more than an 8% depreciation (150 COP per $US).

We believe that, In terms of domestic macro policy, the COP plunge has been *to some extent* a function of:

1. A consistently loose monetary policy stance adopted by the Central Bank (CB) during this year (in response to output slow down)[1].

2. The government's announcement of regulation inducing private pension funds into increasing their exposure to foreign currency (by incorporating foreign indexes into the minimum profitability benchmark they must meet)[2].

Nevertheless, we believe *exogenous factors* (and not domestic monetary or fiscal policy) *have been the main driving force* behind ER dynamics.

For instance, note that after three consecutive cuts in its interest rate (Jan, Feb, and Mar), the CB didn't modify the rate during its April 26 or May 31 board meetings. Yet, the COP continued to depreciate consistently between April and June.

Additionally, the Feb – May international reserve accumulation policy was announced as early as January 31, was fully honored and was not modified during that time period. Plus, the purchase policy for Jun – Sep

[1] Recall that the CB has cut its interest rate in 100 basis points (bps) during 2013: i) 25 bps on Jan 28; ii) 25 bps on Feb 22; iii) 50 bps on Mar 22; iv) 0 bps on Apr 26; v) 0 bps on May 31. The rate is currently standing at 3.25%. The CB also announced an active international reserve accumulation policy after its January 31 board meeting: $US 750 million monthly (or $US 3 billion between Feb and May). After its May 31 board meeting the CB announced a $US 2.5 billion purchase during the Jun – Sep time period.

[2] This regulatory change was announced on April 15 as part of a countercyclical fiscal program known as PIPE (see below). The Ministry of Finance estimates that this regulatory modification will induce a $US 5 billion purchase by pension funds during the next year.

(announced after the May 31 board meeting) implies a slow – down in reserve accumulation compared to the Feb – May period (from $US 750 million to $US 625 million per month). Nevertheless, the COP depreciated systematically during June.

Now, the countercyclical fiscal policy revealed by the government undoubtedly deploys clever instruments aimed at fostering economic growth and tradable sector competitiveness (thus appreciating *and not depreciating* the COP if properly and diligently executed).

Two other empirical facts confirm the lack of a strong correlation between local monetary/fiscal policy and recent ER dynamics:

1. Drop in FDI: on Monday May 13 the CB reported an 8.9% reduction during the first quarter's (QI2013) FDI flows (see below). The drop is explained by the fact that FDI in the Agriculture (AG), Manufacturing and Retail sectors contracted 33%, while FDI in the Oil and Gas (O&G) and Mining sector only grew 0.6%.

2. Depreciation of regional currencies (Mexico, Brazil and Chile).

In sum, exogenous fundamentals other than domestic macro (monetary or fiscal) policy have been the leading factors propelling the COP weakening during the last few months.

In fact, the following exogenous factors significantly explain recent ER dynamics:

i) Commodity price drop (especially oil and gold) in international markets. This deteriorates the terms of trade of Colombia (and also of many of its trading partners).
ii) Announced reduction of the Fed's Quantitative Easing policy (QE) due to economic recovery symptoms in the U.S.
iii) Increased risk aversion in global financial markets: IMF's cut in its global growth forecast, uncertainty in Europe, etc. This induces investors (especially with short run capitals) to flee from emerging markets like Colombia into safe havens like T – Bills.

iv) Output stagnation and deterioration of business environment in some sectors of the Colombian economy (see below and our previous reports). This further discourages FDI.
v) Uncertainty about property rights attributable to peace talks with FARC terrorists and to the government's land policy. This also discourages FDI.

There's no evidence yet of an inflection point in the 30 – day ER average. Hence, we cannot comfortably forecast that the $1,900 threshold is a local max (or medium – run equilibrium) around which the ER will gravitate during the next weeks.

Indeed, if:

i) International commodity prices drop even more;
ii) The Fed effectively reigns in QE (and/or the U.S. economy really picks up);
iii) Uncertainty in Europe persists;
iv) Domestic tradable output continues to stagger;
v) Adverse shocks to business environment and uncertainty regarding property rights in Colombia subsist;
vi) Any (or all) of the above…

…the COP will weaken even more.

Surely, recent COP weakening has provided (very much needed) oxygen to the stumbling tradable sectors of the Colombian economy (Manufacturing and AG).

However, never forget the everlasting truth: all **excess and sudden depreciation of a currency is not a good symptom of confidence in the economy´s fundamentals (and its currency).**

And, even worse, **local currency depreciation always melts down the real (dollar) value of any foreign investor's net worth.**

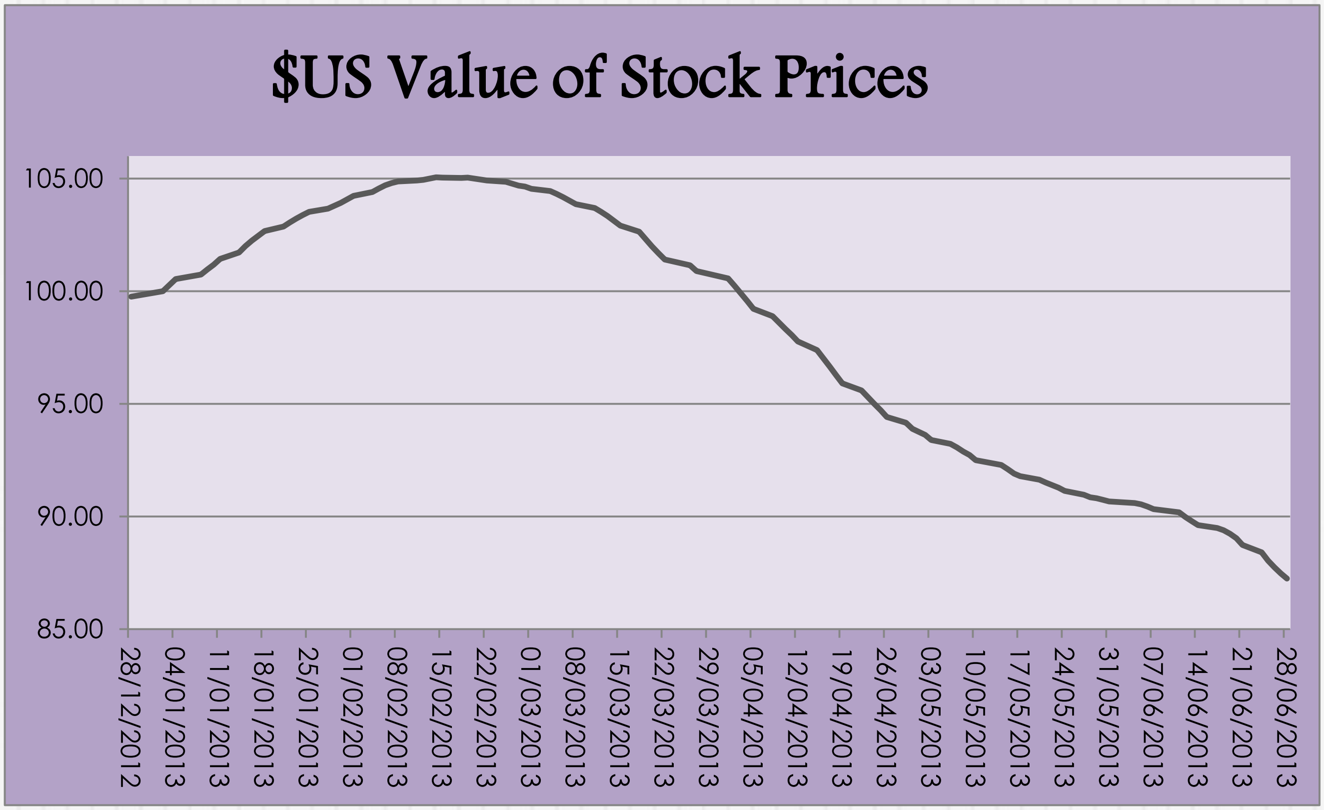
Finally, note how ER volatility skyrocketed during the second quarter:

i) St. Dev. (ER) $_{April\ 1}$ = 15.37 COP
ii) St. Dev. (ER) $_{June\ 28}$ = 36.49 COP

Moreover, ER volatility is way over the max level of the past 6 months (Jan 22 = 22.71 COP).

Hence, we believe **it's a good time for tradable sector companies to purchase and activate hedges against ER fluctuations if the instrument is zero – cost (NDF's basically) or dollar – indexed debt, but other vehicles (options, collars, etc.) might be trading expensively** (recall that the higher the volatility, the more expensive the hedging).

QUAESTOR's $US Value of Domestic Stock Price Index



In close correlation with the COP, asset prices in the stock market have also plummeted.

$US 100 invested on Jan 02 have become $US 80 on June 28 (20% real loss!!!).

$US 100 invested during the markets' peak (Feb 5) have turned into $US 78 on June 28 (22% real loss!!!).

Note that after its Feb 5 max (15,195), the stock market's main index (IGBC) receded systematically in nominal (COP) terms:

i) $IGBC_{\text{March 1}} = 14{,}786$
ii) $IGBC_{\text{April 1}} = 14{,}043$
iii) $IGBC_{\text{May 3}} = 13{,}491$
iv) $IGBC_{\text{June 28}} = 12{,}828$

This is more than a 15% nominal (COP) crash in 5 months (!!!).

Such a nominal stock price collapse, coupled with the 8% Feb – Jun depreciation (see above), adds up to the huge loss in real (dollar value) terms.

Two driving forces underlie the crash:

i) The systematic weakening of the COP during Feb – Jun: ER dynamics have melted down the real/dollar value of any investment in COP.
ii) The stock market's nominal plunge, as a result of:
   a. Dismal corporate results: only 57% of those companies listed in the IGBC reported profit growth.
   b. Disappointing data from O&G sector companies: less than expected reserves, production and profits[3].
   c. Increase in terrorist attacks against the O&G and Mining sectors.
   d. Output stagnation and deterioration of business environment in some sectors of the Colombian economy (see below and our previous reports).

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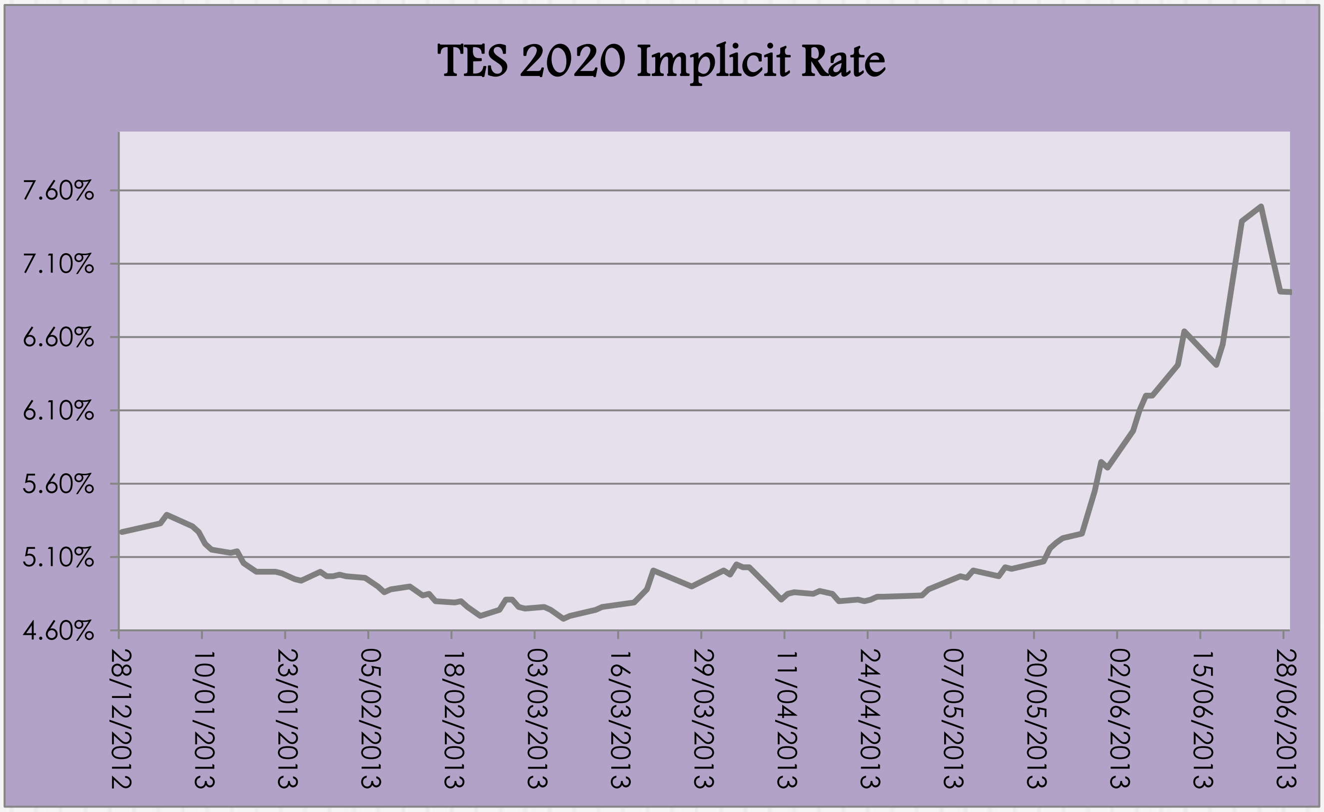
[3] O&G companies represent 23% of the COLCAP Index (capitalization weighted average index of companies with high liquidity levels).

e. Uncertainty about property rights attributable to peace talks with FARC terrorists and to the government's land policy (see below).
f. Recovery of the U.S. economy (inducing investors to flee from emerging markets and back into U.S. assets).
g. Uncertainty in international financial markets (Europe's macro instability, IMF cutting global growth forecast – see above –) has increased relative risk premiums in emerging markets' assets.

Even though we believe **the market will remain bearish in the short – run, there might also be some overshooting in stock prices.**

This means it might be a good opportunity to purchase stock of companies with solid fundamentals.

Treasury Bills (TES) Implicit Interest Rates



Bond prices are no exception to the asset price plunge in the Colombian economy.

Note that the implicit interest rate of the July 2020 TES bond (11% coupon, issued on July 24 2005, expires on July 24 2020) skyrocketed during the previous weeks to levels almost 150 basis points (bps) above the pre 2013 maximums:

i) TES Rate $_{\text{November 29}}$ = 5.70%
ii) TES Rate $_{\text{June 26}}$ = 7.10%.

Furthermore, the rate increase has been a common denominator to all bond prices. For instance implicit rates of the 2024 TES have increased 200 bps (the effect on pension fund portfolios has been devastating).

Undoubtedly, there's a close correlation between **the TES price plunge, the stock price crash and the currency's weakening. In other words, the driving factors of the COP and stock price plunge also apply to the TES bonds.**

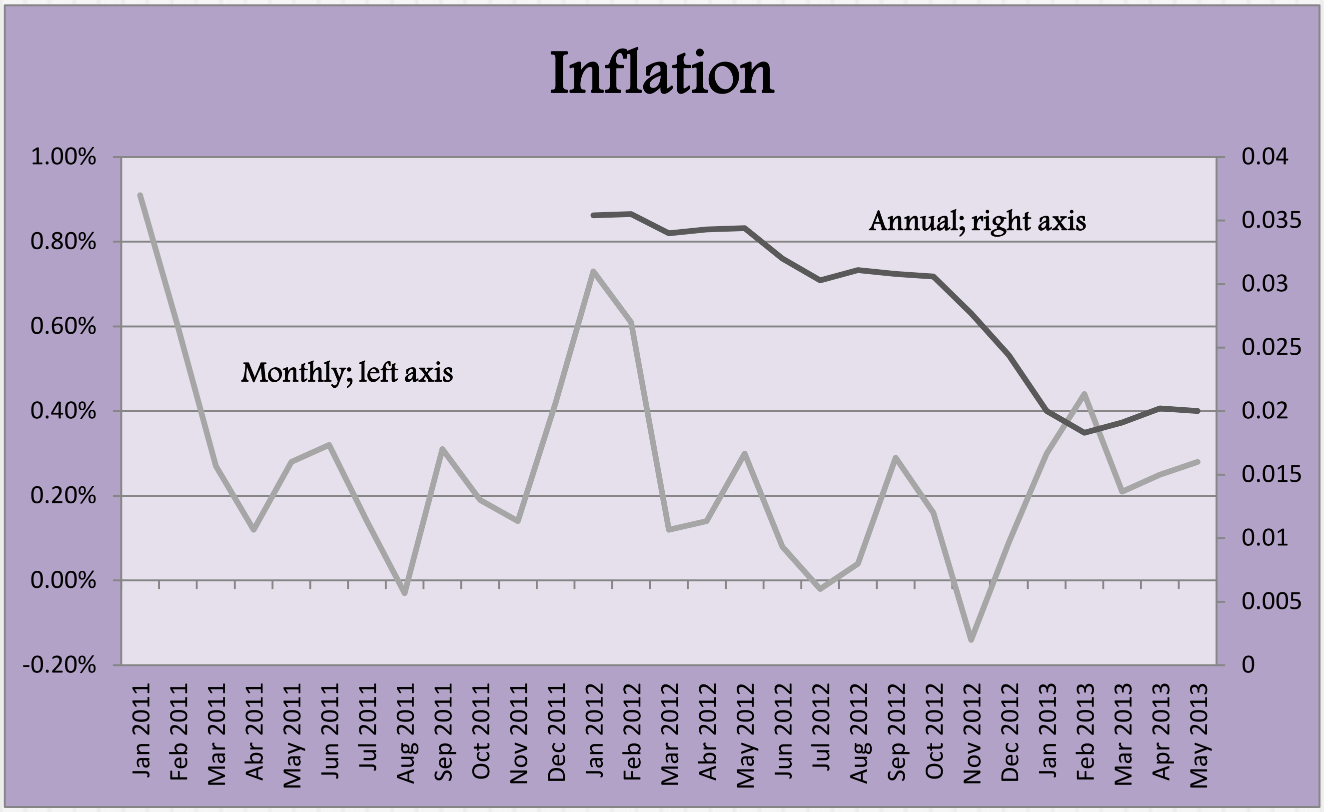
In sum, **the main characteristic of the Colombian economy nowadays is its asset price crash.**

Asset price dynamics is surely an **effect of reduced confidence in the economy, but also a cause (due to the natural wealth effect) of weakened domestic demand and consumer confidence.**

Once again, and even though we suggest caution before adopting a final stance on the future dynamics of asset prices (TES, stock, currency), we don't discard the possibility of some overshooting in recent asset price dynamics.

If so, **asset prices could be cheaper than their medium – run equilibrium levels, meaning also that now is a good time to buy (selectively).**

Inflation Rate



On Wednesday June 5 DANE (National Statistics Agency) published inflation data for May 2013: 0.28% (vs. 0.30% on May 2012).

Hence:

i) Cumulated inflation (Jan – May) stands at 1.49% (compared to 1.92% during Jan – May 2012).

ii) Annual inflation (Jun/2012 – May/2013) is at 2.00% (compared to 3.44% during Jun/2011 – May/2012).

Consumer price data reflects full stability and portrays sufficient macro/monetary stability for investment purposes.

However, **inflation data is also (and significantly) revealing domestic economic deceleration and aggregate demand weakening (see below).**

OUTPUT PERFORMANCE

Relevant quarterly data

i) **<u>Thursday April 11 (Fenalco)</u>**: The President of Fenalco (National Retail Sales Federation) forecasted zero growth in retail sales during the first quarter of 2013 (QI2013). He attributed his dismal augur to the 26% drop in vehicle sales during the first three months of the year (as well as strong declines in sales of records, stationary and other sectors).

ii) **<u>Monday April 15 (Minister of Finance)</u>**: The government revealed a **$US 2.7 billion (1% of GDP) policy package (named PIPE) aimed at boosting tradable sector output (agriculture + manufacturing sectors) and consumption.** The plan includes:

a) Government saving additional resources abroad.
b) Anticipation of the 2012 tax reform benefits for labor intensive sectors (like agriculture and manufacturing)[4].
c) Tax withholdings reduction for the manufacturing, agricultural and retail sales sectors[5].
d) 50% time reduction for refunds of value added tax to the manufacturing sector.
e) 2 more years of zero - tariff on manufacturing inputs not produced domestically.
f) Waiting time reduction at port.
g) Energy cost reductions.
h) Custom reforms aimed at law enforcement against smuggling.
i) 2,500 additional policemen and soldiers.
j) Additional budget for public roads and highways.
k) Subsidies for mortgage rates in houses costing between $US 44k and $US 110k.
l) Cheap 15 – year loans for agricultural infrastructure.

[4] Meaning also anticipation of the tax reform's additional burden on capital intensive sectors (like Mining and O&G).

[5] To compensate, they are increased in the mining sector.

According to a report from Moodys on Tuesday April 23, the PIPE program won´t translate into additional public spending.

However (and unfortunately), even if the PIPE program demanded additional spending, Moody's (and international markets) can be at ease because the **government has shown an extremely poor capacity of executing and implementing effective counter cyclical fiscal policies to offset any further deceleration of the economy.**

iii) **Monday May 13 (Banco de la República)**: 8.9% reduction during the first quarter's FDI flows: $US 3,837 million (QI2013) vs. $US 4,210 million (QI2012). The drop is explained by the fact that FDI in the Ag, Manufacturing and Retail sectors contracted 33%, while FDI in the O&G and Mining sector only grew 0.6%.

iv) **Wednesday May 15 (ANM – National Mining Agency)**: Coal output plunged 21.4% (5 million tons) during the first quarter: 18.4 million tons (QI2013) vs. 23.4 million tons (QI2012). This result confirms DANE's export data in relation to Mining sector exports (see below). The drop is explained by:

a. 32 day long (Feb 7 – Mar 11) labor strike in Cerrejón[6].
b. 22 day long (Feb 7 – Mar 1) suspension of Drummond's license for loading coal in its Santa Marta and Ciénaga port (after the coal ocean spill incident)[7].
c. 22 day long (Feb 7 – Mar 1) suspension of FENOCO's daily night time (10:30 pm – 4:30 am) operation[8].
d. Adverse business environment conditions in mining (see below) are probably starting to kick in.

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[6] Cerrejón belongs to BHP Billiton (Anglo – Australian capital), Anglo – American (Anglo – South African capital) and Xstrata (Swiss capital). The production halt cost the company approximately $US 80 million (2.5 million coal tons were not exported).

[7] Drummond is a global leader in coal and coke production (American and Japanese capital). It ships 80k daily tons of coal from Colombia to Europe. The mines (La Loma, El Descanso) are located in the nearby state of Cesar. At current coal prices the license suspension represented a $US 6.4 million daily loss.

[8] FENOCO is a railway company that carries 160k daily tons of coal from mines in the northern region of the country (Drummond, Prodeco and others) to port.

The Agency also informed that, as a result of the quarterly coal output drop, royalties and compensation crashed in 51.6% (!!!) during the first quarter: 196k million COP (QI2013) vs. 405k million COP (QI2012).

v) **Thursday June 6 (DANE – Exportaciones)**: Total exports declined 1.2% (yoy) during April: $US 4,950 million (Apr 2013) vs. $US 5,011 million (Apr 2012). The sharpest drop occurred in the O&G and Mining sector (–11.6%): $US 3,157 million (Apr 2013) vs. 3,573 (Apr 2012). This fall, in turn, is explained by a 16% drop in O&G exports. In fact, during April 2013 21.8 million barrels of oil were exported (vs. 22.2 million during April 2012). This is equivalent to a 1.6% drop.

During Jan – Apr total exports fell 7.3% with respect to 2012: $US 19,019 million (Jan – Apr 2013) vs. $US 20,508 million (Jan – Apr 2012). This contraction is attributable to the 12% drop in O&G and Mining sector exports: $US 12,523 million (Jan – Apr 2013) vs. $US 14,229 million (Jan – Apr 2012). The latter, undoubtedly, has to do with adverse shocks to the coal sector in Colombia (see number IV above and below).

Finally, Jan – Apr exports to the U.S decreased 15.6% in relation to 2012 (basically due to a contraction of exports in fuels and mineral oils). This datum explains more than 80% of the 7.3% drop in total exports during the first four months of the year.

vi) **Tuesday June 11 (DANE – Informe de Cartera Hipotecaria de Vivienda)**: 2.1% overall increase in the volume of mortgages and housing loans during QI2013 In relation to QIV2012: 5.1% for subsidized housing and 0.8% for non – subsidized housing. Additionally, during the same period (and also in relation to QIV2012) the number of mortgages and housing loans increased a dismal 0.8% (0.9% for subsidized housing and 0.7% for non – subsidized housing).

vii) **Wednesday June 12 (XM – ISA)**: During May total energy consumption grew a meager 2.7% (vs. 4.2% during May 2012). Cumulated energy consumption (Jan – May) increased just 3.6%. The main reason behind the slow – down is the low growth rate exhibited by regulated energy demand (manufacturing sector): 2% (vs. Jan = 4.7%, Feb = 3.5%, Mar/Apr[9] = 4.7%).

viii) **<u>Thursday June 13 (DANE – Grandes Almacenes e Hipermercados Minoristas GAHM)</u>**: During the first quarter of 2013 (QI2013) sales in Large Stores and Supermarkets grew 6.8% in real terms (vs. 12.3% during QI2012). The sharpest slow –down was observed in the following sectors: electrical appliances and furniture (3.6%), apparel (3.3%), hardware (3.3%), food and non – alcoholic beverages (2.4%), personal hygiene products/cosmetics/perfumes (2.1%), pharmaceutical products (1.6%), home cleansing products (1.2%), vehicle parts (– 2.1%) and books/magazines/newspapers (– 2.3%).

During the same period (QI2013) occupied personnel and inventories in these stores grew 6% (vs. 8.3% during QI2012 and 22.6% (vs. 14.2% during QI2012), respectively.

ix) **<u>Thursday June 13 (DANE – Vehicle Sales)</u>**: During QI2013 vehicle sales (domestic and imported) plummeted 10%. This is a result of a 5.3% drop in the number of units sold (68,436 during QI2013 vs. 72,267 during QI2012).

x) **<u>Monday June 17 (Fedesarrollo – Encuesta de Opinión Del Consumidor)</u>**: The Consumer Confidence Index reached 20.1% during May, thus receding 3.6 percentage points with respect to April (and 6.4 percentage points with respect to May 2012). The index is nevertheless above its Feb – Mar levels.

According to the think tank, while consumer confidence (in relation to April 2013) increased in Cali (11.1 percentage points), it declined in Bogotá (– 7.2 percentage points), Medellín (– 3.5 percentage points) and Barranquilla (– 7.3 percentage points).

xi) **<u>Tuesday June 18 (DANE – Importaciones)</u>**: 16.5% yoy increase in imports during April 2013: $US 5,167 million (Apr 2013) vs. $US 4,434 million (Apr 2012). Imports during the first four months grew 4.7%: $US 19,354 million (Jan – Apr 2013) vs. $US 18,478 million (Jan – Apr

[9] Data for both months is reported jointly to eliminate the Holy Week effect.

2012). Now, 28.6% of all Jan – Apr imports originated in the U.S. (16.3% in China and 8.7% in Mexico).

On the other hand, the Colombian economy exhibited a $US 596 million trade surplus during Jan – Apr of 2013. The highest surpluses were with the U.S. ($US 1,491 million), Venezuela ($US 606 million) and Holland ($US 530 million). The highest deficits were with Mexico ($US 1,351 million) and China ($US 1,290 million).

xii) **Tuesday June 18 (ANDI – Encuesta de Opinión Industrial Conjunta EOIC)**: During Jan – Apr manufacturing output declined 0.9%. Furthermore, 10 (out of 14) subsectors exhibited output drops during QI2013. As a result, manufacturing sales receded 1.9% due to a 2.2% sales reduction in the domestic market.

The report also indicates that during the same period:

a. Total sales grew a meager 0.5%.
b. Sales to the domestic market receded 0.5%.
c. Installed capacity utilization reached a historical minimum: 74.5% (avg. = 76.4%).
d. Business environment has not improved.

xiii) **Wednesday June 19 (DANE – Estadísticas de Edificación de Licencias de Construcción)**: Construction licensed area skyrocketed 37.2% yoy during April: 1.904.9198 m² (Apr 2013) vs. 1.388.134 m² (Apr 2012). The increase was especially strong in subsidized housing (107.5% in m² and 145.0% in number of houses).

Year to date (Jan – Apr) there's a 33.2% increase in construction licensed area: 8.047.849 m² (Jan – Apr 2013) vs. 6.040.457 m² (Jan – Apr 2012). Again, the increase was especially strong in subsidized housing (83.3% in m² and 103.7% in number of houses).

However, 12 Month (May 2012 – Apr 2013) licensed area declined 2.2%: 23.174.200 m² (May 2012 – Apr 2013) vs. 23.684.484 m² (May 2011 – Apr 2012).

xiv) **Thursday June 20 (DANE – Cuentas Nacionales)**: During QI2013 GDP grew a meager 2.8%. Recent growth rates have been:

a. QI2011 = 5.7%

b. QII2011 = 6.4%
c. QIII2011 = 7.9%
d. QIV2011 = 6.6%
e. QI2012 = 5.4%
f. QII2012 = 4.7%
g. QIII2012 = 2.8%
h. QIV2012 = 3.1%

The datum was lower than market expectations. Additionally, if it weren't for the performance of the construction sector (16.9%), the overall GDP growth rate would've been even lower. Indeed, the growth rates of the different subsectors are mediocre:

a. Ag = 2.4%
b. Mining = 1.4%
c. Manufacturing = – 4.1%
d. Public utilities = 3.4%
e. Retail sales, repair services, restaurants and hotels = 2.8%
f. Transportation, storage and communications = 2.0%
g. Finance, insurance, real state and services = 3.4%
h. Personal and community services = 4.5%

Demand wise private consumption (3.5%) and investment (3.7%) was the main driving force of overall output.

xv) **<u>Friday June 21 (DANE – Muestra Mensual Manufacturera)</u>**: Manufacturing output increased 8.4% (yoy) during April. Last year (Apr 2012) manufacturing output had declined at a 2.6% yoy rate. 36 subsectors (out of 48) exhibited output growth. The highest growth rates were observed in chemical products (10.9%), vehicles (37.2%), food (23.6%), oil refining (15.6%), other transportation types (28.1%) and milling (9.1%). In contrast, the sharpest drops in output were observed in the following subsectors: iron and steel (– 6.4%), non – precious and non – ferrous metals (– 6.6%), vehicle frames (– 17.9%) and vehicle parts (– 12.6%).

In contrast, during April the overall manufacturing sector exhibited a 1.8% yoy drop in occupied personnel. Sales, however, increased 6.8% yoy during April.

Year to date (Jan – Apr) manufacturing output contracted 2.7%. Particularly, 33 (of the 48) subsectors exhibited production drops. The sharpest drops occurred in: non – metal minerals (– 6.0%), apparel (– 12.7%), iron and steel (– 13.8%), paper and cardboard products (– 8.7%). In consequence, year to date manufacturing jobs and sales receded 1.8% and 3.2%, respectively.

12 – Month (May 2012 – Apr 2013) manufacturing output dropped 1.1% (last year: 4.5% increase). During this time period occupied personnel in the sector and sales declined 0.3% and 1.3%, respectively.

xvi) **<u>Friday June 21 (DANE – Muestra Mensual Comercio al Por Menor)</u>**: 5.7% yoy increase in retail sales during April. If vehicle sales are excluded, the Apr 2013 retail sales yoy growth rate is only 3.4%. Additionally, retail sector jobs exhibit a 4.2% yoy increase during Apr 2013.

Year to date (Jan – Apr) retail sales grew a meager 2.1% (3.9% excluding vehicles), whereas last year they were growing at a 4.3% rate. Year to date jobs in the retail sector grew 4.5% (last year they were growing at a 7% rate).

12 – Month (May 2012 – Apr 2013) retail sales grew a modest 2.3% (last year: 7% growth rate). During this time lapse occupied personnel in the sector increased 5.0% (last year the same variable was growing at a 6.8% rate).

xvii) **<u>Tuesday June 25 (Fedesarrollo – Encuesta de Opinión Empresarial EOE/Industrial)</u>**: During May 2013 the Manufacturing Confidence Index receded 4.3 percentage points yoy: – 2.4% (May 2013) vs. 1.9% (May 2012). It’s also below the Index’s levels during April 2011 (6.3%) and 2010 (– 1.1%). Additionally, the Index also decreased 1.1 percentage points in relation to April 2013 (-1.3%).

Three factors underlie the construction of the index: current sales, inventory levels and output expectations (for the next quarter). The two factors that account for the contraction in the Manufacturing Confidence Index level are sales and output expectations (in contrast, inventory levels improve – decrease –).

Now, according to the think tank, if the index is seasonally adjusted, some signs of recovery are observed (especially due to a sales increase and to less inventories).

xviii) **Tuesday June 25 (Fedesarrollo – Encuesta de Opinión Empresarial EOE/Comercial)**: During May 2013 the Retail Sales Confidence Index dropped 6 percentage points yoy: 18.4% (May 2013) vs. 22.4% (May 2012). It's also significantly below the Index's levels during May 2011 (25.9%) and 2010 (28.3%). In any case, the Index increased 2.9 percentage points in relation to April 2013 (15.5%).

The index is constructed upon three variables: perception of current business (economic) condition, inventory levels and expectations of business condition (for the next quarter). One factor accounts for the yoy drop in the Retail Sales Confidence Index level: fall in perception of current business condition (in contrast, inventory levels fall and expectations of business condition improve).

xix) **Tuesday June 25 (Fedesarrollo – Encuesta de Opinión Empresarial EOE/Construcción)**: During the second quarter of 2013 the overall perception of a favorable (vs. unfavorable) condition from builders/constructors improved yoy: 34.1% (QII2013) vs. 22.4% (QII2012). However, the overall perception receded in relation to QI2013. Additionally, the perception of the overall rhythm of construction and expectations (one quarter ahead) of business conditions for construction also deteriorated both in relation to QI2013 and QII2012.

xx) **Friday June 28 (DANE – Gran Encuesta Integrada de Hogares GEIH)**: During May 2013 the overall unemployment rate was 9.4% (vs. 10.7% during May 2012). In fact, yoy 759,000 jobs were added to the economy.

In the 13 major cities unemployment during May 2013 reached 10.4% (vs. 11.9% during May 2012). This means that yoy 439,000 jobs were created in the 13 major cities.

Evidently, asset price and output data reveals a **weakening of the Colombian economy.**

On the supply side this is **especially true in tradable sectors (Ag, Manufacturing and Mining).** The plummeting of the Manufacturing sector is especially worrisome.

On the other hand, note that the Dutch Disease is probably over because even the mining sector has weakened significantly and the exchange rate has depreciated strongly.

Thus, sectorial output behavior is being affected mainly by **adverse external shocks** (terms of trade, as well as adverse business environment and property right risks in Ag and Mining), and by domestic and external demand weakening.

Undoubtedly, on the demand side, the weakening of the economy is a function **not only of staggered domestic consumption dynamics (as a result of the overall asset price plunge), but also of external demand (as revealed by dismal export data).**

Even worse, **consumer confidence doesn't seem to pick up.**

The only sector that seems to be offsetting the dismal growth rates of the economy is **construction.** This is due to the strong impulse given by the PIPE plan to subsidized housing.

UNDER OUR WATCH

Setback in Eco Tourism: On Wednesday April 10 INCODER (National Institute of Rural Development) began to study the piece land where "*Los Ciruelos*" is (or was?) to be developed ($US 7 million hotel project in the Tayrona National Park, state of Magdalena: 24,000 mts^2, 12 eco – cabins, 2 docks, etc.). INCODER aims at expropriating some (or all?) of the land under the argument that it belongs to the State. Meanwhile, ANLA (National Agency of Environmental Licenses) extended the suspension of the environmental license for the project's development.

In this case, **legal and property rights are being openly ignored due to ideological/political issues.** In fact, this decisiveness comes after President Santos announced on January 14 that the project (despite having a proper environmental license) would not be permitted under his administration due to new environmental considerations and indigenous rights (as if he could do that).

Whenever the central government fuels public feelings against investment in (politically or ideologically) sensitive sectors, **public officials feel free to validate them, thus expelling environmentally responsible investors and attracting illegal activities.**

Setback in Mining: On Wednesday April 10 the President of the Colombian Chamber of Mining reminded the government that Colombia is not a world leader in mining activities due to the lack of FDI in the sector. In fact, Colombia occupies only fifth place globally in coal production and doesn't even classify among the top ten gold producing nations (Colombia is only a world leader in emerald production). Moreover, the latest data shows that FDI in mining has dropped 20.4% during this year. The Chamber also warned that this year's first quarter mining exports will be reduced (with respect to last year's $US 12,523 million).

We agree with the Chamber's assessment. Several factors are hurting FDI in mining:

i) **Enhanced animosity, contempt and fire from public officials against FDI in mining.** Note, for example, from our previous reports the attacks and publicized decisiveness of the Minister of Environment, Attorney General, and General Comptroller against Drummond after the unfortunate coal ocean spill incident.

ii) **Systematic deterioration of physical security in the mining sector.** See in our previous reports (and also below):
   a. Multiple FARC attacks against Cerrejón's infrastructure.
   b. Multiple kidnappings of mining companies' workers (Braeval, Grand Tierra Energy, etc.)

iii) **Legal instability.** Recall that two years ago the Mine Code was declared unconstitutional by the Constitutional Court (CC). However, the CC granted the government a 2 year grace period for consultations (in order to avoid the resurrection of the old Mine Code and the obvious legal instability/disruption of the mining industry).

   Unfortunately time expired and the CC didn't grant the government an extension of the due date. As a result, the old Mine Code resurrected on May 11. Therefore, mining activities in Colombia are now governed by an old and obsolete (2001) Mine Code. Even though the Minister of Mines announced two decrees to make up for the Constitutional Court's ruling, the situation surely entails worrisome legal instability for the industry.

iv) **Bigger state – take.** Indeed, last year's tax reform increased taxes (rates and withholdings) on capital intensive sectors like mining and O&G.

Some particular events illustrate even more our point.

On Wednesday April 10 Anglo Gold Ashanti[10] publicly denounced that Cortolima's decision (March 11) to suspend the company's exploring and drilling activities in the municipality of Piedras (state of Tolima) was arbitrary and illegal. According to the company, the environmental authority is requesting permits that are not required for the type of studies being undertaken in Piedras.

The suspension was based upon the company's supposedly non – compliance of minimal standards when requesting the corresponding

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[10] South African capital; Anglo Gold Ashanti is a global leader in gold mining, and operates in 13 countries (including the U.S., Australia, Argentina, Brazil and South Africa).

environmental permits. Additionally, the environmental authority argued that the area where the company was operating is legally limited to agriculture, forestry and peasant housing (not mining activities). Finally, the authority also established that the area is extremely fragile and that Anglo Gold's activities could endanger its water and soil resources.

The decision was also preceded by local protests during Feb (including road blocks to the company's equipment). Local citizens fear harm against hydric resources in the area where the company must operate. To make things worse, on Thursday March 15 the Mayor of Ibagué (capital city of the state of Tolima) publicly requested Anglo Gold to resign to its 157 mining titles in areas surrounding the city.

Moreover, on Monday April 22 the General Comptroller (GC) issued a report on the company in relation to the 2007 – 2011 time period. According to the GC's report, Anglo Gold, several regional administrations (states of Antioquia, Bolívar and Caldas) and some local offices of the National Mining Agency (Bogotá, Medellín, Cali, Bucaramanga and Ibagué) are accountable for $US 3.8 million of alleged fiscal losses attributable to unpaid obligations by the company. Specifically, the report mentions 39 findings/anomalies in relation to the company (one of them with penal consequences).

All in all (and after evaluating Anglo Gold's public statement), to us it seems that Cortolima's decision, the Mayor's outburst and the GC's report are ideologically motivated (and seeking political dividends). These are all strong blows against the company´s gold mining activities in Colombia (including the controversial Colosa project in the municipality of Cajamarca, also in the state of Tolima).

As if all of the above weren't enough, on Tuesday May 7 the GC issued a very critical report on the Mining sector in Colombia. Posing as a think tank or a public policy school, the GC severely criticized mining in Colombia, claiming that:

i) It's not fostering local development.
ii) It's putting at stake food supply security in regions like Cesar and La Guajira.

iii) It creates mere commodity exports (99% of gold and 92% of coal is exported with no value added whatsoever).
iv) It has created an enormous environmental debt.
v) Entitlements and concessions are not granted with serious and rigorous selection methods.
vi) Public institutions are privileging mining over fundamental human rights in surrounding areas (local communities are being forced to sell their land or end up expropriated, with no adequate compensation plans).

Undoubtedly, the GC's report contains a heavy ideological depth charge. For instance, it's not fortuitous that the report has been elated by www.rebelion.org. Furthermore, we believe the GC should not pose as a think tank or a public policy school. Thus, instead of issuing ideologically contaminated papers, it should devote itself to its real purpose: fiscal control.

Not surprisingly, the mining industry (Minería a Gran Escala of ANDI, Asomineros and Federación Nacional de Productores de Carbón) issued a press release controverting the GC's report and stating that it "*contains appreciations that don´t fit the reality of the operation of formal mining companies in the country and disregard the conclusions of published papers.*"

But there's more. On the same day it published its mining report (May 7), the GC issued another press release arguing that the extension of the concession contract between the Government and Cerro Matoso (BHP Billiton's[11] production of iron, nickel and ferronickel in the state of Córdoba) is not legal and hurts the State's interests. According to the GC, benefits in terms of royalties and compensations paid by the company are not clear and sufficient.

And, believe it or not, simultaneously to all these outbursts from the GC against the mining industry, the National Mining Agency (ANM) issued its own press release establishing that 78% of mining entitlements in

[11] Australian and British capital.

Colombia exhibit some sort of anomaly (no environmental permit, nonpayment of royalties, no insurance, etc.). This came after an auditing exercise over 2,500 entitlements (out of 9,500 that are going to be audited). Hence, the President of ANM has announced that this audit exercise will converge into stronger and more effective controls over mining activities.

No one denies the necessity of severe environmental, fiscal and operational controls over mining activities. But disproportionate (yet politically profitable and fashionable) **official ideological persecution and enhanced animosity against the mining industry (as if all companies were illegal operators) is the worst public policy whatsoever: by harming business environment it induces serious companies to flee the country, thus attracting illegal operators (those that use environmentally razing techniques and pay zero taxes) to mining areas.**

Furthermore, we don't question either the responsibility or authority of the GC in strictly safeguarding and protecting fiscal resources. However, given the recent GC's fiascos in several major national investigations, and given its inappropriate and impertinent role playing as think tank, **the GC's findings in relation to mining must be taken in with major skepticism, for they constitute just one more ingredient of the fashionable witch hunt from public institutions against formal and responsible mining companies.**

What are authorities thinking?

Setback in Tourism: On Saturday April 27 the President of Cotelco (Colombian Hotels' Association) warned against a **witch hunt against some hotels in Cartagena.** According to him, **recent judicial rulings are altering the rules of the game for the hotel industry in Cartagena,** thus affecting several hotel companies that create multiple jobs in the city.

Recall that on Thursday March 14 the Consejo de Estado (Supreme Court in administrative or public vs. private matters) issued a ruling against the current owners – investors of the land piece where Hilton Hotel operates in Cartagena. The ruling demands that:

i) The hotel´s beach area be recognized and formalized by authorities as public space (given that, originally, it was a low sea water area and was turned into beach with seawalls during the late 1970's).
ii) In compensation for having used the area for so many years, current land owners (not Hilton) must buy a piece of land close by (similar in area to the piece being restored as public space), develop a public park, and pay for its maintenance during 30 years (!!!).

With this ruling, **current private investors are being sanctioned for public decisions made more than 30 years ago[12].** Assuming the restoration of Hilton´s beach area as undisputable public space is fair and legal, **the court's penalty and compensation requirement on current investors is completely unfair, exotic and erodes business environment in the Cartagena hotel industry.**

Additionally, the Constitutional Court issued a ruling against Torre de Mar Hotel declaring part of its beach area as public space. Here we have yet **another setback for business environment in the Cartagena hotel industry.**

Undoubtedly, Cotelco's President cry is totally fair.

Setback in Ag I: This time the unrest came from potato farmers. They held a strike (and blocked major roads) during several days. As usual, the strike came to an end on Thursday May 9 when the Ministry of Agriculture gave into farmers' requests and granted more than $US 20

[12] Some of the current investors acquired participation in the building and the land in the early 1990's (for example Corficolombiana – Hoteles Estelar from the Sarmiento Angulo Group with 50% of shareholding). But note that they are being penalized for seawall installation dating back to the late 1970's, when investors were completely different and shareholding was controlled by public entities or corporations.

million in subsidies (lump sums per hectare). **This type of subsidy is a costly and distortive response to please potato growers.**

First of all it will not stimulate productivity in the potato sector. Nothing worse that lump sums per hectare to hinder productivity and perpetuate the subsidy.

Secondly, it adds up to the collection of fiscally costly policies that the government has adopted in order to calm down social unrest in Colombia (judicial employees, coffee farmers, truck drivers, cocoa farmers, Cucuta businessmen, steel workers, rice farmers– see our Quarter I report). Ag sector strikes have cost more than $US 500 million. Recall that last year's judicial national strike ended in a $US 750 million wage leveling package granted by the government (and, ironically, inconformity in judicial employees persists).

Third, the potato subsidy perpetuates a perverse incentive being issued by the government again and again to every dissatisfied sector of society: go to strike (preferably violently) and get a bite of the public budget.

In sum, the **government seems incapable of enduring social unrest. In the midst of every single confrontation it yields to distortive policies, jeopardizing, at the same time, the country's fiscal stance and stimulating, by the way, further strikes.**

Setback in O&G: On Wednesday May 15 several Senators requested the Minister of Mines that Pacific Rubiales'[13] contract not be extended beyond 2016 and that the oil field be given over to Ecopetrol.

The GC (surprised?) joined the debate and claimed that Pacific has damaged the oil field.

This is another **very bad hint in terms of business environment for the O&G sector.** Indeed, this company has also been a systematic target of

[13] Canadian capital.

political and ideological attacks during the previous months (no wonder the GC stepped in).

Setback in AG II: The government and the FARC terrorist group closed a (quasi) deal on the topic of rural development (first of five topics to be negotiated). The details of the deal were not revealed, but according to the speech from the President it includes:

i) A land bank for landless poor peasants to be nourished from:
   a. Expropriation and recovery of illegally obtained (or “stolen”) land (either private property that was bought with illegal money or public land illegally appropriated).
   b. Available public vacant land.

ii) Increasing land taxes to (they wish) induce a more efficient use of land (less cattle raising).

iii) Sufficient fiscal resources for rural development goals (health, education, housing, irrigation, etc.) during a 10 – year time period.

Several issues arise:

First, it’s extremely self – defeating to negotiate State topics (like rural development) with a terrorist group that is no victorious army whatsoever, and that has devoted itself to fostering terror all around the country (especially in rural areas).

Second, it’s extremely dangerous to discuss public policy with criminals (instead of simply asking for their surrender) due to the perverse incentive it creates: aim for power using terror and weapons and, even if you don´t make it, as long as you don´t surrender you’ll get to participate in policymaking.

Third, the terrorist group announced that there were still some loose ends on the topic of rural development to be discussed and negotiated later on with the government. Even though we still believe the Santos administration won’t yield to extreme FARC requests (especially those against private property or FDI), nothing good can come out of pending topics related to rural development. Thus, there's still a **high degree of uncertainty regarding future property rights in the AG sector.**

Even worse, the loose ends will stimulate revolt against the government in regions where FARC terrorists can manipulate peasants (in order to push for more concessions from the government in rural topics during the ongoing peace talks). Indeed, it's not fortuitous that during the last three weeks approximately 14,000 peasants (infiltrated by FARC terrorists) have violently protested in the Catatumbo region (oil rich, state of Norte de Santander, frontier with Venezuela). They demand from the government the withdrawal of soldiers and policemen, the suspension of illegal crop eradication activities and the creation of a Peasant Reserve Zone (area with limitations to private property and public force control).

Fourth, the lank bank policy (if it's really going to differ from the traditional and long – existing one) will demand (¿or unleash?) an aggressive land expropriation attitude by the government and land judges. A mere look at recent land rulings (see our previous reports) reveals that property rights in rural areas are probably going to take several blows.

Fifth, these types of policies won't improve the life quality of poor peasants. On the contrary, populist measures of this sort hinder rural economic and social development. For instance, additional taxes on land hurt investment (and job creation) in rural areas and the AG sector. Additionally, peasants with land grants but lacking credit, technology, economies of scale and insurance[14] usually go bankrupt and abandon (once again) their farm to find a job in the city. In other words, these (probably well intended) policies usually end up, in the first place, killing many job creating investment possibilities in rural areas and, secondly (and paradoxically), expelling out peasants out of their land and back into the cities.

[14] Against exchange rate, climate, phitosanitary and international price risks.

Sixth, rural development goals (health, education, housing, irrigation, etc.) have been embedded in every development plan of every central, state and local government during the last few decades. So there's nothing new there. Unless the deal is not a non – binding one and voluminous fiscal resources end up being earmarked for these noble purposes (say during a 10 – year period). If so, the fiscal sustainability of the Nation will be at stake.

At the end of the day **this deal is a real setback for overall business environment, but especially for investment conditions in the Ag sector. And it's only the beginning.**

Consultations vs. Development: The Constitutional Court (CC) issued a ruling suspending the construction of a multipurpose port in Barú (south of Cartagena) by Sociedad Porturaria Puerto Bahía. According to the CC the company did not carry out the required previous consultations with indigenous native groups.

In a press release Sociedad Portuaria Puerto Bahía informed that the project has the proper environmental license, and that the consultations now ordered by the CC were not carried out because the Ministry of Interior certified that such (afro) communities were not under the area of influence of the project. Furthermore, the company informed that commitments with those communities with which consultations were carried out are being fully honored.

We don't oppose consultations with native indigenous or afro – Colombian communities before projects are developed. The problem arises when the project has to be stopped abruptly because one such community claims (in contradiction to the Ministry of Interior) to be influenced by the project, and judges validate their claim. Or, even worse, when such consultations become (as has happened many times in the recent past) a source of extortion to the project's developers.

When those things happen **business environment is undoubtedly hurt, and economic and social development in poor regions (like Barú) suffer a setback.**

Yielding to Protectionism: Recall that on Wednesday January 23 President Santos signed a decree imposing a 5 $US per kilogram specific tariff on shoe and apparel imports from China. At the time, and according to government officials, this was simply a 6 – month transitory measure (yet extendable) to offset uneven and disloyal competition coming from China, while permanent anti – dumping tools were put in place.

On Wednesday May 22 the government announced that the tariff is to be extended.

For sure, any disloyal competition can (and must) be offset by authorities with any of the long array of instruments available to them. However, **long – lasting protectionist measures (especially specific tariffs) are never a good policy to foster competitiveness. They not only hurt consumers, but also slow down productivity growth in the protected sector. And, even worse, such policies end up inducing other sectors of the economy to ask for similar protection** (as has happened with the iron, steel, notebook, leather, and Ag industry).

Setback in AG III: Our second concern regarding this sector has to do with all the attacks and accusations that landowners and AG investors are suffering from different sectors (opinion leaders, left – wing factions of Congress, some public officials and the GC – ¿surprised? –).

Indeed, investors are being accused of divesting small peasants of land granted by the government. Particularly, they are being accused of having accumulated (illegally through third party owners) thousands of hectares in the state of Vichada. For instance, Riopaila Castilla is being accused of illegally accumulating 42,000 hectares aimed at palm oil production.

Furthermore, a political ingredient has been added: the current Ambassador to the U.S. (and personal friend of the President) was a partner at the law firm that put together the legal strategy enabling Riopaila Castilla to purchase the 42,000 hectares.

It's true that in Colombia any piece of land with property rights obtained from government land grants cannot be sold (or bought by) a person or firm holding more than one such unit of land.

However, landowners and investors are being lynched and stoned, simply because they own large pieces of land and because the current Ambassador to the U.S is in the middle of the debate). Absurd.

First of all, ¿who said that using third parties to purchase land originally granted to peasants is illegal? There's no law prohibiting this.

Furthermore, ¿who said that the land purchases were characterized by violence, threats of lack of free will from the selling peasants? This is not the case either (as happened in other regions, where peasants were forced to sell at meager prices, so that buyers should be held accountable).

But, additionally, ¿who said that the price paid by the investors is unfair? This is not the case either. Prices paid are consistent with market prices in that region.

Moreover, ¿is prohibiting land accumulation in regions like Vichada an optimal public policy? No way. In Vichada (due to the acidity of its soil) economies of scale are required in order to reach competitive production thresholds (as in Brazil). Indeed, farmers producing in small pieces of land in Vichada are condemned to go bankrupt.

Now, ¿is prohibiting land accumulation in regions like Vichada a fair or welfare enhancing public policy? No, no and no. The problem with poor peasants (in Colombia, in Vichada or in any other country) is lack of income (and not lack of land). With large investments in regions populated by small poor peasants lacking technology (like Vichada), job creation provides peasants with more (and more stable) income than that which they can get from the acid soil of a small piece of tropical land.

Even more, 42,000 thousands hectares is not a large piece of land in regions like Vichada. Due to the acidity of its soil, it is estimated that minimum 1,000 hectares are required for family subsistence. Hence, we're talking about a piece of land equivalent only to the area that 42 families require over there to survive.

And now that the General Comptroller joined the club of accusers (on June 11), don't be surprised if the Attorney General also jumps in to avoid being left out of the show and the lynching.

Undoubtedly, this set of attacks and accusations against landowners and investors in Vichada will **harm job and income creation in poor rural areas even more. As if peace talks with FARC weren't harming sufficiently business environment in the AG sector (see our previous report).**

The President of the Farmers' Federation (SAC) was right when he said (June 15) that foreign and domestic investors in the AG sectors are going to flee Colombia due to the uncertainty of property rights and the deterioration of the business climate.

Physical Security:

i) **Thursday April 9**: FARC terrorists blew up the Transandino Oil Pipeline[15] in the settlement of Valle de Las Palmeras (municipality of Orito, state of Putumayo, frontier with Ecuador). According to Ecopetrol, the attack caused an oil spill in the Sucio River (tributary of the Guamez River) and a pumping halt.

ii) **Wednesday April 10**: Terrorist group ELN conditioned the release of Canadian geologist Jernoc Wobert to the return of all mining titles by Braeval Mining Corporation (Canadian capital with gold exploration and development projects in Colombia, México and Perú). The terrorists also threatened that any military operation aimed at rescuing Wobert is "*unfeasible*".

[15] This pipeline, 306 kms long between the oil fields of Orito (state of Putumayo) and the municipality of Tumaco (state of Nariño, Pacific coast), belongs to Ecopetrol and has a 48k bpd capacity.

ELN is demanding Braeval's resignation to mining titles in Mina Seca (1,527 hectares), La Nevera (880 hectares), Casa de Barro (200 hectares) and Las Nieves (36 hectares).

Recall that ELN kidnapped the Canadian and two Peruvian nationals (together with three Colombians) in "*Casa de Barro*" gold mine – municipality of Norosí (south of the state of Bolívar). The Peruvians and Colombians were liberated on February 12. The Canadian remains captive.

iii) **Wednesday April 10**: At 4:30 pm one Army sergeant and one soldier were assassinated by FARC terrorists in the municipality of Arauquita (state of Arauca, frontier with Venezuela). This time the terrorists' modus operandi was an ambush with an explosive artifact. One corporal and another soldier were also injured in the attack.

iv) **Friday April 12**: During an engagement between the Army (Sixth Division) and FARC ("*Columna Móvil Teófilo Forero*") in the settlement of Los Andes (municipality of Puerto Rico, state of Caquetá) three soldiers and five terrorists were killed.

v) **Wednesday April 17**: At 4:00 pm FARC terrorists attacked with assault rifles the Police Station in the settlement of Barragán (municipality of Tuluá, state of Valle).

vi) **Thursday April 18**: At dawn FARC terrorists attacked with explosive artifacts two spots in the municipality of Tumaco (state of Nariño, Pacific coast): the airport (and antinarcotic base) and one Police Station (where one car with 30 kg of explosives was also deactivated).

vii) **Thursday April 18**: At 10:00 pm FARC terrorists ("*Frente 36*") used a bus (with explosives) to block the road that connects Medellín with the municipality of Anorí (state of Antioquia). Personnel from the Army's 14th Brigade deactivated the explosives.

viii) **Monday April 22**: FARC terrorists ("*Columna Móvil Alfonso Castellanos*") attacked the Police Station in the municipality of Tame (state of Arauca, frontier with Venezuela). One policeman was killed.

ix) **Monday April 22**: FARC terrorists ("*Columna Móvil Antonia Santos*") ambushed with explosives an Army patrol in the Catatumbo region (state of Norte de Santander, frontier with Venezuela). As a result, one soldier was assassinated.

x) **Monday April 22**: Army personnel (37th Mobile Brigade) neutralized in the settlement of Chorrera Blanca (municipality of Morales, state of Cauca) a deposit full of explosives (115 kgs) that FARC terrorists were going to detonate in attacks all over the region.

Recall that during this year FARC terrorists have detonated three car – bombs in the state of Cauca (killing one civilian and injuring several soldiers).

xi) **Sunday April 28**: In the settlement of Puerto Jordán (municipality of Tame, state of Arauca) FARC terrorists ("*Frente 10*") attacked with a grenade an Army unit belonging to Artillery Battalion No. 18 (18th Brigade). As a result, one peasant and his 3 year old son were killed. Nine other civilians (including one girl) and two soldiers were injured.

xii) **Sunday April 28**: Amid "*peace*" talks with the government, FARC terrorists announced in Cuba that if they abandon the use of weapons, Colombia´s Military Forces must be restructured (meaning that its current 450k troop size must be cut down).

xiii) **Tuesday April 30**: The Mayor of the municipality of El Tambo (state of Cauca) suffered a terrorist assault with explosive artifacts while heading to the state's capital city (Popayán). Perpetrators almost surely belong to the FARC terrorist group.

xiv) **Wednesday May 1**: A criminal group massacred four people in the municipality of San Roque (state of Antioquia).

xv) **Thursday May 2**: FARC terrorists ("*Frente 6*") attacked the helicopter delivering cash to the public bank (Banco Agrario) of the municipality of Toribío (state of Cauca). Policemen escorting the personnel in charge of carrying the money into the bank were also attacked with assault rifles.

xvi) **Thursday May 2**: Three soldiers (27th Jungle Brigade) stepped on FARC land mines in a rural area of the municipality of Ipiales (state of Nariño, frontier with Ecuador) while patrolling close to the border with the state of Putumayo. The soldiers were severely wounded (one of them lost part of both legs).

xvii) **Thursday May 2**: An explosive artifact was thrown at a small business in the municipality of Pital (state of Huila). Perpetrators almost surely belong to the FARC terrorist group.

xviii) **Wednesday May 8**: Terrorist group ELN conditioned, once again, the release of Canadian geologist Jernoc Wobert to Braeval's resignation to mining entitlements and concessions in Colombia.

xix) **Wednesday May 8**: In the state of Norte de Santander Army troops found a deposit full of explosives belonging to FARC terrorists ("*Cuadrilla Iván Ríos*"). Intelligence sources say that these explosives were aimed at attacking energy infrastructure.

xx) **Friday May 10**: 3 persons were kidnapped in the municipality of Santander de Quilichao (state of Cauca). This was the second kidnapping in this municipality in less than a month.

xxi) **Friday May 10**: Army troops found a deposit with 5 thousand land mines in the settlement of Versalles (municipality of Albania, state of Caquetá) belonging to FARC terrorists ("*Cuadrilla 49*"). The explosive artifacts were going to be used and detonated by the terrorist group in southern Caquetá.

xxii) **Friday May 10**: One policeman was shot in the head by FARC snipers in the municipality of Arauquita (state of Arauca). The incident is part of FARC's "*Pistol Plan*", aimed at killing policemen and soldiers on a one by one basis. During 2013, and under this macabre plan, 70 policemen and soldiers have been shot by FARC in the state of Arauca.

xxiii) **Friday May 10**: A car with explosives was deactivated in downtown Bogotá.

xxiv) **Saturday May 11**: 100 persons had to flee their homes in the municipality of La Hormiga (state of Putumayo) in an attempt to avoid crossfire during intense combats and fighting between the Army and FARC terrorists.

xxv) **Saturday May 11**: In cross – fire between Army troops and ELN terrorists in the municipality of Saravena (state of Arauca) three guerrilla members were shot down and two soldiers were wounded.

xxvi) **Sunday May 12**: FARC terrorists ("*Frente 36*") incinerated one bus on fire in the municipality of Toledo (state of Antioquia).

xxvii) **Monday May 13**: FARC terrorists launched a grenade and fired (with assault rifles) against a Police station in the municipality of Teorama (state of Norte de Santander). One policeman was wounded.

xxviii) **Tuesday May 14**: At 3 a.m. FARC terrorists ("*Frente 32*") attacked with explosives and assault rifles a Police station in the settlement of Pepino (6 kms away from Mocoa, capital city of the state of Putumayo). One policeman was killed and four other were wounded. This was the third attack in 2013 against Police stations in the state of Putumayo.

xxix) **Tuesday May 14**: At 7:40 a.m. FARC terrorists ("*Frente 36*") set another bus on fire in the municipality of Toledo (state of Antioquia).

xxx) **Tuesday May 14**: Five FARC terrorists ("*Columna Móvil Alfonso Castellanos*" and "*Compañía Drigelio Almarales*") were shot down by Army troops (8th Division) in the municipality of Arauquita (state of Arauca). The terrorists were planning extortion acts against local citizens.

xxxi) **Tuesday May 14**: Army troops (23rd Brigade) deactivated several explosive artifacts installed by FARC terrorists in a school in the settlement of Carrizal (municipality of Ricaurte, state of Nariño).

xxxii) **Tuesday May 14**: Local authorities in the municipality of Montecristo (south of the state of Bolívar) denounced a shortage of supplies (food and medicines) in two of its settlements (Dorado and Paraíso – 400 families) due to ELN's prohibition to enter or exit both places (and after the terrorist group burned several vehicles and assassinated a motorcyclist on April 25).

xxxiii) **Wednesday May 15**: Four ELN terrorists ("*Frente José Adonay Ardila Pinilla*") were shot down by Army troops (16th Brigade) in the municipality of Tame (state of Arauca). One soldier was also wounded.

xxxiv) **Friday May 17**: FARC terrorists ("*Frente 33*") attacked with explosives Army troops in the settlement of Otare (municipality of Ocaña, state of Norte de Santander).

xxxv) **Friday May 17**: 2 Spanish citizens (one male – 49 – and one female – 43 –) were kidnapped in the state of La Guajira (frontier with Venezuela). A ransom was demanded by individuals who identified themselves as FARC members. Fortunately, on Saturday June 15 both Spaniards were rescued by the Police and confirmed that the raptors weren't FARC members (just common criminals).

xxxvi) **Sunday May 19**: At midnight FARC terrorists assassinated 2 policemen in San José del Guaviare (capital city of the state of Guaviare).

xxxvii) **Monday May 20**: The main road connecting Medellín and Bogotá had to be closed down by the Army during several hours because some explosive artifacts were detected at km 39. Army specialists eventually detonated the artifacts in a controlled manner.

xxxviii) **Wednesday May 22**: At 2:00 am ELN terrorists ambushed and brutally assassinated 10 soldiers and 1 lieutenant in the settlement of Presidente (municipality of Chitagá, state of Norte de Santander). 6 soldiers were wounded and, unfortunately, 1 corporal was also kidnapped by the terrorists. These troops belong to the Army's "*José Antonio Galán*" Batallion (5th Brigade).

This is one of the biggest military setbacks for the Colombian Army (and the government) in recent months.

xxxix) **Thursday May 23**: FARC terrorists ("*Frente 59*") ambushed and assassinated 2 policemen in a toll in the settlement of Paraguachón on the border with Venezuela (municipality of Maicao, state of La Guajira, frontier with Venezuela). 2 customs officials also died.

xl) **Thursday May 23**: FARC snipers ("*Frente 36*") assassinated 3 soldiers in the municipality of San Andrés de Cuerquia (state of Antioquia). 3 soldiers were also wounded. These troops belong to the Army's "*Coronel Atanasio Girardot*" 10th Batallion (4th Brigade).

xli) **Sunday May 26**: FARC terrorists ("*Frente 39*") blew up the Cerrejón railroad (km 12, municipality of Albania, state of La Guajira) carrying coal from the mine to Puerto Bolívar.

xlii) **Monday May 27**: ELN issued a press release claiming victory after the brutal attack and assassination of 11 Army members (10 soldiers + 1 lieutenant) on May 22 in Chitagá (state of Norte de Santander). The terrorist group confirmed that 1 corporal is being held hostage. Additionally, ELN demanded from the government a bilateral cease fire in order to enhance trust in Colombia's peace process.

xliii) **Monday May 27**: shortly after 7:00 pm FARC terrorists blocked the Panamerican Highway and burned two vehicles in a sector known as "*Pescadero*" (municipality of Caldono, state of Cauca).

xliv) **Monday May 27**: At 9:00 pm and during two hours FARC terrorists attacked (with assault rifles and machine guns) the Police station in the settlement of Mondono (municipality of Santander de Quilichao, state of Cauca). Several houses and the place's church were also hit.

xlv) **Tuesday May 28**: FARC terrorists ("*Frente 6*") assassinated two civilians in a private estate in the settlement of Gabriel López (municipality of Totoró, state of Cauca). The terrorists used several cylinders full of explosive material to blow up the house, thus killing the estate's administrator and another worker. The attack was a retaliation given the fact that the place had already been assaulted on January 20 (150 cattle were then stolen, but Army troops recovered them 5 days later).

xlvi) **Wednesday May 29**: FARC terrorists ("*Frente 36*") blocked any entrance/exit to and from the municipality of Briceño (state of Antioquia). They destroyed local public works infrastructure and also threatened the regional bus company.

xlvii) **Thursday May 30**: 3 soldiers (22th Jungle Brigade) were killed in a place known as Puerto Pororio (municipality of Puerto Concordia, state of Meta) after a mortar grenade (left behind by FARC terrorists) blew up. 1 corporal and 1 soldier were also wounded.

xlviii) **Friday May 31**: At 2:30 am FARC terrorists ("*Frente 6*") used land mines and assault rifles to attack Army troops in a place known as Valle Hondo (municipality of Caloto, state of Cauca). 1 soldier was assassinated and 5 more were injured.

xlix) **Friday May 31**: FARC terrorists ("*Frente 33*") blew up several tranches of the Caño Limón – Coveñas Oil Pipeline[16] in the municipality of Tibú (state of Norte de Santander). Due to the oil

[16] This pipeline, 780 kms long between the Caño Limón oil field in Arauquita (state of Arauca) and the municipality of Coveñas (State of Sucre, Atlantic coast), belongs to Ecopetrol and Occidental Petroleum Company (American capital) and has a 220 bpd capacity.

spill the water intake (from the Catatumbo River) serving the local aqueduct (which supplies water to 30k people) had to be closed down.

l) **Tuesday June 4**: FARC terrorists ("*Frente 3*") massacred four INPEC (National Penitentiary and Prison Institute) guardians while travelling along the road that connects the city of Florencia and San Vicente del Caguán (state of Caquetá). The guardians were taking three inmates to different judicial hearings in San Vicente. One of the inmates was also killed, while the other two were severely wounded. The guardians' weapons (pistols and revolvers) were stolen.

    This is the first time that FARC terrorists attack INPEC guardians with no attempt whatsoever of rescuing the prisoners.

li) **Friday June 8**: At 2:30 pm ELN terrorists ("*Frente Che Guevara*") attacked with assault rifles Police personnel quartered in the municipality of Sipí (state of Chocó). During the attack the terrorists also launched explosive artifacts and impacted a civilian home, thus killing one 18 month – old baby and injuring three other persons (two children and one adult).

lii) **Friday June 8**: At 7 pm FARC terrorists ("*Frente 6*") attacked with assault rifles and explosives the Police station in the settlement of El Mango (municipality of Argelia, state of Cauca). One of the explosives hit a civilian home, killing two persons (one of them a school teacher) and wounding six other (also adults and members of the same family).

liii) **Sunday June 9**: One 14 year – old kid died in the municipality of Juradó (state of Chocó) after stepping over a land mine that was installed by terrorist groups (FARC or ELN).

liv) **Monday June 10**: At 7:00 pm FARC terrorists ("*Frente 29*") attacked with assault rifles the Police station in the municipality of Timbiquí (state of Cauca). Two civilians were injured (one minor and one adult woman).

lv) **Monday June 10**: ELN terrorists blew up the Caño Limón – Coveñas Oil Pipeline in two different spots in the municipality of Teorama (state of Norte de Santander). As a result, there were oil spills in several streams that tribute into the Catatumbo River. In consequence, the aqueducts of Tibú, Teorama and Convención had to be closed down.

lvi) **Tuesday June 11**: Army troops destroyed 31 high – powered explosive artifacts (some hidden, some already installed) in the rural areas of the municipalities of Jambaló, Morales and Suárez (state of Cauca). The explosives belonged to FARC terrorists ("*Columna Móvil Jacobo Arenas*").

lvii) **Tuesday June 11**: At 1:30 pm FARC terrorists attacked with explosive artifacts a Police patrol serving the municipality of Puerto Tejada (state of Cauca). Four policemen were injured.

lviii) **Wednesday June 12**: FARC terrorists ("*Frente 59*") attacked with assault rifles a military base in the rural area of the municipality of Barrancas (state of La Guajira). One 20 year – old soldier was killed. Once Army troops reacted, the terrorists fled into Venezuela.

lix) **Thursday June 13**: Army troops (13th Brigade) captured one man in Bogotá carrying in his vehicle a grenade launcher. He probably belongs to a FARC terrorist urban cell.

lx) **Monday June 24**: Four peasants were massacred in the municipality of Valdivia (state of Antioquia). According to authorities this was the result of confrontations between FARC terrorists and criminal bands seeking for territorial control in that area.

lxi) **Tuesday June 25**: FARC terrorists blew up the Cerrejón railroad (km 12, municipality of Albania, state of La Guajira) carrying coal from the mine to Puerto Bolívar. This was the fifth attack against Cerrejón's infrastructure during 2013.

lxii) **Wednesday June 26**: FARC terrorists blew up the San Miguel – Orito oil pipeline[17]. The incident occurred in a settlement known as La Palestina (municipality of Orito, state of Putumayo). Two civilian homes were burned.

lxiii) **Wednesday June 26**: FARC terrorists burned one bus in the road between the municipalities of Ituango and Toledo (state of Antioquia). During this year 11 buses belonging to the regional bus company have been incinerated in the same area by FARC terrorists ("*Frente 36*").

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[17] This pipeline belongs to Ecopetrol and carries oil from the fields in Putumayo.

lxiv) **Wednesday June 26**: ELN terrorists released a video with a statement by the corporal that was kidnapped after the Chitagá ambush (in which 10 soldiers and 1 lieutenant were brutally assassinated). This proof of life of the corporal is a déjà vu of the most obscure times of the terrorist threat that Colombians have endured during the last decades.

lxv) **Thursday June 27**: FARC terrorists blew up the Petróleos del Norte oil pipeline in the municipality of El Carmen (state of norte de Santander). The oil spill reached several streams in the region of Ocaña, and affected local aqueducts.

lxvi) **Tuesday July 2**: FARC terrorists blew up a segment of the Transandino Oil Pipeline in the settlement of Siberia (municipality of Orito, state of Putumayo). When an Army Patrol (27th Jungle Brigade) arrived to the site, one soldier was assassinated by the terrorists.

lxvii) **Tuesday July 2**: FARC terrorists blew up the San Miguel – Orito oil pipeline. The incident occurred in a settlement known as El Yarumo (municipality of Orito, state of Putumayo). There was an oil spill.

lxviii) **Dismal statistic I:** During 2013 there have been approximately 70 terrorist attacks against O&G + Mining infrastructure. In contrast, during 2010 there were only 31 attacks (less than half during more than twice as long). If the trend continues, total terrorist attacks against O&G and Mining during 2013 will compete with last year's record breaking datum: 308 attacks.

lxix) **Dismal Statistics I:** On Monday May 20 Fundación País Libre reported that 58 persons were kidnapped in Colombia during the first quarter of 2013. 53% of them were kidnapped under extortion. Of those 58 persons:

a. 25 were released by their captors.
b. 17 were rescued by the Army or Police.
c. 6 were released by their captors due to pressure from the Army or the Police.
d. 3 escaped.
e. 7 are still being held captive.

Those regions with more kidnappings are: Cauca, Antioquia, Norte de Santander and states in the Atlantic coast.

lxx) **<u>Dismal Statistics III</u>:** On Friday May 31 the Ministry of Defense issued a report conceding an increase in terrorist attacks during 2012 (with respect to 2011). Nevertheless, the report argues that the number of victims was slightly lower. According to the study, the states with more terrorist attacks were: Antioquia, Arauca, Cauca, Meta, Nariño and Norte de Santander.

OUR ASSESSMENT

Without doubt **security conditions (affecting both infrastructure and life/freedom) have significantly deteriorated in several regions of the country**. The situation is especially critical in frontier states (Arauca, Norte de Santander, La Guajira, Cesar, Putumayo, Nariño), in regions of interest to the O&G, Coal, Gold and Electrical Energy sectors (the same ones from the previous parenthesis plus Antioquia), and in the FARC stronghold state of Cauca.

Paradoxically, this deterioration of security conditions in several regions of the country is a function of "*peace talks*" in Cuba. Indeed, FARC leaders have boosted the brutality and frequency of their terrorist attacks in an attempt to enhance people's perception of their military (and terrorist) capacity and, thereby, strengthen their own political stance (and society's plead for cease fire) during peace talks with the government. Similarly, with their own onrush or swoop of terrorist attacks, ELN is trying to weaken society's will and, hence, induce the Santos Administration into peace negotiations.

Therefore, **expect more (if not an escalation of) terrorist attacks in regions of ELN influence (south of Bolívar, Norte de Santander and Arauca).**