



NEWS 05

Third Quarter
2013
July – September 30

ESCUELA
DE ECONOMÍA

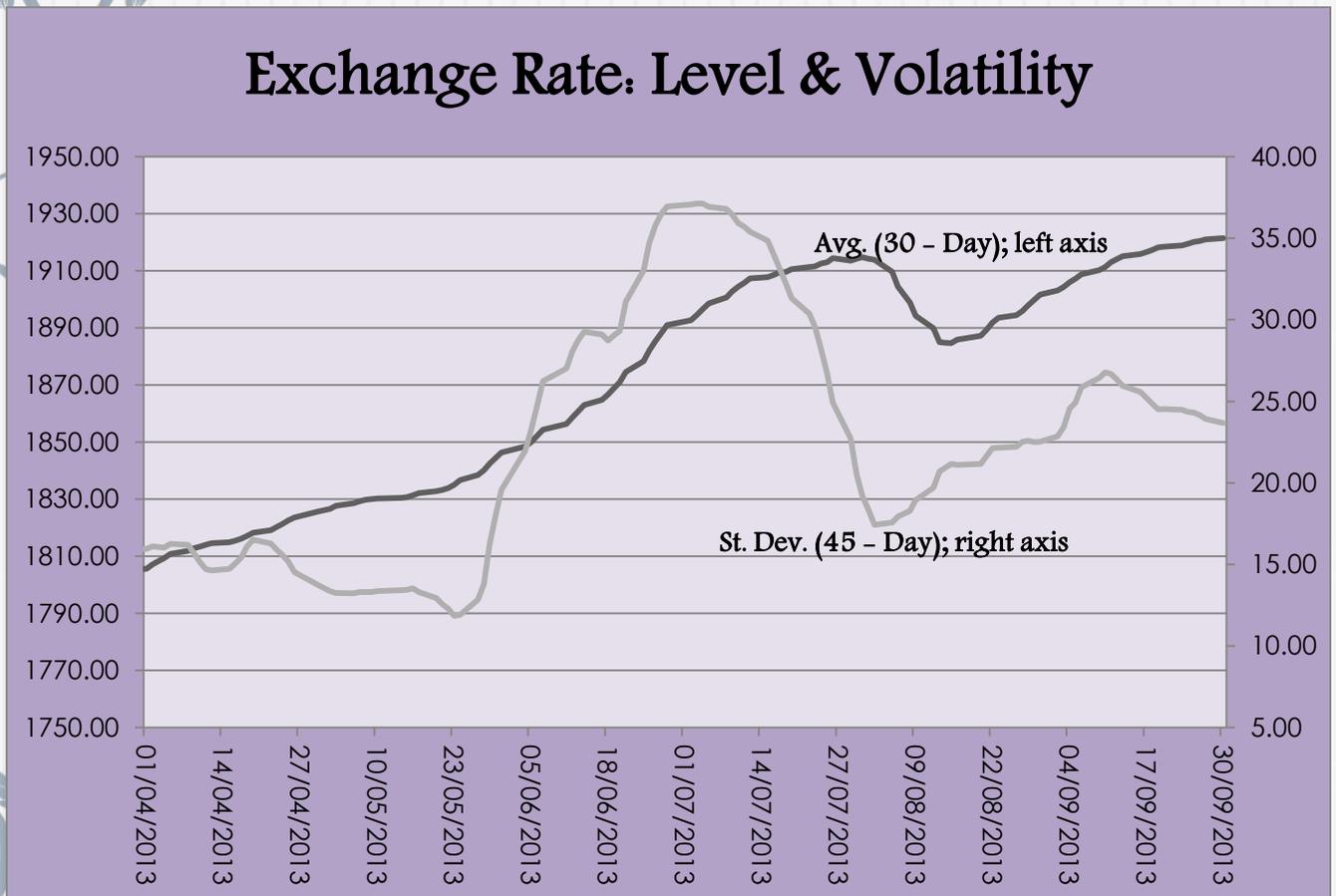


QUAESTOR
Universidad Sergio Arboleda

BUSINESS ENVIRONMENT WATCHDOGS

DATA

Peso – Dollar Exchange Rate (ER)



Despite the **September 2% appreciation of the Colombian peso (COP)**, **its medium – run trend still reveals weakening (depreciation) dynamics.**

As we have said over and over (see our previous reports), recent exchange rate dynamics haven't been the result of domestic macro policy aimed at boosting tradable sector output¹.

On the contrary, **this year's weakening of the COP has been driven by:**

1. **Confidence plunge:** uncertainty attributable to peace talks with FARC, increasing social unrest, the government's popularity plummeting and lack of political leadership, as well as major setbacks to business environment in Mining, Oil & Gas (O&G), Agriculture (Ag) and Tourism have eroded investor confidence regarding property rights and legal stability in Colombia.

It is not fortuitous that during January and August of this year Foreign Direct Investment (FDI) flows contracted yoy 1.8% (see below).

2. **Export drop:** output contraction in tradable sectors (Manufacturing, Ag, Mining, and O&G) has hurt export flows (4.3% reduction between January and July – see below –).

3. **Sudden stop risk:** Colombia ranks fifth in terms of the Capital – Freeze Index (The Economist). This means the Colombian economy is the fifth one with higher risk of going through a sudden stop of capital inflows among emerging markets (see below). Markets have surely discounted this risk.

¹ In terms of monetary policy, note that the Central Bank (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. Afterwards (board meetings of Apr 26, May 31, Jun 28, Jul 26, Aug 30 and Sep 27), the CB has kept the rate untouched at 3.25%. The CB also implemented an active international reserve (IR) accumulation policy after its Jan 31 board meeting: \$US 3 billion between Feb and May. However, after its May 31 and Sep 27 board meetings the CB reigned in its IR accumulation policy: i) \$US 2.5 billion during the Jun – Sep time period, and ii) \$US 1.0 billion during the Oct – Dec time lapse. On the other hand, the countercyclical fiscal policy revealed by the government (PIPE – see our Quarter II report –) undoubtedly deploys clever instruments aimed at fostering economic growth, boosting domestic demand and enhancing tradable sector competitiveness. Yet, if successful (and diligently executed) this will appreciate (*and not depreciate*) the COP.

4. **Fed effect:** recent data about a stronger U.S. economy, and the expectation that the Fed will soon begin to reign in its Quantitative Easing Program (QE) has shifted exogenously and significantly ER fundamentals.

Thus, there's no evidence yet of a trend reversal in COP weakening and, on the contrary, **there's a high chance that the COP will weaken even more in the medium run.**

Now, after rising during August and the first half of September, ER volatility seems to be converging back to its 6 – month average (20 COP).

Since we believe tradable sector companies should always purchase hedges against ER fluctuations, it might be a good time for looking at instruments other than zero cost forwards (recall that the lower the volatility, the less expensive the hedging).

QUAESTOR's \$US Value of Domestic Stock Price Index

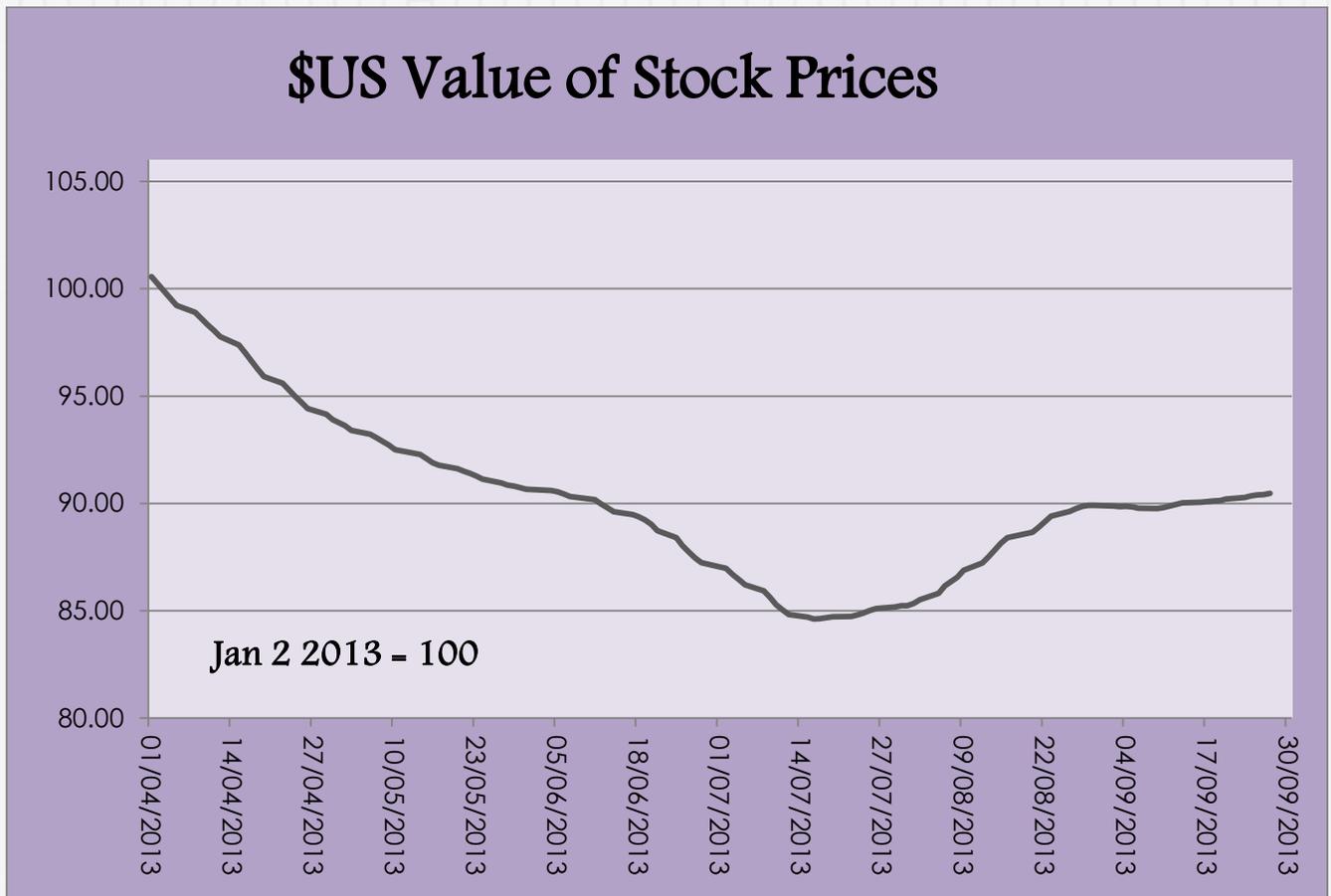
In contrast with the ER market, **dynamics in the stock market exhibit a trend reversal after the Feb – Jul price drop.**

Undoubtedly, after the Feb – Jul losses (2.840 points or – 18.7% between the Feb 5 peak and the July 10 trough) the stock market has recovered 1.760 points (14.2%) in COP or nominal terms.

Moreover, the **weakening of the COP (see above) has inhibited a stronger recovery of the real/dollar value of stocks in the Colombian market.**

In any case, losses are still significant with respect to the previous peak:

- i) \$US 100 invested on Jan 02 have become \$US 85 on September 27.



- ii) \$US 100 invested during the markets' peak (Feb 5) have turned into \$US 83 on August 30.

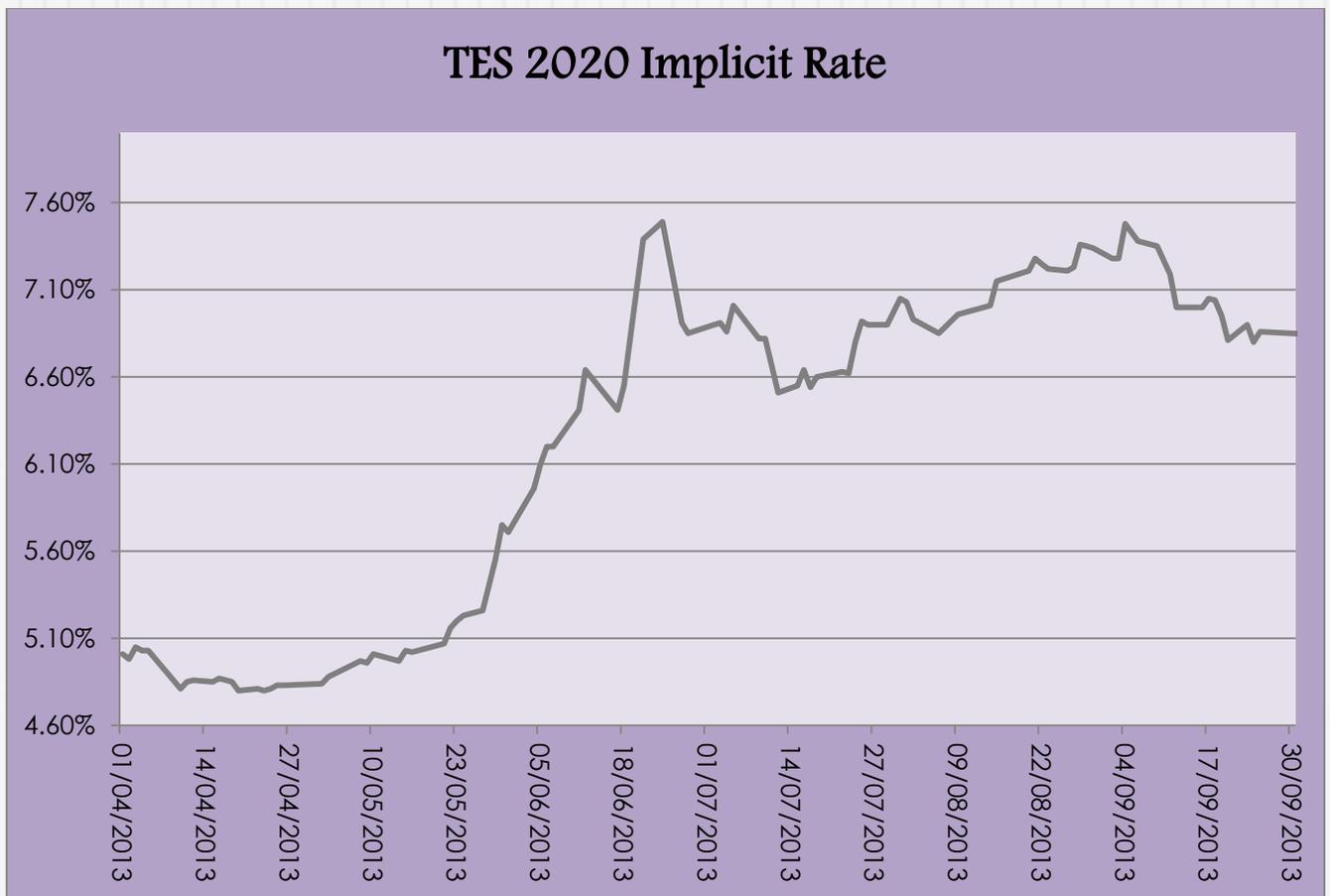
Treasury Bills (TES) Implicit Interest Rates

Even though it might be too soon for a sound forecast, data in the **TES market does portray a possible trend reversal in the price drop that began in May.**

Note that despite the fact that the implicit interest rate of the July 2020 TES bond² is still 190 bps above its pre – June average, during September the rate decreased 50 basis points.

Similarly, the July 2024 bond³ implicit rate dropped 30 bps during September.

In any case, more observation is required before determining a definite trend reversal in the prices of this market.



For instance, recall that the 2014 budget is supposed to be coherent with a 1% deficit in the Non – Financial Public Sector (this is equivalent to

² 11% coupon, issued on July 24 2005, expires on July 24 2020.
³ 10% coupon, issued on July 24 2008, expires on July 24 2024.

a 1.8% primary surplus), and with a 2.3% fiscal deficit in the Central Government (which means a 0.3% primary surplus), just in line with the Fiscal Rule.

However, after the violent social unrest all around the country (see below) the **President yielded into US\$ 1.7 billion of additional expenditure (probably distortive subsidies and policies) earmarked at the Ag sector.**

The Finance Minister is planning to **finance this additional volume of fiscal expenditure with a one year delay in the phasing – out of the financial transaction tax.**

Whether this goes through or not in Congress is something that will necessarily **impact the fiscal stance of the Colombian economy and, thereby, prices in the TES market.**

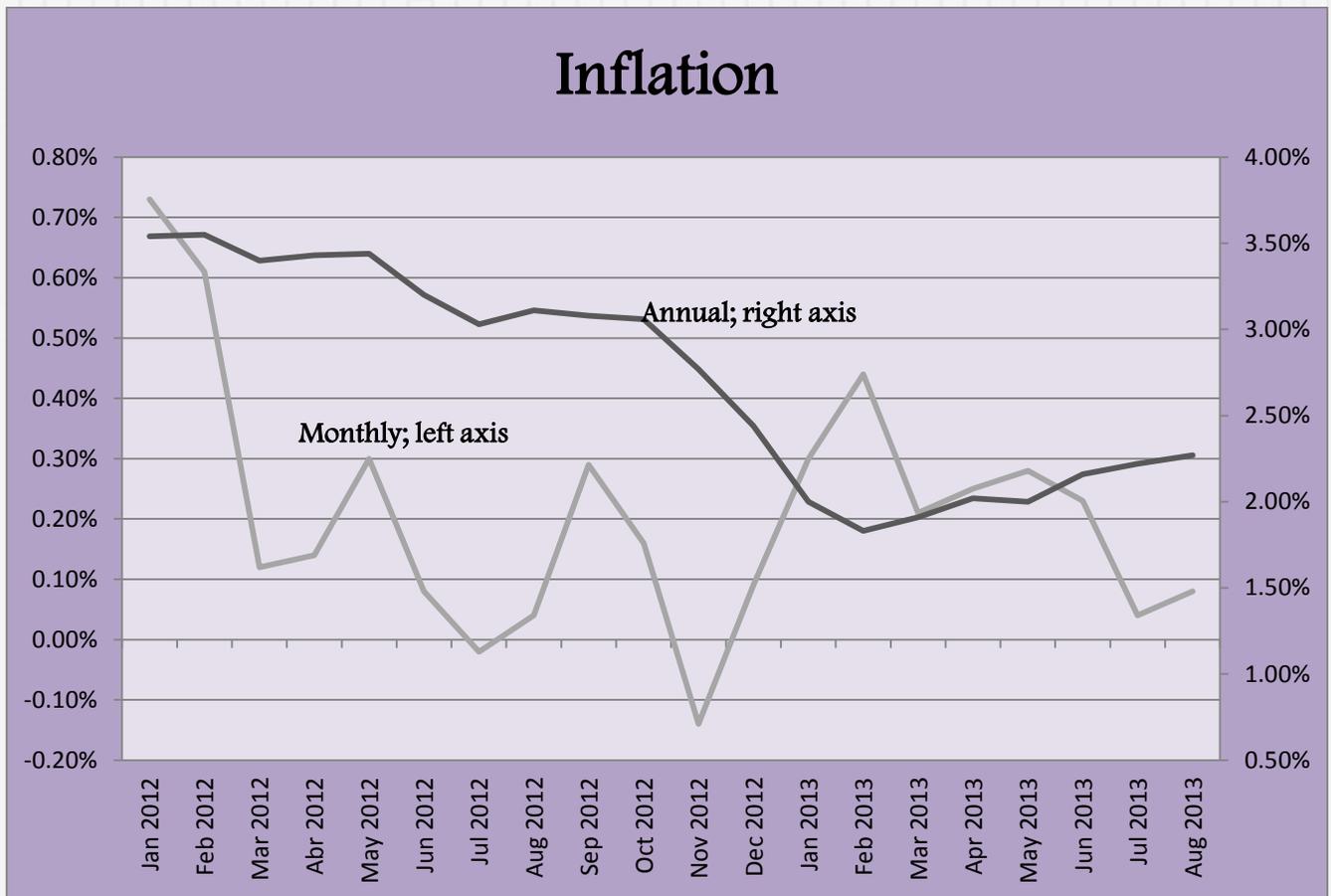
Inflation Rate

On Thursday September 5 DANE revealed inflation during August 2013: 0.08% (vs. 0.04% on Aug 2012).

This means:

- i) Cumulated inflation (Jan – Aug) stands at 1.86% (compared to 2.03% during Jan – Aug 2012).
- ii) Annual inflation (Sep/2012 – Aug/2013) is at 2.27% (compared to 3.11% during Sep/2011 – Aug/2012).

Once again, **consumer price data exhibits satisfactory macro/monetary stability for investment purposes.**



Once again, **consumer price data exhibits satisfactory macro/monetary stability for investment purposes.**

Yet, it is also **revealing aggregate demand weakening.**

OUTPUT PERFORMANCE

Recent relevant data:

- i) **Wednesday August 14 (ANM – Producción de Carbón):** Between January and June coal output plunged 13% in comparison to the same period last year: 40.5 million tons during Jan – Jun 2013 vs. 46.8 million tons during Jan – Jun 2012.

- ii) **Tuesday September 3 (DANE – Censo de Edificaciones)**: Area under construction increased a meager 0.8% during the second quarter of the year (QII2013 with respect to QII2012). New area under construction receded 2.5% during the same period. In contrast, and also during the same time lapse (QII2013 vs. QII2013), finished area increased 9.7%.
- iii) **Friday September 6 (MME – Producción Petróleo y Gas)**: Oil output augmented 13.2% during August yoy [1.031.000 bpd (Aug 2013) vs. 911.000 bpd (Aug 2012)]. It also grew 1.08% with respect to July 2013 (1.020.000 bpd).
- iv) **Friday September 6 (DANE – Exportaciones)**: Total exports dropped 6.6% (yoy) during July: \$US 4,650 million (Jul 2013) vs. \$US 4,977 million (Jul 2012). This result is explained by exports' plunge in coal (– 33.8%), gold (– 46.7%), machinery and transportation equipment (– 22.1%), flowers (– 31.8%) and live cattle (– 72.1%).

Now, cumulated exports declined 4.3% with respect to 2012: \$US 33,938 million (Jan – Jul 2013) vs. \$US35,452 million (Jan – Jul 2012). This contraction is attributable to a 5.8% drop in cumulated exports of the O&G and Mining sector: \$US 22,600 million (Jan – Jul 2013) vs. \$US 23,989 million (Jan – Jul 2012). This, in turn, has to do with a severe plunge (– 29.8%) in coal exports.

Not surprisingly, 12 – Month total exports reveal a 2.6% fall.

Finally, Jan – Jul exports to the U.S decreased 12.5% in relation to 2012 (due to a 14.4% contraction in fuel and mineral oil exports). The plummeting of exports to the U.S. explains 109% of the 4.3% drop in total exports during the first seven months of the year.

- v) **Tuesday September 10 (XM – ISA)**: During August energy demand grew yoy a dismal 2.0% (vs. 3.1% during August 2012). Year to date (Jan – Aug 2013) energy demand is growing at a 3.1% rate (vs. 3.7% during Jan – Aug 2012). Similarly, 12 – Month energy demand (Sep 2012 – Aug 2013) is growing at a 3.4% rate (almost identical to the 3.5% growth rate during the lapse Sep 2011 – Aug 2012).

On the other hand, during August non – regulated energy demand grew yoy 2.1% (and year to date 2.6%). It's important to note that energy demand in the manufacturing sector is dropping (– 0.3% yoy), and in the mining sector it's stagnant (0.9% yoy).

- vi) **Wednesday September 11 (DANE – Informe de Cartera Hipotecaria de Vivienda)**: 13.5% overall increase in the volume of mortgages and housing loans during QII2013 in relation to QII2012: 11.3% for subsidized housing and 14.5% for non – subsidized housing. Additionally, during the same period (and also in relation to QII2012) the number of mortgages and housing loans increased 4.8% (3.6% for subsidized housing and 1.3% for non – subsidized housing).

- vii) **Wednesday September 11 (Fedesarrollo – Encuesta de Opinión Del Consumidor)**: The Consumer Confidence Index plummeted to 13.4% during August, thus receding 11.7 percentage points (!!!) with respect to July (and 4.7 percentage points with respect to August 2012).

According to the think tank, the consumer confidence plunge occurred all over the country:

- Medellín: – 20.7 percentage points in relation to July 2013 and – 8.6 percentage points in relation to August 2012.

- Cali: – 17.0 percentage points in relation to July 2013 and – 0.6 percentage points in relation to August 2012.
- Bogotá – 7.8 percentage points in relation to July 2013 and – 1.4 percentage points in relation to August 2012.
- Barranquilla: +0.9 percentage points in relation to July 2013 and – 18.7 percentage points in relation to August 2012.

Additionally, there was also a severe drop in consumer confidence in all socio – economic segments:

- High: – 10.4 percentage points in relation to July 2013 and – 5.8 percentage points in relation to August 2012.
- Middle: – 12.6 percentage points in relation to July 2013 and – 4.2 percentage points in relation to August 2012.
- Low: – 9.3 percentage points in relation to July 2013 and – 4.7 percentage points in relation to August 2012.

viii) **Thursday September 12 (DANE – Grandes Almacenes e Hipermercados Minoristas GAHM)**: During QII2013 sales in Large Stores and Supermarkets grew 9.3% in real terms in relation to QII2012 (vs. 5.3% between QII2012 and QII2011). During the same period occupied personnel and inventories in these stores grew 5.9% and 13.0%, respectively (vs. 7.1% and 14.8% between QII2012 and QII2011).

ix) **Thursday September 12 (DANE – Vehicle Sales)**: During QII2013 vehicle sales (domestic and imported) receded 2.5% in real terms. This was the result of a 1.3% drop in the number of units sold (76,684 during QII2013 vs. 77,723 during QII2012).

x) **Friday September 13 (Banco de la República – Inversión Extranjera Directa)**: Cumulated (Jan – Aug) Foreign Direct Investment (FDI)

decreased 1.81%: \$US 11,541 million (2013) vs. \$US 11,754 million (2012). Similarly, 12 – month FDI receded 3.24%: \$US 16,471 (Sep 2012 – Aug 2013) vs. \$US 17,023 (Sep 2011 – Aug 2012).

- xi) **Friday September 13 (DANE – Estadísticas de Edificación de Licencias de Construcción ELIC)**: Construction licensed area dropped 5.1% yoy during July: 1.794.134 m² (July 2013) vs. 1.890.780 m² (July 2012). Licensed area both for housing and non – housing projects receded 3.4% and 9.9%, respectively. Now, licensed area for subsidized housing skyrocketed 42.4%, while licensed area for non – subsidized housing plunged 17.4%.

In contrast, year to date (Jan – July) there's an 18.6% increase in licensed area: 14.053.232 m² (Jan – July 2013) vs. 11.848.146 m² (Jan – July 2012). This behavior corresponds to a 16.2% and 26.0% increase in licensed area for housing and non – housing projects, respectively.

Correspondingly, 12 Month licensed area grew 7.4%: 23.419.970 m² (Aug 2012 – Jul 2013) vs. 21.802.397 m² (Aug 2011 – Jul 2012). This is the result of a 5.8% and 12.9% increase in licensed area for both housing and non – housing projects, respectively.

- xii) **Friday September 13 (FENALCO – Encuesta de Opinión)**: During August 30% of retail sales merchants observed a reduction in their yoy sales (vs. 24% during July). On the other hand, 37% of them observed an increase in their yoy sales (vs. 39% during July).

- xiii) **Tuesday September 17 (ANDI – Encuesta de Opinión Industrial Conjunta EOIC)**: Between January and July manufacturing output contracted 0.7%, while sales grew a dismal 0.9% (with a 0.7% sales growth rate in the domestic market). Additionally, 7 and 5 (out of 15) manufacturing subsectors exhibited output and sales drops, respectively, during the Jan – Jul 2013 period.

The report also indicates that during June installed capacity utilization reached 77.5% (slightly above the historic average of 76.4%).

Finally, perception of business environment did not improve among manufacturers during July of this year: 52.9% considered business environment to be good (vs. 56.8% during June and 66.1% one year ago), while only 36.7% expect it to improve (vs. 44.3% during June).

xiv) **Thursday September 19 (DANE – Cuentas Nacionales Trimestrales):**

During QII2013 real GDP increased 4.2% in relation to QII2012.

Sectors with the highest quarterly growth rates were:

- Ag (7.6%).
- Construction (6.4%).
- Social, community and personal services (4.7%).
- Electricity, gas and water (4.7%).
- Mining (4.3%).
- Retail, repair, restaurant and hotel services (4.1%).

Sectors with the lowest GDP growth rates were:

- Manufacturing (1.2%).
- Transportation, storage and communication services (2.8%).
- Financial (3.9%).

Demand wise quarterly GDP performance was as follows: final consumption (4.6%), investment (2.9%) and exports (7.6%). In contrast, Imports just grew 1.3%.

Note that QII2013 GDP growth is significantly explained by the AG output growth datum. However, the latter is not a reflection of some sort of recovery in AG output, but rather a simple statistical

rebound in coffee data (32.4%) after the sharp contraction of previous periods.

Additionally, output in some activities different than non – coffee Ag behaved dismally and, in some cases, even contracted sharply. For instance, in the mining sector coal and gold output plunged 5.5% and 10.3%, respectively. For its part, in the manufacturing sector the following activities exhibited severe output drops: Printing/editing (– 9.1%), Transportation equipment (– 7.9%), Paper and cardboard (– 5.6%), Leather and shoes (– 5.5%), Basic metallurgic products (– 4.4%).

xv) **Friday September 20 (DANE – Muestra Mensual Manufacturera):**

Manufacturing output increased 0.2% (yoy, in real terms) during July. Furthermore, 25 subsectors (out of 48) exhibited output contractions. The sharpest drops occurred in the following subsectors: precious non – ferrous metals (– 27.3%), vehicles (– 21.0%), and apparel (– 11.1%). Not surprisingly (and during the same month) sales in the aggregate manufacturing sector increased only 1.3% (yoy), while occupied personnel receded 2.7% (yoy).

Year to date (Jan – Jul) real manufacturing output contracted 2.9%. Particularly, 36 (of the 48) subsectors exhibited production drops. The sharpest drops occurred in: vehicles (–16.3%), apparel (– 9.8%), iron and steel (– 9.3%), paper and cardboard products (– 8.3%), sugar refining (– 6.5%), and non – metal minerals (– 4.9%). Therefore, year to date manufacturing jobs and sales receded 2.0% and 2.3%, respectively.

12 – Month (Aug 2012 – Jul 2013) manufacturing output receded 2.4% in real terms. During this time lapse occupied personnel in the sector and sales declined 1.1% and 1.9%, respectively.

xvi) **Friday September 20 (DANE – Muestra Mensual Comercio al Por Menor):** 5.4% yoy real increase in retail sales during July. If vehicle

sales are excluded, the July 2013 retail sales yoy real growth rate falls to 3.2%. Additionally, jobs in the retail sales sector exhibited a 3.8% yoy increase during July 2013 (vs. 5.7% during Jul 2012).

Year to date (Jan – July) retail sales only grew 3.4% in real terms (4.3% excluding vehicle sales). Additionally, year to date jobs in the retail sector augmented 4.3% (vs. 6.6% during Jul 2012).

Now, 12 – Month (Aug 2012 – Jul 2013) retail sales grew in real terms 3.0% (3.8% excluding vehicle sales). During this time lapse occupied personnel in the sector increased 4.5% (vs. 6.7% during Jul 2012).

- xvii) **Monday September 23 (DANE – Importaciones)**: 1.6% yoy fall in imports during July 2013: \$US 5,112 million (July 2013) vs. \$US 5,194 million (July 2012). During the Jan – July period imports receded 1.1%: \$US 33,958 million (Jan – Jul 2013) vs. \$US 34,319 million (Jan – Jul 2012).

On the other hand, the Colombian economy exhibited a \$US 1,589 million trade surplus during the first seven months of 2013. The highest surpluses were with the U.S. (\$US 2,502 million), Panamá (\$US 1,875 million) and Holland (\$US 1,143 million). The highest deficits were with China (\$US 2,672 million) and Mexico (\$US 2,540 million).

- xviii) **Thursday September 27 (Fedesarrollo – Encuesta de Opinión Empresarial EOE/Industrial)**: During August 2013 the Manufacturing Confidence Index receded 4.5 percentage points yoy: – 1.8% (Aug 2013) vs. +2.7% (Aug 2012). It's also significantly below the Index's levels during August 2011 (10.1%) and August 2010 (8.0%). In any case, the Index increased 0.2 percentage points in relation to July 2013 (– 2.0%).

Three different factors underlie the construction of the index: current sales perception, inventory levels perception and output expectations (for the next quarter). Even though all three factors account for the undergoing drop in the Index, the perception of current sales exhibits the strongest deterioration of all three (9.5 percentage points yoy).

During August installed capacity utilization stood at 69.3% (vs. 70.9% during Aug 2012).

- xix) **Thursday September 27 (Fedesarrollo – Encuesta de Opinión Empresarial EOE/Comercial)**: During August 2013 the Retail Sales Sector Confidence Index plummeted 9.6 percentage points yoy: 12.0% (Aug 2013) vs. 21.6% (Aug 2012). Furthermore, the datum is the lowest one for this month since 2008 and receded 9.8 percentage points in relation to July 2013 (21.8%).

The index is constructed upon three variables: perception of current business (economic) conditions, perception of inventory levels and expectations of business conditions (for the next quarter). All of them account for the plunge (both yoy and vs. Jul 2013) in the Index level. Yet, the deterioration in expectations of business conditions for the next quarter was especially strong.

- xx) **Monday September 30 (DANE – Gran Encuesta Integrada de Hogares GEIH)**: During August 2013 the overall unemployment rate dropped to 9.3 (vs. 9.7% during August 2012). In the 13 major cities unemployment during August 2013 was 10.3% (vs. 10.5% during August 2012).

The sectors that are adding jobs to the economy are: i) Retail sales, restaurants and hotels, ii) Community, social and personal services, iii) Real state, and iv) Construction. Those sectors destroying jobs are: i) Ag, ii) Manufacturing and iii) Transportation, storage and communications.

DATA SUMMARY

Except for the ER market, the asset price plunge of the Colombian economy seems to have stopped.

Naturally, the asset price recovery will **strengthen domestic demand (through the natural wealth effect)**.

In any case, the **Colombian economy is still weak and stagnant**.

In terms of domestic demand: **consumer confidence has plummeted** (in all socio – economic segments and in all regions of the country), **imports are receding, growth in retail sales is still meager, and expectations of retail sellers are totally pessimistic**.

In terms of external demand, **exports have contracted severely and FDI is decreasing**.

On the supply side, **manufacturing output keeps on plunging, output in some mining sectors (like coal and gold) is stagnant, non – regulated energy demand exhibits weak dynamics (especially in the manufacturing and mining sectors), and expectations of manufacturers are gloomy**.

In contrast, the **construction sector is on the way to recovery**.

Paradoxically, **QII2013 GDP growth significantly exceeded all forecasts. However, such behavior is significantly explained by the AG output growth datum, which is not a reflection of recovery in AG activities, but rather a simple statistical rebound in coffee data (32.4%) after the sharp contraction of previous periods**.

UNDER OUR WATCH

O&G: On Thursday July 11 the President of the Colombian Petroleum Association highlighted the **adverse impact over oil production of the escalation of terrorist attacks** in the states of Arauca, Norte de Santander and Putumayo. He also complained of 14 – month delays in the process of obtaining licenses for O&G exploitation.

Mining I: On Wednesday July 24 **Braeval Mining Corporation⁴ announced its departure from Colombia.** The decision was linked to the kidnapping⁵ and later (Aug 28) release of Canadian geologist Jernoc Wobert⁶. After Wobert's release President Santos congratulated the terrorists and announced the imminent initiation of peace talks with ELN.

In sum: terrorists kidnap a foreign citizen; the terrorists condition his release to FDI destruction; once pleased, the terrorists release the victim; next, the President congratulates them and compensates them with peace – talks.

This is a **big triumph for ELN terrorists and an enormous setback for business environment in Colombia.**

Mining II: The **General Comptroller (GC)** seized BHP Billiton's⁷ Cerro Matoso⁸ bank accounts arguing the company owes the government 61 billion COP (approximately \$US 31.2 million) of unpaid royalties between 1998 and 2003.

⁴ Canadian capital with gold exploration and development projects in Colombia, México and Perú.

⁵ On Thursday July 25 ELN issued a press release celebrating the company's decision and announcing that the hostage would soon be released.

⁶ Recall that, on January 18, ELN terrorists kidnapped the Canadian and two Peruvian nationals (together with three Colombians) working for the company in the municipality of Norosí (south of the state of Bolívar). The Peruvians and Colombians were liberated on February 12. ELN conditioned the release of Wobert to Braeval's resignation to its mining entitlements in Mina Seca (1,527 hectares), La Nevera (880 hectares), Casa de Barro (200 hectares) and Las Nieves (36 hectares).

⁷ Australian and British capital.

⁸ BHP Billiton's production of iron, nickel and ferronickel in the state of Córdoba.

No one questions the GC's job of protecting the treasury. However, **seizing assets arbitrarily and violating every due legal process**, as seems to be the case (once again), is not only an outrage against people's rights (when perpetrated against an individual), but also a **protuberant regression for business environment** (especially when perpetrated against an international company that has been operating during decades in the country).

In any case, expect even more hostility from the GC against BHP Billiton. Recall that on May 7, the GC issued a press release arguing that the extension of the concession contract between the government and Cerro Matoso is not legal and hurts the treasury's interests.

Mining III: On Sunday July 28 the citizens of the municipality of Piedras (state of Tolima) voted against Anglo Gold Ashanti's operation. It was a **legitimate political process** (though preceded by hostility and ideological persecution against the company by local authorities). However, it has set a **precedent against business environment in the Mining sector in Colombia**: ¿how will the company's property rights and entitlements going to be protected or compensated by the State?

Mining IV: On Thursday August 15 the President of the Chamber of Large Mining Companies warned of a recession in the sector during this year. She also revealed that **large mining companies have reduced in 42% the volume of resources that they originally planned to invest in Colombia during the next 5 years**. Moreover, during the first semester mining exports dropped 22.4%.

She also complained about contradictory signals coming from the State: while the national government proclaims the mining sector as one of its engines (or locomotives), **local governments, environmental authorities and the General Comptroller are determined to stop mining activities**.

Social Unrest I: During August **protests (many of them violent) became the daily ration in many regions of Colombia. Even worse, the situation was handled with clumsiness by the President and his Ministers.** For example, the contempt with which the government initially underestimated the unrest ignited fierce reactions from protesters all over the country.

Due to this clumsiness and lack of leadership from the government, what began as an isolated protest in several Ag subsectors turned into a violent upheaval in several regions (road blocks, clashes with the Police, scarcity of food and medical supplies, suspension of activities in schools and universities, etc.), with active participation from farmers, miners, truck drivers, teachers, students, labor unions, political opposition, etc. At this point (end of September) several regions (like Caquetá) are still undergoing violent protests.

Protestors have demanded the suspension of FTA's (especially the ones with U.S., Canada and Europe), price controls in fertilizers and fuel, (still) more distortive subsidies (especially for Ag), taxes on banks, etc.

Two considerations:

First, this was going to happen sooner or later due to the perverse incentives created by the government by pleasing FARC terrorists with peace talks in Cuba. In fact, **what is to be expected from ordinary citizens when their government shows the world that violent insurrection pays off?**

Second, **don't be surprised if the President ends up yielding to populist (and business environment eroding) measures and policies.**

Sudden Stop Risk: On Friday September 20 The Economist published its Capital – Freeze Index ranking the Colombian economy as the **fifth one with higher risk of going through a sudden stop of capital inflows** among emerging markets (and with 65% of the highest possible risk).

Lack of Leadership: The **President's popularity has plunged dramatically.** This is attributable to four phenomena:

1. Lack of communication and contact with ordinary citizens.
2. Clumsy behavior of social unrest (see above).
3. Citizen rejection of impunity and no – jail scenarios being discussed with FARC terrorists in Cuba.
4. Erratic and weak response to Nicaragua's expansionist ambitions with Colombian seawaters.

Physical Security:

- i) **Friday July 5:** FARC terrorists (belonging to “*Frente 36*”) installed an explosive artifact in a baby care center in the municipality of Anorí (state of Antioquia). The Police deactivated it.
- ii) **Friday July 5:** At 3:05 pm ELN terrorists (belonging to “*Frente Domingo Laín*”) blew up the Caño Limón – Coveñas Oil Pipeline⁹ in the municipality of Saravena (state of Arauca, frontier with Venezuela). The attack caused a fire and an oil spill that affected the settlement of Miramar.
- iii) **Saturday July 6:** FARC terrorists blew up the Transandino Oil Pipeline¹⁰ in the settlement of San Juan (municipality of Ipiales, state of Nariño, frontier with Ecuador). The attack caused a fire. This year there have been 5 terrorist attacks against this pipeline.

⁹ 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.

¹⁰ 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.

- iv) **Saturday July 6:** FARC terrorists (belonging to “*Columna Móvil Jacobo Arenas*”) detonated an explosive artifact against a Police patrol in the settlement of San Pedro (municipality of Santander de Quilichao, state of Cauca). 17 persons were injured (7 Policemen and 10 civilians).
- v) **Sunday July 7:** FARC terrorists attacked with assault rifles a group headed by Congressman Constantino Rodríguez (President of the Accusations Commission in the House of Representatives). The attack occurred in the settlement of Boquerón (municipality of San José del Guaviare, state of Guaviare).
- vi) **Monday July 8:** FARC and ELN terrorists (belonging to FARC's “*Frente 28*” and ELN's “*Columna José David Suárez*”) attacked during 3 hours the Police Station in the municipality of Paya (state of Boyacá). This is the second attack against this place during 2013.
- vii) **Friday July 12:** The kidnapping of a Spanish citizen on June 5 was confirmed. According to intelligence sources, the kidnapping took place in the municipality of Santander de Quilichao (state of Cauca), and the raptors belong to a criminal band known as “*Rastrojos*” operating jointly with FARC's “*Columna Móvil Jacobo Arenas*”. 1 million Euros are being demanded as ransom.
- viii) **Monday July 15:** The Army revealed that FARC terrorists are now holding as hostage an engineer who had been kidnapped by ELN terrorists one year ago in the municipality of Amalfi (state of Antioquia), while working for a Chilean forestry company. According to the Army's 4th Brigade Commander, FARC and ELN terrorists are not only trading weapons, but also their victims.

- ix) **Tuesday July 16:** At 9 a.m. FARC terrorists (belonging to “*Frente 29*”) attacked with the assault rifles the municipality of Timbiquí (state of Cauca). The attack was repealed by the Navy’s Infantry, but two civilians were injured.
- x) **Wednesday July 17:** FARC terrorists used a “*dog – bomb*” (dog with explosives attached to it) to attack the Police Station in the municipality of El Charco (state of Nariño). Two civilians were severely injured and several houses were also affected.
- xi) **Thursday July 18:** FARC terrorists attacked with assault rifles and explosives the Police Station in the municipality of Ancuya (state of Nariño). Three policemen were wounded.
- xii) **Thursday July 18:** FARC terrorists attacked the municipality of Roberto Payán (state of Nariño). Two policemen were injured.
- xiii) **Friday July 19:** FARC terrorists revealed that on June 20 they kidnapped an American citizen in the municipality of El Retorno (state of Guaviare). They offered to set him free as a peace gesture amid talks with the government.
- xiv) **Saturday July 20:** In combats between the Army (12th Brigade) and FARC units (belonging to “*Columna Móvil Teófilo Forero*”) that took place in the municipality of El Doncello (state of Caquetá), 4 soldiers were killed (3 were injured), while 6 terrorists were shot down (3 were wounded). The terrorists were attempting an attack against the Police Station.
- xv) **Saturday July 20:** At 12:30 pm FARC terrorists ambushed and assassinated 2 non – commissioned officers and 13 professional soldiers (belonging to the 18th Brigade) in the municipality of Fortul (state of Arauca).

- xvi) **Monday July 22:** FARC terrorists ambushed and attacked a Police patrol in the rural area of the municipality of Policarpa (state of Nariño). As a result 2 policemen were injured.
- xvii) **Thursday July 25:** ELN terrorists (belonging to “*Frente Manuel Hernández*”) intercepted several vehicles along the road that connects Medellín (capital city of the state of Antioquia) and Quibdó (capital city of the state of Chocó). The Army reacted cutting off the terrorists and impeding the vehicle theft. However, two soldiers were wounded with an explosive artifact launched by the terrorists.
- xviii) **Thursday July 25:** FARC terrorists (belonging to “*Frente 36*”) assassinated 3 soldiers and wounded another one in combats that took place in the rural area of the municipality of Anorí.
- xix) **Friday July 26:** FARC terrorists (belonging to “*Columna Móvil Daniel Aldana*”) attacked with explosives an Army patrol in the settlement of El Playón (municipality of Tumaco, state of Nariño). One soldier died. One lieutenant, one corporal and two other soldiers were injured.
- xx) **Monday July 29:** FARC terrorists (belonging to “*Frente 33*”) blew up the Caño Limón – Coveñas Oil Pipeline in the settlement of El Consuelo (municipality of Saravena). The attack caused an oil spill that forced a pumping halt.
- xxi) **Tuesday July 30:** FARC terrorists assassinated a soldier in the Tumaco airport using an explosive artifact hidden in a package that was being inspected by him.

- xxii) **Monday August 5:** The Police confiscated (and deactivated) in Bogotá a heavy load of explosives that was going to be used by FARC terrorists to extort several businesses in the city.
- xxiii) **Thursday August 8:** FARC terrorists assassinated a lieutenant of Ecuador's Army in the province of Sucumbíos (frontier with Colombia).
- xxiv) **Sunday August 11:** FARC terrorists (belonging to "Frente 48") attacked (with explosives and assault rifles) the Police Station in the settlement of El Placer (municipality of La Hormiga, state of Putumayo, frontier with Ecuador). As a result, one policeman was assassinated and a 13 – year old boy was fatally wounded. This is the second attack this year against this Police Station.
- xxv) **Friday August 16:** Explosions and assault rifle firing in the settlement of Esmeralda (municipality of Caldono, state of Cauca). Civilians had to take shelter in their own homes.
- xxvi) **Saturday August 17:** FARC terrorists (belonging to "Frente 21") burned a civilian bus in the road that connects the municipalities of Rovira and Roncesvalles (state of Tolima).
- xxvii) **Tuesday August 20:** FARC terrorists (belonging to "Frente 34") assassinated one Army corporal during combats in a region between the municipalities of Andes and Urrao (state of Antioquia).
- xxviii) **Tuesday August 20:** Army personnel deactivated two explosive artifacts installed by FARC terrorists (belonging to "Frente 34") along the road that links the municipalities of Rovira and Roncesvalles.

- xxix) **Saturday August 24**: At 2:00 am FARC terrorists assassinated 2 soldiers (5 others were wounded) after a surprise attack to a military base in the municipality of Totoró (state of Cauca).
- xxx) **Saturday August 24**: FARC terrorists (belonging to “*Columna Móvil Alfonso Castellanos*”) attacked and assassinated (with explosives and assault rifles) one Sergeant, one Corporal and 12 soldiers in the rural area of the municipality of Tame (state of Arauca, frontier with Venezuela).
- xxxi) **Thursday August 29**: FARC terrorists kidnapped one Army Corporal and one civilian in the municipality of Palmira (state of Valle).
- xxxii) **Saturday September 7**: One policeman who had been kidnapped in the municipality of Saravena was found shot dead in the settlement of Barrancones (along the road that connects Saravena and Fortul). The Police commander attributed the kidnapping and brutal assassination to ELN terrorists.
- xxxiii) **Sunday September 8**: The Army Corporal and the civilian who had been kidnapped by FARC terrorists on August 29 were found dead in a rural area of the municipality of Palmira (state of Valle). The Legal Medicine Institute reported that their deaths were caused by violent traumatismos in head, throat and thorax.
- xxxiv) **Tuesday September 10**: 3 employees of Termo Técnica (contractor of the oil pipeline known as Bicentenario de Colombia¹¹) were kidnapped in Saravena apparently by ELN terrorists.

¹¹ This pipeline, 975 kms long between Araguaey (state of Casanare) and Coveñas (state of Sucre) is still under construction and belongs to Ecopetrol and other partners. The pipeline is supposed to have a capacity of 600k bpd between Araguaey and Banadía (state of Arauca), and of 450k bpd between Banadía and Coveñas.

- xxxv) **Tuesday September 17:** Army personnel neutralized terrorist actions in the municipalities of El Castillo (state of Meta), Puerto Asís and Orito (state of Putumayo), attributable to FARC's "*Frente 53 – José Antonio Anzoátegui –*" and "*Frente 48 – Pedro Martínez –*", respectively.
- xxxvi) **Tuesday September 17:** FARC terrorists (belonging to "*Frente 36*") assassinated a 17 – year old in the municipality of Campamento (state of Antioquia). According to the Police, the minor's homicide was FARC's retaliation to his apparent responsibility in the assassination of a 22 – year old teacher in the municipality of Guadalupe (also state of Antioquia).
- xxxvii) **Friday September 20:** FARC terrorists attacked with explosives and assault rifles the Police station in the municipality of Toribío (state of Cauca). One policeman was severely injured.
- xxxviii) **Monday September 23:** FARC terrorists (belonging to "*Frente 29*") attacked an Army patrol in the municipality of Policarpa. Two civilians and two terrorists were killed.
- xxxix) **Tuesday September 24:** Army personnel ("*Fuerza de Tarea Omega*") killed 9 FARC terrorists (belonging to "*Columna Móvil Teófilo Forero*") in the settlement of Brisas de Losada (municipality of San Vicente del Caguán, state of Caquetá).
- xl) **Wednesday September 25:** Army personnel (3rd Division) killed 3 FARC terrorists (belonging to "*Columna Daniel Aldana*") in the settlement of Palai (municipality of Tumaco).
- xli) **Thursday September 26:** ELN terrorists blew up the Caño Limón – Coveñas Oil Pipeline in the settlement of San Bernardo de Bata

(municipality of Toledo, state of Norte de Santander). The oil spill in the Margua River caused a severe environmental damage.

- xliv) **Thursday September 26**: One soldier died (and another was wounded) during combats between Army personnel and FARC terrorists (belonging to “*Columna Jacobo Arenas*”) in the municipality of Sucre (state of Cauca).
- xlvi) **Thursday September 26**: One cattle breeder was kidnapped in the rural area of Florencia (capital city of the state of Caquetá).
- xlvii) **Friday September 27**: Farmers and peasants in the municipalities of San Jacinto and Carmen de Bolívar (Montes de María region, state of Bolívar) denounced that insecurity and cattle theft has skyrocketed in the area.
- xlviii) **Sunday September 29**: FARC terrorists (belonging to “*Frente 36*”) detonated an explosive artifact in the town square of the municipality of Anorí (state of Antioquia). One policeman was injured.
- xlvi) **Monday September 30**: Two soldiers died (and two were injured) during combats between Army troops and FARC terrorists (belonging to “*Frente Libardo Rojas*”) in the municipality of Rioblanco (state of Tolima).
- xlvii) **Monday September 30**: One soldier died (and two were injured) during combats between Army troops (17th Brigade) and the terrorist band known as “*Urabeños*” in the municipality of Turbo (Urabá region, state of Antioquia).
- xlvi) **Dismal Statistics I**: Centro de Seguridad y Democracia (CSD – Universidad Sergio Arboleda) revealed that homicides in

Colombia increased 7% during the first semester of this year (6,918 in 2012 vs. 7,380 in 2013). This is the first time in 7 years that the homicide rate during the first semester exhibits a trend reversal in Colombia (32.3 homicides per 100,000 habitants in 2012 vs. 34.4 homicides per 100,000 habitants in 2013).

CSD also informed that the states with the highest homicide rates during the first semester of 2013 were: Guaviare (90 per 100,000 habitants), Valle (82 per 100,000 habitants), Caquetá (65 per 100,000 habitants), Arauca (55 per 100,000 habitants), Putumayo (55 per 100,000 habitants), Antioquia (47 per 100,000 habitants) and Quindío (47 per 100,000 habitants).

- xlix) **Dismal Statistics II:** According to United Nations 80% of entrepreneurs, businessmen and merchants suffer extortion (from FARC and criminal bands) in the municipality of Tumaco.

Thus, it is not fortuitous that Chocolate Luker closed down its business in Tumaco during July. This firm, which used to buy cocoa from farmers nearby, no longer operates in that region due to the numerous extortions it was suffering. The same thing happened with Cordeagropaz, which used to provide technical assistance to farmers in the surrounding area.

- l) **Dismal Statistics III:** It's been 3 years since the government allocated more than \$US 8 million to an electrical plant in the municipality of Solano (state of Caquetá). Since then, the works have been suspended due to threats and attacks from FARC terrorists ("*Frente 15*") who argue that, even though the project will provide electricity to more than 1,100 civilian families in town, it will also benefit a nearby military base ("*Tres Esquinas*").
- li) **Dismal Statistics IV:** Centro de Seguridad y Democracia (CSD – Universidad Sergio Arboleda) revealed a strong deterioration in

security conditions in 27 Colombian cities with populations above 200.000. This is due to an increase in homicides, personal injuries and theft.

- lii) **Dismal Statistics V:** Centro de Seguridad y Democracia (CSD – Universidad Sergio Arboleda) showed that, despite the Feb 2012 public commitment by FARC to stop kidnapping, during that year (2012) the terrorist group kidnapped 20 persons; even worse, during the first semester of 2013 FARC terrorists kidnapped 21 persons (a 75% increase in relation to the first semester of 2012). These kidnappings took place in the states of Arauca, Valle, Cauca, Huila, Tolima, Putumayo and Meta.

According to CSD, between 2009 and the first semester of 2013 FARC terrorists kidnapped 227 persons in Colombia (with special concentration in the states of Arauca, Cauca, Meta, Huila and Putumayo).

- liii) **Dismal Statistics VI:** According to one FARC member who turned into the Army, this terrorist group forcefully recruited 30 indigenous persons in the Amazon region between Colombia and Brazil.

Our assessment: The August 24th assassination by FARC terrorists of 14 Army members in Tame is not only an awful déjà vu of the July 20th Fortul massacre (15 Army members dead), but also a cruel example of how FARC seeks to enhance people's perception of their military strength, in the middle of peace negotiations with the government.

Additionally, note that ELN's escalation of its terrorist acts and kidnappings, was a successful strategy to induce the government into peace talks.

Thus, at this point **the government cannot keep on claiming that the deterioration of safety and security conditions in several regions of the country** (frontier states and traditional strongholds of FARC – Cauca and

some regions of Antioquia and Tolima –) **is a mere perception in the mind of citizens as a result of political opposition. Facts don't lie.**