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By Andrea Jaramillo

March 8 (Bloomberg) -- Lured to Colombia with the promise of peso-juiced bond returns, some of the world's biggest debt investors are now facing losses as the government moves to weaken its currency.

While yields on Colombia's $9.3 billion in peso bonds due 2024 have dropped 0.79 percentage point since the government cut taxes on foreigners' bond profits by half at the start of the year, the country's local debt has left investors who didn't hedge against currency declines with a 1.2 percent loss in dollars. That's the biggest drop in emerging markets after Poland and Peru and compares with an average 0.4 percent return for local-currency debt in developing nations, according to JPMorgan Chase & Co.

The peso has fallen 2 percent this year as Colombia bought dollars and cut overseas debt sales after the biggest emerging-market currency gain since 2009 made coffee, flower and banana exports less competitive and lifted the jobless rate to 13.1 percent, the highest in Latin America. The peso touched a 17-month high on Jan. 2 after Colombia cut the tax to push down yields. Bill Gross's Pacific Investment Management Co. and State Street are the biggest foreign holders of 2024 peso debt, according to data compiled by Bloomberg.

'Punishing Them'

"You are encouraging investors to come in on the one hand and on the other hand you are punishing them with the depreciation of the exchange rate," Bret Rosen, a Latin America strategist at Standard Chartered Bank, said in a telephone interview from New York. "Colombia has had a battle with the strong currency for a while and so there is always the risk of a forced depreciation of the peso as the one we're seeing."

Mark Porterfield, a spokesman for Newport Beach, California-based Pimco, didn't reply to phone and e-mailed messages seeking comment. The world's biggest bond fund manager held $11.2 million of the notes due 2024 as of Dec. 31. Elizabeth Bartlett, a press official at State Street declined to comment. The Finance Ministry didn't respond to telephone and e-mail messages seeking comment.

Finance Minister Mauricio Cardenas said Feb. 13 the nation will reduce international debt offerings by 38 percent to $1.6 billion this year and asked state-oil company Ecopetrol SA to raise 80 percent of its financing locally, the latest steps to stem a flood of dollars into the Andean country.

Dollar Buying

The central bank said Jan. 28 it will buy at least $30 million a day, bringing purchases in the foreign-exchange market to $3 billion between February and May.

Cardenas has also said that Colombia will buy $1 billion of U.S. currency to pay for interest and principal on foreign bonds coming due this year, in addition to the $1 billion it will purchase for its oil-stability fund.

Starting this year, Colombia lowered the tax on foreign investors' bond profits to 14 percent from 33 percent in 2012. Foreigners held 3.8 percent of government peso notes as of January.

The peso has surged 13.5 percent since the end of 2009, the best performance among 25 emerging-market currencies tracked by Bloomberg.

Last year's 9.7 percent gain was the biggest among 170 currencies tracked by Bloomberg apart from the Polish zloty and Hungarian forint as the country received a record $16.7 billion in foreign direct investment. The currency rally helped boost returns on the local bonds to 22 percent in dollar terms, compared with an average advance of 17 percent for developing-nation debt, according to JPMorgan.

'More Vocal'

Alejandro Urbina, who helps oversee $800 million in emerging-market assets at Silva Capital Management, said his fund sold its Colombian peso-linked bonds in mid-2012 because of the government's intervention in the currency market.

"That's exactly the reason why we aren't in Colombia at the moment," Urbina said in a telephone interview from Chicago. "Colombia has been one of the countries where the central bank has been more vocal about fighting appreciation and therefore to us it gives us the sense of too much risk existing in the local investment."

Investors can still profit from Colombian bonds by hedging against currency losses, according to Jaime Valdivia, the head of global emerging-market research at Bluecrest Capital Management, which holds $1.4 billion of emerging-market assets.

It costs investors about 3.4 percent a year to eliminate their currency risk by selling the peso in three-month non-deliverable forwards, according to data compiled by Bloomberg. On a hedged basis, Colombia's peso bonds have returned an average 0.3 percent so far this year.

'Very Well'

"If you give some credence to the Minister, you have to take your precautions and hedge against currency risk," Valdivia said in a telephone interview from New York. "Because we've done that, we've done very well."

The extra yield investors demand to own Colombian government dollar bonds instead of Treasuries narrowed one basis point, or 0.01 percentage point, to 126 basis points at 1:01 p.m. in New York. Yields on Colombia's dollar bonds due in July 2021 rose five basis points to 2.76 percent.

The cost to protect Colombian debt against non-payment for five years fell three basis point to 92 basis points, according to data compiled by Bloomberg. Credit-default swaps pay the buyer face value in exchange for the underlying securities or cash equivalent if the issuer fails to comply with debt agreements.

The peso rose 0.1 percent to 1,801.5 per dollar.

Blocked Roads

Growing pressure on the government to curb gains in the peso may prompt other investors to cut holdings of Colombia’s local-currency bonds, according to Silva Capital’s Urbina.

Coffee growers staged protests and blocked roads in the past two weeks, demanding greater government subsidies to compensate for losses from the stronger currency. Agriculture Minister Juan Camilo Restrepo asked yesterday that the central bank do more to ease the peso’s appreciation.

“We’ve liked the idea of Colombia from a macro perspective,” Urbina said. ‘We just don’t like this position the government has taken in terms of the peso. It’s hard to judge because understandably other countries in the region do the same but for us it stopped making sense given this limitation of gains from a currency perspective.’’