BTMU Focus Latin America

Colombia : macroeconomic performance

(2Q GDP and Current Monthly Indicators)

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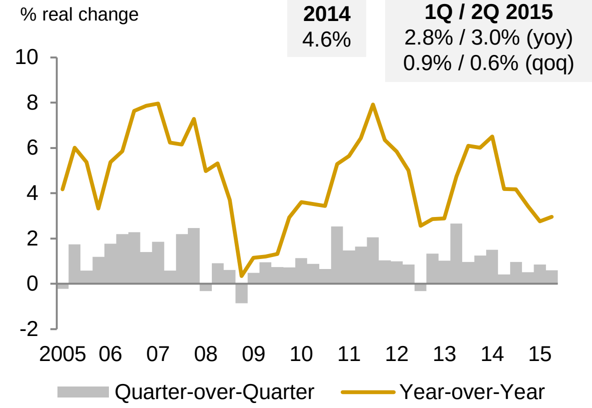
I) Colombia: Growth Momentum (1)

▪ Second-quarter result signals smooth adjustment to the collapse of oil prices, but caution is still required.

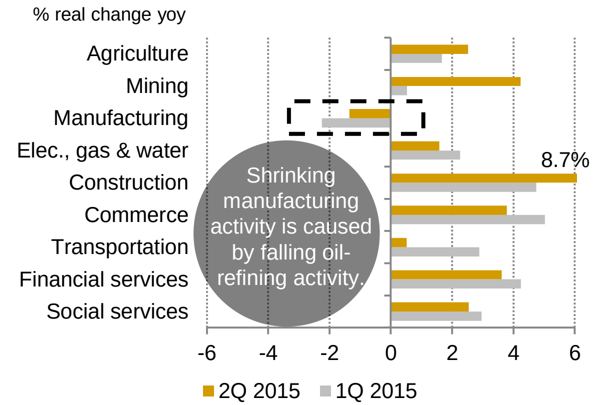
- The Colombian economy grew 3% yoy in 2Q 2015, a similar pace as in the first quarter. This result, albeit pale compared to last year's pace of growth, is arguably positive as it signals that the economy is adjusting smoothly to the slump in oil prices and a weaker external demand. Still, caution is required as the adjustments are far from over. For instance, import volume dropped abruptly by 1.8% yoy in 2Q, after growing by more than 8% in the first quarter. This sudden shift possibly suggests that the peso's depreciation (fueled by the fall in world oil prices) is starting to hurt firms and households by raising import costs. And judging by how imports of durable goods (-16.7%) and capital goods (-19.6%) plunged yoy in 2Q, that is probably the case. True, the decline in imports was a needed adjustment as it helped enhance the country's widening current-account deficit and boosted net exports. But on the flip side of the equation, it led to a feebler domestic demand as well: the rate of growth in household consumption and gross fixed capital formation (GFCF) continued to slow in 2Q.

Figure 1: GDP Growth



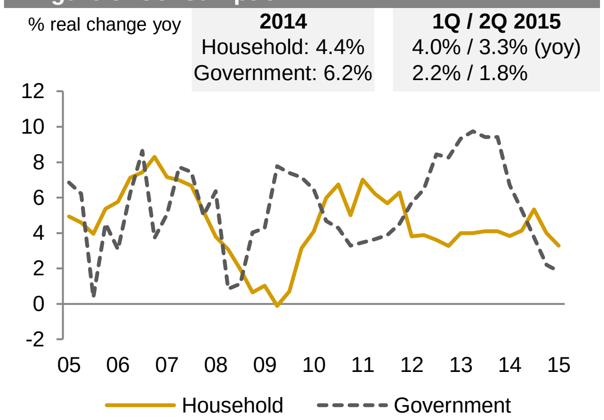
Source: Departamento Administrativo Nacional de Estadistica (DANE); BTMU

Figure 2: GDP by Sector



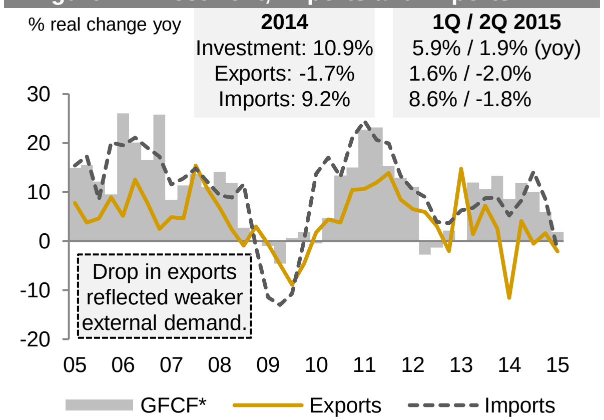
Source: DANE; BTMU

Figure 3: Consumption



Source: DANE; BTMU

Figure 4: Investment, Exports and Imports



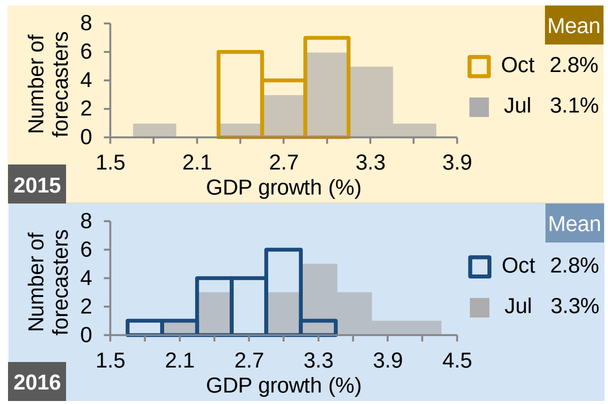
*Gross Fixed Capital Formation
Source: DANE; BTMU

I) Colombia: Growth Momentum (2)

- **Economic growth in Colombia is set to slow in 2015, but will likely stay as one of the fastest in Latin America.**

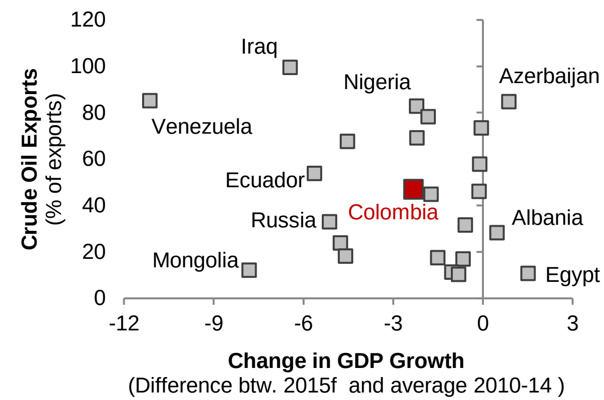
- Ever since international oil prices plummeted in late 2014, there was the question of how well Colombia, a country that has grown more and more reliant on oil exports, would adjust to that shock. So far, the data has painted a relatively positive picture: GDP grew at a 2.9% yoy pace in 1H 2015. Yes, this pace of growth looks tarnished next to last year's 4.6% rate; but avoiding a slowdown is probably too much to ask since commodity price fluctuations tend to dampen both actual and potential output, as the IMF argued in its latest World Economic Outlook. Also, from a wider view, Colombia's situation looks anything but daunting: it has fared reasonably well among major oil exporters, and has stayed as one of the fastest-growing economies in Latin America. Now, going forward, we see growth slowing to 2.5%-3.0% this year as the economy continues to adjust to lower oil prices. And though the renovated Reficar, the country's second-largest refinery, will boost manufacturing activity in 2016, growth will probably continue to slow a bit, inhibited by feebler consumption, and tight fiscal and monetary stance.

Figure 5: GDP Growth (Private forecasts)



Source: Consensus Economics; BTMU

Figure 6: Crude Oil Exports and GDP Growth

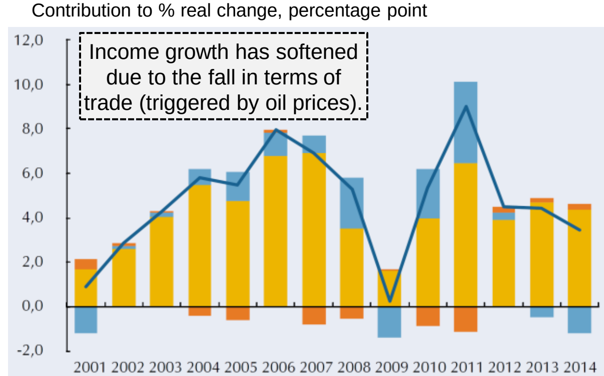


*Sample: all countries with crude oil exports as % of total exports >10%

Source: IMF, WEO, October 2015; UN Comtrade; BTMU

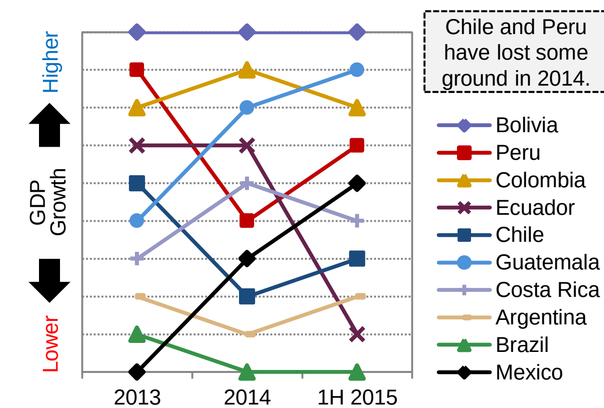
Figure 7: Gross National Disposable Income

Contribution to % real change, percentage point



Source: Central Bank of Colombia, Inflation Report (07/2015); BTMU

Figure 8: Ranking of GDP Growth



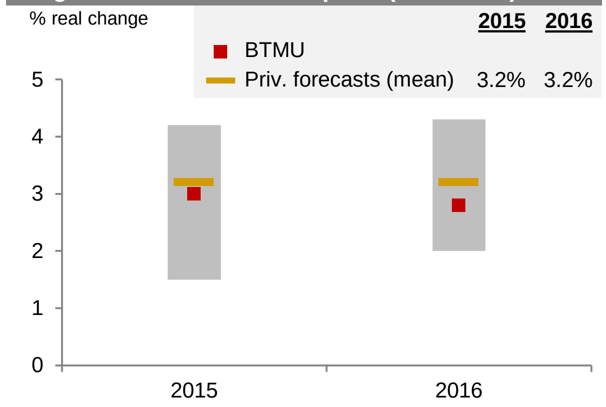
Source: Thomson Reuters Datastream; BTMU

I) Colombia: Growth Momentum (3)

- **Consumer spending will probably continue to decelerate in 2016, but it will remain growth-supportive.**

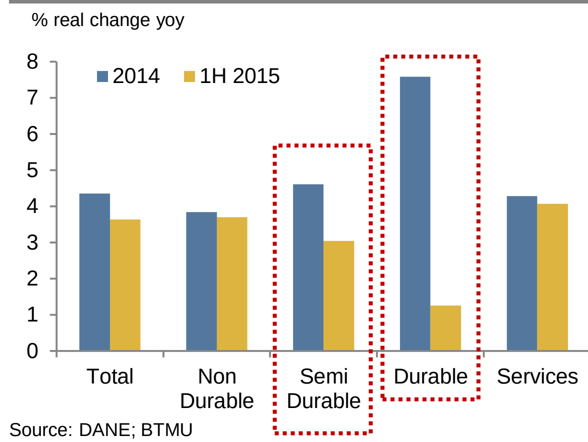
- Over the last 5 years, consumer spending growth in Colombia has been fairly stable and solid, contrary to the weakening trend seen in other economies of the region. But when oil prices plummeted in late 2014, one thing was expected: consumer spending was going to lose some strength. That is clear now. Households are beginning to feel the brunt of that external shock. The peso has lost 52% of its value against the US dollar since September 2014, lifting the cost of import goods. So far, the impact has not been extensive, but it has been especially acute on purchases of durable goods (~70% are imported), which tend to be sensitive to income changes. Still, we expect consumption of non-durable goods and services to slow in the next quarters, as consumers grow more cautious in the face of high inflation and weaker growth prospects. Against this backdrop, it is likely that consumer spending will soften further in 2016, albeit it will remain fairly growth-supportive as well because the unemployment rate is still relatively low and employment growth has shown signs of speeding up in 3Q 2015.

Figure 9: Private Consumption (Forecasts)



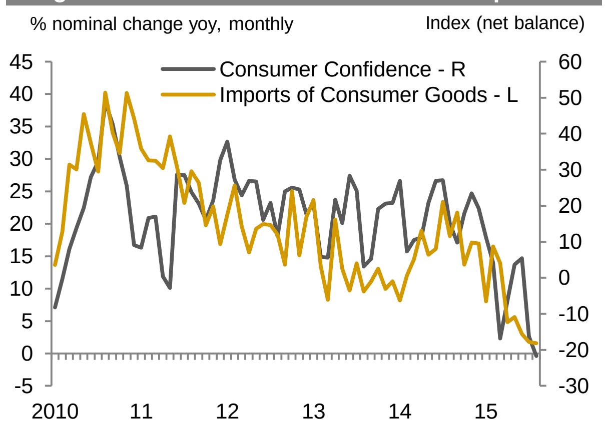
Source: Bloomberg; BTMU

Figure 10: Private Consumption by Components



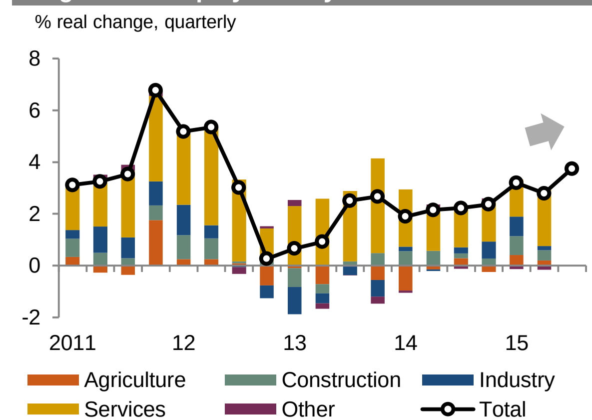
Source: DANE; BTMU

Figure 11: Consumer Confidence and Imports



Source: DANE ; FEDESARROLLO; BTMU

Figure 12: Employment by Sector



Source: DANE; BTMU

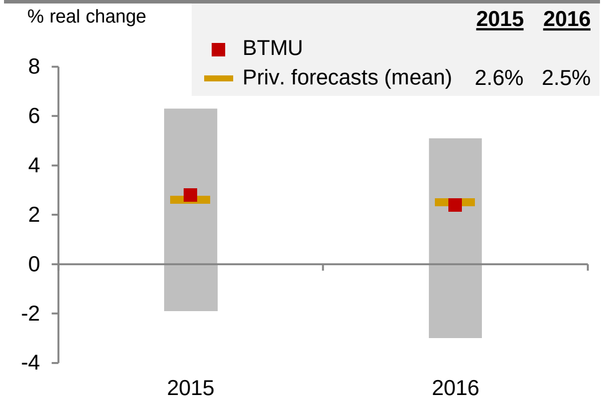
Index (net balance)

I) Colombia: Growth Momentum (4)

- **Investment growth will probably remain positive in 2015 and 2016, but it will also slow steadily.**

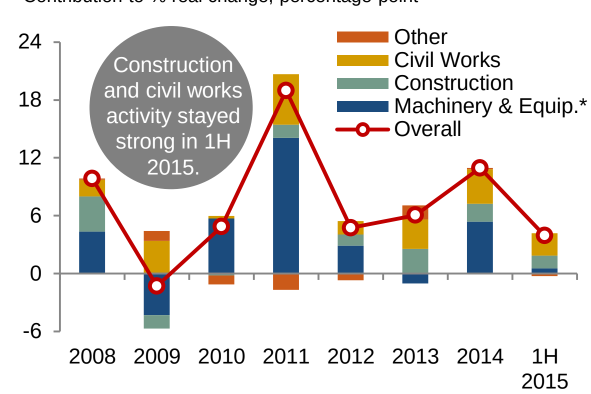
- Growth of GFCF, a measure of overall investment, will slow harshly this year as businesses rein in capital spending to deal with the fallout from low oil prices. This behavior is probably more pronounced in the oil sector, where firms are perhaps operating under heavy cash-flow constraints. But of course, the impact is not confined to the oil industry, nor to the sectors that are closely tied to oil business. In fact, overall investment in machinery & equipment, the largest component of GFCF, fell by 1.7% yoy in 1H 2015 after growing 12.3% last year. Arguably, this stark slowdown was prompted by higher import costs, and to a lesser extent, weakening domestic demand. Yet despite this harsh environment, we expect GFCF to grow around 2.8% this year, driven by the increase in infrastructure projects (reflected in civil works and construction activity), though its pace of growth will likely slow a bit more in 2016. True, the 4G road program (see previous report) could be a big push in 2016, but there are forces weighing it down too: falling inward FDI, sagging public investment, and feeble business confidence.

Figure 13: Gross Fixed Investment (Forecasts)



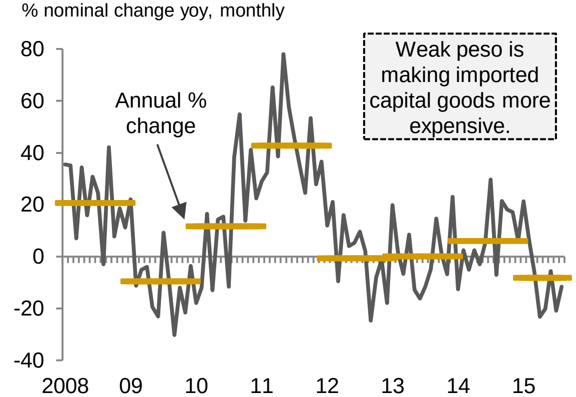
Source: Consensus Economics; BTMU

Figure 14: GFCF by Components



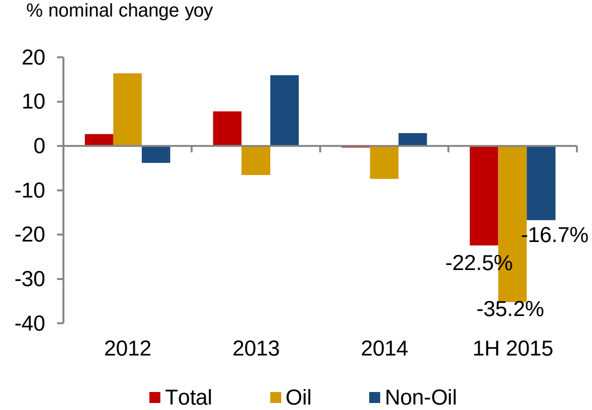
*Includes transport equipment
Source: DANE; BTMU

Figure 15: Imports of Capital Goods



Source: DANE; BTMU

Figure 16: Oil and Non-oil Inward FDI



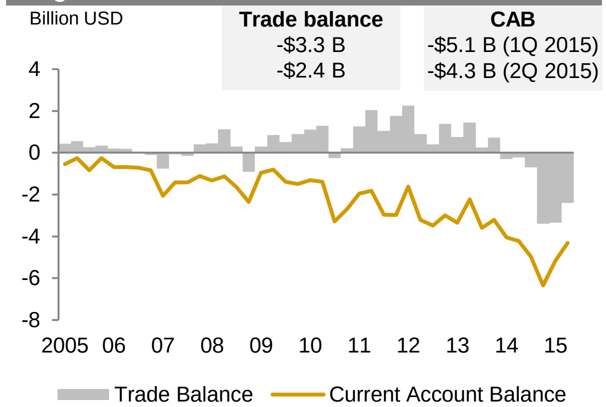
Source: Central Bank of Colombia; BTMU

II) Colombia: External Sector

- **Colombia's current-account deficit will remain large and as a source of risk to economic growth in 2016.**

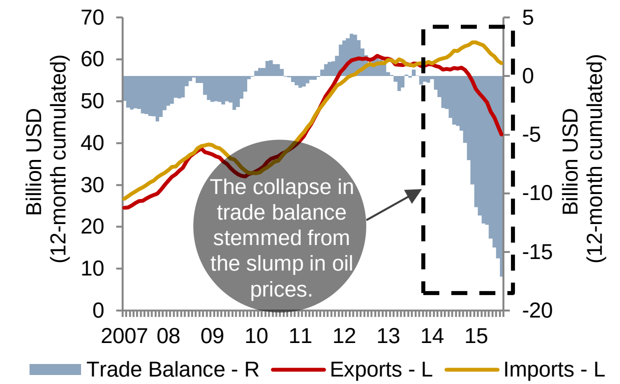
- Colombia's external sector has no doubt borne the immediate brunt of the slump in world oil prices: current account deficit (CAD) swiftly widened from 3.3% of GDP in 2013 to an estimated 6.9% in 1H 2015, a record-high level according to IMF data. And though it improved a tad in 2Q 2015, mostly led by lower imports of capital goods, chances are the deficit will remain large (possibly above 6% this year and about 5% in 2016) and as a source of risk to economic growth in the short-to-medium term. There are compelling reasons for this dim view. For example, Colombia's relatively narrow CAD during 2010-13 (averaged 3% of GDP) was basically held up by large trade surpluses, which, in turn, was propped up by higher oil exports. But now, with oil prices expected to hover around $50 a barrel for a while, the chances for a major turnaround in the trade sector are very slim. Still, we expect the country's CAD to narrow down the road, as a weaker currency and softer domestic demand will continue to drag imports down and narrow the deficits in the service and income balance.

Figure 17: Current Account Balance



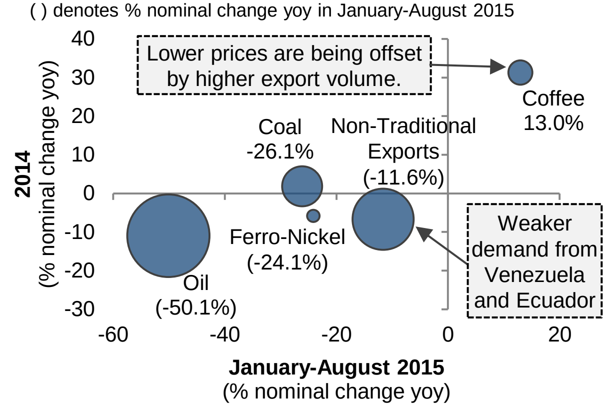
Source: Central Bank of Colombia; BTMU

Figure 18: Trade Balance, Exports and Imports



Source: DANE; BTMU

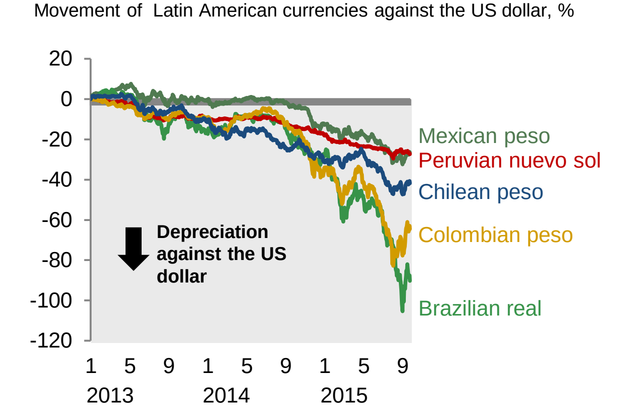
Figure 19: Exports



*Size of bubbles indicates share in total Colombia's exports

Source: DANE; BTMU

Figure 20: Exchange rates



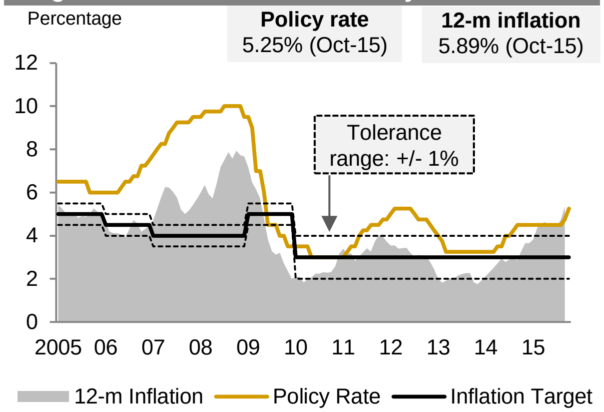
Source: Thomson Reuters Datastream; BTMU

III) Colombia: Prices and Monetary Policy

▪ **Poor weather conditions and sharp currency depreciation will keep inflation above the target range for a while.**

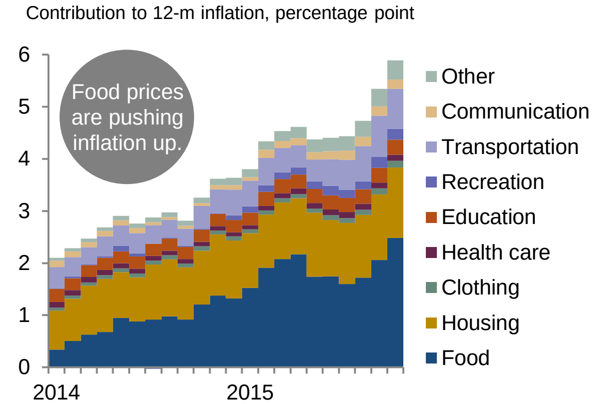
- Analysts and policymakers alike were caught by surprise as 12-month CPI inflation ballooned from 4.42% in June to 5.89% in October, far above the target range of 2%-4%. In fairness, the central bank did admit that there was a one-in-two chance that inflation would remain above 4%; although it also foretold in its March's inflation report that, by now, pressures on consumer prices should have shown signs of cooling down. So what did the monetary authority missed? First off, contrary to what they expected, the shortfall in the supply of food, largely sparked off by poor weather conditions as a result of El Niño weather event, did not ease in 2H 2015. In fact, the recent surge in food inflation possibly suggests the opposite. Second, the pass-through effect from a weaker peso to non-food prices has been much larger than they anticipated: inflation of tradable goods (sensitive to currency movements) climbed from 4.2% in June to 6.4% in October. In response, the central bank began to tighten in September, though chances are that inflation will remain above the target of 3% in 2015 and 2016.

Figure 21: CPI Inflation and Policy Rate



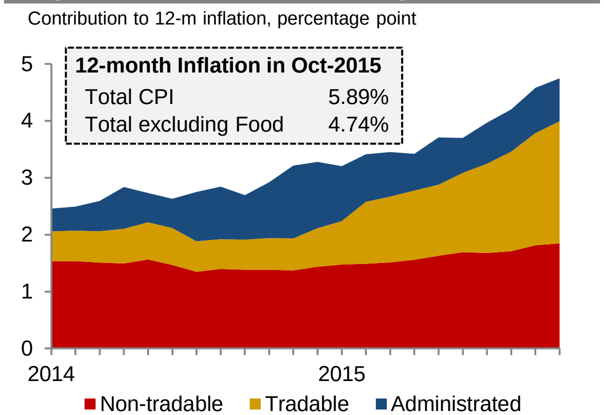
Source: DANE; Central Bank of Colombia; BTMU

Figure 22: CPI Inflation by Sub-indexes



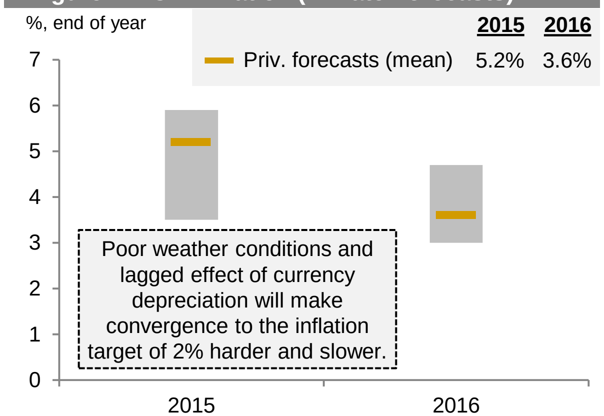
Source: DANE; BTMU

Figure 23: CPI Inflation excluding Food



Source: Central Bank of Colombia; BTMU

Figure 24: CPI Inflation (Private Forecasts)



Source: Consensus Economics; BTMU

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