BTMU Focus Latin America

Colombia: macroeconomic performance (1Q 2015)

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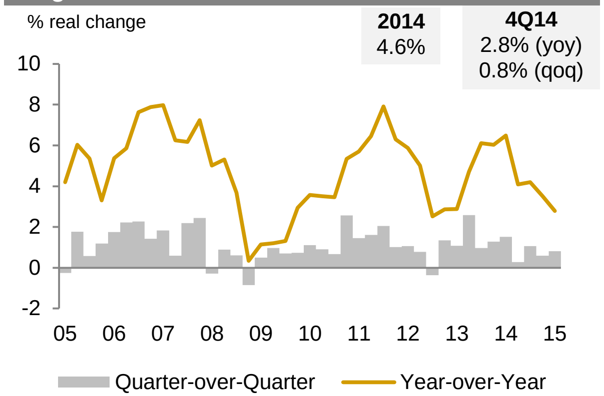
I) Colombia: Growth Momentum (1)

▪ Colombia's economy slowed in 1Q 2015 and yet was the fastest among major Latin American economies.

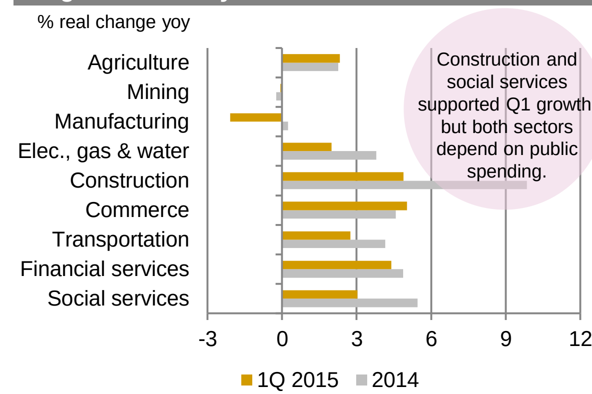
- When it comes to Colombia's 1Q economic results, two facts stand out. First, the economy showed clear signs of cooling off as growth slowed to 2.8% yoy in the first quarter, the slowest pace since 3Q 2012. Second, the Colombian economy, though, fared better than its regional peers despite the recent steep decline in oil prices, which not only hit hard the country's external accounts (oil accounts roughly half of total exports), but also cut a good chunk of government revenues (~20% of total fiscal revenue came from oil-related taxes in 2013). Yet in moments like this, it is often hard to tell whether the glass is half empty or half full. For instance, overall consumer spending remained robust in 1Q, but purchases of durable goods rose by only 3% yoy in real terms, after growing by 13% in the prior quarter, which hints that consumers are cautious. Also gross fixed capital formation (GFCF) slowed to 6% in 1Q from the 10.1% recorded a quarter earlier. But then again, when GFCF is still falling in other commodity-reliant economies such as Peru and Chile, some would see this pace as positive.

Figure 1: GDP



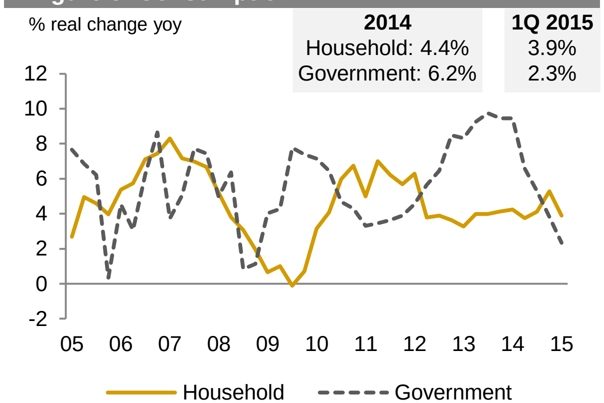
Source: Departamento Administrativo Nacional de Estadistica (DANE); BTMU

Figure 2: GDP by Sector



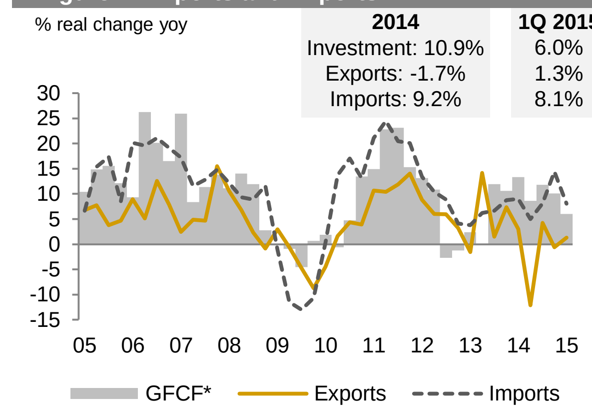
Source: DANE; BTMU

Figure 3: Consumption



Source: DANE; BTMU

Figure 4: Exports and Imports



*Gross fixed capital formation
Source: DANE; BTMU

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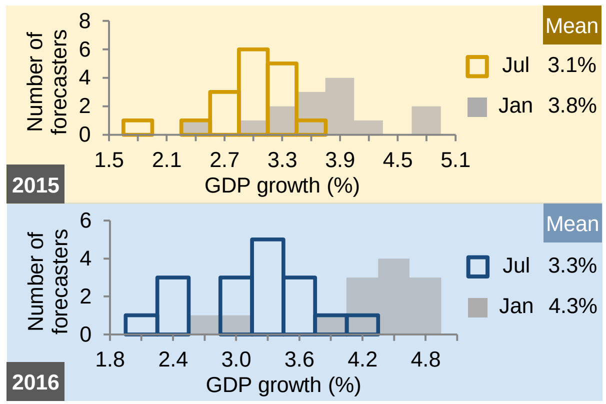
I) Colombia: Growth Momentum (2)

- **The economy will decelerate this year and next year as it absorbs the impact of low oil prices.**

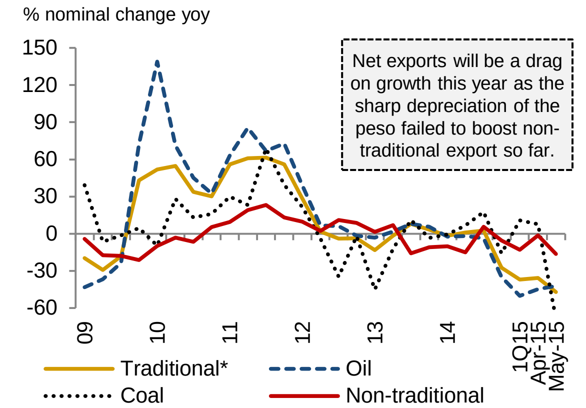
- **Overall Outlook:** The economy will slow down this year and next year as it gradually absorbs the negative terms of trade shocks, caused by the fall in oil prices. The shift in market expectations clearly points to that direction and highlights this new reality for Colombia. But to be fair, Colombia will likely stay as one of the fastest-growing economies in the region. In fact, we expect this year's growth to be about 3%, mostly shored up by robust private consumption, high government spending amid local elections in October, and cooling, but still positive, investment climate. Next year's growth rate should also stay close to 3% as the expected boost from higher exports, spurred by a weaker currency, will likely be offset by weaker domestic demand.
- **Private Consumption** will continue to be growth-supportive in the coming quarters as labor market remains robust and credit growth stays high; but the picture is not as rosy as in the past. There are considerable downside risks: consumers could lose confidence and further delay purchases of durable goods as strong growth prospects begin to wane.

Figure 5: GDP Growth (private forecasts)



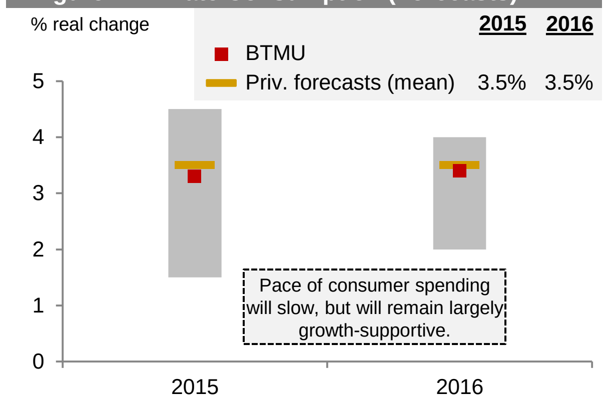
Source: Consensus Economics; BTMU

Figure 6: Traditional and Non-traditional Exports



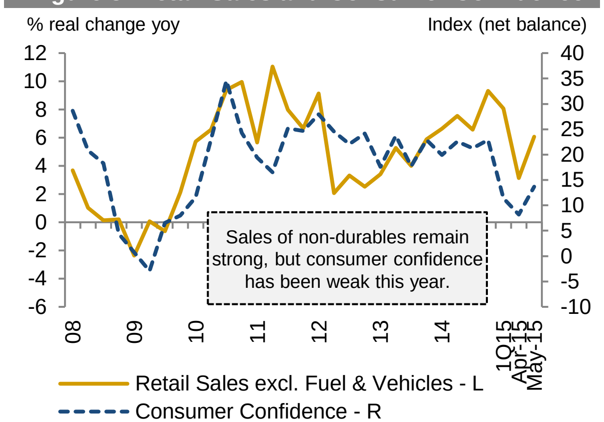
*Include oil and coal exports
Source: DANE; Central Bank of Colombia; BTMU

Figure 7: Private Consumption (Forecasts)



Source: Bloomberg; BTMU

Figure 8: Retail Sales and Consumer Confidence



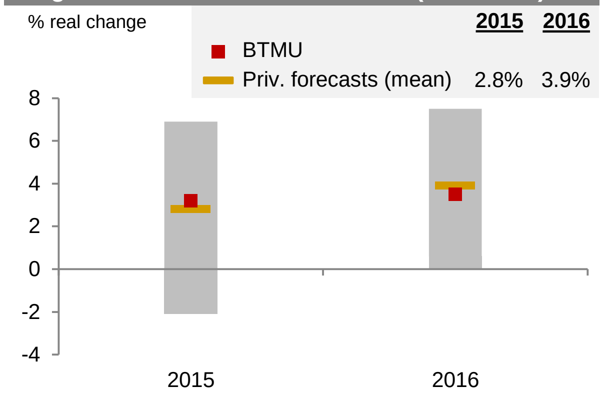
Source: FEDESARROLLO; DANE; BTMU

I) Colombia: Growth Momentum (3)

- **With oil prices floating at around $50 a barrel so far this year, investment will probably slow sharply.**

- There is no doubt that the oil sector is a major source of capital investment for Colombia. Not only did the sector receive more than 30% of total FDI inflows over the last 4 years, but it also contributed to higher capital spending in other sectors that are closely linked to the oil industry. Now, with oil prices hovering around $50 a barrel, as compared to $100 in September 2014, the industry is probably operating under hefty cash-flow constraints. In this challenging environment, the **growth of GFCF** will certainly slow sharply this year as some indicators suggest: FDI inflows plunged in 1Q and imports of capital goods contracted sharply in April and May. The question, though, is how severe would be this slowdown. The market expects GFCF to expand 2.8% this year, down from 10.9% in 2014; and mildly pick up to 3.9% in 2016. We see, however, a slightly higher pace this year as the recent fiscal stimulus measures will likely pep up civil works, a large component of GFCF, in the coming quarters. But as business confidence remains subdued, we do not expect a strong rebound next year.

Figure 9: Gross Fixed Investment (Forecasts)



Source: Consensus Economics; BTMU

Figure 10: Fiscal Stimulus Measures

4G PPP Program

- Plan duration: 2015-19
- Total investment: $23 billion in roads
- Through Public-Private partnership
- Impact on potential GDP: 0.6 pp
- 1st round of projects awarded and worth than $4.6 billion in CAPEX

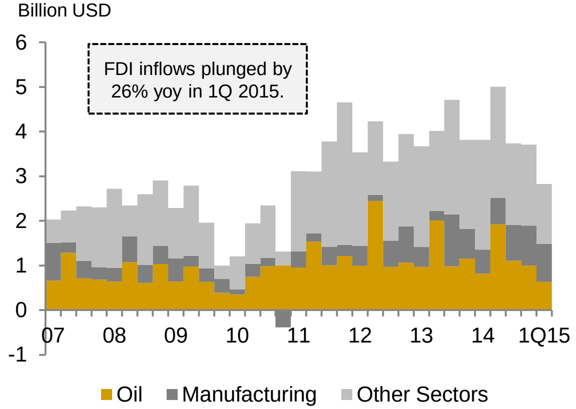
PIPE 2.0

Short-term Impact

- Launched on May 28.
- A $6.7 billion stimulus package (about 2.1% of GDP) aims to fuel growth.
- Measures include spending more than $4 billion on infrastructure projects: new classrooms, roads and housing.

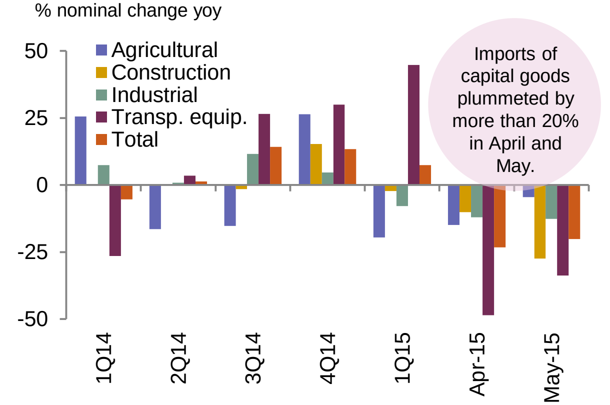
Source: National Infrastructure Agency; BTMU

Figure 11: Foreign Direct Investment Inflows



Source: Central Bank of Colombia; BTMU

Figure 12: Imports of Capital Goods



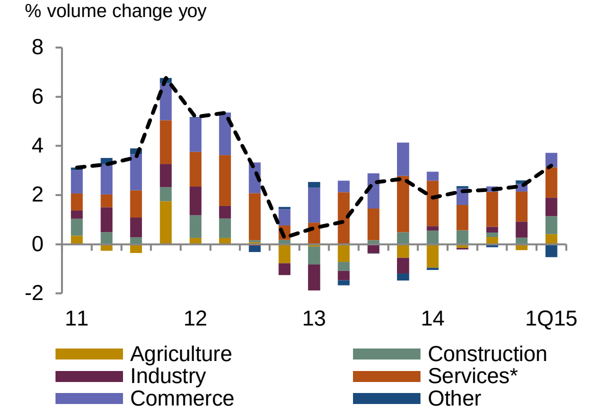
Source: DANE; BTMU

II) Colombia: Labor Market and Prices

▪ Inflation will probably stay above the Central Bank's target range of 2%-4% this year.

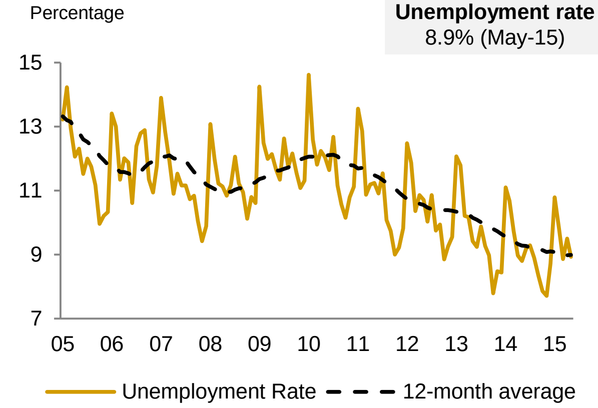
- **Labor market:** labor conditions in Colombia remain robust in general. Job growth softened slightly in May, but is still largely positive. Unemployment rate also remained low at 8.9% in May. All this bodes well for consumer spending.
- **Inflation**: 12-month inflation has been rising steadily from September 2014 to April 2015, when it hit its peak of 4.64%. Since then, upward pressures have eased off and inflation has inched down a tad to 4.42% in June, although it is still above the Central Bank's target range of 2%-4%. The main force behind these inflationary pressures was a shortfall in the supply of food caused by poor weather conditions (linked to El Niño weather phenomenon). The steep depreciation of the peso also helped push prices up, but the pass-through effect was modest as tradable goods (excluding food) only make up 26% of a typical consumer's basket. Yet the Central Bank acknowledges the risk that inflation could stay above 4% this year. As food supplies improve, inflation should gradually converge to 3% in 2016.

Figure 13: Employment by Sector



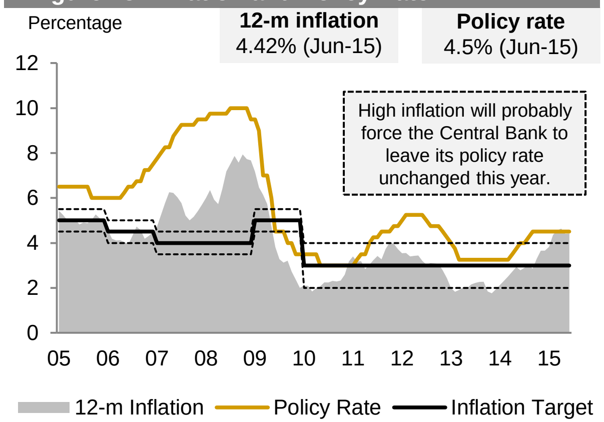
Source: DANE; BTMU

Figure 14: Unemployment Rate



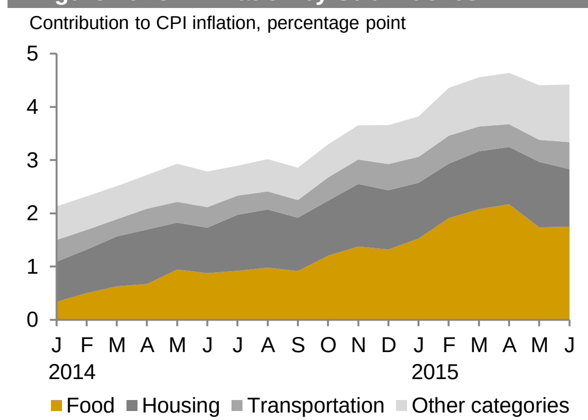
Source: DANE; BTMU

Figure 15: Inflation and Policy Rate



Source: DANE; Central Bank of Colombia; BTMU

Figure 16: CPI Inflation by Sub-indexes



Source: DANE; BTMU

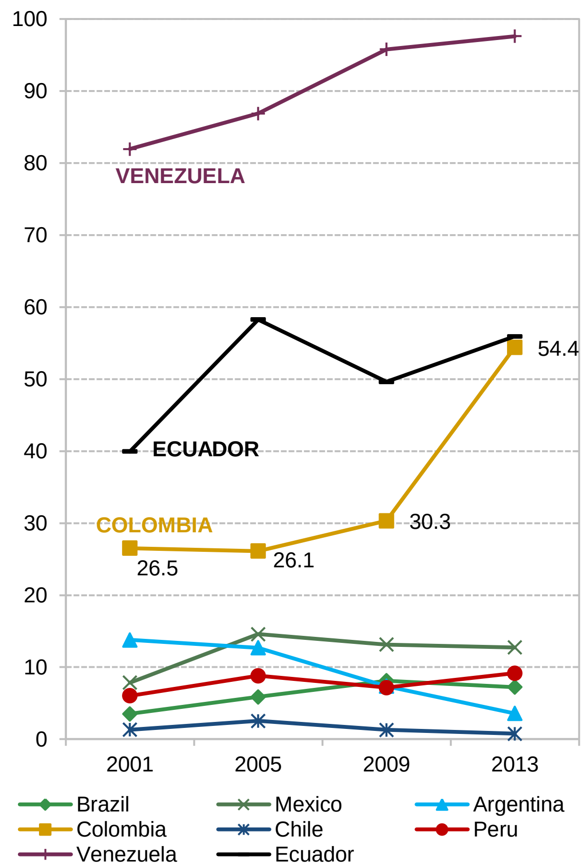
III) Colombia: Exchange Rate

▪ The fall in oil prices drove the peso down, and higher budget deficits could weaken the currency further.

- Colombia was the fastest-growing major economy in Latin America last year, and it seems that it is on track to take the lead again this year. Surprisingly (or not), the peso has been performing poorly since late 2014. In fact, it is the second worst-performing currency of the region so far this year. This raises the question of what underlying forces might be driving the depreciation of the peso. The answer probably lies in Colombia's heavy dependence on oil for its exports. Over the years, oil exports have become increasingly more important for Colombia's external accounts, so when oil prices plunged in Q4 2014, trade balance immediately swung into deficit and current account widened sharply, creating an excess demand for foreign currency. In situations like this, the local currency tends to weaken in order to boost exports and narrow the deficits; but in the case of Colombia, the depreciation of the peso has not yet translated into higher exports. Moreover, the normalization of monetary policy in the US and the expected higher budget deficits will likely add more downward pressures on the peso.

Figure 17: Oil Exports

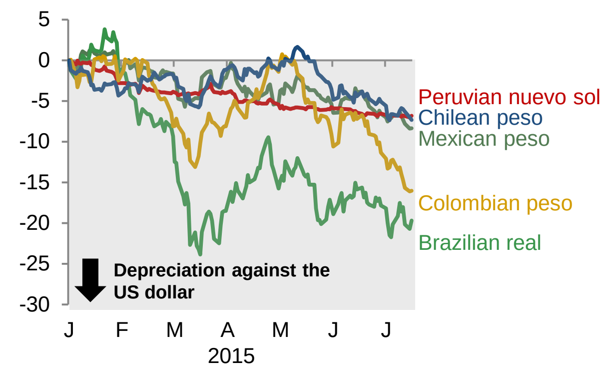
Share of total exports, %



Source: UN Comtrade; BTMU

Figure 18: Exchange Rates

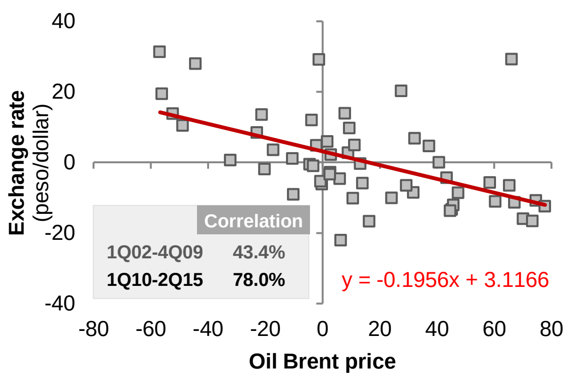
Movement of Latin American currencies against the US dollar, %



Source: Thomson Reuters; BTMU

Figure 19: Exchange rate and Oil Price

% nominal change yoy



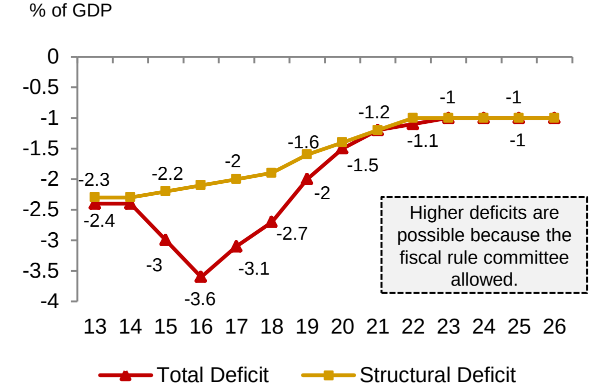
Sample: 1Q 2002 – 2Q 2015, Quarterly
Source: Thomson Reuters; ICIS Pricing; BTMU

IV) Quarterly Brief: Fiscal Challenge and Twin Deficits

▪ Budget deficit will remain high for the next two years, and current account deficit could widen more.

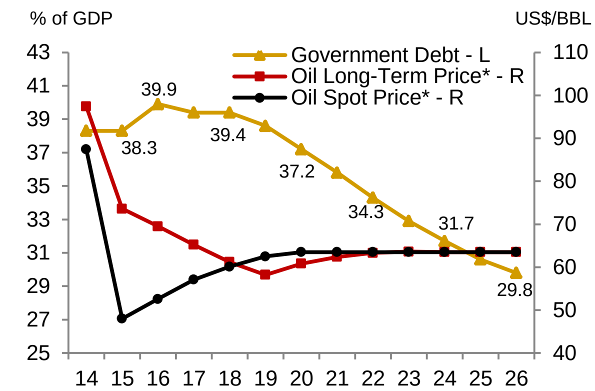
- Ever since oil prices started to tumble in 2014 and fiscal revenue began to fall, economists have been eager to see how the government would cope with this difficult situation of having to comply with the fiscal rule targets, while keeping public spending high to beef up the economy. There were several policy options in theory, but in practice only two were realistic: slashing spending to keep budget deficit fairly constant, or running higher budget deficits (but still sticking to the fiscal rule) to keep spending high. Unsurprisingly, the government decided to keep spending at 19.1% of GDP in 2015 and 2016 (similar to last year's), which means that Colombia will run a higher budget deficit this year and next year. True, this should not be an issue given its large pile of reserves and because public debt will stay low and mostly denominated in local currency. Yet that choice does not come free as higher budget deficits, all else equal, will force Colombia's already-high current account deficit to widen more, making the country less resilient to sudden shift in investors' sentiment.

Figure 20: Fiscal Deficit (Government's Outlook)



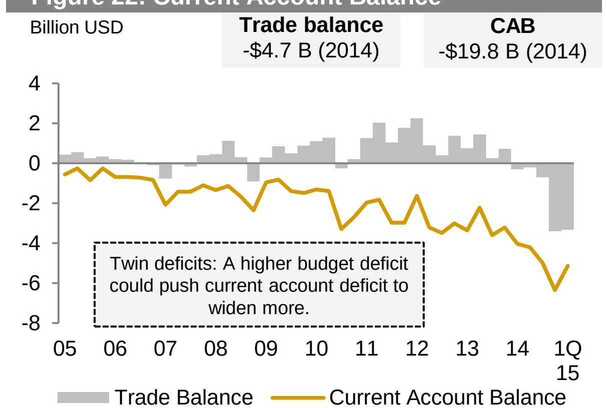
Source: Medium Term Fiscal Framework 2015-2026; BTMU

Figure 21: Government Debt and Oil Price



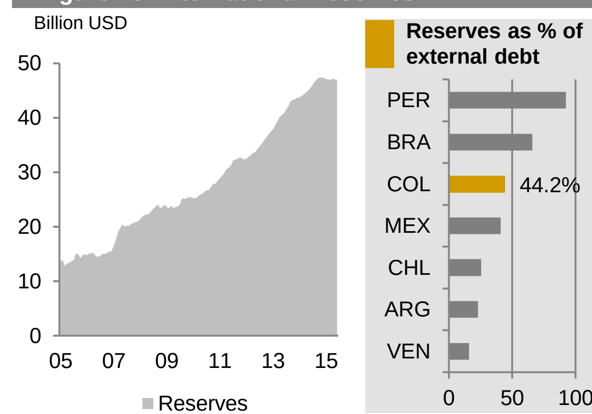
*Forecasts set by the fiscal rule committee
Source: Medium Term Fiscal Framework 2015-2026; BTMU

Figure 22: Current Account Balance*



*Current Account = National Saving – Domestic Investment
Source: Central Bank of Colombia; BTMU

Figure 23: International Reserves



Source: Central Bank of Colombia; Thomson Reuters; Economist Intelligence Unit; BTMU