MUFG Focus Latin America

Colombia : macroeconomic performance

(2015 GDP and Current Monthly Indicators)

Hongrui Zhang

Latin America Economist

Economic Research (New York)

MUFG Union Bank

hozhang@us.mufg.jp | +1(212)782-5708

April 27, 2016

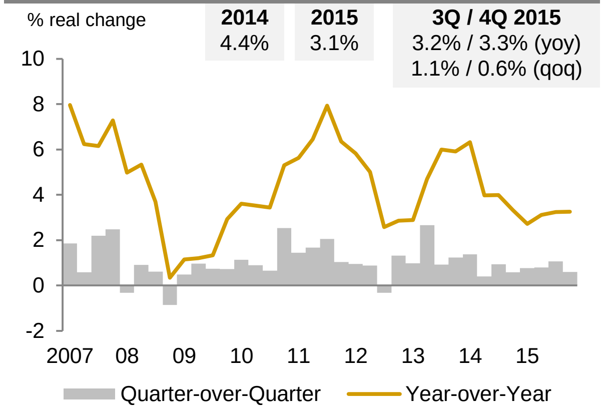
Contents

I) Colombia: Growth Momentum (1)

- **GDP growth slowed to 3.1% in 2015, and the effects of low oil prices on the economy became visible.**

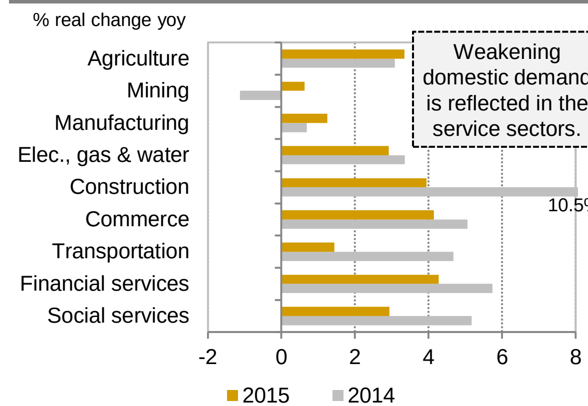
- 2015 was, as expected, a very challenging year for Colombia's oil-exporting economy (+50% of its total exports in 2014 were oil). Global prices of crude oil averaged about half of what they were in 2014. The Colombian peso, driven by the plunge in oil prices, lost 33.6% of its value against the US dollar. And inflation, which had been floating within the central bank's comfort zone of 2% to 4% for most of 2014, shot up to 6.8% last year. Against that complicated backdrop, the economy obviously slowed to 3.1% growth from 4.4% a year earlier, with the effects of low oil prices becoming more visible. For instance, gross fixed capital formation (GFCF), a measure of investment in property & equipment, grew by just 2.8%, down from 9.8% in 2014, as firms cut capital spending to adapt to tougher business conditions. Similarly, the pace of government spending slowed sharply in response to lower fiscal revenue from oil. And though household spending grew by 3.9%, a similar pace as in 2014, consumption of durable goods (mostly imported and usually reacts swiftly to economic slowdown) actually contracted by 2%.

Figure 1: GDP Growth



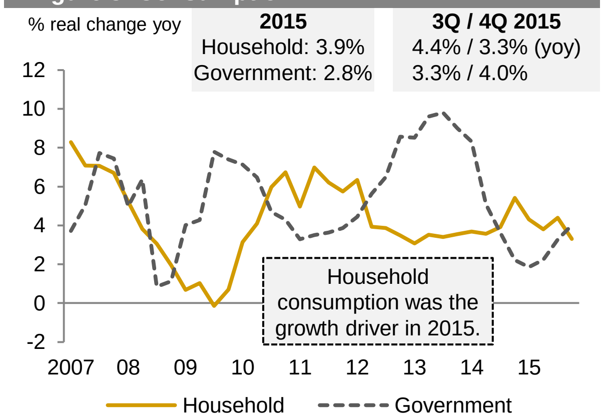
Source: Departamento Administrativo Nacional de Estadistica (DANE)

Figure 2: GDP by Sector



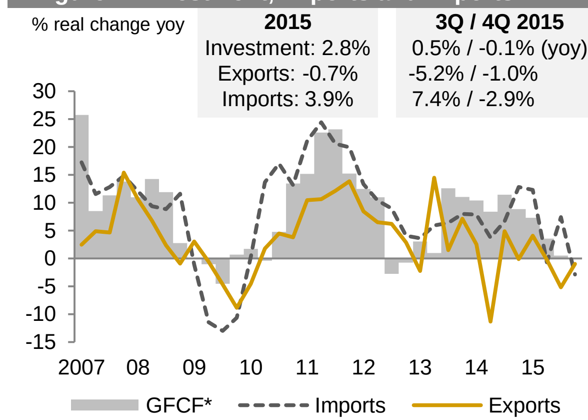
Source: DANE

Figure 3: Consumption



Source: DANE

Figure 4: Investment, Exports and Imports



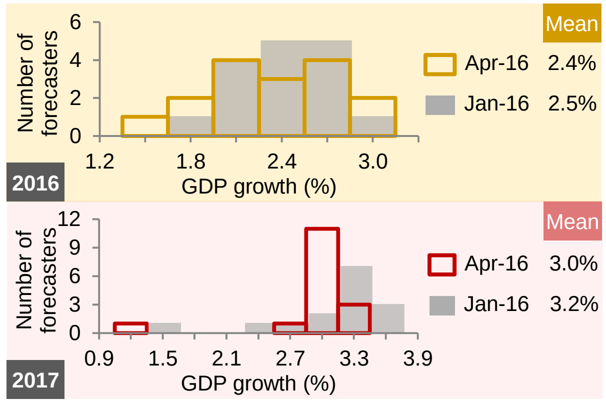
*Gross Fixed Capital Formation
Source: DANE

I) Colombia: Growth Momentum (2)

- **Caution for Colombia's economic prospects: adjustment process to low oil prices will continue in 2016.**

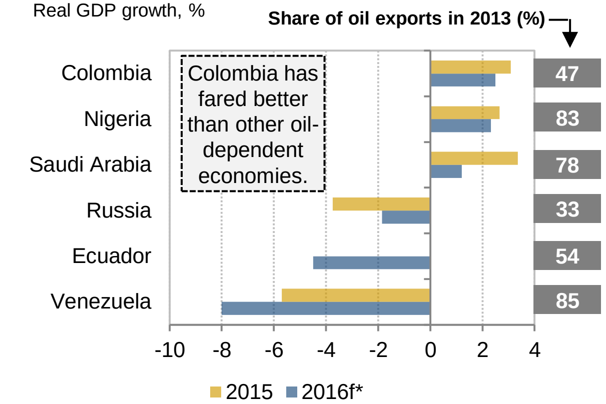
- It is difficult not to acknowledge that the Colombian economy has, so far, adjusted to the collapse in oil prices in an orderly way, especially compared with the situations of other oil-exporting countries of the region. In Ecuador, for example, economic growth halted in 2015 and will likely dip into negative zone in 2016. The outlook for Venezuela's oil-dependent economy is even gloomier: the recession will likely worsen this year and linger for a while. That being said, it is also important to be aware that, given the sheer scale of the external shock (its terms of trade slumped by 14% in 2015), Colombia's economy will continue to adjust to this low oil price environment, and GDP growth will probably slow further in 2016, possibly to the range of 2%-3%. Why? Last year's growth rate was already the slowest since 2002, except for 2009. Its current-account deficit, fueled by the plunge in oil exports, will likely remain large (6% of GDP, according to IMF's estimates) and an important source of downside risk to this outlook as investors' appetite for emerging-market assets may weaken down the road (continued next slide).

Figure 5: GDP Growth (Private forecasts)



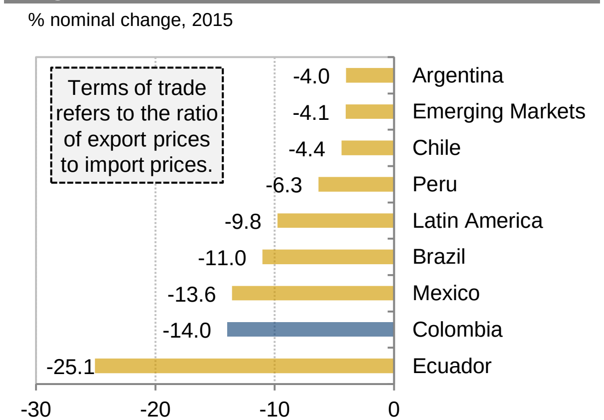
Source: Consensus Economics

Figure 6: Growth of Oil-Dependent Economies*



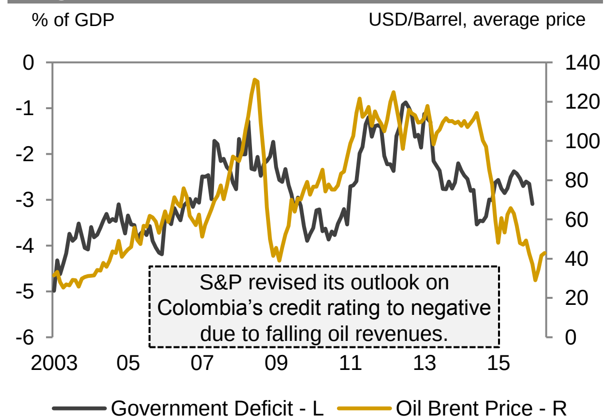
*Forecasted by IMF
Source: IMF, WEO April 2016; UN Comtrade

Figure 7: Terms of Trade in 2015



Source: Thomson Reuters Datastream; IMF, WEO April 2016

Figure 8: Government Deficit and Oil Price



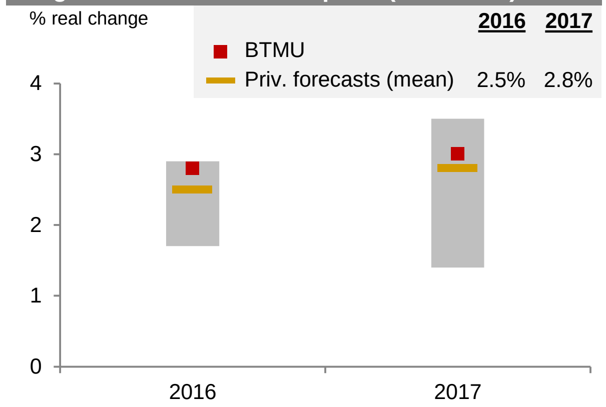
Source: Central Bank of Colombia; ICIS Pricing

I) Colombia: Growth Momentum (3)

- **Domestic demand will probably weaken further in 2016.**

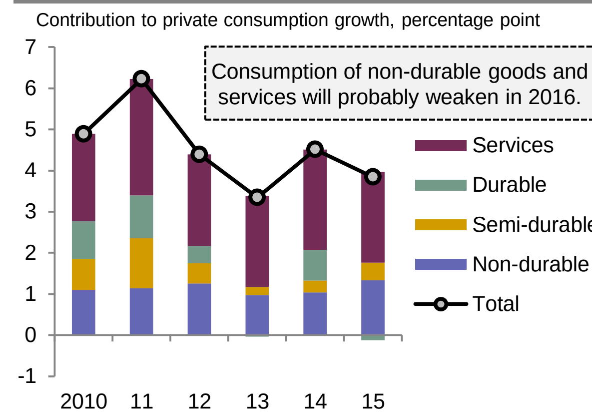
- Neither the government nor the central bank is in a comfortable position to give the slowing economy a push. Quite the opposite actually. Fiscal deficit rose to 3.1% in 2015 from 2.6% a year earlier; and gross public debt appears to have risen 5 pp to 49.4% of GDP. And with global oil prices unlikely to swing back to $100 a barrel in the foreseeable future, the government announced a new budget cut of about 0.7% of GDP (half will fall on public investment) for 2016, in order to meet the fiscal rule. Likewise, the central bank is having a hard time curbing inflation due the pass-through effects of the weaker peso on prices. And because inflation expectations are still on the rise, more interest rate hikes are possible in the coming months. More important still, domestic demand growth will probably continue to abate due to the ongoing effects of low oil prices on domestic income and companies' incentives to invest in the oil industry and supporting sectors like construction and services. Slower income growth, for instance, will sooner or later hit consumption of non-durable goods and services, affecting consumption growth.

Figure 9: Private Consumption (Forecasts)



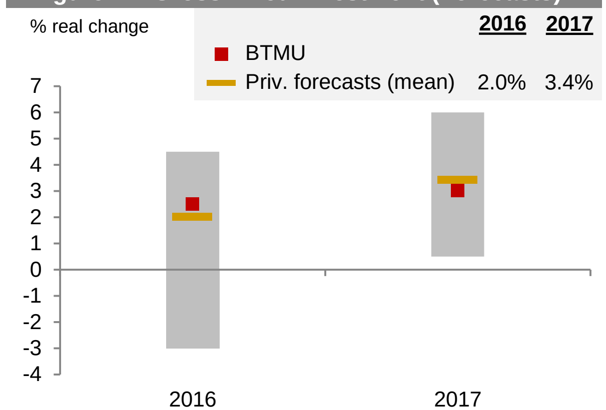
Source: Bloomberg

Figure 10: Private Consumption by Components



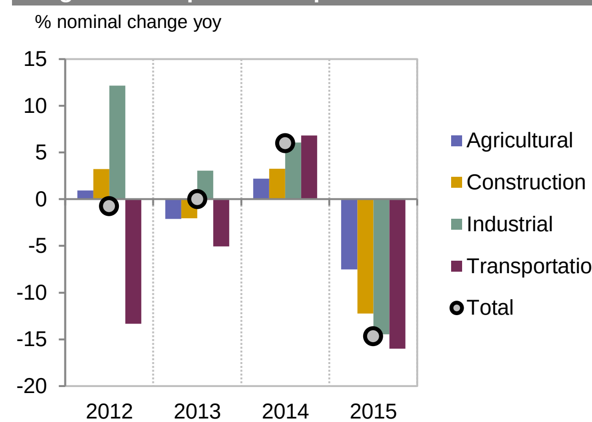
Source: DANE

Figure 11: Gross Fixed Investment (Forecasts)



Source: Consensus Economics

Figure 12: Imports of Capital Goods



Source: DANE

II) Colombia: External Sector

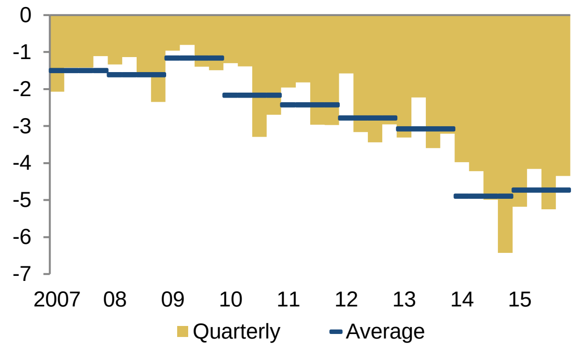
▪ Colombia's large current-account deficit is a source of downside risk to GDP growth.

▪ Colombia's current-account deficit (CAD) narrowed 3.4% in 2015, to $18.9bn, largely thanks to declines in its service deficit (-40.4%), and to a larger extent, its income deficit (-52.6%) as companies in the oil and mining sectors trimmed their profit remittances. But in spite of those adjustments, CAD stayed fairly large. In fact, the deficit, measured as a % of GDP, rose by 1.3 pp to 6.5%, the second-highest among major Latin American economies, only exceeded by Venezuela (7.6%). Of course, Colombia's large CAD is a consequence of lower oil prices. In 2013, its trade surplus amounted to $3.2bn, supported by rising oil exports (~55% of the total). Last year, with export earnings from oil down 56% compared with 2013, the country recorded a colossal trade deficit of $14bn. Naturally, this is a source of concern as it suggests further depreciation of the peso might be needed in order to narrow the external imbalances. Moreover, a large CAD, though still largely financed by FDI, could make the economy less resilient to sudden shifts in investors' sentiment, especially in the face of falling capital inflows.

Figure 13: Current Account Balance

Billion USD

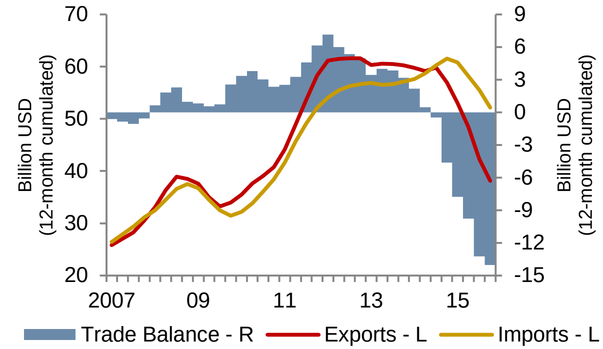
2014	2015
-19.6 B	-18.9 B



Source: Central Bank of Colombia

Figure 14: Trade Balance, Exports and Imports

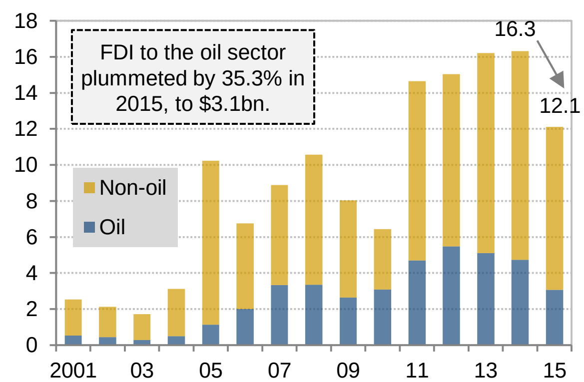
Trade Balance
-$14.0 / -$4.6 B (2015 / 2014)



Source: DANE

Figure 15: Oil and Non-oil Inward FDI

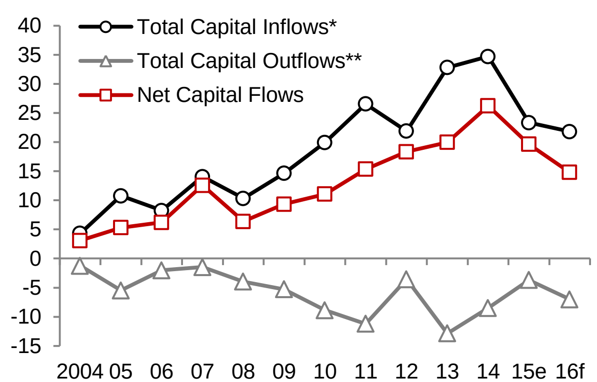
Billion USD



Source: Central Bank of Colombia

Figure 16: Capital Flows to Colombia

Billion USD



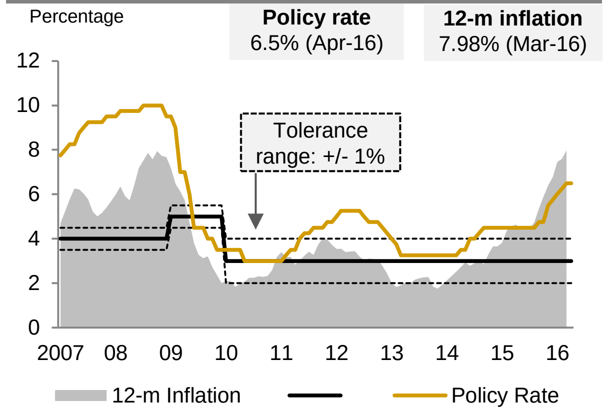
*Non-residential; **Residential but exclude reserves
Source: Institute of International Finance

III) Colombia: Prices and Monetary Policy

- **Inflation should slowly ease during the second half of 2016, but will remain above the target range of 2%-4%.**

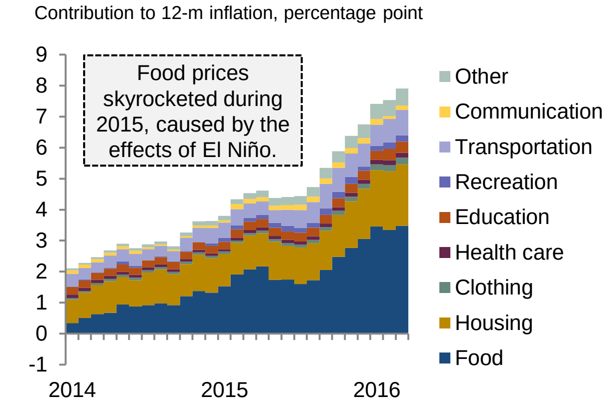
- 12-month Inflation is still on the rise, even after the central bank embarked on an ongoing tightening cycle in which its policy rate has risen continuously since August 2015 (by 2 pp to 6.5%). Recent CPI data points to an annual inflation rate of around 8% in March, up by 1.2 pp compared with December's rate, and far above the official target range of 2% to 4%. And as we argued in our previous report, the reasons behind Colombia's ballooning inflation are twofold. First, poor weather conditions, triggered by El Niño weather phenomenon, disrupted the supply of foodstuffs, prompting food inflation to skyrocket (12.4% in March). Second, the pass-through effects of the weaker peso, which began to be visible in 1H15, have slowly intensified thereafter. Of course, those two forces are reinforced by price indexation for some services. Now, we expect them to slowly tail off in 2H16: the peso has appreciated by 9.2% so far this year; and the effects of El Niño on food supply should wane. Yet, with inflation expectations still rising, inflation will stay above the target range in 2016, despite a tighter monetary stance.

Figure 17: CPI Inflation and Policy Rate



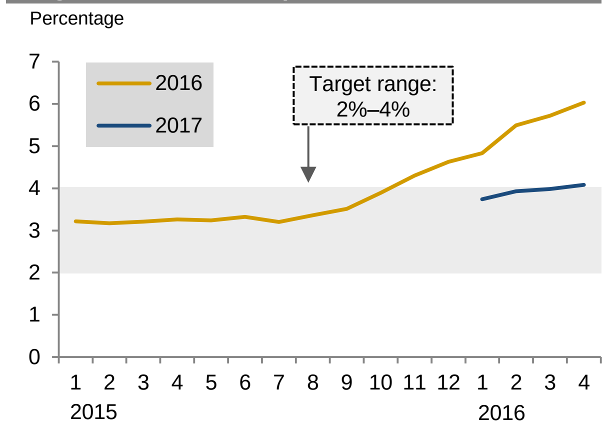
Source: DANE; Central Bank of Colombia

Figure 18: CPI Inflation by Sub-indexes



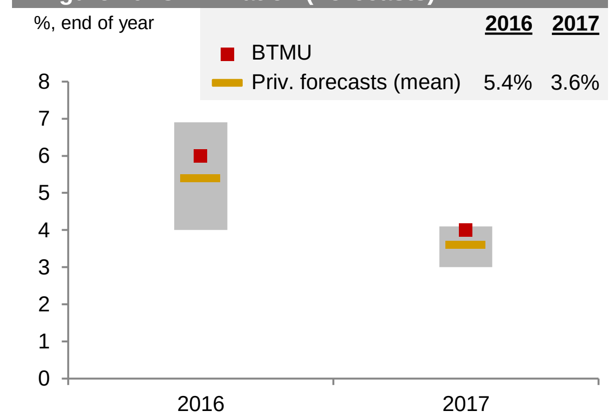
Source: DANE

Figure 19: Inflation Expectations



Source: Central Bank of Colombia

Figure 20: CPI Inflation (Forecasts)



Source: Consensus Economics

- **This report is intended only for information purposes and shall not be construed as solicitation to take any action. In taking any action, readers are requested to do so on the basis of their own judgement.**

- **This report is based on information believed to be reliable, but we do not guarantee its accuracy. The contents of this report may be revised without notice.**

- **This report is a literary work protected by the copyright act. No part of this report may be reproduced in any form without express statement of its source.**