Colombia: Staff Concluding Statement of the 2020 Article IV Mission

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- A Concluding Statement describes the preliminary findings of IMF staff at the end of an official staff visit (or 'mission'), in most cases to a member country. Missions are undertaken as part of regular (usually annual) consultations under Article IV of the IMF's Articles of Agreement, in the context of a request to use IMF resources (borrow from the IMF), as part of discussions of staff monitored programs, or as part of other staff monitoring of economic developments.
- The authorities have consented to the publication of this statement. The views expressed in this statement are those of the IMF staff and do not necessarily represent the views of the IMF's Executive Board. Based on the preliminary findings of this mission, staff will prepare a report that, subject to management approval, will be presented to the IMF Executive Board for discussion and decision.

Resilient Growth in a Challenging Environment

In contrast to weak regional trends, Colombia's resilient economy expanded by 3.3 percent in 2019. Despite challenging external conditions and social tensions throughout Latin America, domestic demand—including from substantial migration inflows from Venezuela—led growth higher while the external deficit widened, largely financed through stable FDI. Vulnerabilities to downside risks, however, have risen. Policy efforts aimed at raising fiscal revenues in a progressive manner, enhancing public spending efficiency, boosting external competitiveness, and integrating workers (including migrants) into the formal sector, continue to be instrumental for economic inclusion and prosperity.

1. Colombia's commendable efforts to integrate Venezuelan migrants continue to boost economic activity . With over 2 million arrivals in recent years, Colombian society has shown exemplary commitment and support to vulnerable migrants, with estimated annual fiscal costs of around ½ percent of GDP in the near term. These costs are expected to diminish as migrants integrate into the economy, aided by the recent expansion of special work and residency permit programs. Migrant inflows boosted economic growth by around ¼ percent last year and have largely been absorbed by the informal sector with little evidence of labor displacement thus far. Venezuelan migration is expected to continue to be an engine of Colombia's growth, with the extent of potential gains depending on the speed of migrant integration into the formal economy.

2. In contrast to regional peers, growth strengthened in Colombia in 2019 . Despite slower regional and global growth, real GDP grew 3.3 percent in 2019 and is forecast to grow by 3.4 in 2020 led by internal demand. Sustained immigration, remittances, and accommodative monetary and credit conditions are expected to continue supporting private domestic demand, including rising investment. Notwithstanding growth resilience, the labor market remained weak in 2019.

3. Strong internal demand and lackluster exports have widened external imbalances . Robust domestic demand, including from inflows of migrants and from higher capital goods purchases, has raised imports. But exports were sluggish due to weak external demand and a decline in commodity prices, amid structural impediments to Colombia's external competitiveness. Higher remittances and tourism receipts, however, partly offset the worsening trade balance. Overall, the current account deficit widened to an estimated 4.4 percent of GDP last year. Lower commodity prices, partly attributable to the Novel Coronavirus outbreak, are expected to

keep the external deficit at around this level in 2020. The deficit should continue to be comfortably financed by buoyant FDI and relatively resilient portfolio inflows given very favorable global financial conditions.

4. Colombia's credit cycle should continue to improve and support demand . Business credit is recovering in line with the economy while consumer credit is rapidly expanding. Financial system solvency and liquidity have remained strong, and NPLs have declined since their peak in 2018. Nonetheless, continued vigilant and proactive supervision will help ensure that problem assets remain sufficiently provisioned for. Moreover, given the noticeable acceleration in consumer credit, continued close monitoring of these trends by the financial supervisor (SFC) is important to avoid risks of overborrowing and a potential future build-up of NPLs. The mission supports additional provisioning requirements to mitigate risks associated with consumer loans, currently being considered by the SFC.

5. Vulnerabilities to downside risks have increased . While the external deficit is expected to be comfortably financed, increased external financing needs raise Colombia's vulnerability to a downside scenario such as a steep fall in commodity prices and a sharp rise in risk premia. Possible external triggers include renewed trade tensions globally or a more widespread and prolonged Coronavirus outbreak. Venezuela's ongoing crisis, and spillovers from regional social tensions constitute additional external sources of risk. Domestically, renewed strikes and work stoppages could slow activity and reforms. Other internal risks include a further deterioration of labor market conditions and shortfalls in mobilizing revenue that would necessitate large cuts in social and infrastructure spending to meet the fiscal rule.

Policy mix can continue to support growth while addressing external imbalances

6. The monetary stance remains appropriate . Headline inflation is projected to end 2020 near the 3 percent target, as last year's temporary supply shocks continue to fade. With prevailing economic slack, core inflation close to target, and well-anchored inflation expectations, monetary policy can remain moderately accommodative. Accommodation can be gradually withdrawn as the recovery continues to materialize and if downside risks to growth recede.

7. Preserving reserve coverage as insurance against external risks is important. While it was operating, the central bank's reserve accumulation program purchased USD 2.8 billion which, together with accumulated returns of USD 2.3 billion in 2019, enhanced Colombia's reserve adequacy. The IMF's Flexible Credit Line (FCL) provides additional buffers. Amid elevated external vulnerabilities and risks, further reserve accumulation should be considered, market conditions permitting. Exchange rate flexibility should remain as the first line of defense against external shocks.

8. Fiscal policy has reduced the headline deficit and should continue to be anchored by the fiscal rule . As in 2019, the authorities' target for 2020 reduces the headline and structural deficit and saves some of the space provided by the Fiscal Rule Consultative Committee. The planned reduction of the 2020 headline deficit target to 2.2 percent of GDP is appropriate given robust domestic demand and a wider external deficit. Over the medium term, fiscal adjustment beyond what is in the 2019 Medium Term Fiscal Framework will be required to adhere to the fiscal rule and to place the public debt ratio firmly on a downward path. Increasing structural revenues by 2-3 percent of GDP would help to meet these future deficit targets, as well as growth and inclusiveness challenges. In this context, the mission welcomes recent tax collection improvements and the authorities' focus on spending efficiency including through better targeting of subsidies in line with past Fund advice. Further measures could include the elimination of preferential regimes for particular sectors and a broadening of the tax base while protecting vulnerable groups.

9. The mission welcomes the authorities' recognition of previously unrecognized public expenditures to enhance fiscal transparency . The 2018-2022 National Development Plan authorizes the central government to

recognize as public debt arrears stemming from past court rulings, social security, energy subsidies and liabilities from pension bonds and FOMAG. The authorities have put in place a well-defined strategy for clearing these arrears, including on the timing and sources of funding through a combination of cash deposits and issuance. The mission welcomes the authorities' plans to strengthen provisioning and spending mechanisms to address the accumulation of future arrears—including managing legal claims, auditing and control of health expenditures, and improved fiscal accounting by subnational governments and state-owned enterprises. Public debt, including recognized arrears, should decline as share of GDP if the authorities' fiscal targets are met going forward.

Structural reforms for financial stability, inclusive growth and external competitiveness

10. Colombia is strengthening its financial regulatory framework . As part of modernization efforts, regulations issued under the Conglomerates Law are going into effect starting in early 2020. This includes added resources for SFC oversight over these entities, their consolidated risks and risk management frameworks. Basel III definitions of capital ratios will also be implemented in 2020. Since this *increases* capital adequacy ratios for most banks while additional capital requirements are only introduced gradually, maintaining heightened supervisory vigilance is appropriate during the transitional period. A Financial Sector Assessment Program (FSAP) will be undertaken later this year to review Colombia's financial frameworks, oversight, and soundness.

11. Structural reforms are needed to raise growth, expand employment and promote inclusion. In the wake of protests, the government is conducting national consultations and the recently approved Growth Law tries to address some inequality concerns to benefit low-income households. Colombia's deeper inclusion challenges, however, will need more fundamental structural reform. Programs aimed at tackling regional disparities and boosting inclusive growth under the NDP and the Peace Agreement should be prioritized. Beyond that, meaningful pension reform including an expansion of the social pillar *Colombia Mayor* and removing regressive subsidies for higher-income pensions warrant consideration. Civil works execution is proceeding well and 4G infrastructure investments should reduce transportation costs and help boost exports, especially if complemented with a reduction in non-tariff barriers. Given high structural unemployment, informality, and migration inflows, promoting formal employment remains a priority.

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The mission would like to thank the Colombian authorities for their cooperation and open discussions.

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