Macroeconomic Outlook for Colombia

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* The opinions presented here are personal and do not represent the official position of the *Banco de la República* or its Board of Directors.
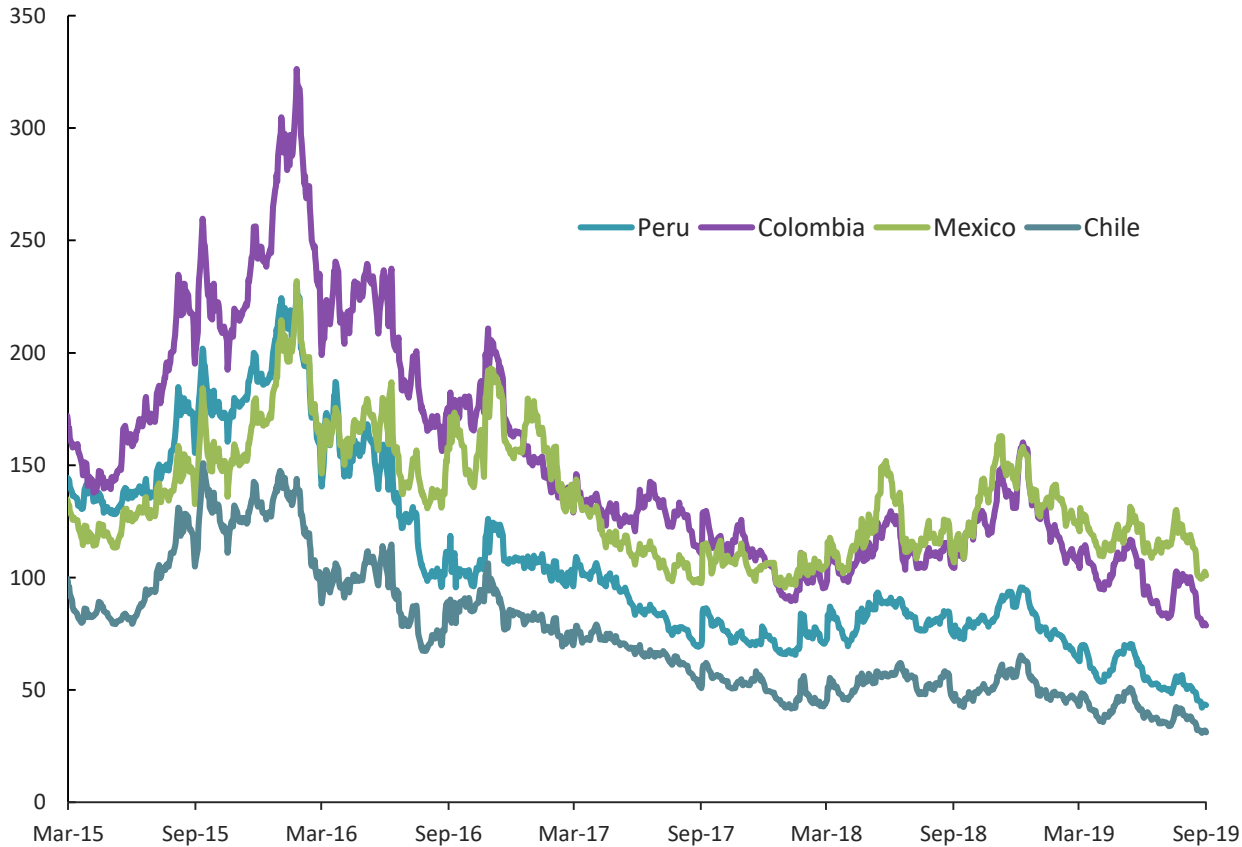
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External Conditions

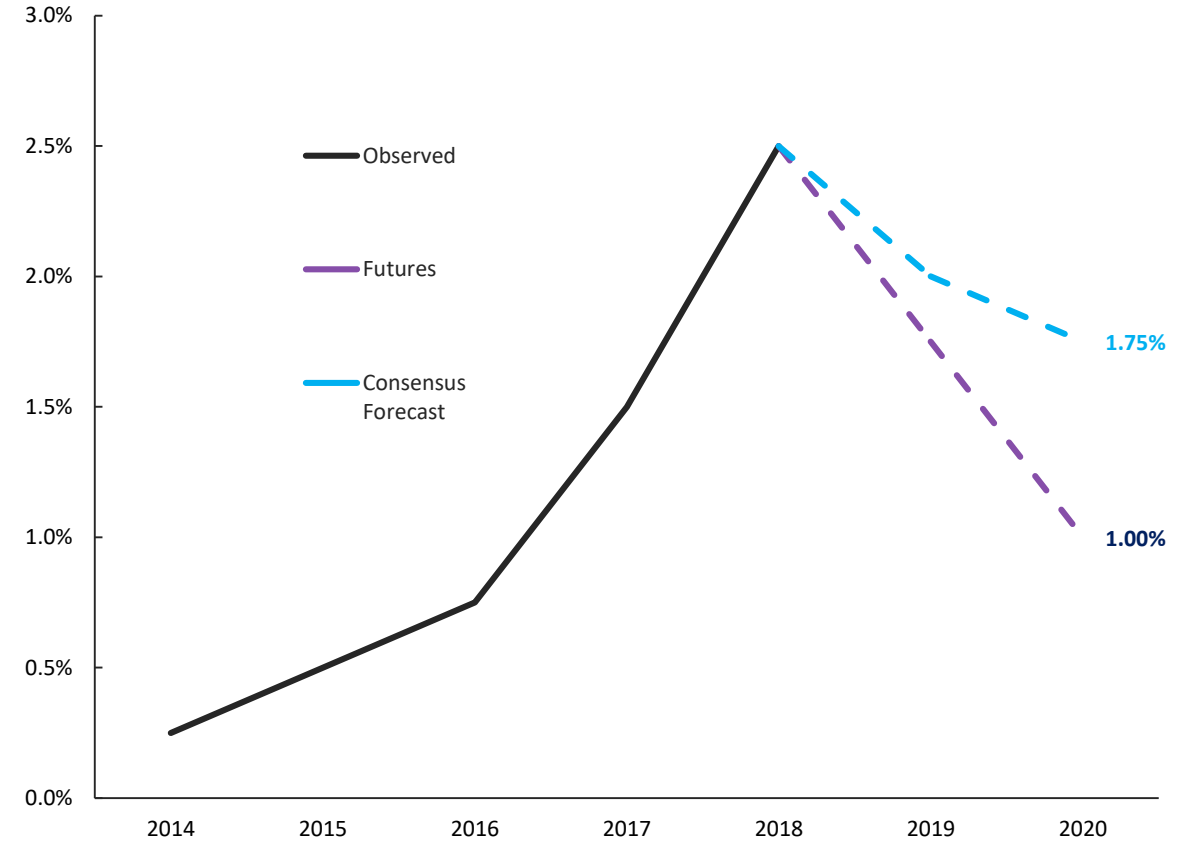Growth, inflation and policy responses

Risks

Financial system

- International financial conditions have improved and expectations of further monetary easing in advanced economies have increased.
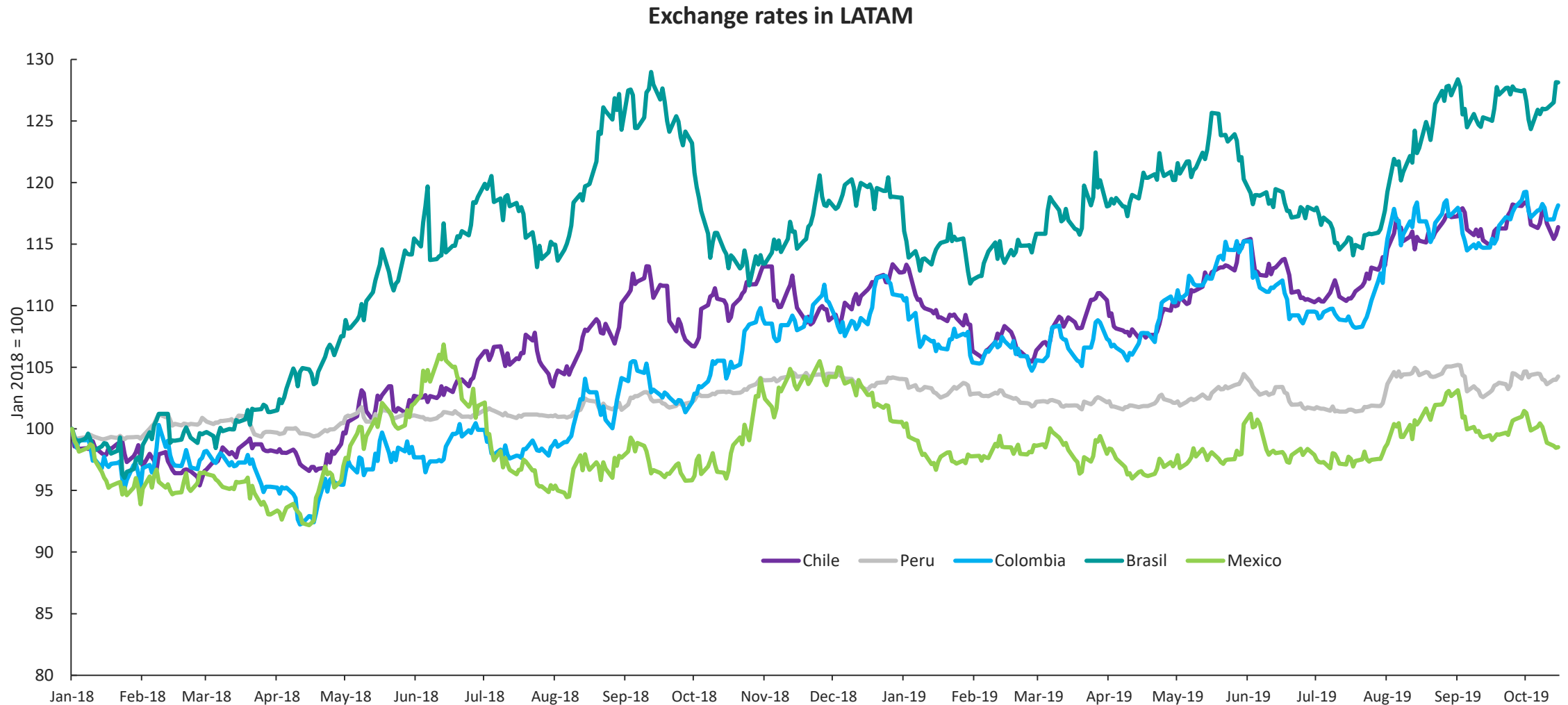
5-Year CDS
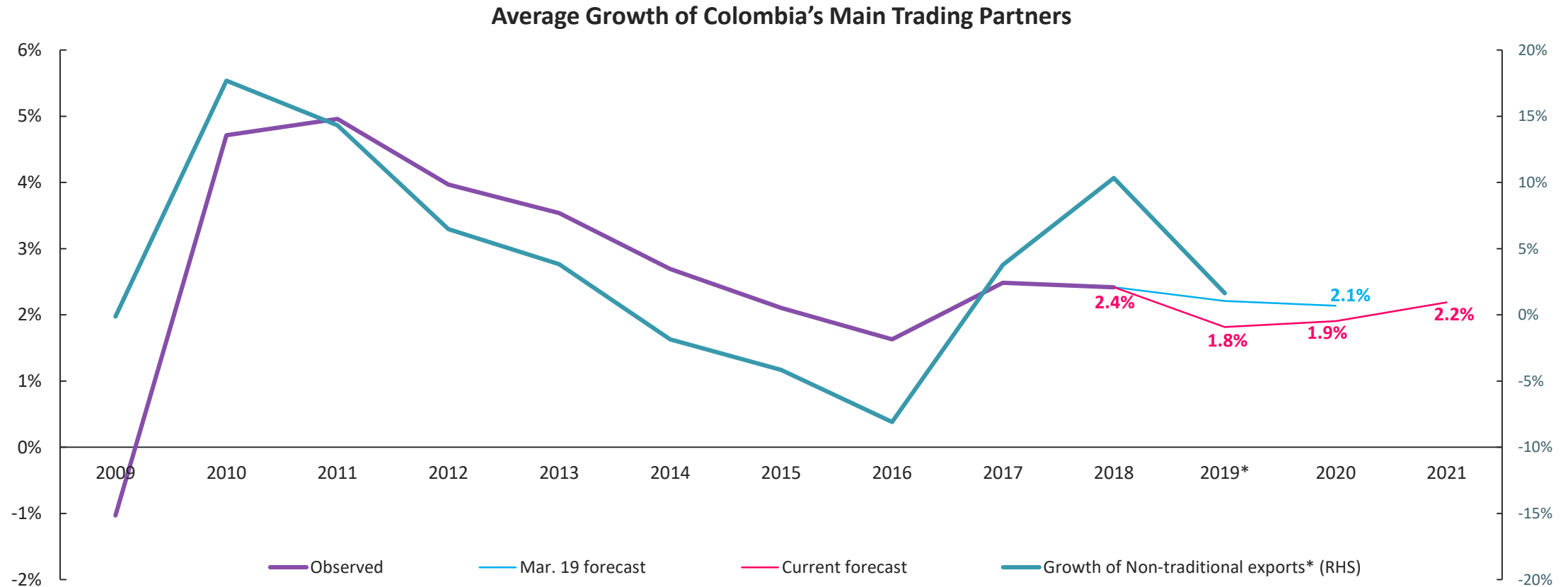

Fed funds rate upper bound and forecasts

Source: Bloomberg and Consensus Forecast.

- Despite the lower risk premia and the expectations of lower fed funds rate, EM currencies have depreciated.

Exchange rates in LATAM

Legend: Chile, Peru, Colombia, Brasil, Mexico
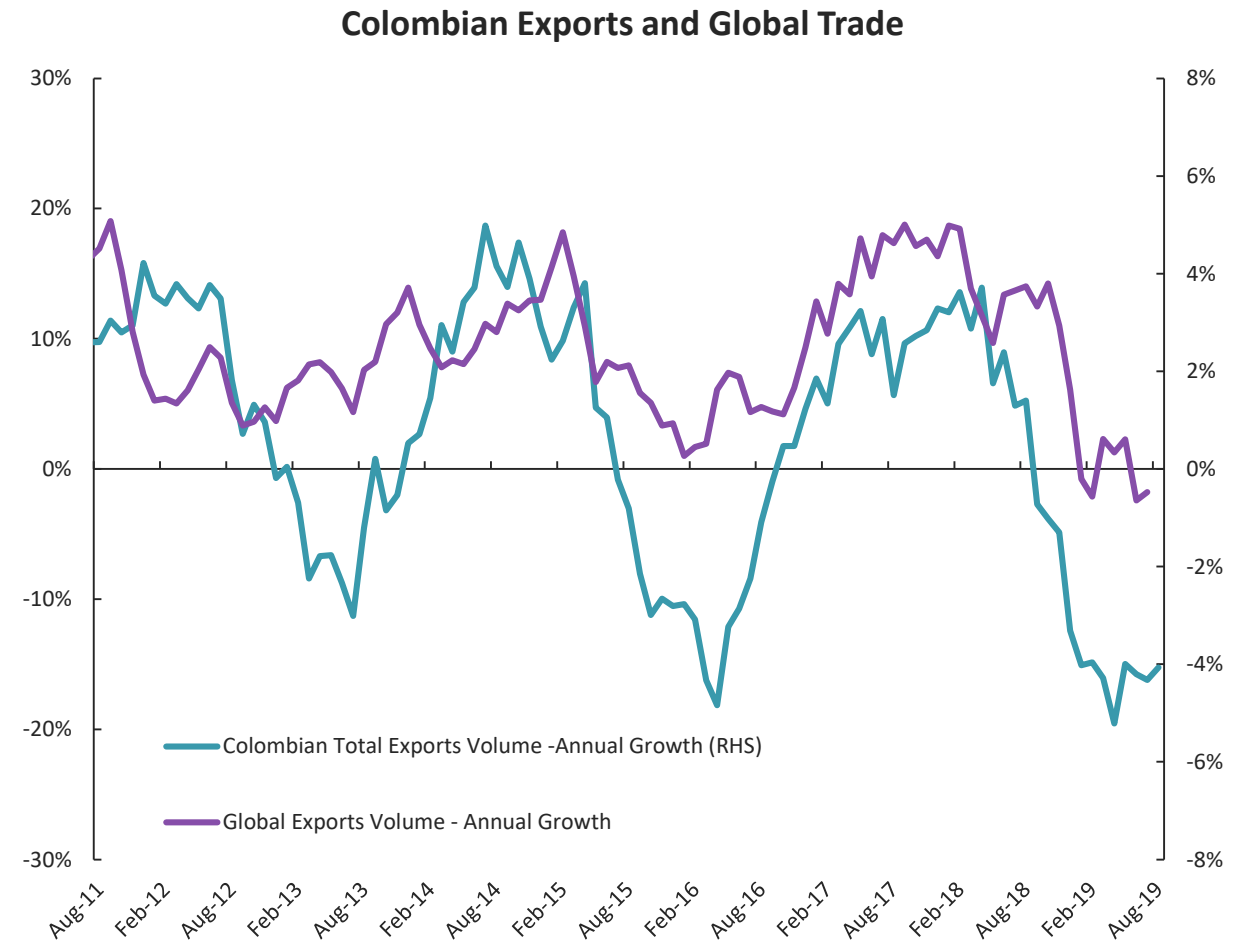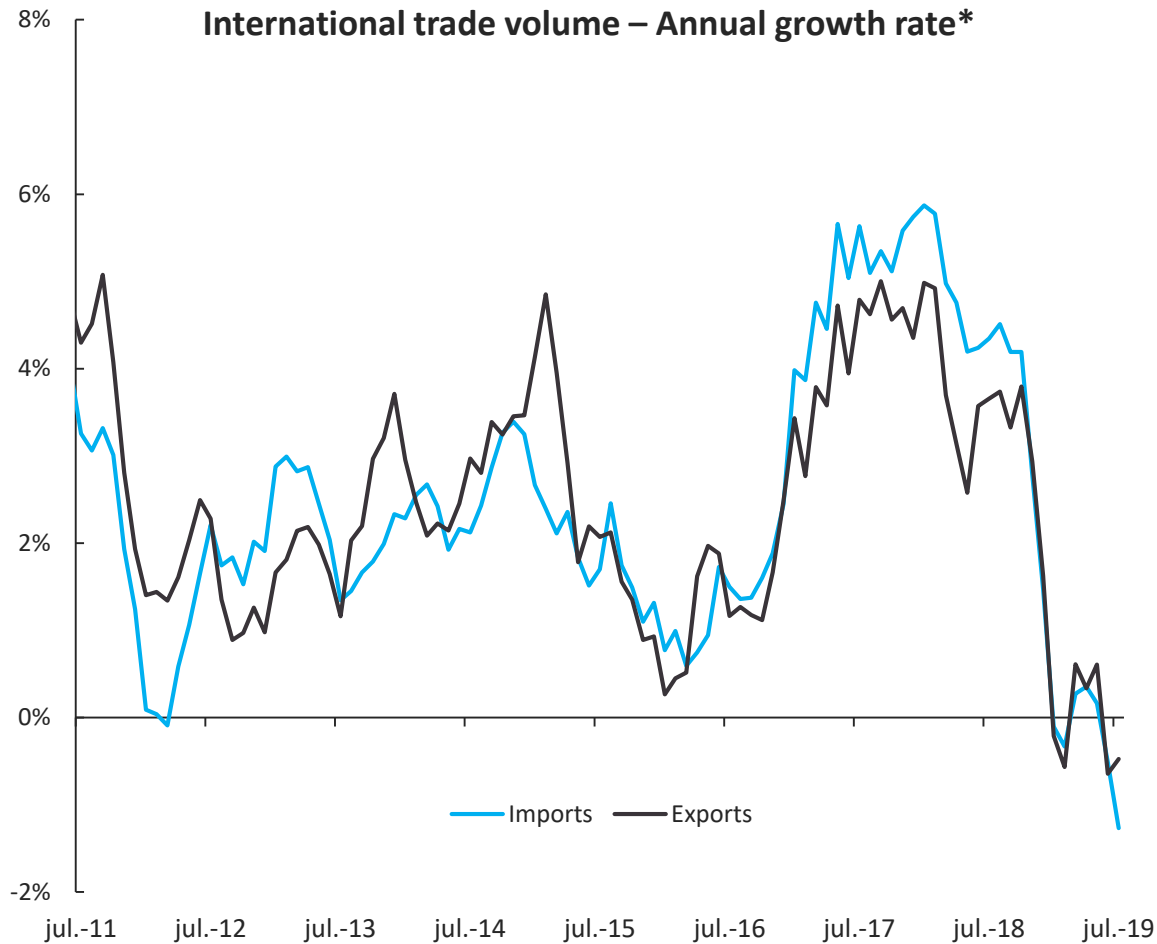
Source: Bloomberg.

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- Growth has deteriorated and a deceleration of the global economy is now a source of concern.
- In this scenario, the growth of Colombia's trading partners is expected to slow down.

Average Growth of Colombia's Main Trading Partners

Legend: Observed — Mar. 19 forecast — Current forecast — Growth of Non-traditional exports* (RHS)

[1] USA, Euro area, China, Brazil, Ecuador, Peru, Mexico, Chile. Weighted by non-traditional exports. * Non-traditional exports exclude coffee, oil and derivatives, coal, ferronickel, gold, bananas and flowers. For 2019 first semester YoY growth.

Source: *Banco de la República* and *Departamento Administrativo Nacional de Estadística* - DANE

- Trade tensions might be driving down industrial production and global trade, which implies a downside risk for the economic activity in Colombia and other EMEs.

International trade volume – Annual growth rate*

Imports ——— Exports

Colombian Exports and Global Trade

—— Colombian Total Exports Volume -Annual Growth (RHS)

—— Global Exports Volume - Annual Growth

Source: CPB – Bureau for Economic Policy Analysis and Banco de la República
*Annual growth rate for the quarterly moving average.

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- Lower growth and the uncertainty about the global economy could affect commodity prices and the level of Colombia's terms of trade.

Oil Prices (Brent, WTI)
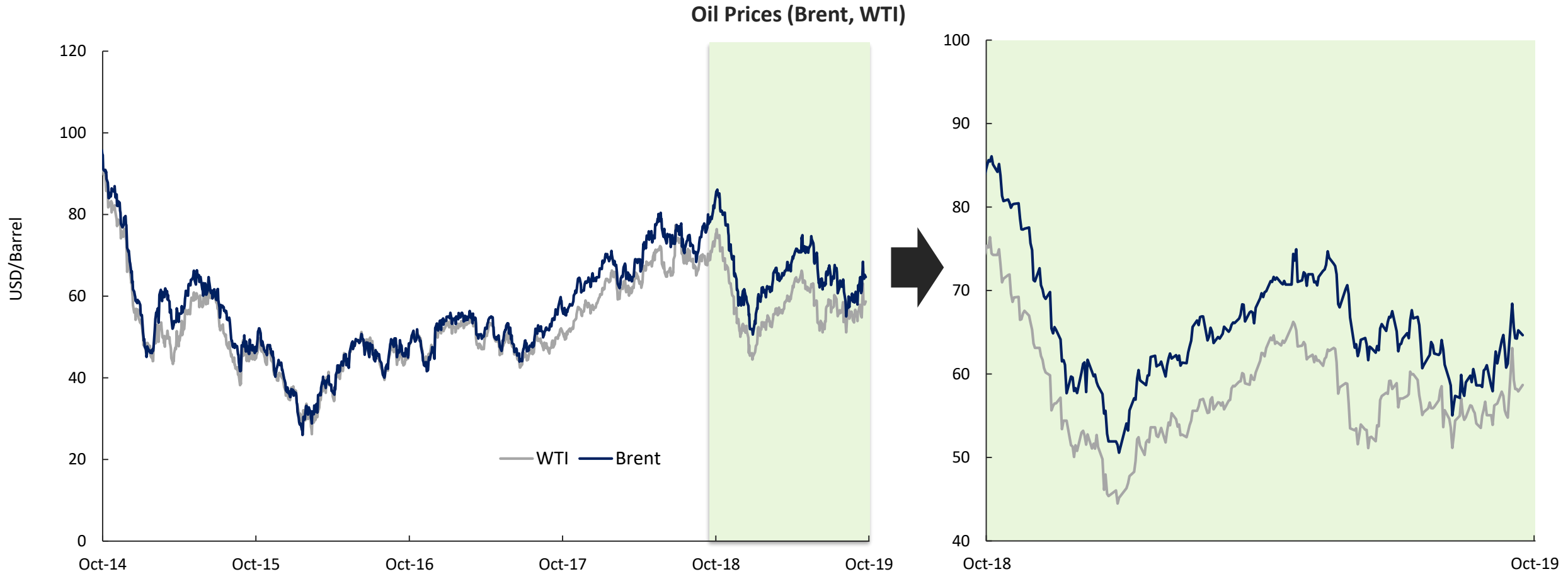
Source: U.S Energy Information Administration (EIA)

- This in turn could have negative impact on investment and the fiscal accounts.
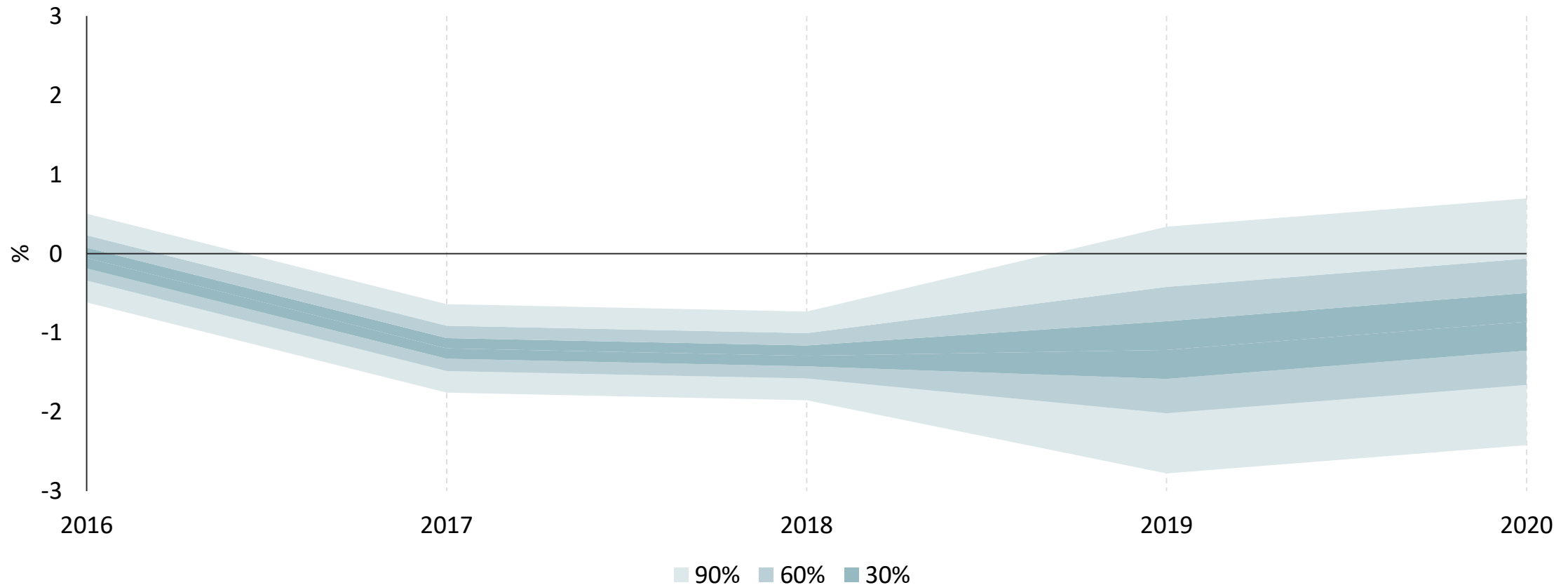
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External Conditions

Growth, inflation and policy responses

Risks

Financial system

- There has been a persistent negative output gap that is expected to close over the next two years.

**Fan Chart for the Output Gap**

90%   60%   30%

Source: Banco de la República.
a/ The graph shows the symmetric intervals at 30%, 60% y 90% confidence levels for the output gap path over an 8 month horizon. The intervals are built from the forecast errors of the central scenario.
b/ The results assume an active monetary policy in which the monetary policy rate is adjusted to reach the inflation target.

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- Growth is expected to increase in 2019 on the back of a dynamic private domestic demand.
- The growth figure for Q2 was surprisingly positive after a disappointing Q1. For 2019, BanRep estimates a growth rate of 3,2%.

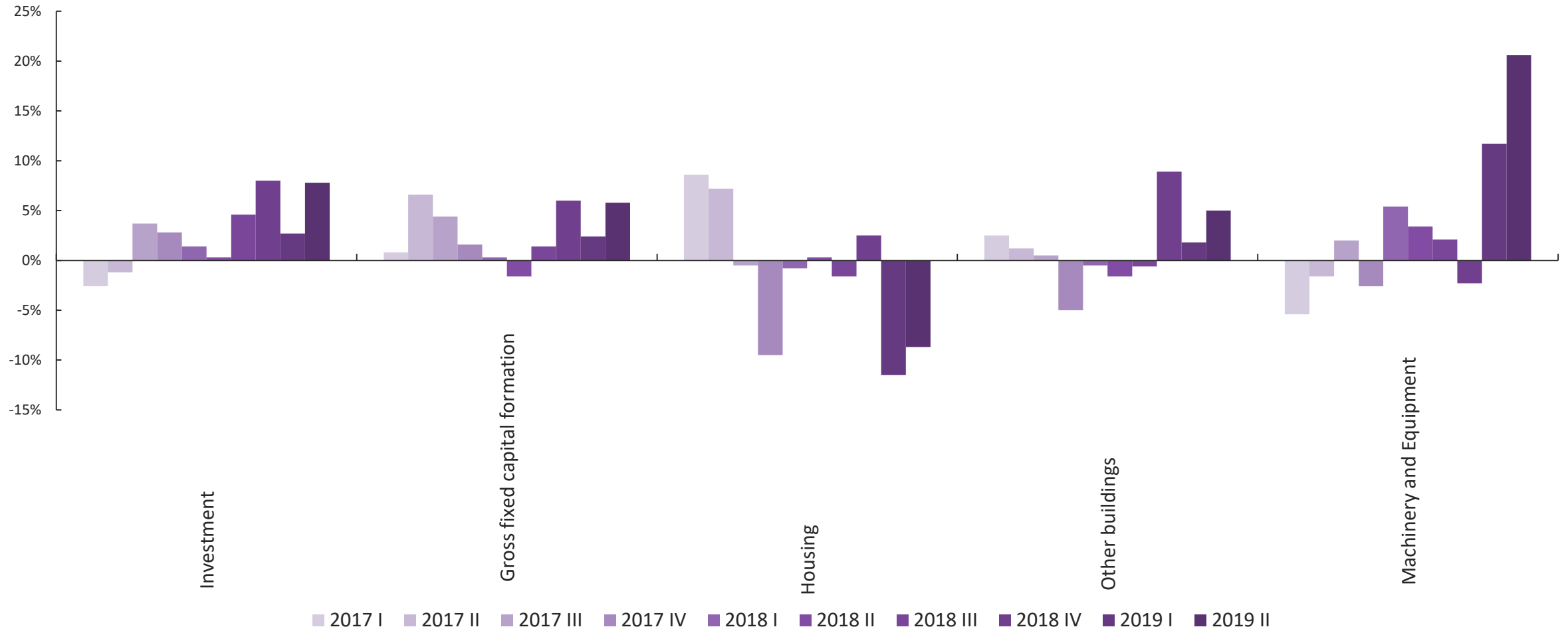**GDP and Domestic Demand**
(Annual Growth Rate)
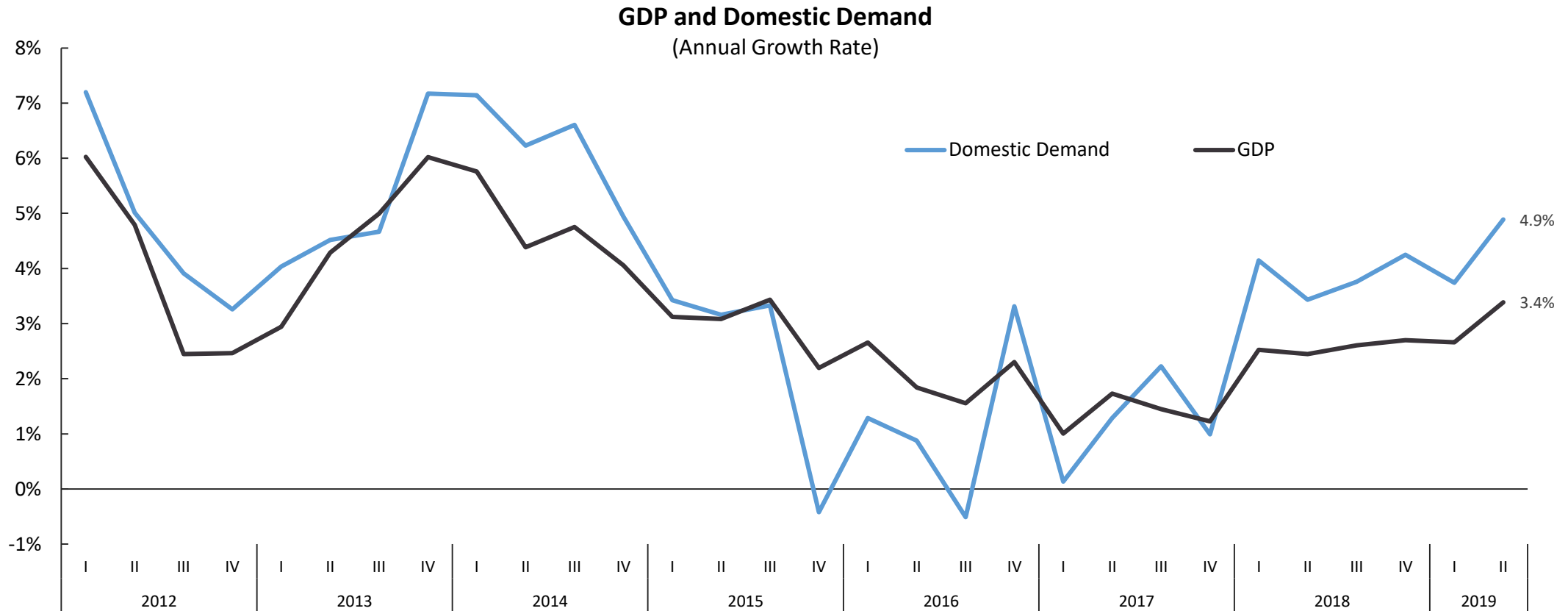
Source: DANE and Banco de la República.

- Public consumption at the regional level has been robust in 2019. For the central government however, some weakness has been observed.

- Investment remains strong, except for the housing sector.

Investment and its Components
(Annual Growth Rate)

Legend: 2017 I, 2017 II, 2017 III, 2017 IV, 2018 I, 2018 II, 2018 III, 2018 IV, 2019 I, 2019 II

Categories: Investment, Gross fixed capital formation, Housing, Other buildings, Machinery and Equipment

Source: DANE. Calculations by Banco de la República
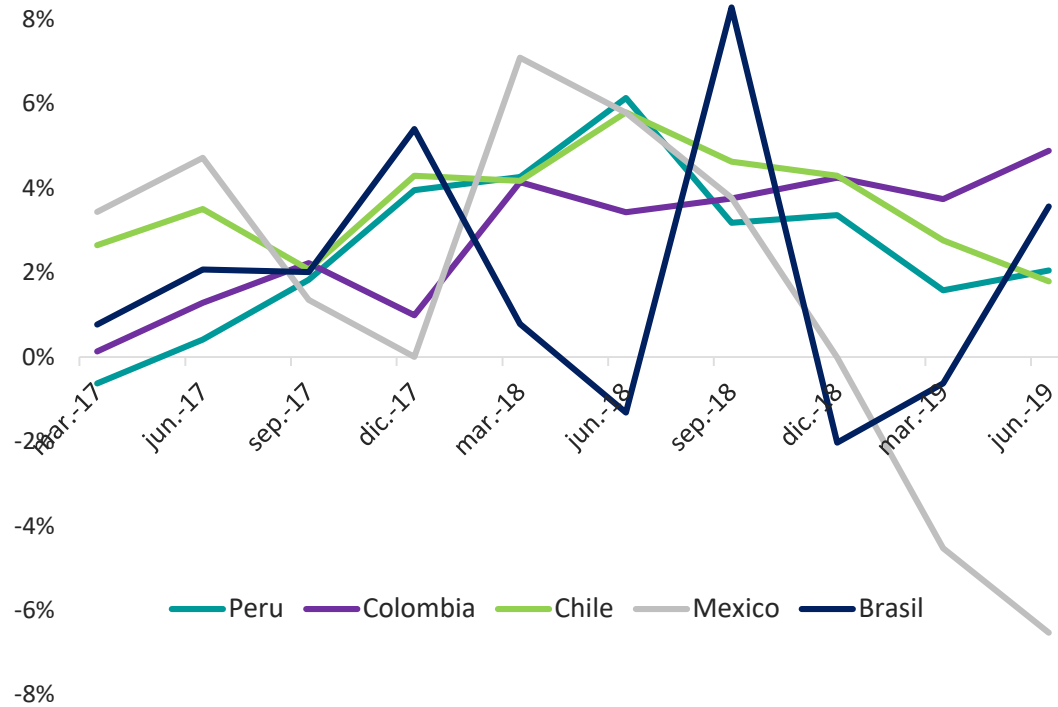
- Private consumption is growing fast.

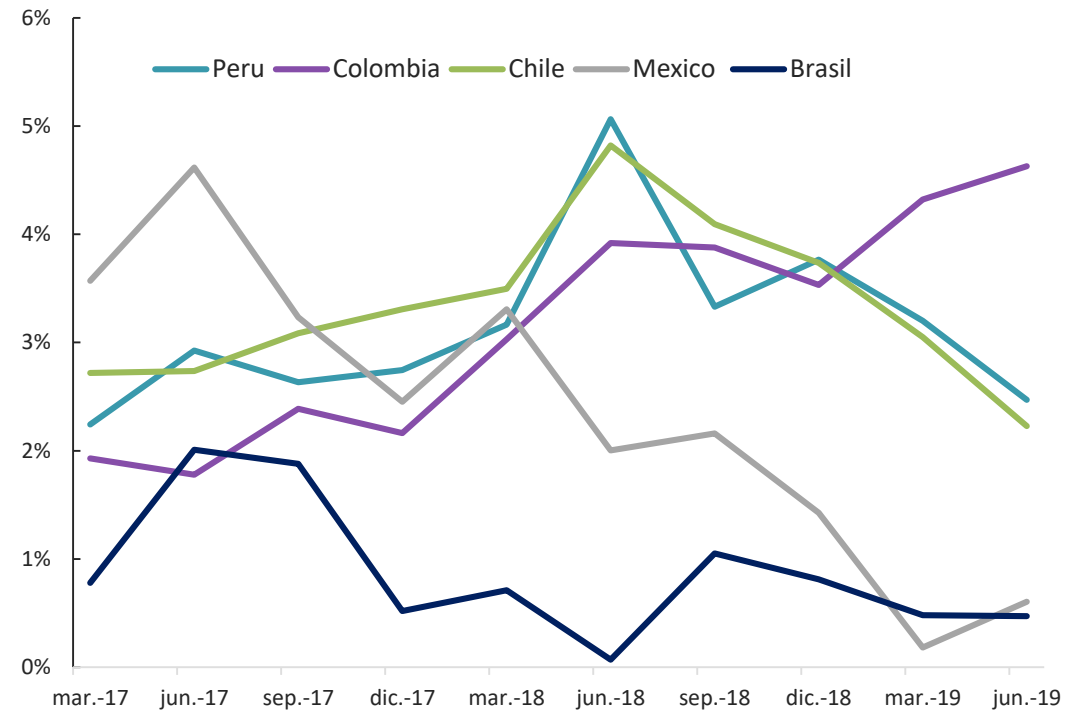**Household Consumption – Annual Growth Rate**
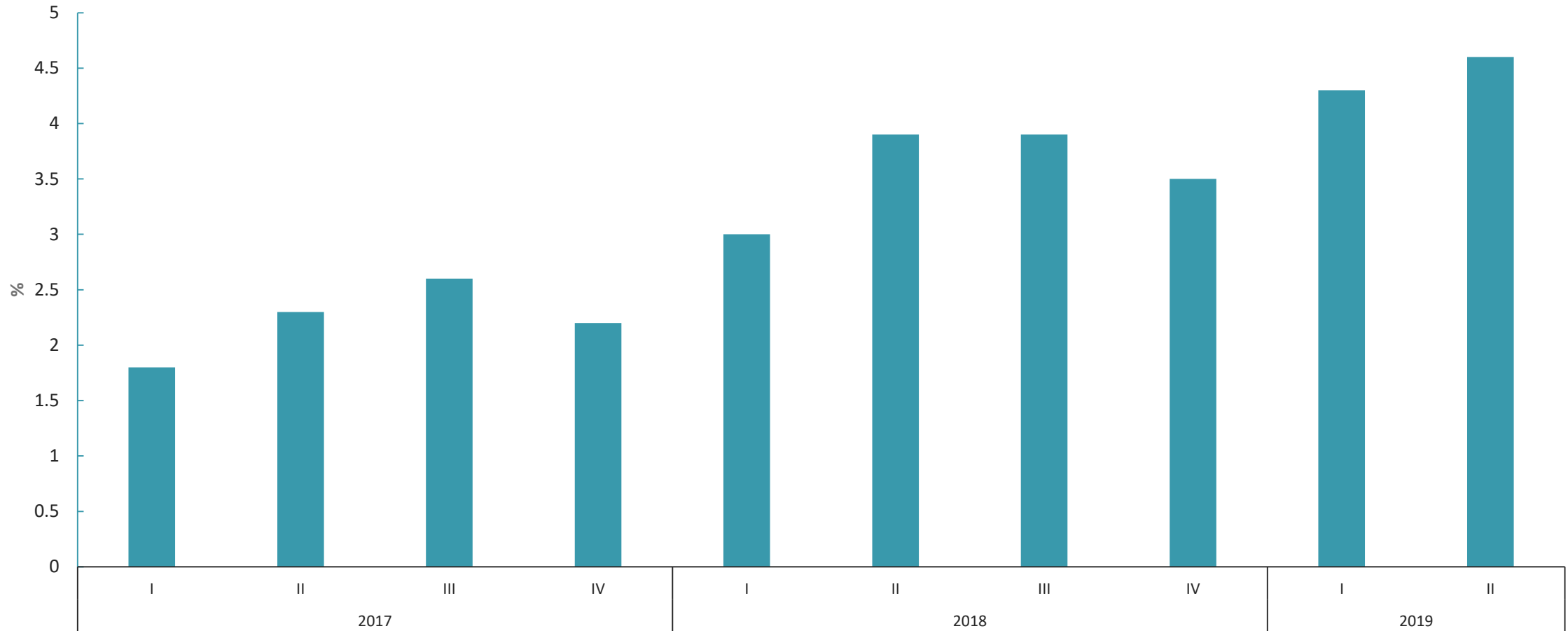
*Seasonally adjusted. Source: DANE.

- Internal demand and consumption in Colombia remain strong compared to other countries in the region.

Internal Demand – Real Annual Growth Rate
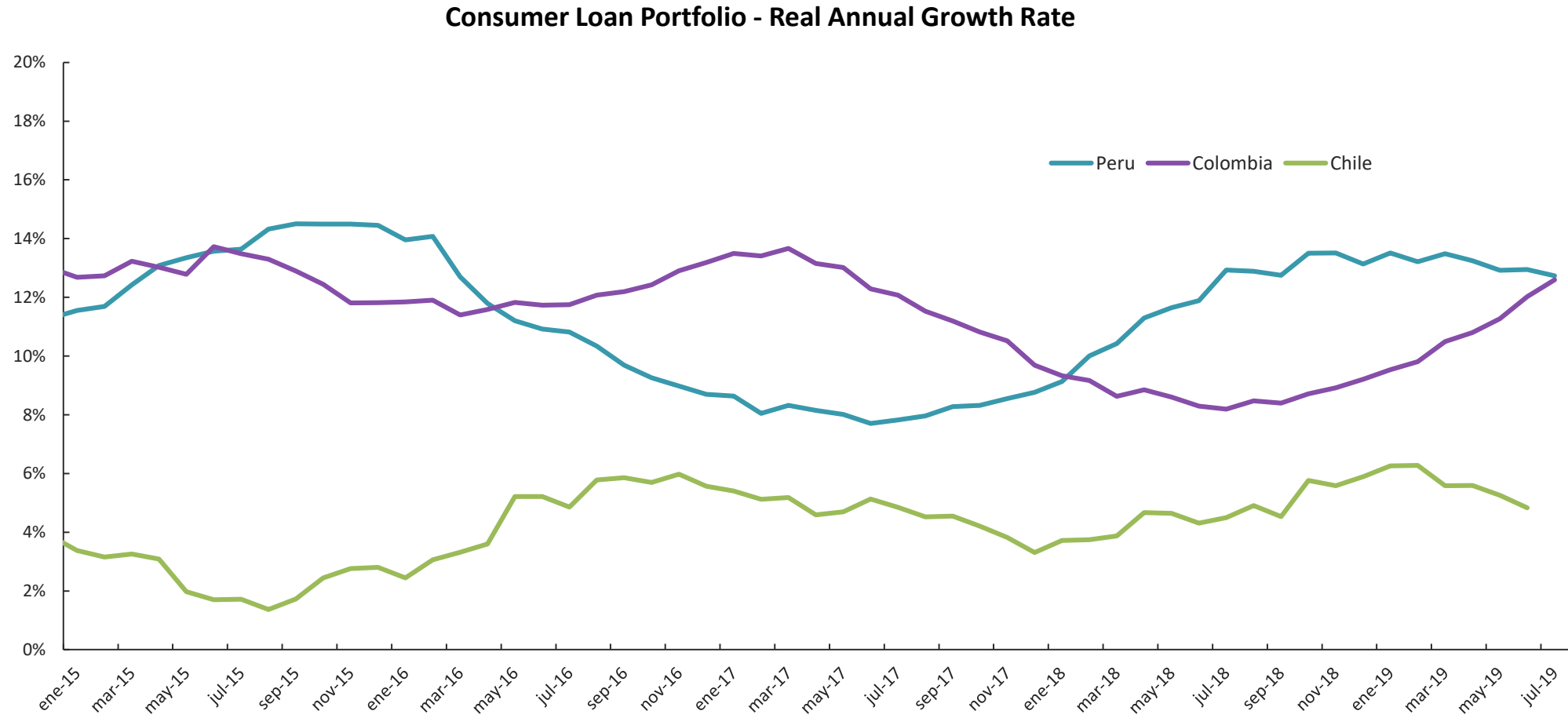

Legend: Peru, Colombia, Chile, Mexico, Brasil

Household consumption – Real Annual Growth Rate


Legend: Peru, Colombia, Chile, Mexico, Brasil

Source: Central Banks. For Chile, household consumption includes NPISH.

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- This is consistent with a strong growth of consumer loans.

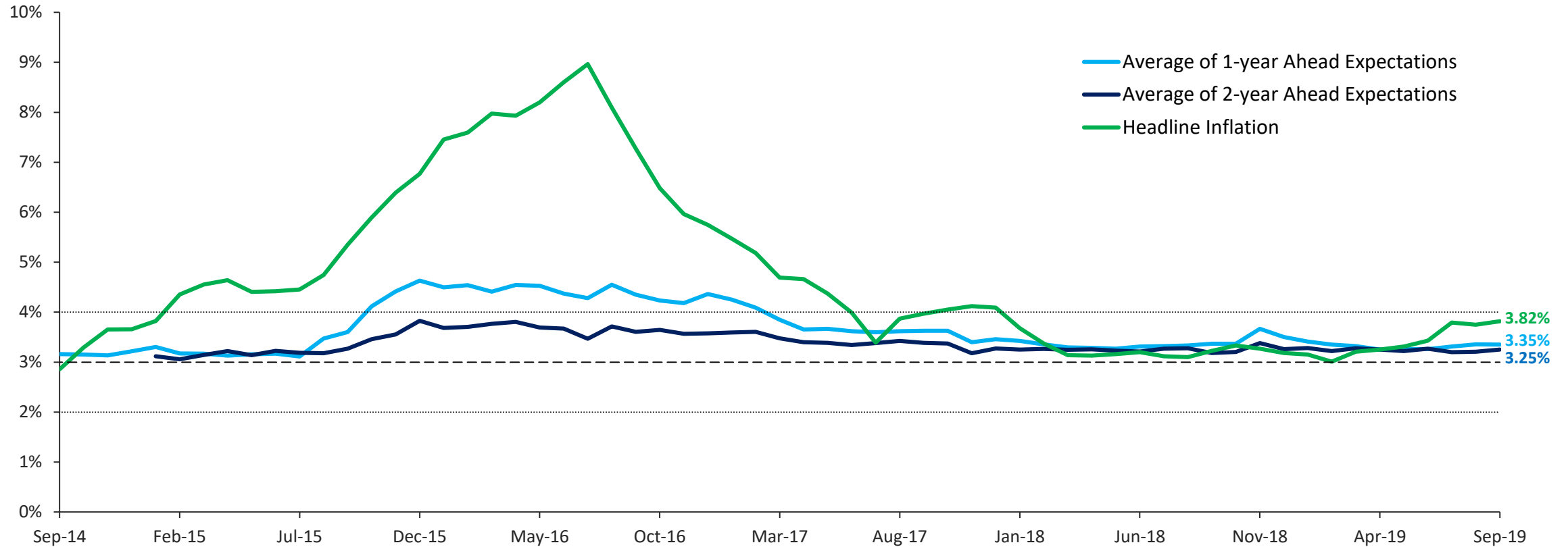**Consumer Loan Portfolio - Real Annual Growth Rate**

Legend: Peru, Colombia, Chile

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- Imports have increased due to higher domestic demand. As a result, the current account deficit is widening.

Current Account Balance

Source: Banco de la República and DANE
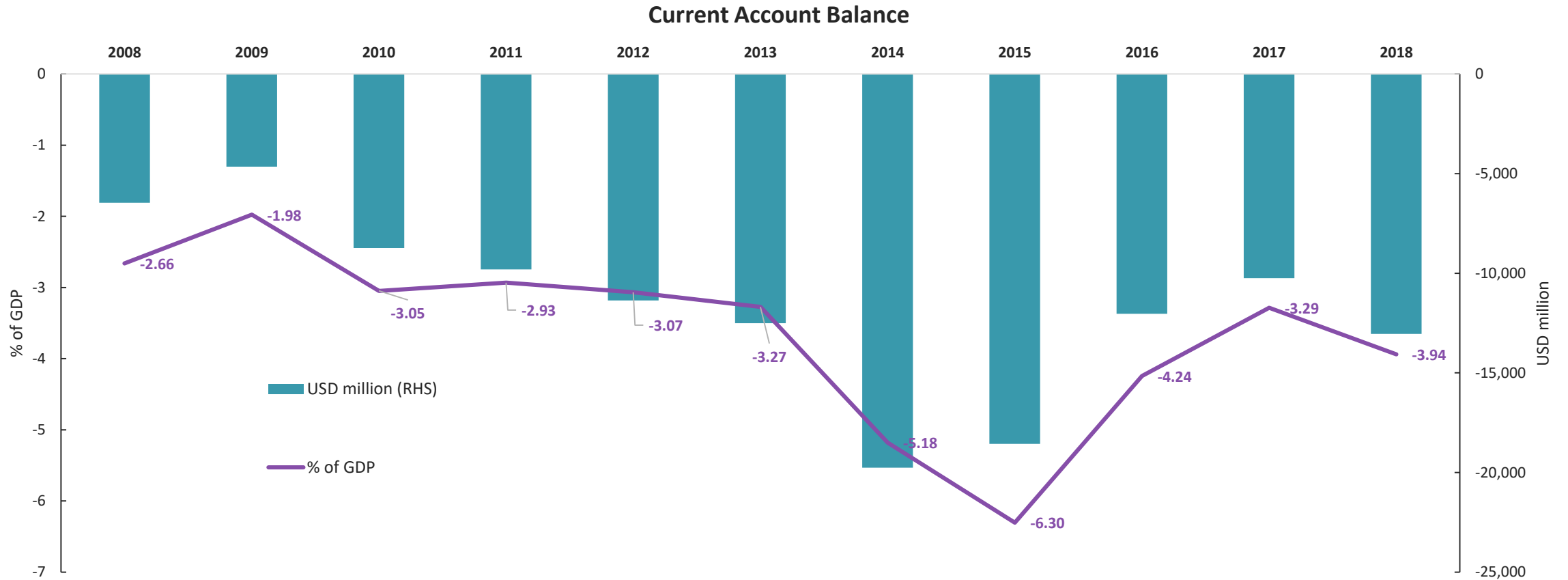
- Inflation expectations are close to target over the policy horizon.

Inflation and Inflation Expectations

Legend:
- Average of 1-year Ahead Expectations
- Average of 2-year Ahead Expectations
- Headline Inflation

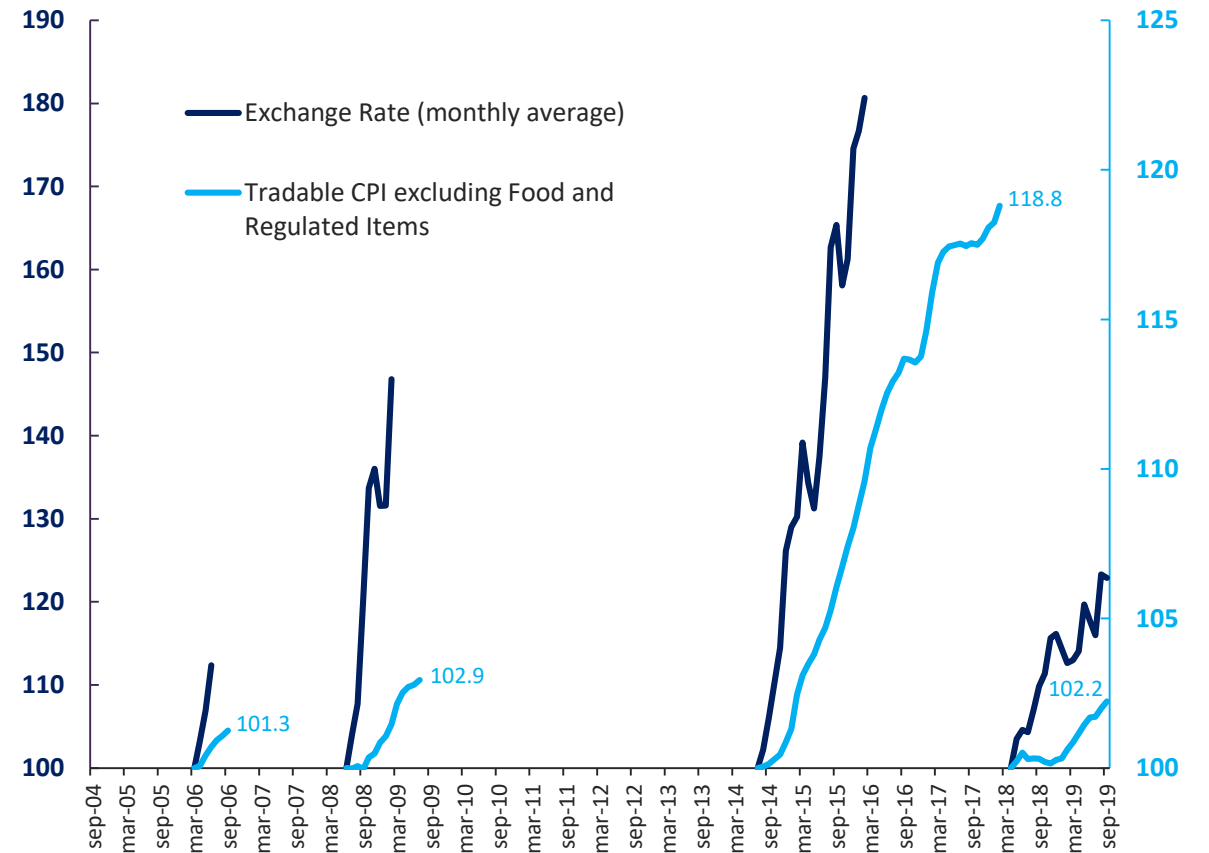End values:
- 3.82%
- 3.35%
- 3.25%

- We are facing a transitory shock, but inflation should converge to the 3% target in 2020.

- Recent episodes have shown evidence of low pass-through in Colombia when compared to the region.
- Inflation should remain subdued if pass-through remains low. Hence, the recent depreciation of the COP is not expected to entail a significant risk for the achievement of the inflation target.


Exchange Rate Pass-Through Estimates*

- Pass-through (headline)
- Pass-through (core)
- Implied pass-through
- Import content
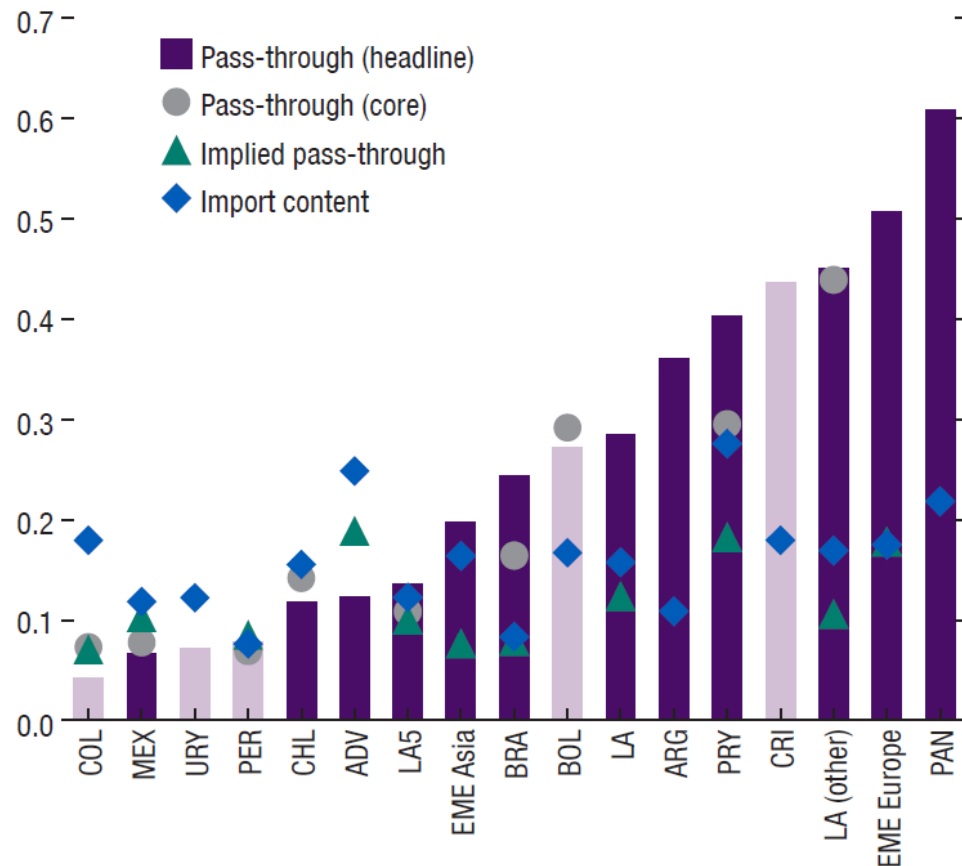
Exchange Rate and Tradable CPI

- Exchange Rate (monthly average)
- Tradable CPI excluding Food and Regulated Items

Source: DANE and the IMF-*Regional Economic Outlook 2016*. * The bars show the cumulative response of consumer prices two years after a 1 percent increase in the nominal effective Exchange rate. Pass-through estimates for individual countries are obtained from country-specific regressions while average regional pass-through correspond to panel model estimates. "Implied pass-through" corresponds to the product of the cumulative exchange rate pass-through to import prices after two years and the country-specific "import-content" of domestic consumption. "Import content" is the proportion of households' consumptions that is made of imports.
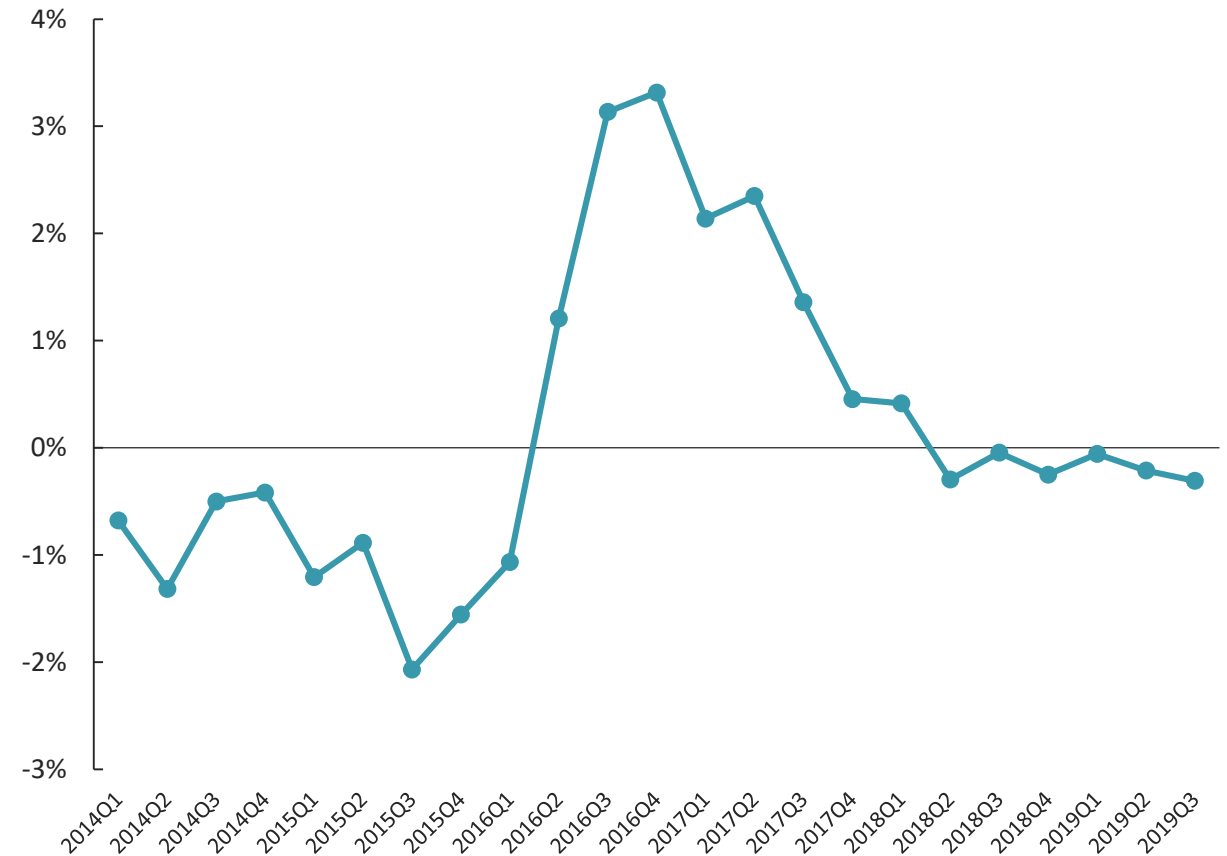
- In this scenario monetary policy has remained moderately expansionary, supporting a gradual closing of the negative output gap.

Policy Rate

4.50%   7.75%   4.25%
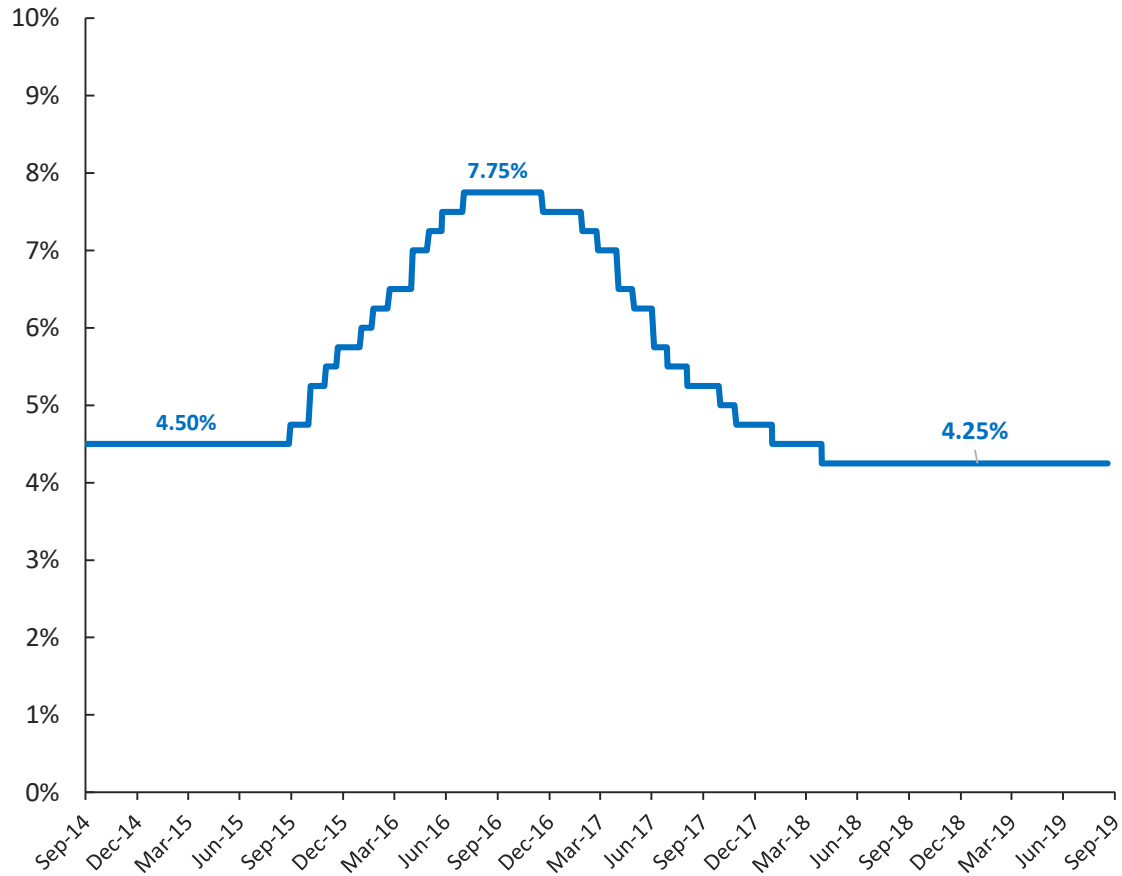
Source: Banco de la República.

Real interest rate gap

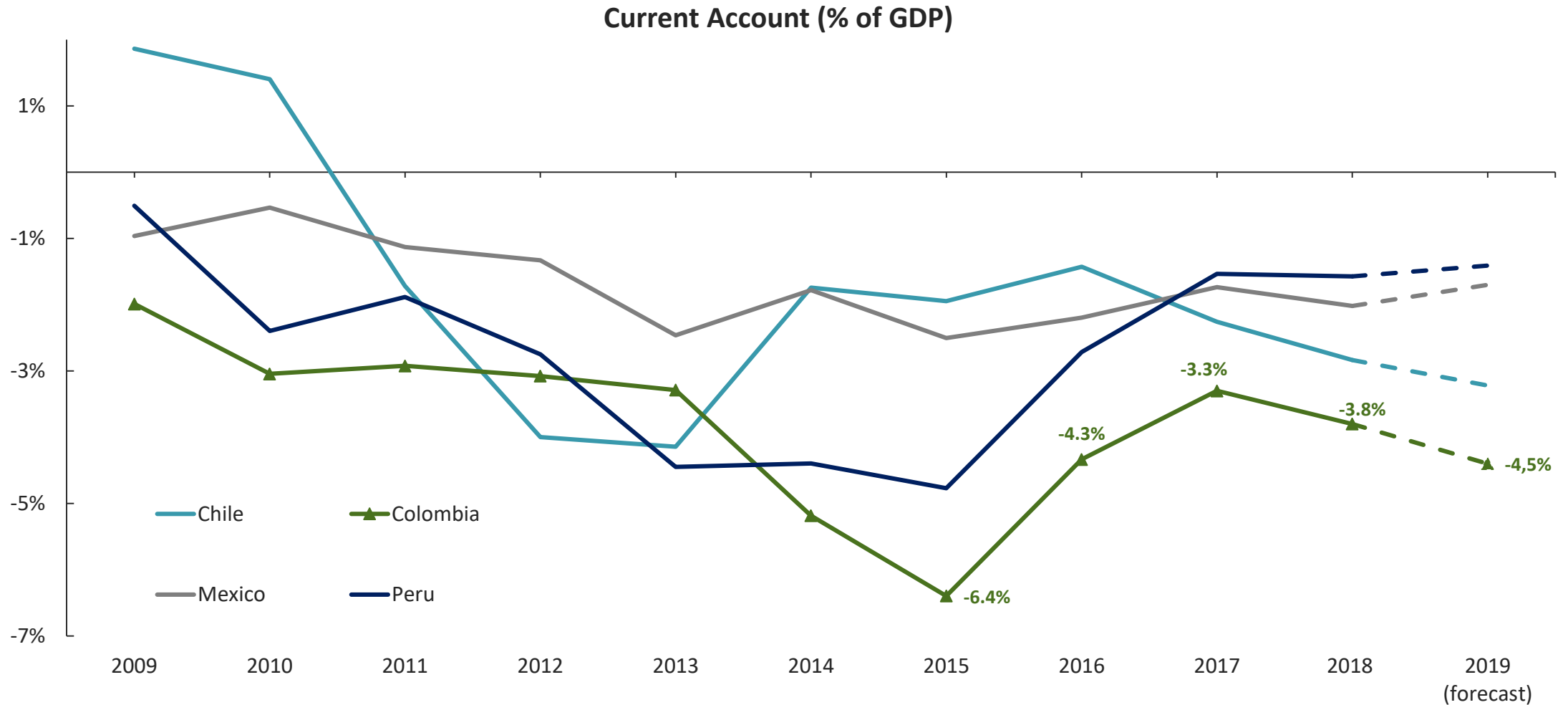Source: Banco de la República.

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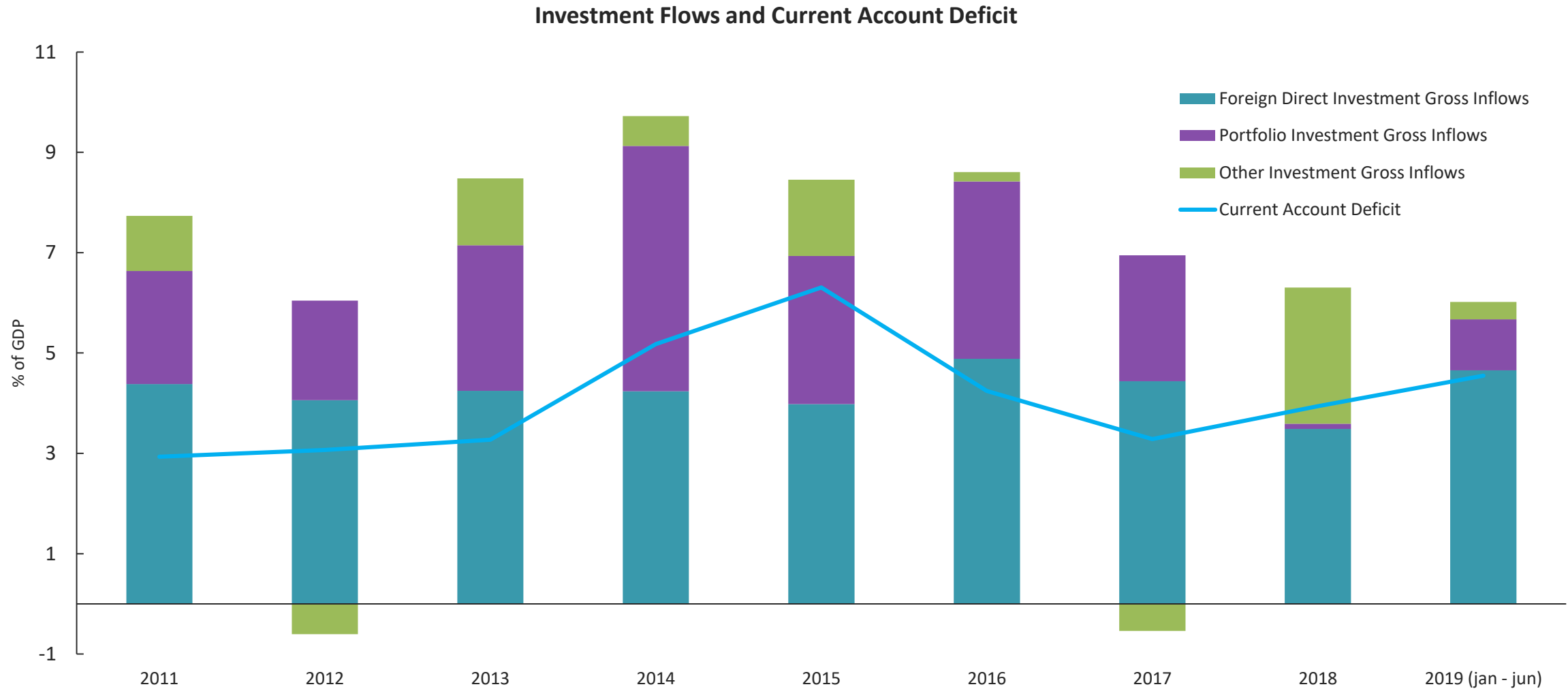External Conditions

Growth, inflation and policy responses

Risks

Financial system

- The rebound in domestic demand plus a weaker external demand is causing a widening of the current account deficit.

Current Account (% of GDP)

Chile — Colombia — Mexico — Peru

Labeled values (Colombia): -6.4%, -4.3%, -3.3%, -3.8%, -4,5%

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- But the current account deficit is being financed mostly by FDI.

Investment Flows and Current Account Deficit

Legend:
- Foreign Direct Investment Gross Inflows
- Portfolio Investment Gross Inflows
- Other Investment Gross Inflows
- Current Account Deficit

Y-axis: % of GDP

X-axis: 2011, 2012, 2013, 2014, 2015, 2016, 2017, 2018, 2019 (jan - jun)

Source: Banco de la República.

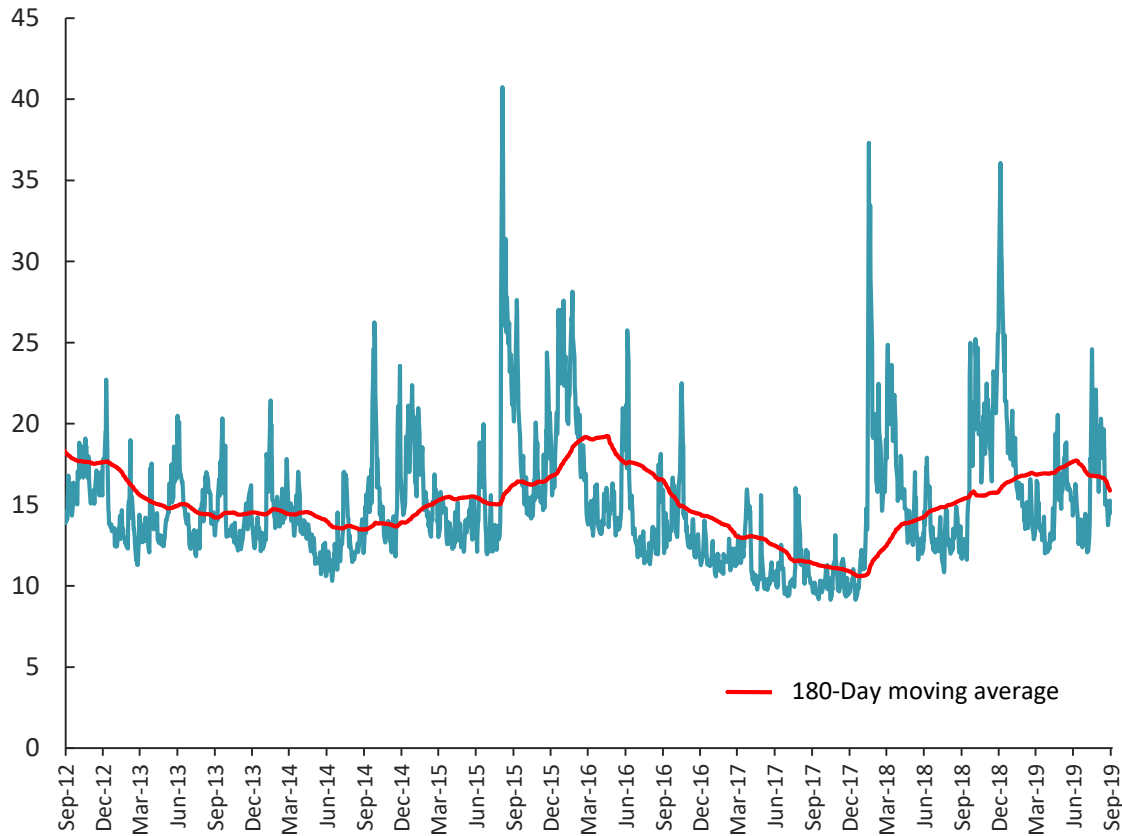- Net foreign assets without the stock of net FDI are substantially larger.

Net Foreign Assets as Percentage of GDP
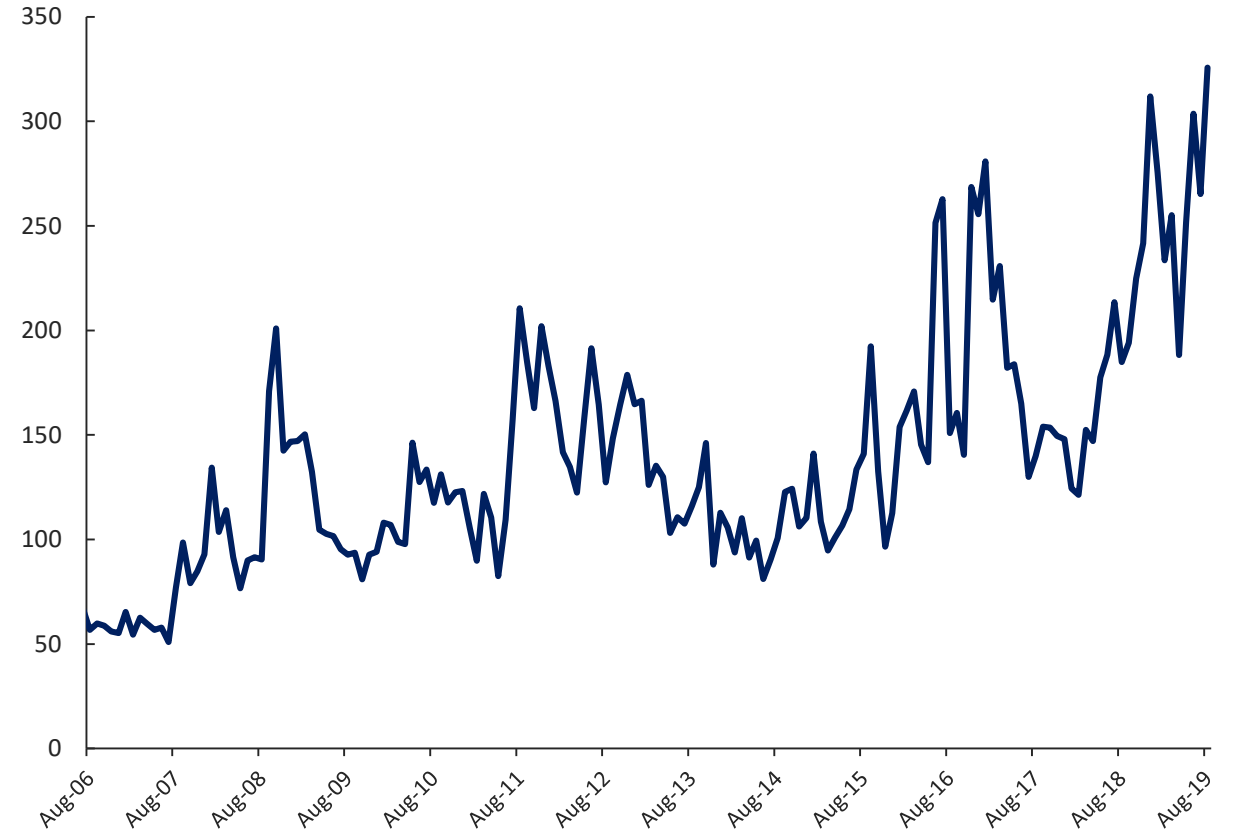

Source: Banco de la República.
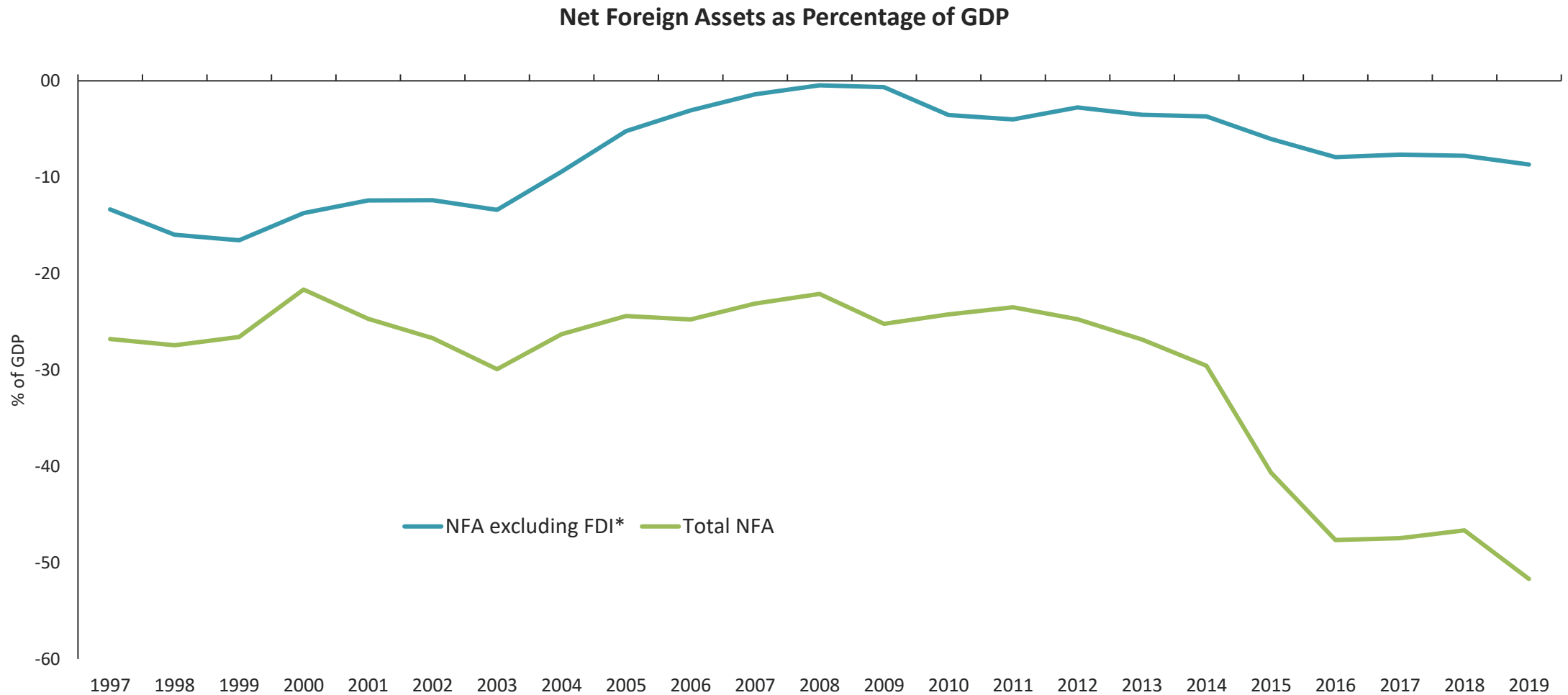
- And better international financial conditions should facilitate the financing of the current account deficit, albeit in a more volatile external environment.

VIX Index

180-Day moving average

Source: Bloomberg

Index of Global Economic Policy Uncertainty*


*The index reflects the relative frequency of own-country newspaper articles that contain a trio of terms pertaining to the economy (E), policy (P) and uncertainty (U). In other words, a national EPU index value is proportional to the share of own-country newspaper articles that discuss economic policy uncertainty in that month. The GEPU Index value for each month as the GDP-weighted average of 18 national EPU index values, Davis, Steven J., 2016. "An Index of Global Economic Policy Uncertainty," Macroeconomic Review

- Furthermore, the country holds adequate external liquidity buffers.

International Reserves - Percentage of IMF's ARA Metric

Legend: ■ Reserves ■ Flexible Credit Line

Adequate level suggested by the IMF
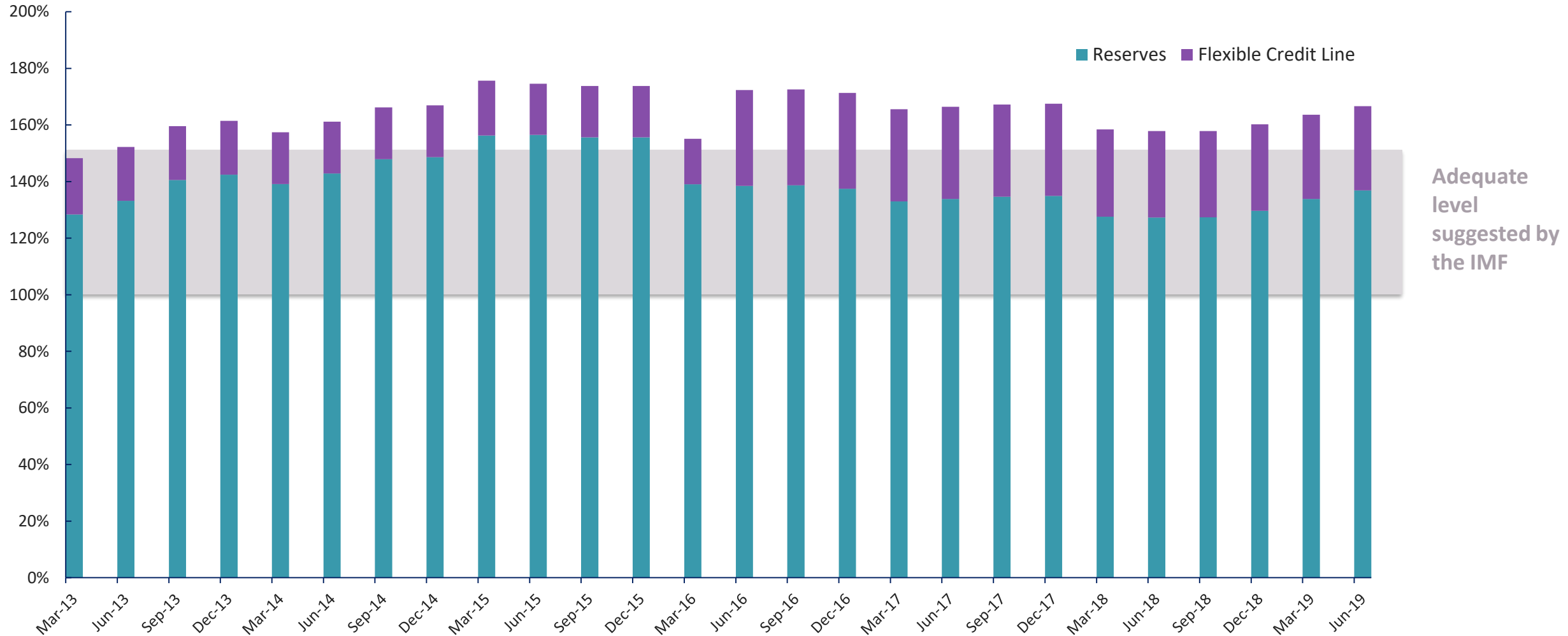
Source: IMF and Banco de la República. The ARA Metric is updated yearly, the reserves quarterly.

- The government's medium term fiscal framework envisions a declining path for the debt ratio. This forecast is subject to global and local uncertainty.

Central Government's Net Debt and Forecast under the Fiscal Rule
(% of GDP)
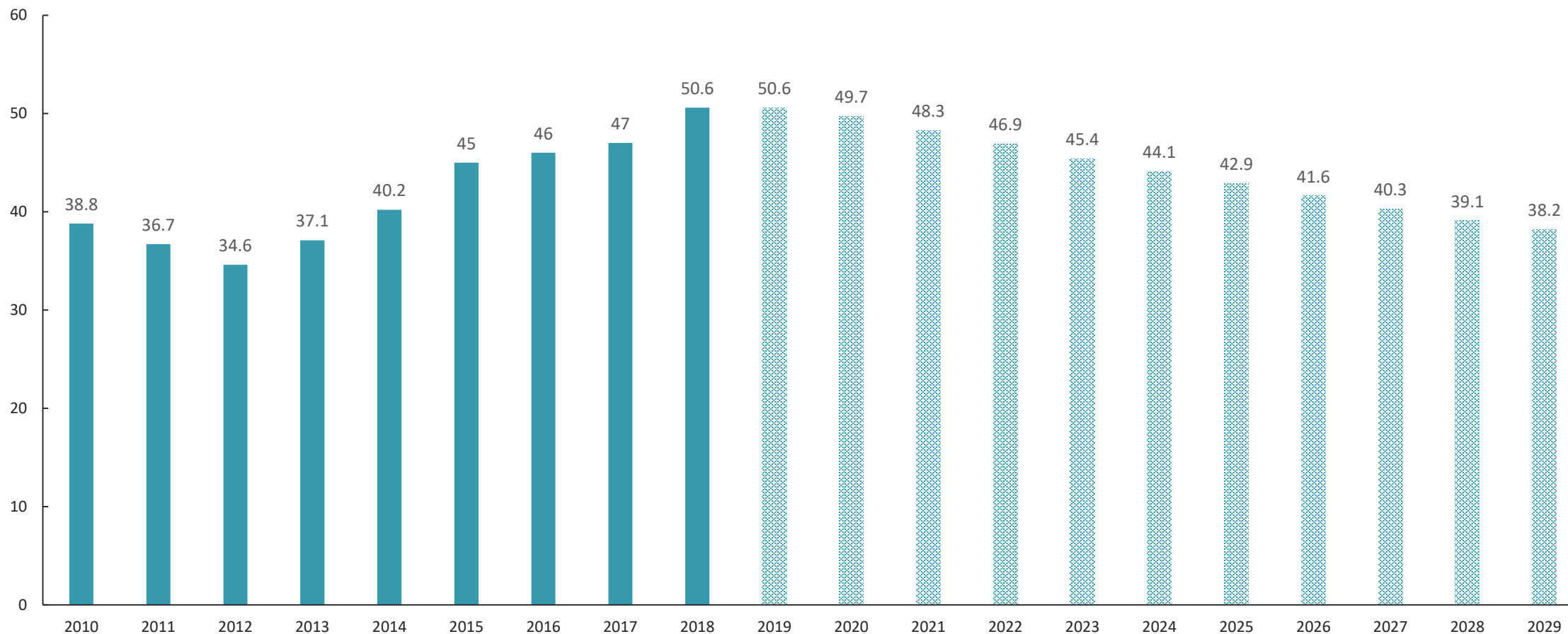
Source: Ministry of Finance – Medium Term fiscal Framework
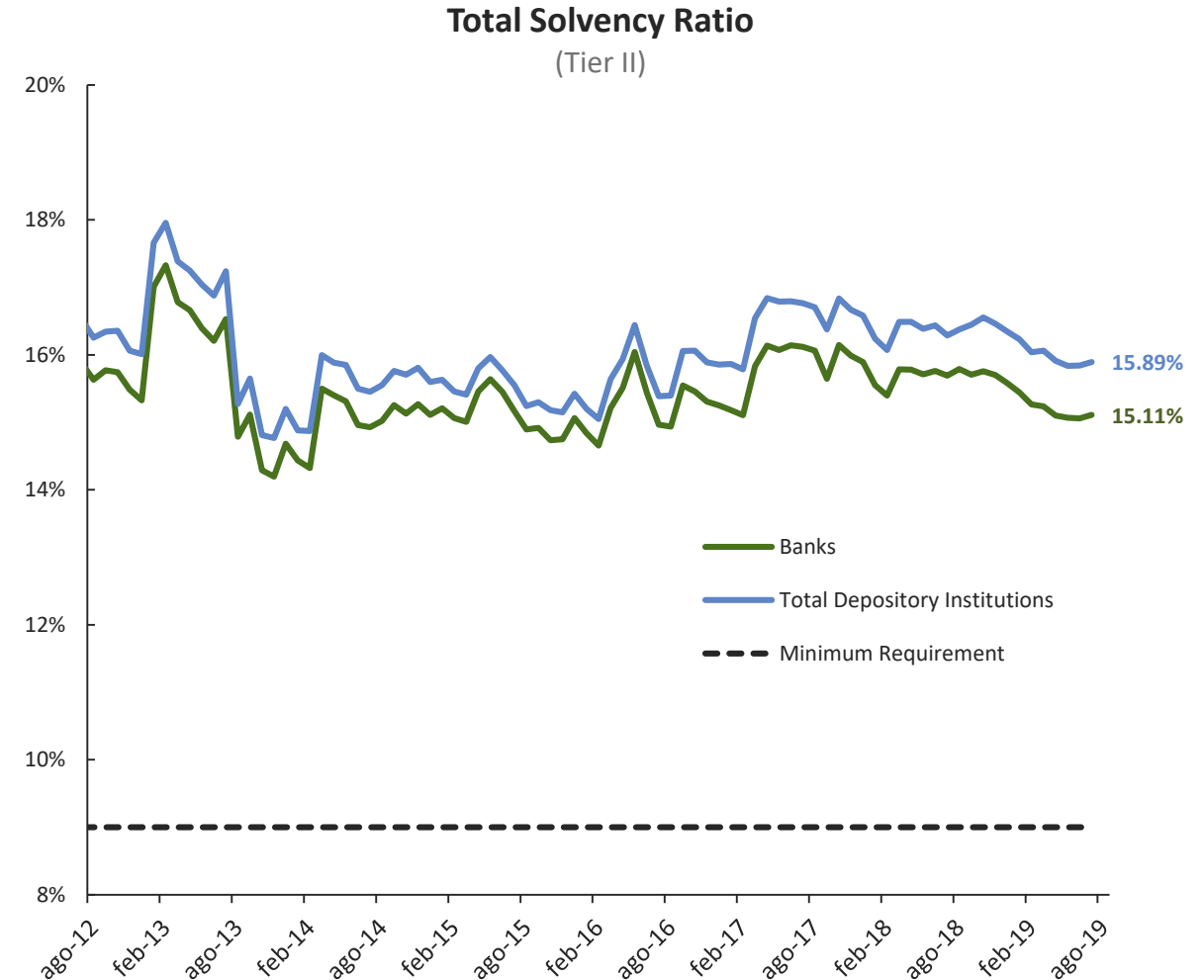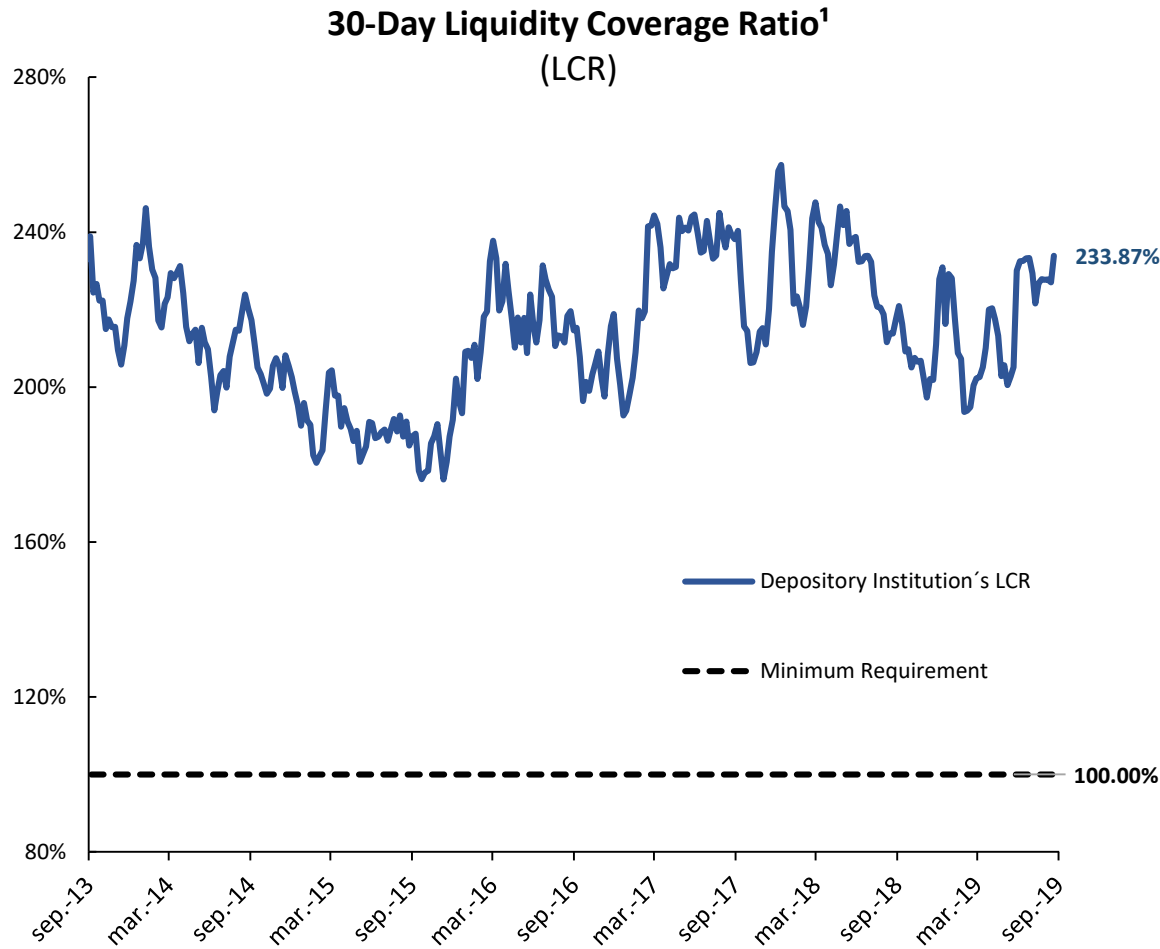
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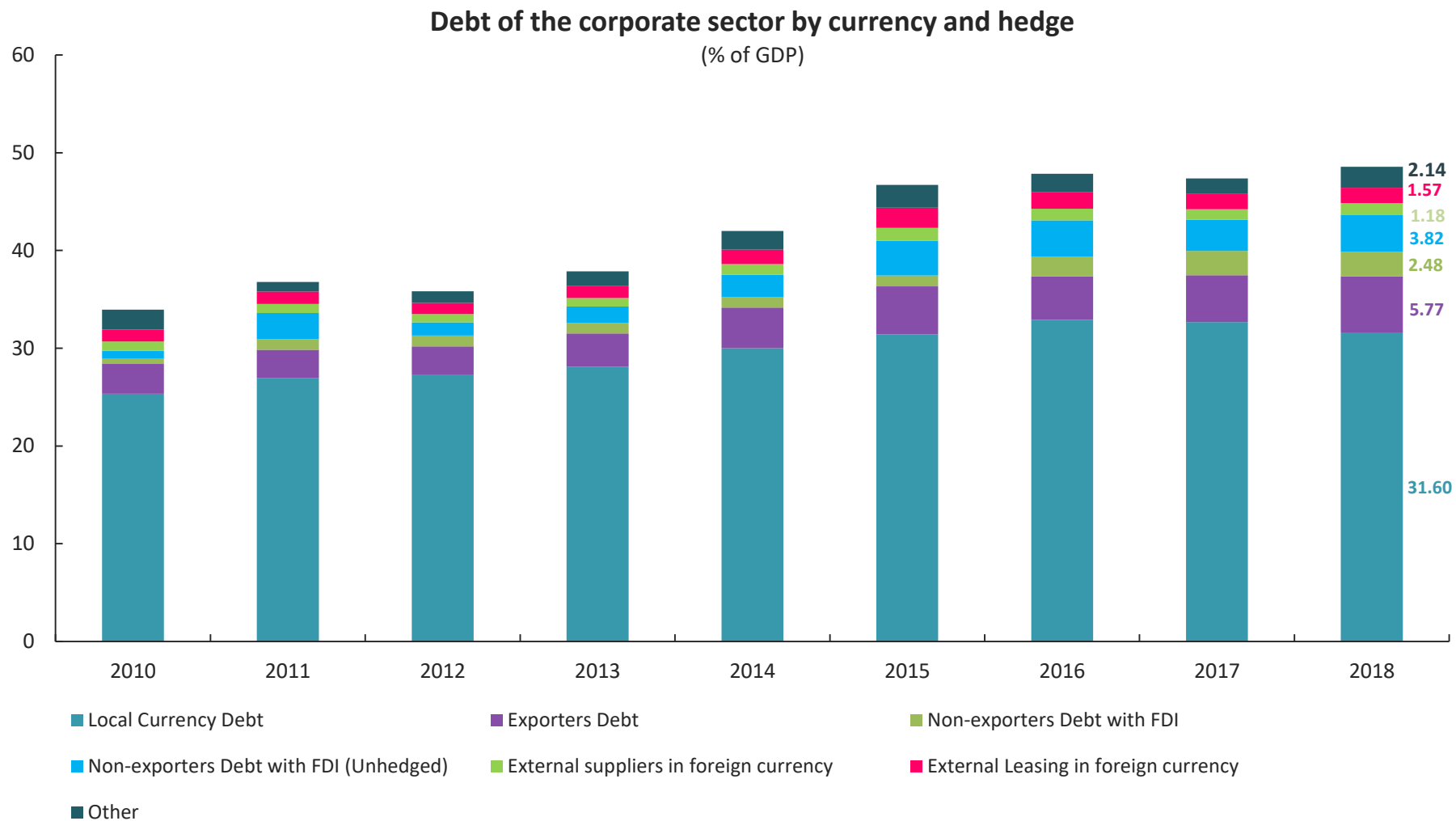Growth, inflation and policy responses

Risks

Financial system

- The financial system remains liquid, profitable and well capitalized.
- Convergence to the Basel III standard is underway.

30-Day Liquidity Coverage Ratio[1]
(LCR)

Depository Institution´s LCR

Minimum Requirement

233.87%

100.00%

Total Solvency Ratio
(Tier II)

Banks

Total Depository Institutions

Minimum Requirement

15.89%

15.11%

[1] 30-Day LCR is the ratio of high-quality liquid assets to total net cash outflows over the next 30 calendar days. In March 2019 the Liquidity Coverage Ratio (LCR) was adjusted to comply with Basel III. The indicator shown was adjusted to account for that change. Source: Superintendencia Financiera de Colombia. Calculations by Banco de la República.

- While currency mismatches remain low in both the real and financial sector.

Debt of the corporate sector by currency and hedge
(% of GDP)

Legend:
- ■ Local Currency Debt
- ■ Exporters Debt
- ■ Non-exporters Debt with FDI
- ■ Non-exporters Debt with FDI (Unhedged)
- ■ External suppliers in foreign currency
- ■ External Leasing in foreign currency
- ■ Other

*For the categories: debt due to suppliers in foreign currency, foreign currency leasing and "other", the information is insufficient to determine if firms hedge these debts.

Source: Banco de la República, Financial Superintendency and DANE

Thank you