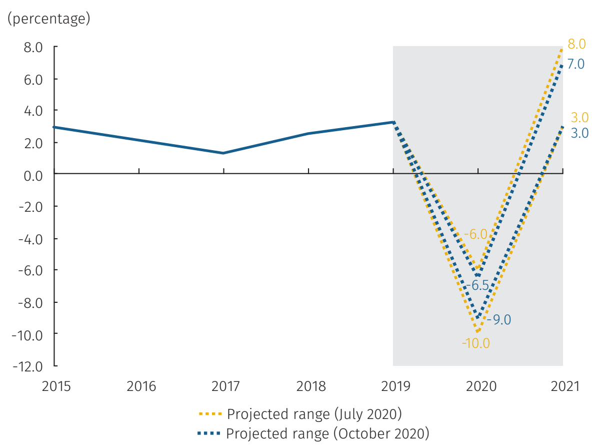
01 / Summary

1.1 Macroeconomic summary

Recent data suggest that the technical staff's appraisals of the condition and development of economic activity, inflation and the labor market have been in line with current trends, marked by a decline in demand and the persistence of ample excess productive capacity. A significant projected fall in output materialized in the second quarter, contributing to a decline in inflation below the 3% target and reflected in a significant deterioration of the labor market. A slow recovery in output and employment is expected to continue for the remainder of 2020 and into next year, alongside growing inflation that should remain below the target.

The Colombian economy is likely to undergo a significant recession in 2020 (GDP contraction of 7.6%), though this may be less severe than projected in the previous report (-8.5%). Output is expected to have begun a slow recovery in the second half of this year, though it is not projected to return to pre-pandemic levels in 2021 amid significant global uncertainty. The output decline in the first half of 2020 was less severe than anticipated, thanks to an upward revision in first-quarter GDP and a smaller contraction in the second quarter (-15.5%) than had been projected (-16.5%). Available economic indicators suggest an annual decline in GDP in the third quarter of around 9%. No significant acceleration of COVID-19 cases that would imply a tightening of social distancing measures is presumed for the remainder of this year or in 2021. In that context, a gradual opening of the economy would be expected to continue, with supply in sectors that have been most affected by the pandemic recovering slowly as restrictions on economic activity continue to be relaxed. On the spending side, an improvement in consumer confidence, suppressed demand for goods and services, low interest rates, and higher expected levels of foreign demand should contribute to a recovery in output. A low base of comparison would also help explain the expected increase in GDP in 2021. Based on the conditions laid out above, economic growth in 2020 is expected to be between -9% and -6.5%, with a central value of -7.6%. Growth in 2021 is projected to be between 3% and 7%, with a central value of 4.6% (Graph 1.1). Upward revisions compared to the July report take into account a lower-than-expected fall in first-semester growth and a somewhat faster recovery in the third quarter in some sectors. The forecast intervals for 2020 and 2021 growth tightened somewhat but continue to reflect a high degree of uncertainty over the evolution of the pandemic, the measures required to deal with it, and their effects on global and domestic economic activity.

Graph 1.1
Annual gross domestic product
(Annual change)



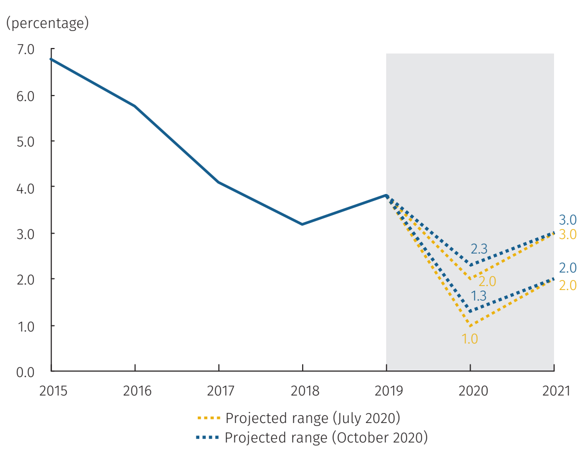
Source: Central Bank of Colombia.

Labor market deterioration has been significant, and the unemployment rate remains at historically high levels despite some improvement in total employment, particularly

among informal urban workers. Despite month-on-month improvement beginning in May, national employment in August remained 2.9 million workers below its pre-pandemic total (February). A slow recovery in labor demand in Colombian cities has been concentrated in non-salaried workers, particularly among the self-employed and to a lesser degree in formal employment. Three million people were incorporated into the labor supply between May and August, a significant number of whom then found employment, either in their old jobs or in new places of work. Nevertheless, there remains a significant number of inactive workers who could enter the labor market and thus put upward pressure on the unemployment rate in the months ahead. The national unemployment rate in the fourth quarter is expected to fall to between 15.1% and 16.9%. As a result, the labor market should continue to be very loose, which would help explain significant excesses in productive capacity and a significant fall in available household income.

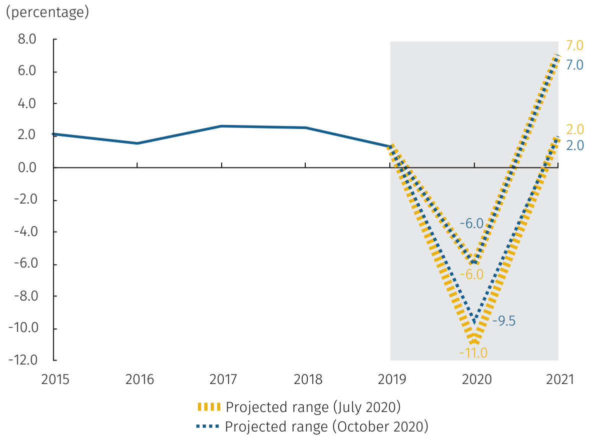
Inflation projections have been revised upward but remain below 2% for the end of 2020 and 3% for the end of 2021. Average inflation expectations for December are below 2%, and at five years or less continue below or close to the target rate. Annual inflation continued to decline in September (1.97%), though less than projected in the July report (1.63%). Nevertheless, significant downward pressure on inflation continued and will likely contribute to inflation below the target rate over the entire forecast horizon. Favorable climate conditions and perishable food supplies should continue to support the deceleration of the perishable foods component of the Consumer Price Index (CPI). Ample excess productive capacity is expected to continue and should contribute to keeping price adjustments low. Annual price changes for several goods and services with significant and persistent elements of inflation indexation (real estate rentals and education services) continue to decline, a trend that is expected to continue in 2021. Nevertheless, inflation should increase in the second quarter of next year as the effects of price relief measures implemented to address the pandemic disappear. The inflation trajectory has risen slightly compared to the previous forecast but remains below the target rate. There are several factors that can help explain this increase. First, a temporary reduction in the consumption tax applied to food away from home (FAH) has not been reflected in final consumer prices and as a result prices in this component of the CPI are not expected to fall for the remainder of the year. Cost pressures (sanitization, the regulation of installed capacity, etc.) associated with efforts to address the pandemic could be influencing these prices. Second, while the output gap is expected to continue in significantly negative territory in 2021, it is now projected to tighten more quickly than forecast in the previous report. Finally, accumulated peso depreciation is expected to pass through more significantly than previously projected on some components of the CPI. Given the above, year-end inflation for 2020 and 2021 is expected to be around 1.9% and 2.6%, respectively. Other measures of inflation over the same time horizon offer similar results. As was the case with economic activity, uncertainty surrounding the inflation forecasts remains high, with an interval for 2020 between 1.3% and 2.3% and for 2021 between 2% and 3% (Graph 1.2).

Graph 1.2
Consumer price index (CPI)
(end-of-period; annual change)



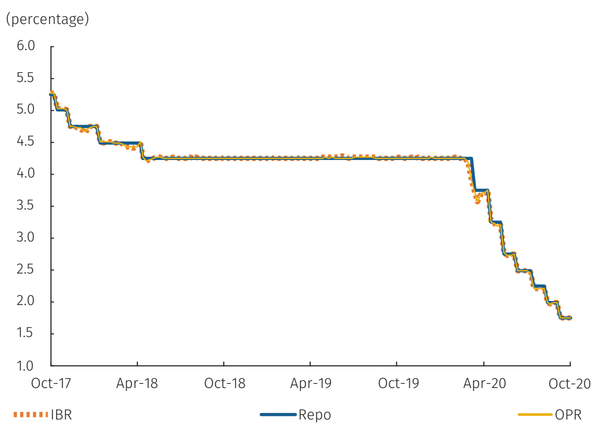
Source: Central Bank of Colombia.

Graph 1.3
Assumed trade partner GDP
(Annual change)



Sources: Bloomberg, statistics offices, and central banks; calculations and projections by the Central Bank of Colombia.

Graph 1.4
Policy interest rate, interbank rate (IBR) and OPR [a/]
(weekly data)



a/Repo: policy interest rate
OPR: overnight policy rate
Source: Office of the Financial Superintendent of Colombia and the Central Bank of Colombia.

Both foreign demand and oil prices should continue to recover slowly in 2021, though without returning to pre-pandemic levels. Uncertainty over the pace and sustainability of this recovery is high. Third-quarter data suggest an improvement in global economic activity and remittances, and some oil prices have risen following significant declines in the second quarter of the year. This rebound has come amid fewer restrictions on mobility, a gradual opening of economic sectors, significant fiscal and monetary stimulus measures, and a reduction in the global oil supply. Average output among Colombia's primary trade partners is expected to fall by around 7.7%, with a forecast interval between -9.5% and -6.0%. Growth among these trade partners is expected to recover in 2021 to around 4.6%, with an interval between 2.0% and 7.0% (Graph 1.3). Average oil prices for 2020 and 2021 are projected at USD 42 and USD 49 per barrel, respectively. There remains a high degree of uncertainty surrounding the recovery of foreign demand and commodities prices, due in part to a significant upsurge of COVID-19 in several countries, weak consumer confidence, high levels of public debt, the large number of firms facing financial challenges, and economic tensions between the United States and China.

Global and domestic financial conditions have improved in the context of ample liquidity, though some indicators have not yet returned to pre-pandemic levels. Major central banks have significantly expanded their balance sheets, which has been reflected in high levels of global economic liquidity. In the United States, the Federal Reserve recently announced changes to its monetary policy framework that could extend the duration of its expansionary stance. Risk premiums both at the global level and for Colombia have come down but remain above pre-pandemic levels amid significant uncertainty over future risk due to increases in public debt and credit downgrades in some emerging market economies. Colombia's household financial portfolio ended its decline at the beginning of October, while the portfolio for commercial businesses fell slightly; both registered decelerations in annual growth rates. The transmission of reductions in the benchmark rate on interbank and debt interest rates has been significant, while the effects on commercial and consumer rates continue to register more slowly. Mortgage rates, meanwhile, have remained relatively stable.

1.2 Monetary policy decision

The Central Bank's Board of Directors (BDBR) reduced the policy interest rate by a quarter of one percentage point in both its August and September meetings. In October the BDBR decided to keep the rate at 1.75% (Graph 1.4). The August and October decisions were made unanimously, while the September decision was made by majority.