Macro Vision

July 11, 2024

COLOMBIA – Public Finance: Revenue blues

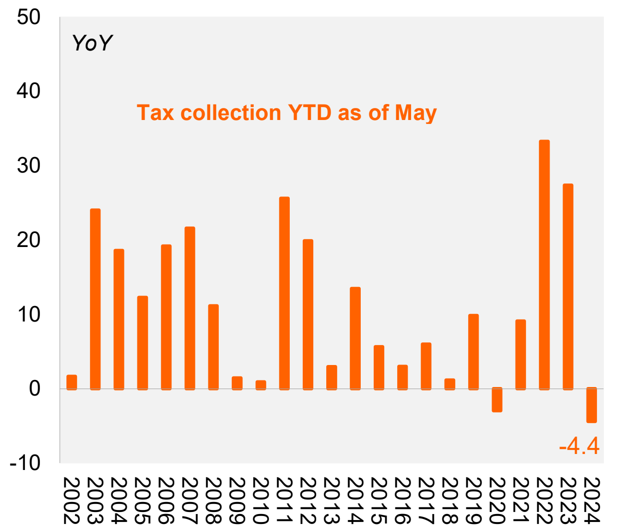
- Colombia's fiscal accounts have been under additional scrutiny this year, mainly due to significant revenue underperformance, affecting the Treasury´s cash balances. In this report we discuss the ambitious fiscal consolidation path proposed by the administration and the government's financing needs.

I. A story of revenue underperformance…

Tax revenues have slumped this year... As has been the case in other economies in the region, the deceleration in economic activity in Colombia led to a 4.4% YoY contraction of fiscal revenues through May. This year's revenue decline is greater than the one posted for the same period in 2020, and contrasts with last year's increase of 27.4%. Importantly, the decline so far this year, is greater than the MoF's projected annual 1.7% nominal contraction.

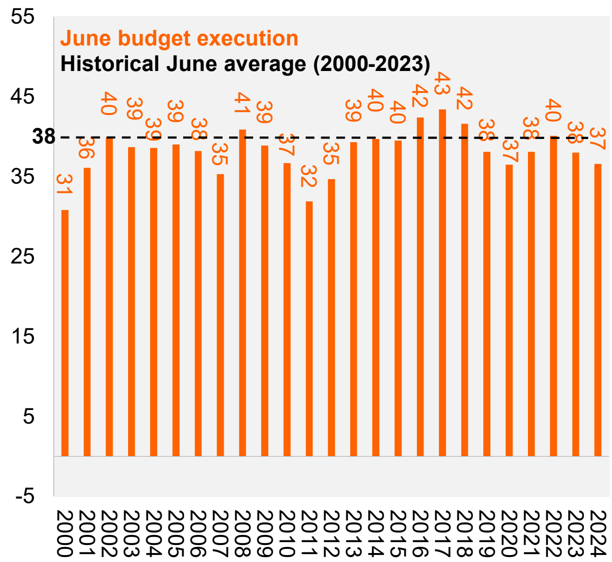
… as spending has been slightly below with historical averages. Despite calls from the president claiming low budget execution, even triggering changes at the cabinet level, fiscal spending has been slightly below historical averages. Spending excluding debt service reached 36.6% of the annual budget (1.6 pp below the historical average for the same period in 2000-2023).

Tax collection fell sharply this year



Source: Ministry of Finance, Itaú

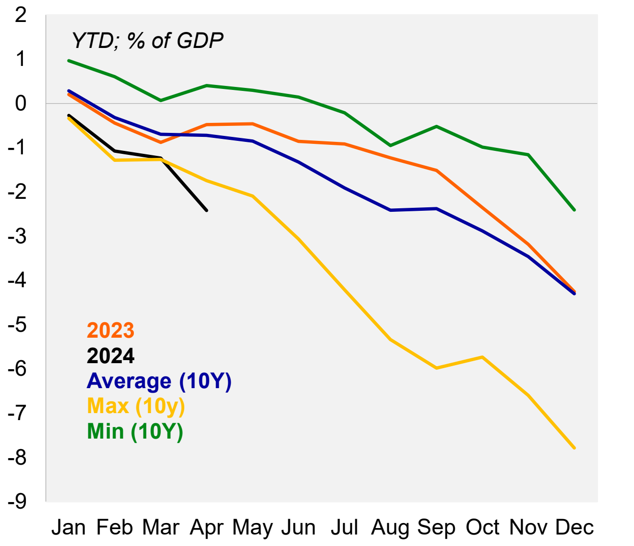
Budget execution as of June



Source: Ministry of Finance, Itaú

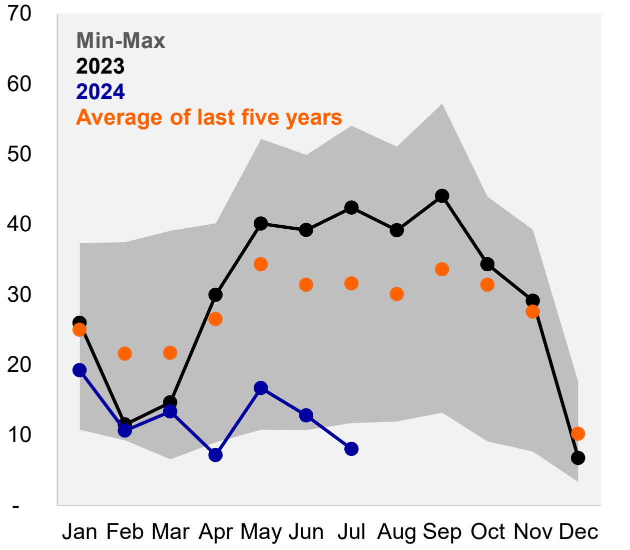
The fiscal deficit year-to-date through April, the latest data available, is the new peak over the last ten years. As of April, the nominal fiscal deficit closed at 2.4% of GDP, above from the 1.7% observed in 2021, being the new peak over the last ten years.

Nominal Fiscal Deficit YTD



Source: Ministry of Finance, Itaú

Treasury Assets



Source: Ministry of Finance, BanRep, Itaú.

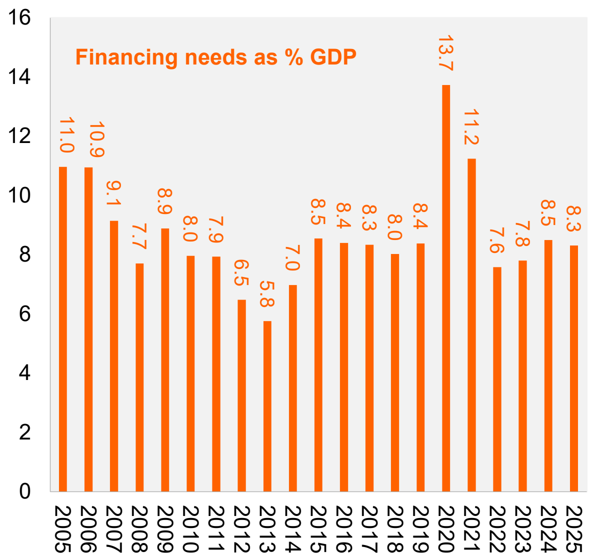
"No hay plata." The combination of weak revenues and unchanged spending led to a deterioration of liquid resources at the Treasury, which fell to COP 7.9 trillion in the week ending July 05, well below the average of the last 5 years for the month of July (COP 31.6 trillion).

Reality bites. In this context, the MoF significantly reduced their 2024 revenue forecast by 1.9% of GDP, and announced spending cuts of 1.6% of GDP, leading to an increase in the fiscal deficit forecast of only 0.3% of GDP to 5.6% of GDP (4.3% in 2023), while the 2024 primary deficit rose to 0.9% of GDP (0.3% of GDP in 2023), still consistent with the fiscal rule. The nominal fiscal deficit is seen gradually narrowing to 5.1% of GDP in 2025 (primary: -0.5% of GDP), amid higher tax revenues at 16.3% of GDP (15.4% expected in 2024).

II. Government financing

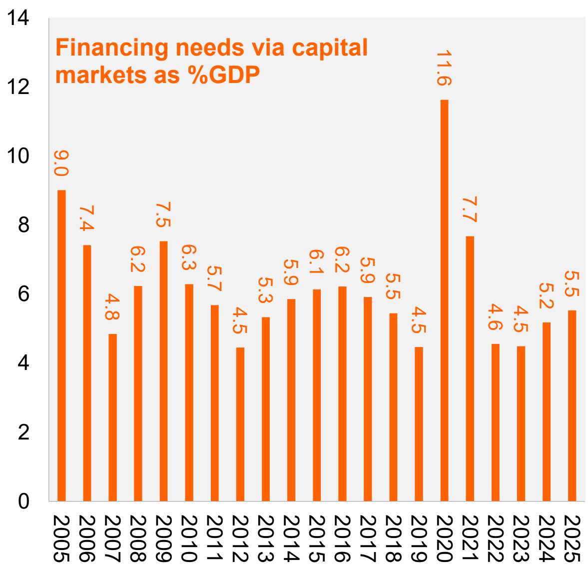
Higher financing needs for 2024. In their revised forecasts, the MoF estimates 2024 gross financing at 8.5% of GDP, up from the 7.8% of GDP from the previous estimate, with interest payments rising to 4.7% of GDP (3.9% in 2023; 66.2% of the total financing) and amortizations at 1.5% of GDP. The government is expected to seek market-based financing for 5.2% of GDP in 2024, above the 4.5% of GDP projected in February.

An upward trend in financing needs



Source: Ministry of Finance, Itaú

More financing is expected via capital markets

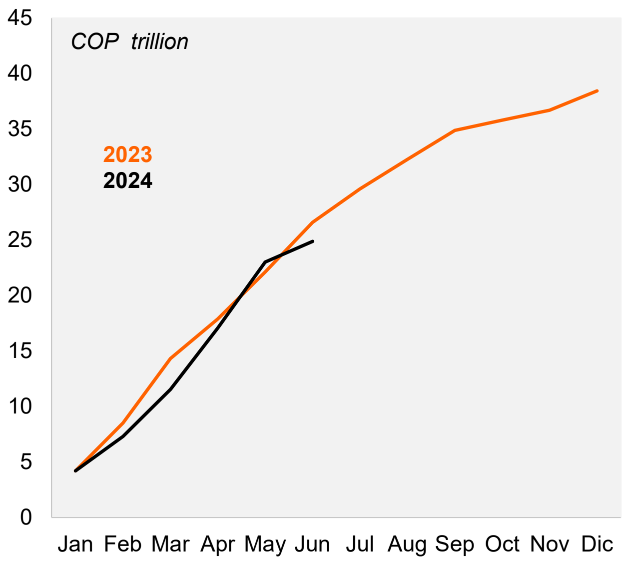


Source: Ministry of Finance, Itaú

Financing mix to rely less on external sources. The government now targets USD 5.7 billion in external financing, up USD 0.2 billion from the previous estimate, of which 56% will be sourced from loans with international financial institutions. The remaining needs are projected to be sourced from debt issuance in international capital markets. Thus, the targeted financing mix is 73% in local currency, and 27% in foreign currency.

We estimate that the MoF issued a total of COP 24.8 trillion in the year through June, of the COP 40 trillion annual plan (USD 9.8 billion).

Cumulative Debt Issuance in the year



Source: Ministry of Finance, Itaú

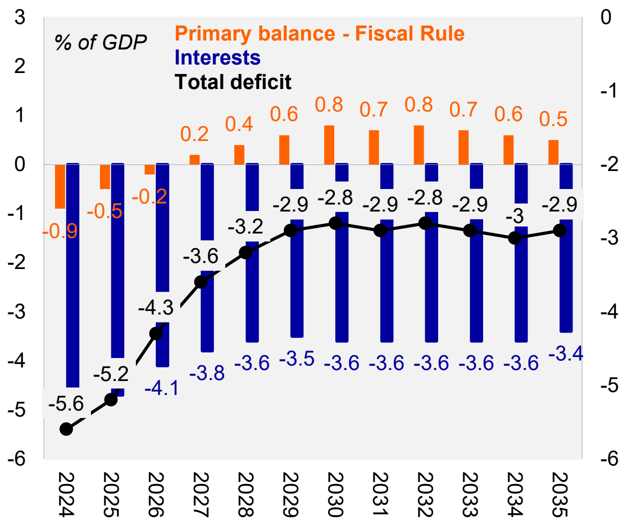
III. Testing the limits of the fiscal rule

The fiscal rule is a financial planning instrument of the national government that aims to establish specific targets for the fiscal balance based on the level of public debt, ensuring the credibility and sustainability of public finances.

Colombia has only suspended the fiscal rule once since its implementation in 2011. During 2020 and 2021, in the context of the pandemic, the government requested the transitory suspension of the fiscal rule, allowed by Law 1473 under exceptional circumstances. The decision provided more flexibility to the government yet maintained the medium-term fiscal commitments, with the fiscal rule coming back into effect in 2022. Given the impact of the pandemic, the fiscal rule considered a transition between 2022-2025, allowing for a gradual convergence to balance over the medium-term. This transition established that the Structural Net Primary Balance as a percentage of GDP should be at least -4.7% in 2022, -1.4% in 2023, -0.2% in 2024 and -0.5% by 2025.

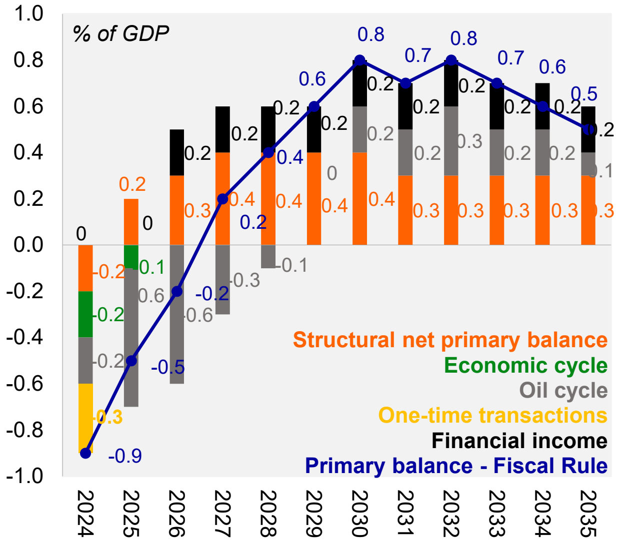
Adjustments to the fiscal rule on the table. A higher fiscal deficit implies abandoning the transitional regime of the rule and moving to a parametric regime, which would require congressional approval in 2S24. Such a change would provide additional fiscal space of 0.3% of GDP in 2025. A primary surplus of 0.2% of GDP is seen materializing in 2027, and then averaging 0.6% between 2028 and 2035.

Total Fiscal balance breakdown



Source: Ministry of Finance, Itaú

Primary balance fiscal rule breakdown



Source: Ministry of Finance, Itaú

IV. *Our take:*

The official forecasts reflect Colombia's challenging fiscal outlook, as anticipated by the persistent revenue disappointments this year and in the context of low liquid buffers. Even though the MoF under executed the 2023 budget by COP 7 trillion (USD 1.8 billion), this year's spending cuts seem particularly ambitious, as a slow recovery suggests revenues may take longer to pick up. The Ministry of Finance has indicated that the fiscal strategy complies with the fiscal rule, although the proposal to adjust the fiscal rule seems to weaken the administration's commitment with the consolidation path.

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