Macro scenario - Colombia

April 12, 2024

Fast and furious?

- Inflation remains high, even without a significant effect from El Niño. Looking ahead, base effects and favorable FX dynamics are likely to help consolidate the disinflationary process. Monetary policy remains significantly contractionary, which will probably prompt the Central Bank to continue to cut rates. However, fewer Fed rate cuts and a stronger global dollar have led us to revise our policy rate and inflation estimates up. We now expect BanRep to take the policy rate to 8.75% by year-end (+50bps from March), 350 bps below the current level, while our updated expectation of a slower inflation convergence path has led us to raise our 2025 year-end call by 75 bps, to 6.0% (5.5% neutral). Gradual disinflation, in a globally uncertain environment, does not seem conducive to fast easing.

Reforms at a crossroads

The healthcare reform was rejected by Congress. After 8 of the 14 senators of the Senate Commission presented a motion to shelve the reform several weeks ago, the Senate Commission confirmed the decision. The bill aimed at expanding primary care and reducing the role of healthcare insurance providers (EPS). Separately, the pension reform proposal, after being approved in the first debate in the Senate committee, is now subject to a debate and vote on the Senate floor. If approved by the Senate, the pension reform will have to be approved in two more votes in the Lower House. Finally, the labor reform package faces a more challenging scenario after being rejected last year and resubmitted to the current legislature; it is now pending approval by a committee in the Lower House. With the president's approval rating below 40%, the reforms will continue to have a difficult path forward in Congress.

Fiscal targets will remain a challenge

Fiscal Council flags risks of not complying with the fiscal rule. The Autonomous Fiscal Council flagged the continued inclusion of (uncertain) COP 10 trillion for litigation arbitration as structural revenue. Consequently, in order to comply with the fiscal rule, the Fiscal Council is recommending an additional spending adjustment of COP 10 trillion in 2024. The Fiscal Council highlighted that the economy must return to trend growth rates to achieve the proposed fiscal consolidation. Despite the challenges highlighted by the Council, budget execution started off slowly this year, mainly due to weak public investment outlays (5.4% as of February, compared with an average of 7.8% since 2017).

Mixed economic signs to start the year

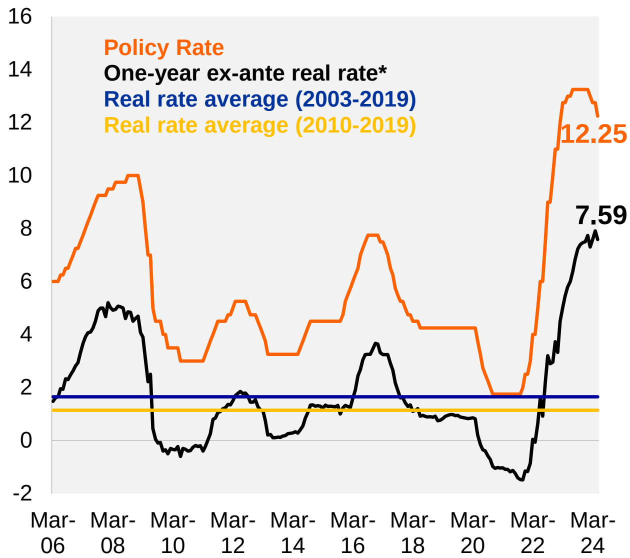
Activity surprised to the upside in January, but employment and sentiment weakened. The coincident activity indicator (ISE) increased by 2.2% from December to January (SA, +0.2% in December). As a result, activity increased by 1.6% YoY (+0.1% in December). At the margin, activity increased by 5.4% qoq/saar (+0.2% in 4Q23). On the other hand, employment dynamics weakened in February. Sequentially, total employment fell by 0.5% MoM/SA from January, with the unemployment rate reaching 11.7%, up 0.3 pp over one year. Meanwhile, business sentiment continued to fall, reaching 10.9% in February (0=neutral), down 3.6 pp from January and below the +12.7% registered in February of last year.

Core inflation continued to fall, but services inflation remains sticky. Consumer prices increased by 0.7% from February to March, taking YoY inflation to 7.36% (from 7.74% in February). Core inflation (excluding food and energy) declined from 7.59% to 7.32% (10.60% peak in April last year). Services inflation remained elevated, and broadly stable at 8.58% (9.51% peak in September). At the margin, we estimate that inflation accumulated in the quarter was 5.3% (SA, annualized), decelerating from 7.2% in 4Q23. Meanwhile, core inflation reached 6.4% (SA, annualized, +6.9% in 4Q23). While inflation is quite high, the central bank's latest analyst survey showed medium-term inflation expectations are only gradually correcting from elevated levels (one-year inflation expectations fell by 18 bps, to 4.66%; 3% target).

A divided board accelerates the gradual easing cycle

In a divided decision, BanRep increased the pace of rate cuts from 25 bps to 50 bps in March, taking the policy rate to 12.25%, as expected. Interestingly, despite still high inflation, the two dissenting votes favored cuts of 75 bps and 100 bps. Upcoming decisions will be data-dependent. Meanwhile, the technical staff revised their year-end CPI call downward by 50 bps, to 5.4%; they expect inflation to return to 3% by mid-2025 and see below-potential growth of 1.1% this year (up from 0.8% previously). The central bank's analyst survey showed the one-year inflation outlook dropping by 33 bps, to 4.84%, while the two-year inflation expectation fell by 10 bps, to 3.5% (3% target). On the monetary policy front, analysts now expect the interest rate to end 2024 at 8.25%, and to end 2025 at 5.5%.

Highly contractionary real rate



Source: , Itaú

Raising the cycle endpoint

Our 2024 growth forecast remains at 1.0%, slightly above the 0.6% growth registered in 2023. Despite better-than-expected activity at the start of the year, the significantly contractionary monetary policy, along with still-elevated inflation, will likely prevent a swifter rebound. The higher inflation and rates path led us to revise our 2025 GDP growth call down by 30 bps to 2.6%.

The current account deficit (CAD) should remain low this year. We have left our 2024 CAD forecast unchanged at 3.0% of GDP (2.7% in 2023), but revised our 2024 year-end exchange rate up to 4,000 COP/USD (3,880 COP/USD previously) on the back of a stronger global dollar amid fewer Fed rate cuts.

The disinflation process is likely to continue, but at a slightly more gradual pace. On the back of higher-than-expect inflation in 1Q24, and weaker COP expectation, we have raised our 2024 year-end inflation call by 40 bps, to 5.2%. Our call still has upside risks, as diesel price increases are only a risk (given the challenging negotiating process with the affected parties), rather than a settled assumption.

We expect BanRep to maintain its 50-bp easing pace at its next meeting. Surprises in inflation dynamics and the evolution of inflation expectations will play a key role in determining the Board's preference for the speed of the cycle. Tighter global financial conditions have resulted in our yearend policy rate call rising 50 bps to 8.75%, for a total of 350 bps of cuts from the current level, which would still leave the policy rate well above the nominal neutral level of around 5.5%. For 2025, the updated expectation of a slower inflation convergence path now leads us to see the policy rate ending the year at 6% (75 bps above our previous forecast). Gradual disinflation should, in principle, pose limits to the central bank's ability to deliver fast easing.

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Colombia | Forecasts and Data

	2019	2020	2021	2022	2023	2024F		2025F	
						Current	Previous	Current	Previous
Economic Activity									
Real GDP growth - %	3.2	-7.2	10.8	7.3	0.6	**1.0**	1.0	**2.6**	2.9
Nominal GDP - USD bn	323	270	322	345	364	**428**	434	**448**	461
Population (millions)	50.4	50.9	51.4	51.8	52.2	**52.7**	52.7	**53.2**	53.2
Per Capita GDP - USD	6,411	5,308	6,272	6,659	6,976	**8,127**	8,246	**8,414**	8,664
Unemployment Rate - year avg	10.9	16.7	13.8	11.2	10.2	**10.6**	10.6	**10.5**	10.4
Inflation									
CPI - %	3.8	1.6	5.6	13.1	9.3	**5.2**	4.8	**3.0**	3.0
Interest Rate									
Monetary Policy Rate - eop - %	4.25	1.75	3.00	12.00	13.00	**8.75**	8.25	**6.00**	5.25
Balance of Payments									
COP / USD - eop	3,287	3,428	4,070	4,850	3,855	**4,000**	3,880	**4,000**	3,890
Trade Balance - USD bn	-10.8	-10.1	-15.3	-14.3	-9.9	**-6.5**	-6.5	**-7.0**	-8.5
Current Account - % GDP	-4.6	-3.4	-5.6	-6.2	-2.7	**-3.0**	-3.0	**-3.4**	-3.8
Foreign Direct Investment - % GDP	4.3	2.8	3.0	5.0	4.8	**3.2**	3.1	**3.3**	3.3
International Reserves - USD bn	52.7	58.5	58.0	56.7	59.1	**60.6**	60.6	**61.0**	61.0
Public Finances									
Nominal Central Govt Balance - % GDP	-2.5	-7.8	-7.1	-5.3	-4.3	**-5.3**	-5.3	**-4.0**	-4.0
Central Govt Gross Public Debt - % GDP	50.3	65.0	63.0	60.8	56.7	**59.5**	56.1	**60.2**	56.9

Source: IMF, Bloomberg, Dane, Banrep, Haver and Itaú

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