Macro scenario - Colombia

November 18, 2024

Higher fiscal noise, higher rates

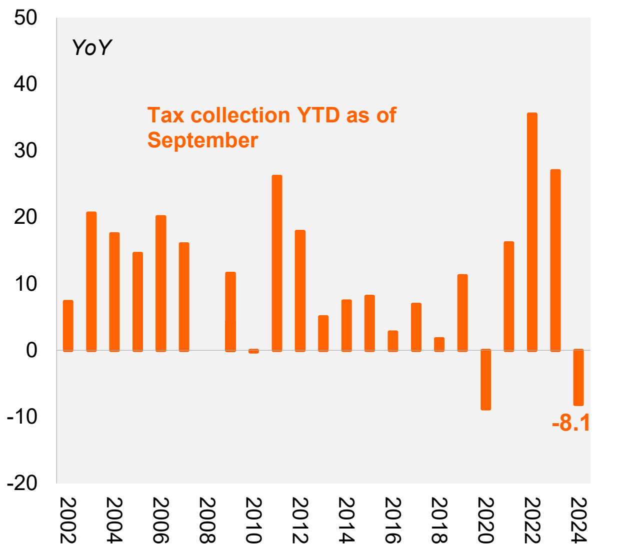
- Following the unexpected deflation in October, we now forecast a YE24 CPI at 5.1% (5.6% in the previous scenario) but revised our 2025 estimate up by 10bps to 3.7% due to higher pass-through from a weaker COP to goods prices.
- Despite the CPI surprise, fewer cuts by the Fed, and heightened pressure on the exchange rate led us to believe BanRep will maintain a 50bp pace in the last meeting of the year, taking the policy rate to 9.25%. We revised our terminal rate for 2025 to 6.5% (6.0% in the previous scenario), primarily due to our call of fewer Fed cuts in 2025. Turnover at BanRep's board, in early 2025 might lead to larger cuts and an acceleration towards neutral, to be eventually reflected in a weaker exchange rate.

Fiscal accounts still front and center

Tax revenues finally swung back to record annual growth in September, expanding by 3.3% YoY in nominal terms. Nevertheless, the YTD nominal tax collection has contracted by a whopping 8.1% YoY, taking the revenue shortfall through 3Q24 to 0.7% of GDP with respect to official forecasts, posing additional headwinds to this year's nominal fiscal deficit target (5.6% of GDP). In turn, the Government is discussing a large 2% of GDP spending cut for the final quarter of the year. In this context, the sovereign issued the largest single transaction in its history (USD3.6 billion) with dual tranche dollar denominated bonds, even achieving negative issue premium in both bonds, completing this year's financing needs and pre-funding an important share of 2025.

A proposal to increase revenue transfers from the Central Government to the regions surprised in Congress. The latest proposal of the reform lowered the transfers from the central government to the regions from 46.5% of revenues to 39.5% and to extend the transition period from 10 to 12 years. For context, transfers last year reached 20% of the central government's revenues. The adjustments to the initial proposal mean the fiscal effort between 2026 and 2035 would decrease from 3.1pp to 1.7pp. The bill is likely to progress.

Tax collection remains below target



Source: DIAN, Itaú

The disinflationary process continues

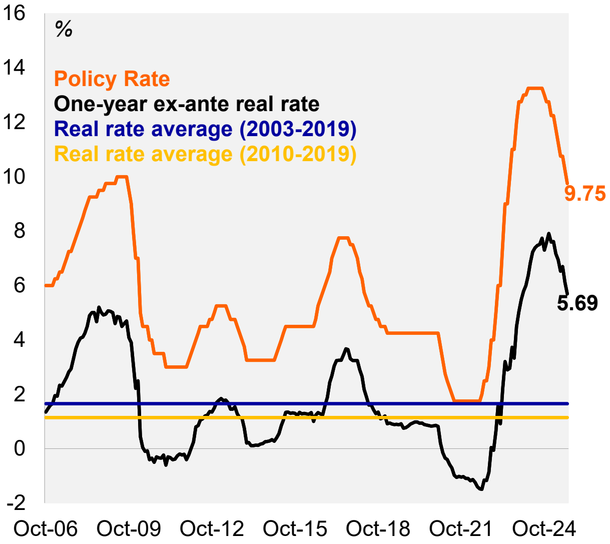
Positive surprises to activity persisted in August. In the context of a gradual recovery, activity has broadly surprised to the upside during the past several months. On an annual basis, the monthly GDP proxy posted an annual expansion of 2.0% YoY in August, despite a marginal sequential decline (0.5% MoM SA). We expect the economy grew 1.4% QoQ/SAAR during 3Q24, up from 0.4% in 2Q. Looking at the labor market, the national unemployment rate fell sequentially in September to 9.1%, well below BanRep's NAIRU estimate of 10.7%.

Non-core prices are leading the swifter disinflation process. Consumer prices fell 0.13% MoM in September, while inflation excluding food and energy rose by 0.13% (core; 0.24% one year earlier). Overall, annual headline inflation fell by 40bps from September to 5.41%. Non-durable goods inflation (mainly food) came in at 3.8% yoy, dropping 91bps from the previous month. Meanwhile, energy inflation fell to 9.7%, a drop of 162bps from September. Core inflation dropped 12bps to 5.96% (10.60% peak in April last year). At the margin, we estimate that inflation accumulated in the quarter was 2.9% (SA, annualized; 3.5% in 3Q24), with core inflation increasing to 5.4% from 5.1% in 3Q24 (SA annualized).

Banrep resists increasing the pace of cuts

In a divided decision, BanRep maintained the pace of cuts at 50bps to take the policy rate to 9.75%. As in the previous meeting, three members voted for a larger cut (75bp), while four members favored a 50bp cut. Following the decision, the one-year ex-ante real rate fell to 5.7% (using the monthly analyst survey; -42bps from the previous meeting in September), well above BanRep's real neutral rate estimate of 2.4%. The majority (4 members), which voted for a 50 bp cut to 9.75%, highlighted the unfavorable impact of the currency depreciation on inflation amid growing fiscal pressures, recalling the persistence of services inflation despite the current contractionary stance, and the derived risks that could arise from a large minimum wage increase for 2025 that will be determined next month. In the quarterly monetary policy report, BanRep's technical staff's baseline scenario implies a policy rate path that, on average over the following eight quarters, is somewhat above the analyst's expectations of 9.0% by yearend, and 6.0% by YE25 (implying that an acceleration from the 50bp cutting pace is not incorporated in the short-term). The estimated neutral rate was revised up 10bps to 2.6% for next year (5.6% nominal).

Monetary policy still highly contractionary



Source: BanRep, Itaú

More exposed to the US, than China

Colombia's largest trade partner is the US with 27% of total exports headed north and only 5% directed to China. Measures that boost short-term US growth should favor the Colombian economy, although these gains could be netted by tighter global financial conditions or a deterioration in terms-of-trade.

Less space to cut

GDP revised upward in the short term. Given persistently better than expected activity prints, we revised our 2024 GDP growth forecast up to 2.0% (1.8% previously expected; 0.6% in 2023). We maintained our GDP call for 2025 at 2.4%, as prior upside risks are countered by higher rates and inflation scenario. Colombia's potential GDP is estimated at roughly 2.7% for next year; our scenario has a carryover of 0.5% for next year.

The current account deficit (CAD) remains low. High transfers and a better services balance will sustain the CAD at a low 2.5% this year (stable from 2023; 2010-19 average: 4%), and gradually widen to 2.8% of GDP next year amid lower oil prices. A stronger global dollar and greater domestic policy uncertainty (primarily related to fiscal policy) led us to revise our YE25 COP call to 4,500/USD (COP 4,300 previously expected).

Lower YE inflation, but weaker COP pressures the disinflation path next year. Following the deflation in October, we now forecast a YE24 CPI at 5.1% (5.6% in the previous scenario) but revised our 2025 estimate up by 10bps to 3.7% due to higher pass-through to goods prices.

Amid tight global financial conditions and domestic fiscal noise, we believe BanRep will remain cautious in the last monetary policy meeting of the year. We now expect a year-end rate of 9.25% (50 bp cut; 8.75% previously). We revised the YE25 rate up by 50bps to 6.5%, primarily due to changes in our international scenario. Nevertheless, the replacement of two board members by President Petro in February 2025, in line with BanRep's institutional framework, may tilt the balance of the Board towards favoring larger cuts. Such a development would see a negative response through the FX channel.

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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	**2.0**	1.8	**2.4**	2.4
Nominal GDP - USD bn	323	270	322	345	364	**416**	421	**411**	424
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	5,312	6,272	6,659	6,976	**7,893**	7,987	**7,710**	7,970
Unemployment Rate - year avg	10.9	16.7	13.8	11.2	10.2	**10.6**	10.6	**10.5**	10.5
Inflation									
CPI - %	3.8	1.6	5.6	13.1	9.3	**5.1**	5.6	**3.7**	3.6
Interest Rate									
Monetary Policy Rate - eop - %	4.25	1.75	3.00	12.00	13.00	**9.25**	8.75	**6.50**	6.00
Balance of Payments									
COP / USD - eop	3,287	3,428	4,070	4,850	3,855	**4,300**	4,200	**4,500**	4,300
Trade Balance - USD bn	-10.8	-10.1	-15.3	-14.5	-9.7	**-7.5**	-6.5	**-7.0**	-7.0
Current Account - % GDP	-4.6	-3.4	-5.6	-6.2	-2.7	**-2.5**	-2.5	**-2.8**	-3.0
Foreign Direct Investment - % GDP	4.3	2.8	3.0	5.0	4.8	**3.3**	3.2	**3.7**	3.5
International Reserves - USD bn	52.7	58.5	58.0	56.7	59.1	**60.6**	60.6	**61.0**	61.0
Public Finances									
Primary Central Govt Balance - % GDP	0.4	-5.0	-3.6	-1.0	-0.3	**-0.9**	-0.9	**-0.9**	-0.9
Nominal Central Govt Balance - % GDP	-2.5	-7.8	-7.1	-5.3	-4.3	**-5.6**	-5.6	**-5.5**	-5.5
Central Govt Gross Public Debt - % GDP	50.3	65.0	63.0	60.8	56.7	**61.3**	60.5	**64.5**	63.1

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

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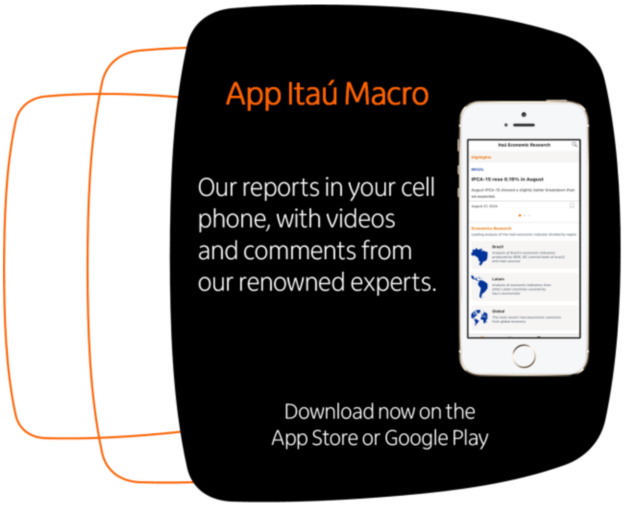

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