Macro scenario - Colombia

October 4, 2024

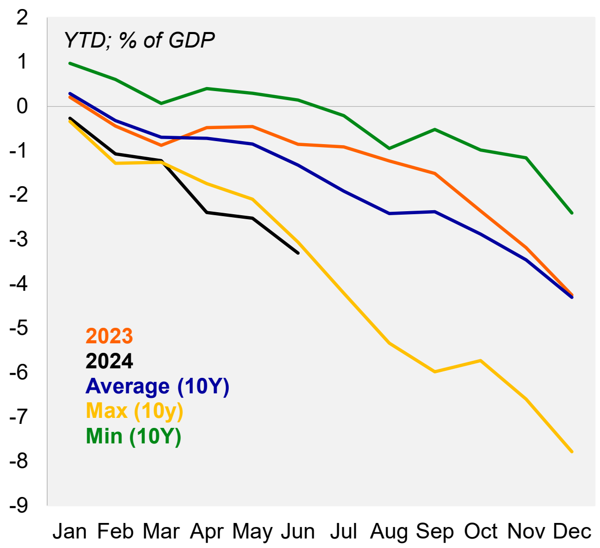
Unsettling fiscal scenario

- A 4-3 split in BanRep's latest policy meeting is in line with our view that larger cuts are coming up. We expect a YE24 rate of 8.75%, and 6.0% for YE25. After the divided 50-bp cut in September, we believe the Board will be inclined to accelerate to 75 bps in October, while CPI and inflation expectations will remain key.
- Discussions related to the fiscal accounts are becoming even noisier. Persistently lower-than-expected tax revenues and the administration's inability to reach an agreement in Congress on the 2025 Budget reflect rising fiscal risks. We expect an elevated nominal fiscal deficit of 5.6% of GDP this year, but revised our call upward by 40 bps, to 5.5% of GDP for 2025, in light of an ambitious tax revenue target.

Déja vu…fiscal uncertainty persists

Tax revenues fell significantly again in August. Tax revenues contracted by 30.8% yoy in nominal terms in August, taking the year-to-date tax collection to -9.3% yoy (+30.3% ytd increase in 2023; +33.8% ytd in 2022), well below the -1.7% yoy official full-year forecast. Downbeat revenue dynamics are likely to continue weighing on the fiscal accounts. By the end of June, the nominal fiscal deficit in the year reached 3.3% of GDP, the highest in the month over the last 10 years.

Fiscal deficit above historical average



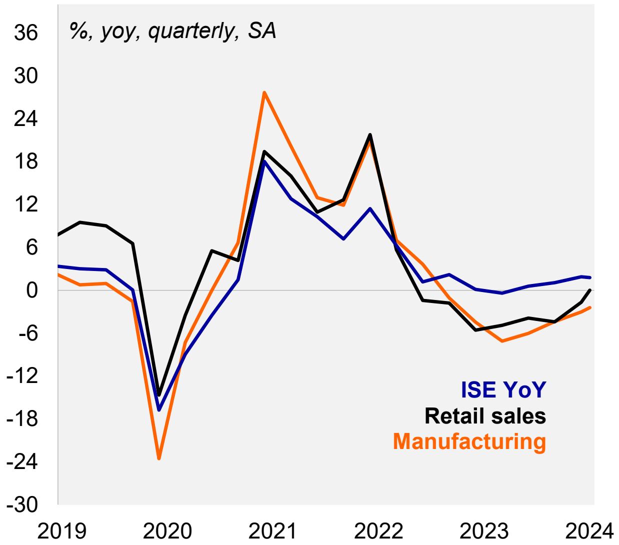
Source: Ministry of Finance, Itaú

With weak revenues, economic commissions in Congress failed to reach an agreement on the national budget for next year. According to the Ministry of Finance, the original proposal of COP 523 trillion (USD 122 billion, 29% of GDP) is likely to be enacted by decree. At this stage, however, there is limited political capital in Congress to follow through on the Financing Bill that aims to raise the COP 12 trillion (0.7% of GDP) needed to cover the funding shortfall. As a result, the budget's allocated spending will automatically be revised down to reflect the funding gap.

A divided board moves toward larger cuts

Activity surged in July, exceeding expectations. The coincident activity indicator (ISE) rose 2.5% from June to July (sa, -1.6% in June revised up from -1.9% initially). As a result, activity rose by 3.7% yoy, above the negative print of -1% yoy in June. In seasonally and calendar-adjusted terms, activity was up 3.9% yoy (-0.7% in June). Meanwhile, the labor market remained resilient in August, with employment increasing by 0.7% mom/sa from July (+0.8% in the previous month).

Partial recovery of activity indicators



Source: Dane, Itaú

The food price impact of the transport strike faded. The initial effects of the four-day transporters' strike that concluded on September 6 have faded. We estimate headline inflation to rise by 0.28% mom in September (0.54% one year ago), corresponding to 5.85% yoy (falling 27 bps from August's print).

In a divided decision, BanRep continued with the 50-bp rate-cut pace, to 10.25% in September. In contrast to previous meetings, three members favored an acceleration of the cycle to 75 bps (two members previously), while four members voted to maintain the 50-bp pace. Governor Villar likely made the deciding vote to prevent a larger cut. Nevertheless, with inflation dropping and global financial conditions easing, pressure to accelerate the cycle will continue to rise. As is usual, Governor Villar signaled that upcoming decisions will be data dependent.

Balancing the risks

Revising growth upward. We now expect GDP growth of 1.8% this year (1.6% previously expected; 0.6% in 2023). Nevertheless, in an environment of still-high interest rates and inflation and elevated political uncertainty, a more noteworthy activity rebound is unlikely. More-demanding base effects result in a 10-bp downward revision for 2025 to 2.4%.

The current account deficit (CAD) remains low. Amid high transfers and a narrow trade deficit, we continue to expect a CAD of 2.5% this year (stable from 2023), only gradually widening to 3.0% of GDP next year. Nevertheless, due to heightened domestic political uncertainty, we revised our COP/USD year-end estimate up to COP 4,200/USD (COP 4,100 in the previous scenario) and to COP 4,300/USD for next year (COP 4,200 previously expected).

The disinflationary process will be partially countered by stronger FX pass-through pressures. We maintain our YE24 CPI at 5.6%. but revised our 2025 estimate up by 10 bps to 3.6%. We retain an upward bias to our scenario, as uncertainty persists about weather-related effects on food prices and pressure on gasoline and diesel prices, as well as the magnitude of the year-end minimum wage adjustment.

Amid ambitious tax-collection targets, a wider 2025 fiscal deficit is expected. We kept our nominal fiscal deficit estimate at 5.6% for this year. Nevertheless, the likelihood that tax revenues underwhelm for longer, as has been the case elsewhere in the region, leads us to revise our 2025 nominal deficit forecast to 5.5% of GDP (up 0.4 pp). The persistence of large fiscal deficits, further delaying the fiscal consolidation process, raises the risk of credit-rating downgrades.

We expect the market to converge to a 75-bp rate cut in October, barring large unfavorable data surprises. We continue to expect a year-end rate of 8.75% (two 75-bp cuts), but we cannot rule out the board opting to stick to the 50-bp pace, particularly if there is a further spike in fiscal noise and unfavorable inflation developments ahead of the October meeting. We maintain our YE25 call at 6.0%. The replacement of two board members by President Petro early next year will consolidate the rate-cut path ahead.

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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	**1.8**	1.6	**2.4**	2.5
Nominal GDP - USD bn	323	270	322	345	364	**421**	425	**424**	434
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	**7,987**	8,072	**7,970**	8,150
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	**5.6**	5.6	**3.6**	3.5
Interest Rate									
Monetary Policy Rate - eop - %	4.25	1.75	3.00	12.00	13.00	**8.75**	8.75	**6.00**	6.00
Balance of Payments									
COP / USD - eop	3,287	3,428	4,070	4,850	3,855	**4,200**	4,100	**4,300**	4,200
Trade Balance - USD bn	-10.8	-10.1	-15.3	-14.5	-9.7	**-6.5**	-6.5	**-7.0**	-7.0
Current Account - % GDP	-4.6	-3.4	-5.6	-6.2	-2.7	**-2.5**	-2.5	**-3.0**	-3.0
Foreign Direct Investment - % GDP	4.3	2.8	3.0	5.0	4.8	**3.2**	3.2	**3.5**	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**	-0.5
Nominal Central Govt Balance - % GDP	-2.5	-7.8	-7.1	-5.3	-4.3	**-5.6**	-5.6	**-5.5**	-5.1
Central Govt Gross Public Debt - % GDP	50.3	65.0	63.0	60.8	56.7	**60.5**	60.0	**63.1**	62.2

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

Macro Research – Itaú

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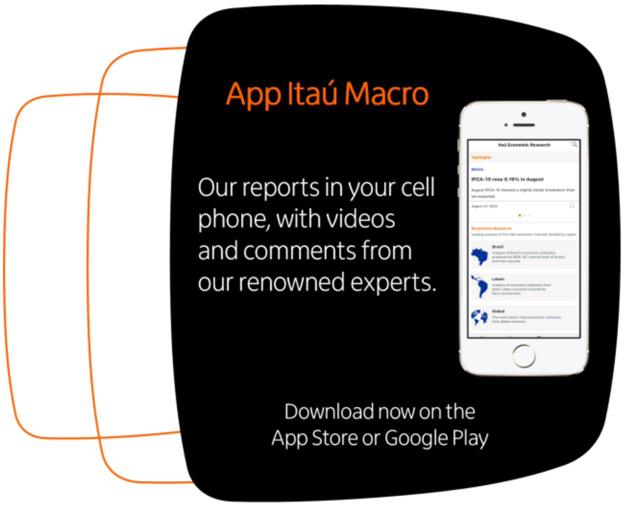

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