Macro scenario - Colombia

September 13, 2024

Easing amid a strike and a tax reform

- Following a large downside surprise to inflation in August and weak activity, we expect BanRep to cut the policy rate by 50-bps this month and continue easing later this year to 8.75% by year-end.
- Fiscal accounts remain stressed in the short-term as revenues have persistently underperformed. A gradual removal of diesel subsidies and another tax reform are projected to provide some relief to public finances, but risks of larger deficits loom.

Presidential approval remained low

President Petro's approval rating reaches a new low. An Invamer poll showed that Petro's approval rating fell again to 29% (from 34.6% one month earlier and 56% at the start of his presidential Period in August 2022), although the poll does not capture the effects of the brief transport workers' strike early in September.

The government reached an agreement with transporters, ending the strike. In the context of the necessary reduction of subsidies to diesel prices presented by the administration, transporters finally agreed to two adjustments in 2024, one in September (COP400, 4.2% MoM) and another in December (COP400, 4.1% MoM). While the adjustment is less ambitious than the government's original attempt (20.1% MoM or COP1904 in September) and will only reduce the fuel stabilization fund's deficit by 0.05% of GDP in 2024 (0.1% of GDP previously), it is a step in the right direction.

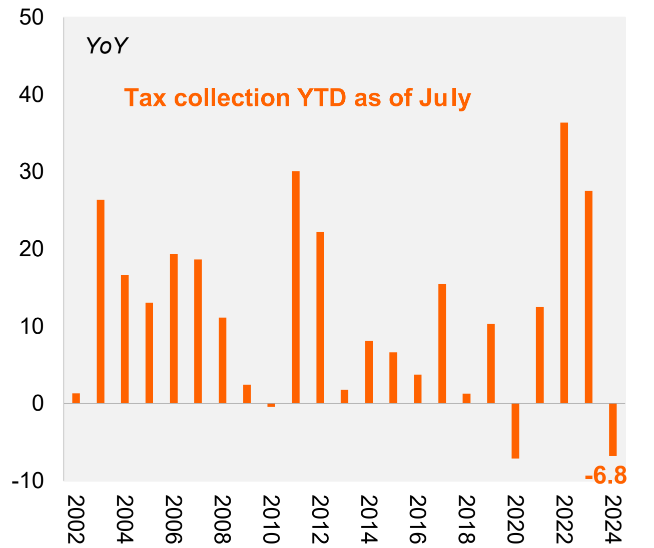
A challenging fiscal scenario

The 2025 budget bill considers a 3.9% nominal annual rise in fiscal expenditure. The 2025 national budget of COP 523 trillion (29.4% of GDP) considers a 3.9% nominal annual rise in fiscal spending for the next year. Revenues are projected to increase by 8% YoY in nominal terms, which takes the projected 2025 primary deficit to 0.5% of GDP. In light of persistent revenue underperformance this year, risks tilt toward a larger deficit.

The Ministry of Finance presented another tax reform to raise revenues, adjust the fiscal rule and fill the budget's financing needs. The reform seeks to fill the COP 12 trillion (0.7% of GDP) financing shortfall. The bill considers tax efficiency gains (0.1% of GDP), VAT on online betting, and a higher personal income tax rate for high-income earners, and higher carbon tax rate. Nevertheless, in the immediate term, 0.4% of the needed revenue in 2025 would be derived from modifying the fiscal rule transition period by one-year to 2026, and excluding renewable energy investments from the spending cap. These additional revenues are offset over time by a gradual reduction of the corporate income tax for non-oil and gas companies, leading to a null net effect on revenues once fully phased in. The 2025 budget must be finalized by September 15. If there is no agreement in Congress, the Budget will be set by decree with an enforced deduction of the COP 12 trillion financing shortfall. We expect the government and congress to reach a compromise in the hours ahead.

Tax collection remains weak. On a year-to-date basis, tax collection is down 6.8% YoY in nominal terms (- 8.7%YoY as of 1H24; a +30.3% YTD increase in 2023), well below the -1.7% YoY nominal official full year forecast. The current revenue gap stands at COP 4.9 trillion with respect to the administration's Medium-Term Fiscal Framework.

Tax collection remains below target



Source: Dian, Itaú

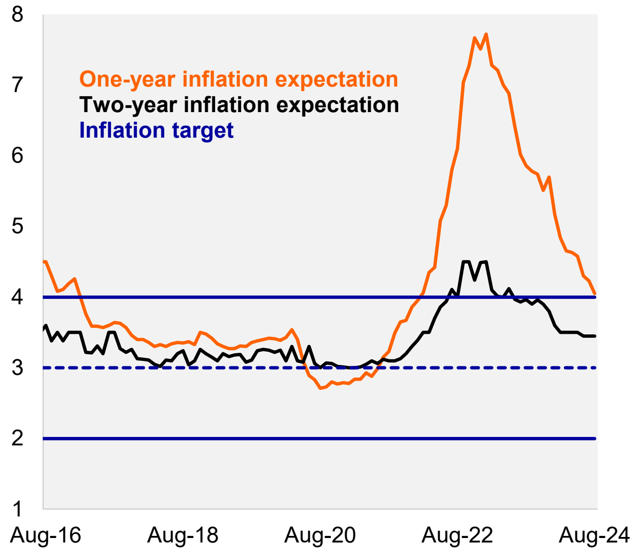
Weaker than expected GDP in 2Q24

The economy rose 0.1% (SA) from 1Q24 to 2Q24, leading to a 2.1% YoY in 2Q24 (+0.8% in 1Q24). The annual GDP increase was boosted by net exports, while gross fixed investment gradually recovered from the previous quarters. Gross fixed investment increased 4.3% (-6.2% in 1Q24; -13.8% in 4Q23). Entertainment, agriculture and public administration pulled activity up in 2Q24, while manufacturing remained in negative territory. At the margin, activity increased 0.4% qoq/saar, below the 4.9% registered in 1Q24.

A significant narrowing of the CAD was observed in the 2Q24. A USD 1.6 billion current account deficit (1.6% of GDP) was registered in 2Q24, narrowing USD 0.6 billion from 2Q23. A mild narrowing of the services deficit and higher transfers led to the significant narrowing of the CAD in the 2Q24. Meanwhile, net direct investment reached USD 1.8 billion (a USD 3.6 billion drop from 2Q23), resulting in USD 11.5 billion for the rolling year, achieving a 148% coverage of the CAD (175% in 2023; 65% in 2022).

A widespread deceleration in inflation, but services remain elevated. Annual headline inflation fell by 74bps in August from July to 6.12%, while core inflation dropped from 6.37% to 6.09% (10.60% peak in April last year). Non-durable goods inflation (mainly food) came in at -0.35% YoY, dropping by 158bps from the previous month. Meanwhile, energy inflation fell to 13.74%, a drop of 225bps from July. Durable goods inflation remained in negative territory, falling on an annual basis from -4.94% to -5.32% (16.8% peak in January 2023), still dragged by a softening domestic demand. Services inflation fell only 21bps to 7.84% (9.51% peak in September). At the margin, we estimate that inflation accumulated in the quarter was 4.8% (SA, annualized; 7.2% in 2Q24), registering its lowest level since April 2021. Core inflation moderated to 5.1% from 5.9% in 2Q24 (SA annualized).

CPI expectations close to the target range



Source: Dane, Itaú

The board is likely to remain cautious in September

This year's recovery of economic activity will be gradual. Amid still high interest rates, high (but falling) inflation and elevated domestic policy uncertainty, continue to weigh on economic activity. We expect growth at 1.6% this year (0.6% in 2023), and 2.5% in 2025.

The current account deficit (CAD) to remain at low levels. Given the downside surprise in 2Q24, boosted by higher transfers and a lower services deficit, we now expect a CAD of 2.5% of GDP this year (2.7% previously), and a slight widening for 2025 at 3.0% of GDP (3.2% previously expected). Nevertheless, we continue to expect an exchange rate of COP 4,100/USD for YE24 and COP 4,200 for 2025; with an upside bias given the fiscal noise about the government's ability to meet its fiscal targets.

Risks to inflation are on the rise. With the diesel price increase in September and December, transport and food prices should be pressured further, while the price of services continues to be sticky, especially rent prices that weigh 25% of the CPI basket. However, given the significant downside surprise in August, we maintain our year-end CPI of 5.6% for 2024. For YE25 we now expect a CPI of 3.5%, given next year's expected diesel prices adjustments.

Although inflation expectations have moved closer to the target range, inflation is still far from the 3.0% target, leading us to expect that the Board will remain cautious. We expect BanRep to proceed with a 50-bp rate cut in the September policy meeting, and to reach 8.75% by YE24. For YE25, we estimate a rate of 6.0%, with risks tilted to less cuts throughout 2025.

Andrés Pérez M.
Vittorio Peretti
Carolina Monzón
Juan Robayo

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	**1.6**	1.6	**2.5**	2.5
Nominal GDP - USD bn	323	270	322	345	364	**425**	425	**434**	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	**8,072**	8,072	**8,150**	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	**3.5**	3.3
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	**4,100**	4,100	**4,200**	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**	-2.7	**-3.0**	-3.2
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	**-0.5**	-0.5
Nominal Central Govt Balance - % GDP	-2.5	-7.8	-7.1	-5.3	-4.3	**-5.6**	-5.6	**-5.1**	-5.1
Central Govt Gross Public Debt - % GDP	50.3	65.0	63.0	60.8	56.7	**60.0**	60.0	**62.2**	62.4

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

Macro Research – Itaú

Mario Mesquita – Chief Economist

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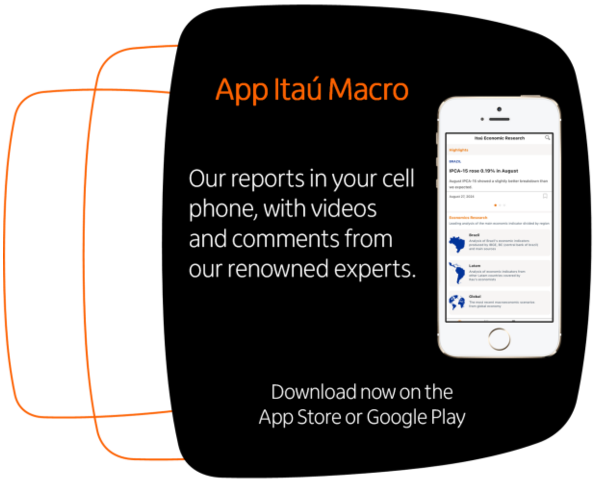

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