Macro scenario - Colombia

July 12, 2024

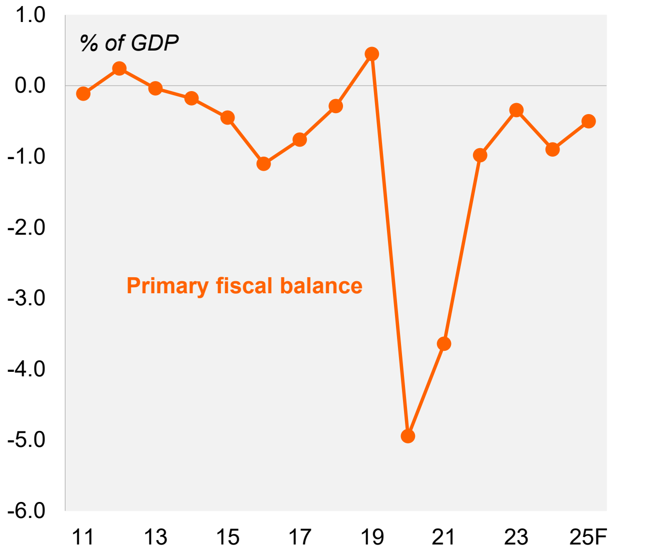
A weak fiscal revenue story

- We expect BanRep to maintain its relatively cautious monetary policy approach. Although it was another divided decision, with two votes for a 75bps cut, we reckon the 50-bp easing pace is likely to continue, as above-target inflation expectations, a pressured currency and fiscal vulnerabilities prevent a swifter loosening of the restrictive stance. We maintain our YE24 policy rate forecast at 8.75% but acknowledge that inflation risks could lead to a higher yearend policy rate.

A challenging fiscal scenario

Persistent fiscal challenges. As noted in last month's review, the pressure on fiscal accounts, stemming from weak revenues, led to significant revisions of official forecasts. In fact, the Ministry of Finance's medium-term fiscal framework (MTFF) cut this year's revenue forecast by a whopping 1.9% of GDP, and the expenditure forecast by 1.6% of GDP, leading to an increase in the estimated fiscal deficit of 0.3% of GDP to 5.6% of GDP (from 4.3% in 2023), while the 2024 primary deficit forecast rose to 0.9% of GDP (from 0.3% of GDP in 2023). More discussion on Colombia's fiscal accounts is available here.

Widening of the primary fiscal balance



Source: Finance Ministry

Rating agencies reacted to the challenging fiscal scenario. Following the updated fiscal forecasts, Moody's revised Colombia's outlook from stable to negative on the Baa2 rating. According to the agency, the country's rating could be downgraded if fiscal consolidation efforts are not enough to achieve compliance with the fiscal rule and stabilize public debt. Fitch noted that its BB+ (stable) sovereign rating remains hamstrung by fiscal challenges, dependence on commodity prices and large current account deficits.

Focus on reforms

President Petro's approval rating fell in June. A mid-June Invamer poll showed that Gustavo Petro's approval rating fell again, to 32%, from 34% in April. Notwithstanding the declining approval, the administration has made progress in its structural reform agenda. The pension reform was approved, while the labor reform will make its way through Congress during the second half of the year. The administration is expected to resubmit the education and healthcare reforms. An economic recovery plan is also in the pipeline, which should include a gradual reduction of the corporate income tax (from 35% to 30%) and changes to the fiscal rule to provide additional fiscal space for 2025.

Positive activity surprise

After moderate growth in 1Q24, activity improved early in 2Q24. The coincident activity indicator (ISE) expanded by 2.0% from March to April (SA), leading to an increase of 4% YoY (SA; 0.9% in 1Q24). Labor market dynamics also surprisingly improved, with the national unemployment rate falling to 10.3% (-0.2 pp YoY) and employment rising by 1.0% MoM/SA from April (+0.6% previously).

A gradual core disinflation process. Annual headline inflation increased 2bps from May to reach 7.18% in June, while core inflation declined moderately from 6.66% to 6.59% (10.60% peak in April last year). Inflation remains high and the disinflation process is gradual, while medium-term inflation expectations are still above target. Non-durable goods inflation (mainly food) came in at 7.84% YoY, increasing by 22bps from the previous month. Meanwhile, energy inflation fell to 18.35%, a drop of 135bps from May. Durable goods inflation remained in negative territory, falling from -4.36% to -4.78% in June (16.8% peak in January 2023), dragged by a weakening domestic demand. Services fell 5bps, remaining elevated at 8.23% (9.51% peak in September). At the margin, we estimate that inflation accumulated in the quarter was 7.1% (SA, annualized; 5.9% in 1Q24). Core inflation moderated to 5.8% from 6.5% in 1Q24 (SA annualized, +7.0% in 4Q23).

In a divided decision, BanRep stuck to the 50-bp rate cut pace, although a minority favored larger cuts. Governor Villar emphasized the still-tight global financial conditions, as well as the rise in country's risk premium, which led to a depreciation of the currency. According to Mr. Villar, monetary policy decisions will continue to be data dependent. BanRep surveys indicate a rate of 8.5% for YE24 and above-target medium-term inflation expectations, with the two-year inflation outlook declining by 5 bps to 3.45% (3% target).

A gradual easing cycle supported by above-target inflation expectations and exchange rate pressure

The better-than-expected activity dynamics led to an upward revision of our GDP growth forecast of 0.2 pp to 1.4% for 2024 and 0.1 pp to 2.7% for 2025. Contractionary monetary policy and weak business confidence, amid high political uncertainty, are likely to yield below-trend growth this year and the next.

Still-narrow current account deficit (CAD) this year. With below-potential domestic demand, we maintain our call of a CAD at 3.0% of GDP (vs. 2.7% in 2023) – in line the historical average. We now expect an exchange rate of COP 4,100/USD for YE24 (vs. 4,000 previously), due to the higher risk premium and tighter interest rate differentials with the U.S., among other factors.

Upward revision of inflation expectations driven by rents and exchange rate pressure. We now expect a year-end CPI of 5.6% for 2024 (vs. our previous expectation of 5.2%) and 3.3% for 2025 (vs. 3.0% previously). We maintain an upside bias, given the potential upward revision of forecasts dependent on the removal of diesel price subsidies.

We expect Banrep to maintain a relatively cautious stance given the slow disinflation process, tight financial conditions and challenging domestic fiscal scenario. We expect the board to maintain the 50-bp rate cut cycle in the near term and accelerate the pace to 75 bps only in 4Q24. In sum, risks are tilted to a higher rate for YE24.

Wider fiscal deficits in 2024 and 2025. We now estimate a nominal fiscal deficit of 5.6% for this year (vs. 5.3% previously) and 5.1% for 2025 (vs. 4.0% in our previous scenario). Large fiscal deficits ahead suggest that ratings are more likely to be downgraded than upgraded.

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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	**1.4**	1.2	**2.7**	2.6
Nominal GDP - USD bn	323	270	322	345	364	**424**	429	**434**	449
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	**8,056**	8,143	**8,150**	8,431
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**	5.2	**3.3**	3.0
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**	4,000	**4,200**	4,000
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	**-3.0**	-3.0	**-3.4**	-3.4
Foreign Direct Investment - % GDP	4.3	2.8	3.0	5.0	4.8	**3.2**	3.2	**3.5**	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									
Primary Central Govt Balance - % GDP	0.4	-5.0	-3.6	-1.0	-0.3	**-0.9**	-0.8	**-0.5**	0.0
Nominal Central Govt Balance - % GDP	-2.5	-7.8	-7.1	-5.3	-4.3	**-5.6**	-5.3	**-5.1**	-4.0
Central Govt Gross Public Debt - % GDP	50.3	65.0	63.0	60.8	56.7	**60.1**	59.4	**62.4**	60.1

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

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