Macro scenario - Colombia

June 10, 2024

The shifting fiscal sands

- BanRep is expected to maintain a cautious stance in its easing process, keeping the monetary policy rate well above neutral throughout the year, with global financial conditions remaining an important driver of future rate movements. We maintain our forecast for a rate of 8.75% by year-end 2024 (300 bps below the current level) and 6.0% by the end of 2025 (5.5% neutral). On a separate note, a steep decline in revenues poses a challenge to the fiscal targets, with the medium-term fiscal framework to be announced in mid-June expected to provide some insight into the government's strategy.

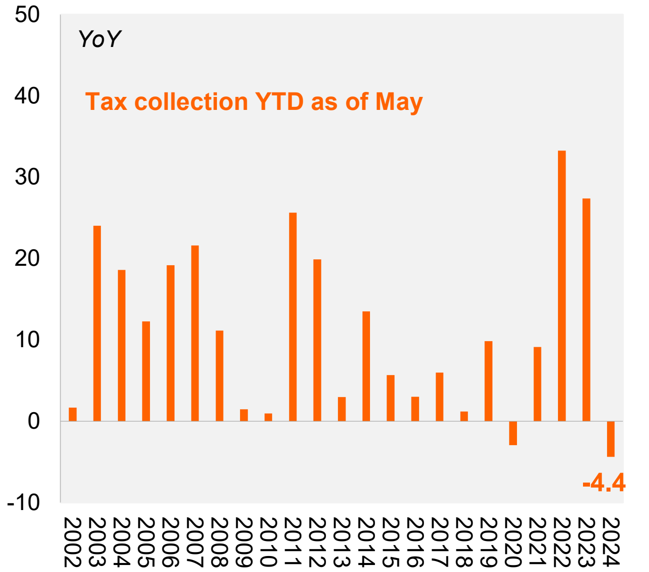
Pension reform close to being approved

The administration's pension reform was approved by the Lower House Commission and is now headed to the final debate in the Plenary. So far in the process, lawmakers have approved the allocation of contributions for wages up to 2.3 times the minimum salary (an estimated 65%-75% of total contributions) to Colpensiones (the state pension fund), with the remainder going to private pension fund administrators. The article appointing the Central Bank as the savings fund administrator is still there, but it has been adjusted to address BanRep's reservations so that the board will no longer appoint the members of the fund's steering committee. If approved, the new pension system would become effective in July 2025.

Fiscal headwinds

Tax revenues fell in May, remaining below target. Given the deceleration in economic activity, this year's tax collection through May fell by 4.4% YoY in nominal terms (vs. an increase of 27.4% for the same period in 2023), well below the 10.3% nominal growth target for FY24 (according to the official fiscal plan). Meanwhile, spending remains on track, with budget execution excluding debt service reaching 24.1% of the annual plan (0.7 pp above the historical average for the same period in 2000-23). This combination of falling revenues and steady expenditure growth has further stressed the fiscal accounts. Moreover, the Constitutional Court denied the government's request to keep the resources collected from the elimination of the deductibility of royalties on income taxes (amounting to COP 6.7 trillion; 0.39% of GDP in 2023-24), which puts further pressure on the government's already stressed cash flow. In this context, the government announced a budget freeze of around 1% of GDP.

Tax collection falls sharply

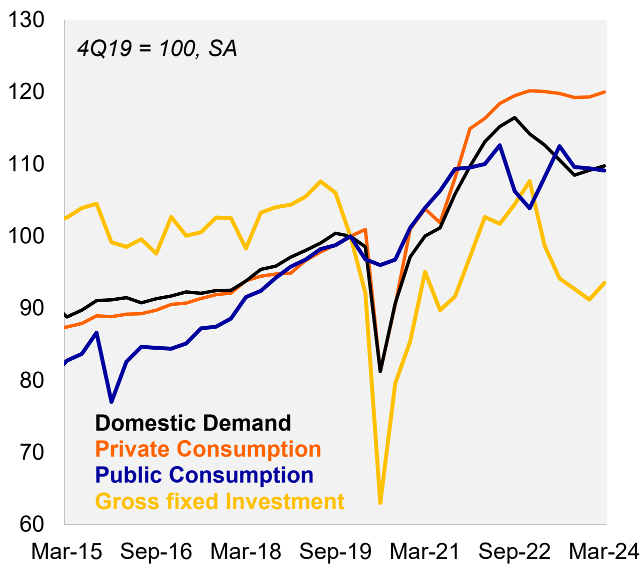


Source: DIAN, Itaú

Investment dynamics remained weak in 1Q24

The economy grew by 1.1% (SA) from 4Q23 to 1Q24, building on the previous gain of 1.0%, primarily driven by entertainment, public administration and agriculture. Activity increased by 0.7% YoY in 1Q24, vs. 0.3% in 4Q23. The annual increase in GDP was driven by net exports, while private consumption gradually picked up. Gross fixed investment contracted by 6.5%, moderating from the 14.1% decline in 4Q23 but weighed down by another double-digit drop in the machinery and equipment categories. Investment dynamics are likely to remain weak amid the uncertainties surrounding the proposed reforms and restrictive monetary policy.

Gross fixed investment remains weak



Source: Dane, Itaú

Disinflation process underway. While favorable COP dynamics are expected to support the disinflationary process, the risks remain. Inertia in rents (25.2% of the CPI basket) and risks associated with higher diesel prices and potential La Niña weather shocks could slow down the disinflation process. In this context, the decline in survey-based inflation expectations for the one- and two-year horizons has slowed and remain above the 3% target.

The minutes of BanRep's monetary policy meeting in April showed the board's majority wariness in implementing more aggressive cuts in light of the less favorable global financial conditions and uncertain domestic fiscal scenario. While the majority of the board opted to maintain the 50-bp pace, the two members who voted for larger cuts (75 bps and 100 bps) argued that a faster pace would not interrupt the disinflation process and could improve investment.

A slow recovery

We expect a gradual activity recovery this year. Tight global financial conditions and contractionary monetary policy are likely to limit the rebound in economic activity this year. We continue to expect growth of 1.2% this year, slightly above the 0.6% registered in 2023.

The current account deficit (CAD) will remain narrow this year. Our CAD forecast remains at 3.0% of GDP (2.7% in 2023) amid soft domestic demand, in line with this century's average. We continue to expect an exchange rate of COP 4,000/USD for YE24, supported by a still-wide interest rate differential, but with a bias toward further weakening, mainly due to the higher risk premium associated with calls for changes in the fiscal rule.

Upside risks to inflation. Still-favorable COP dynamics could help support the disinflationary process. We continue to expect a year-end CPI of 5.2% for 2024 and 3.0% for 2025. However, we maintain our upward bias given the potential increases in diesel prices, inertia in rental prices, and potential shocks from weather events during 2H24.

BanRep's board is expected to remain cautious amid a challenging domestic fiscal scenario, tight global financial conditions, and above-target inflation expectations. We expect BanRep to proceed with a 50-bp rate cut pace in the near term, and to reach 8.75% by yea-rend. For YE25, we estimate a rate of 6% (5.5% neutral).

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	**1.2**	1.2	**2.6**	2.6
Nominal GDP - USD bn	323	270	322	345	364	**429**	429	**449**	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	**8,143**	8,143	**8,431**	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	**5.2**	5.2	**3.0**	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	**4,000**	4,000	**4,000**	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	**3.3**	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									
Primary Central Govt Balance - % GDP	0.4	-5.0	-3.6	-1.0	-0.3	**-0.8**	-0.8	**0.0**	0.0
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	**59.4**	59.4	**60.1**	60.1

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

Macro Research – Itaú

Mario Mesquita – Chief Economist

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