Macro scenario - Colombia

June 13, 2025

Fiscal framework will set the tone

- Indexation pressures and higher-than-expected rent price increases led us to revise our year-end inflation forecast to 5.1%. The possibility of another significant minimum wage increase next year, in the context of an election process, poses upside risks to the disinflation path.
- We continue to expect a year-end 2025 policy rate of 8.5% and 7.75% for year-end 2026, although an increase in domestic policy uncertainty could lead to fewer cuts.

The activity recovery continues

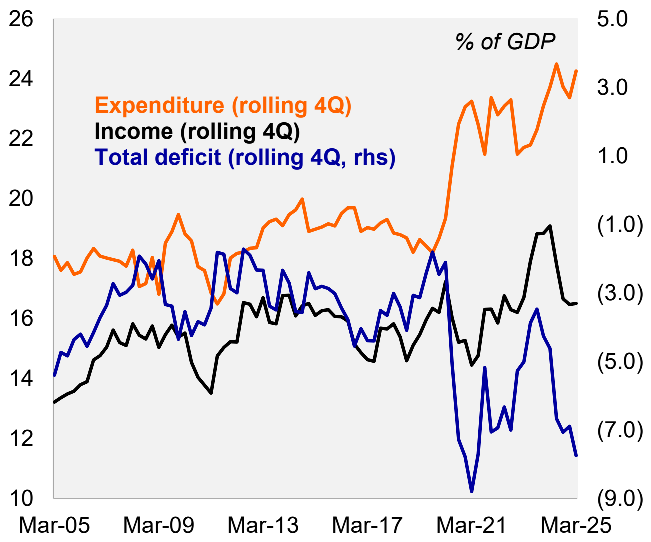
Colombia's GDP grew above expectations in 1Q25. The economy expanded by 0.8% (SA) from 4Q24 to 1Q25, primarily driven by household consumption. However, gross fixed investment fell at the margin, while import dynamics remained strong. On an annual basis, GDP increased by 2.7% in 1Q25, slightly above BanRep's staff forecast (2.5%). The labor market remains tight, with the unemployment rate (SA) at 8.8%, its lowest level since 2000, well below BanRep's NAIRU estimate of 10.2%. Meanwhile, business confidence was mixed in April but is gradually improving.

Gradual CAD widening in 1Q25; FDI flows retreat. A USD 2.3 billion current account deficit was registered in the first quarter of the year, representing 2.2% of GDP, which is USD 0.3 billion larger than in 1Q24. Consequently, the rolling 4-quarter current account deficit increased by 0.1pp from 4Q24 to 1.8% of GDP (USD 7.6 billion). Our own seasonal adjustment shows that, at the margin, the annualized deficit sits at 2.3% of GDP in 1Q25, 0.5pp wider than in 4Q24. Meanwhile, direct investment into Colombia totaled USD 3.1 billion in the first quarter of 2025 (3.2% of GDP), which is USD 0.5 billion (or 15%) lower than in the first quarter of 2024. Net direct investment reached USD 2.5 billion in the quarter (2.4% of GDP). Overall, net direct investment posted 107% coverage of the CAD, down from recent periods.

The long-awaited fiscal update

On a year-to-date basis, tax revenues have increased by 10.1% YoY nominal. Amid the second payment of tax rents by companies, gross tax collection continued to recover, growing by 20% YoY in April, partially explained by calendar base effects. The government decreed an increase in withholding tax rates, estimating an additional 0.3%-0.4% of GDP in this year's revenues, while reducing 2026 revenues by the same magnitude. A similar measure was implemented during the first year of the administration. The administration is expected to present the updated fiscal forecasts in mid-June.

Spending levels remain high



Source: Ministry of Finance; Itaú

The press reports that the Superior Council of Fiscal Policy (CONFIS) unanimously approved the Fiscal Rule's escape clause, allowing for a greater deficit. The clause has only been activated under extraordinary circumstances, such as during the pandemic in 2020. The reasons behind the triggering of the escape clause have yet to be unveiled, but they are presumably related to lingering spending pressures and budget rigidities, amid revenue underperformance. CONFIS is the only organism capable of activating this mechanism and can determine the deviation from the 0.2% primary deficit rule established for 2025 for three consecutive years. This suggests that the scenario of a nominal fiscal deficit close to 7.0% of GDP is more likely, in line with our scenario.

Political uncertainty increases

Opposition senator and potential presidential candidate shot in public. Senator and potential presidential candidate of the opposition center-right party Centro Democrático, Mr. Miguel Uribe Turbay, was shot Saturday during a public meeting with supporters in the west of Bogotá. Uribe Turbay remains in critical condition. Uribe, a 39-year-old right-wing political leader, was first elected as a senator in 2022. His family was also affected by violence in the past, with his mother being kidnapped and murdered by Pablo Escobar's cartel in the nineties. Political tensions are likely to ramp up ahead of the presidential election primaries in October and the presidential election in May 2026.

CPI Pressures And Fiscal Concerns Call For Caution

Sequential inflation pressures remain at elevated levels. Consumer prices rose by 0.32% MoM in May, below consensus, driven by housing and utilities, food, hotels and restaurants prices. On an annual basis, headline inflation fell by 11bps from April to 5.05% in May, while core inflation dropped by 8bps to 5.43%, not only resuming its downward trend but also returning to March level (10.60% peak in April 2023). Services inflation fell by 26bp to a still high 6.6% (9.51% peak in September), as rent prices gradually normalize. At the margin, we estimate that inflation accumulated in the quarter reached 5.5% (SA, annualized; 5.2% in 1Q25). Core inflation remains elevated at 5.1%, from 5.0% in 1Q25 (SA, annualized).

Inflation expectations increased to 4.8%, and another pause is anticipated. According to BanRep’s monthly analyst survey, published prior to the May downside surprise and the news regarding the escape clause, year-end inflation expectations for 2025 increased by 30 bp to 4.8% in the month, accumulating a 90 bp increase on a year-to-date basis. Regarding monetary policy, analysts expect another pause in the cycle at the June meeting, with interest rates remaining at 9.25%. The resumption of the cycle is expected in July, with a cautious 25 bp cut and a year-end rate of 8.25% (compared to 8.0% in the previous survey). Similarly, the terminal rate of the cycle increased from 6.75% to 7.0%.

A Slower Disinflationary Process

The recovery of domestic demand supports a better performance in economic activity this year. Following last year's GDP growth of 1.7% and the upside surprise in 1Q25, we revised our 2025 GDP forecast to 2.5% for this year and next (previously expected at 2.2% and 2.6%, respectively). The tertiary and agricultural sectors will continue to drive activity, with private consumption remaining the main driver.

Amid high remittances, CAD levels are expected to remain low. Despite a more pronounced recovery in imports relative to exports, driven by strong internal demand, high remittance levels lead us to anticipate a still-contained CAD of 2.6% this year (stable from the previous scenario; 1.8% of GDP in 2024). Following the agreement between the US and China, the domestic risk premium corrected significantly, leading to currency appreciation. We now expect the exchange rate to end this year at COP 4,300/USD (previously expected at COP 4,400) and for YE 2026 at COP 4,200 (COP 4,300 in the previous scenario).

The upward bias on inflation remains. Amid indexation pressures and higher-than-expected rent price increases (which account for 25% of the total CPI basket), we now expect year-end inflation to be 5.1% (previously expected at 4.8%). Next year, the possibility of another significant increase in the minimum wage gains weight. We now expect year-end CPI to be 3.6% (previously expected at 3.5%).

Fiscal concerns will lead BanRep to maintain a cautious stance. Despite the unanimous decision to cut rates in April, a slower disinflation process and fiscal concerns set a high bar for another cut in June's meeting. We still expect a year-end rate of 8.5% and 7.75%for year-end 2026, stable from the previous scenario.

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Colombia | Forecasts and Data

	2020	2021	2022	2023	2024	2025F		2026F	
						Current	Previous	Current	Previous
Economic Activity									
Real GDP growth - %	-7.2	10.8	7.3	0.7	1.7	**2.5**	2.2	**2.5**	2.6
Nominal GDP - USD bn	270	322	345	364	420	**421**	414	**458**	445
Population (millions)	50.9	51.4	51.8	52.2	52.7	**53.2**	53.2	**53.5**	53.5
Per Capita GDP - USD	5,312	6,272	6,657	6,972	7,968	**7,909**	7,775	**8,554**	8,309
Unemployment Rate - year avg	16.7	13.8	11.2	10.2	10.2	**9.6**	9.8	**9.8**	9.8
Inflation									
CPI - %	1.6	5.6	13.1	9.3	5.2	**5.1**	4.8	**3.6**	3.5
Interest Rate									
Monetary Policy Rate - eop - %	1.75	3.00	12.00	13.00	9.50	**8.50**	8.50	**7.75**	7.75
Balance of Payments									
COP / USD - eop	3,433	3,981	4,810	3,822	4,409	**4,300**	4,400	**4,200**	4,300
Trade Balance - USD bn	-10.1	-15.3	-14.5	-9.7	-10.8	**-11.0**	-11.0	**-10.0**	-10.0
Current Account - % GDP	-3.4	-5.6	-6.1	-2.4	-1.8	**-2.6**	-2.6	**-3.1**	-3.1
Foreign Direct Investment - % GDP	2.8	3.0	5.0	4.6	3.4	**3.6**	3.6	**3.7**	3.7
International Reserves - USD bn	58.5	58.0	56.7	59.1	61.9	**62.5**	62.5	**64.0**	64.0
Public Finances									
Primary Central Govt Balance - % GDP	-5.0	-3.6	-1.0	-0.3	-2.4	**-2.2**	-2.2	**-1.2**	-1.2
Nominal Central Govt Balance - % GDP	-7.8	-7.1	-5.3	-4.2	-6.8	**-7.0**	-7.0	**-5.5**	-5.5
Central Govt Gross Public Debt - % GDP	65.0	63.0	60.8	56.7	63.3	**65.2**	66.3	**65.8**	66.8

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

Macro Research – Itaú

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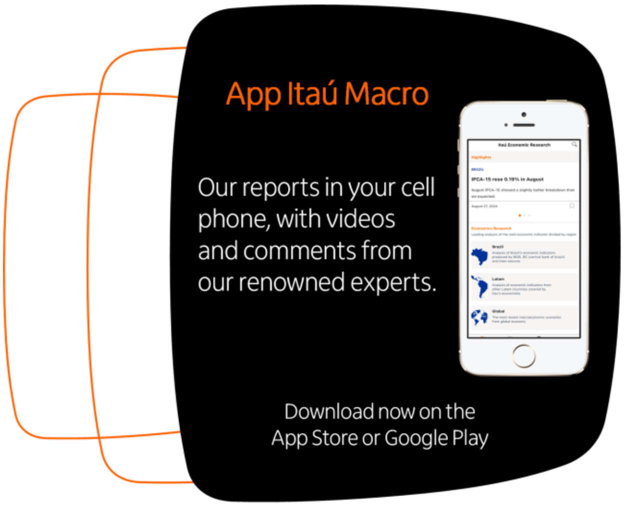

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