Colombia

Outlook

	Average 10-14	2015	2016	2017	2018	2019	Forecasts 2020	2021	2022
GDP growth (%)	5.0	3.0	2.1	1.4	2.5	3.3	-6.5	4.5	3.3
CPI inflation (%)*	2.8	5.0	7.5	4.3	3.2	3.5	2.4	3.0	3.0
Fiscal balance (% of GDP)	-2.4	-3.1	-3.8	-3.3	-3.1	-2.2	-8.7	-5.1	-3.3
Public debt (% of GDP)	37.4	50.4	49.8	49.4	53.7	52.3	68.2	68.1	67.3
Reference rate (%)*	3.9	4.6	7.1	6.1	4.3	4.2	2.8	2.0	2.7
Exchange rate (COP/USD)*	1,883.1	2,749.1	3,051.8	2,952.1	2,958.1	3,282.6	3,710.2	3,422.6	3,314.5
Current account balance (% of GDP)	-3.5	-6.3	-4.3	-3.3	-3.9	-4.2	-4.0	-3.9	-3.8
External debt (% of GDP)	23.7	39.1	43.1	40.8	40.5	45.0	59.8	55.0	49.9

Note: * Annual average.
Source: CaixaBank Research, based on data from national statistical agencies and IMF.

- **Colombia had one of the strictest lockdowns in Latin America** and one of the lowest mortality rates in the region as a result. Despite strong isolation measures, the economic contraction in Q2 was near the regional average. Although the loosening of these measures has generated a more dynamic economy, **the recovery is still uncertain and will largely depend on how the pandemic evolves**. Despite modest fiscal expenditure during COVID-19 compared to other countries, **the fiscal outlook in the near future will be challenging** and will require fiscal reform to maintain the investment grade rating (it is currently one notch away from losing it). On the other hand, the pandemic has increased the unpopularity of the current Government, resulting in a risk of social unrest and for major protests to continue into 2021.

- **Real shock of COVID-19 and health strategy.** Although each city has the legal authority to implement its own isolation measures, the general lockdown strategy was one of the strictest in Latin America, initially preventing a fast spread of the virus and a collapse of the health system. The total number of cases and deaths per million residents therefore sits below the regional average. The easing of the lockdown measures and the reopening of more productive sectors in Q3 of 2020 boosted economic activity. As a result, the decrease in year-on-year GDP slowed from –15.8% in Q2 to –9.0% in Q3 (8.7% quarter-on-quarter), with a rise in both private consumption and investment. The recovery process will remain uncertain and uneven across economic sectors, and will largely depend on how the pandemic evolves.

- **Economic policy response**
  - **Monetary policy.** This year, the central bank reduced the reference rate by 250 b.p. to 1.75% and strengthened its liquidity provision scheme by granting extensions and including new participants from the financial sector in liquidity operations (repos). It also intervened in the foreign exchange market by selling dollars with legally binding forward contracts at market rates. Although the bank remains concerned about high unemployment and the possible impacts of a second wave of infections in the country, we believe it has ended the cycle of interest rate cuts. Meanwhile, the central bank is satisfied with current inflation rates, despite them being somewhat lower than the target minimum threshold (the range is 2%-4%).
  - **Fiscal policy.** Fiscal support for the crisis caused by a pandemic has been relatively modest compared to other countries in the region. In mid-June the Government decided to suspend the Fiscal Rule in 2020 and 2021,

Outlook *(continued)*

which structures the fiscal deficit, in order to withstand the shock on public finances. This context creates a challenging fiscal outlook, and it will be imperative to increase tax collection when the shock of the pandemic diminishes (we estimate that revenues equivalent to 2% of GDP will be needed starting in 2022). With this in mind, the Government is promising fiscal reform next year. If this does not happen, the investment grade rating, which was recently ratified by Fitch and S&P, will be at risk.

- **Evolution of the sovereign debt.** Given the increased need for spending to confront the pandemic, lower tax revenues and the economic slowdown, the fiscal deficit is expected to reach 8.7% of GDP in 2020 (–2.2% in 2019), causing public debt to rise to 68.2% of GDP (52.3% in 2019). Due to the difficulties of accessing government bond markets, and so as not to pressure markets in moments of high uncertainty, the Government decided to optimise its resources, leveraging its available financial assets. This includes making use of Government savings from public funds, borrowing some of the resources available from each one. That said, increasing the size of the public debt won't necessarily increase its cost.

- **Evolution of the exchange rate.** The Colombian peso was highly volatile in 2020 due to the uncertainty surrounding the coronavirus, the global slowdown and falling oil prices. In the medium term, we can expect it to appreciate moderately as oil prices slowly rise, the economy recovers and aversion to emerging markets declines.

Main risks

The risk balance is clearly trending downward. Specifically, there are several categories:

- **Macrofinancial risk.** The fiscal adjustment path is uncertain beyond the Government's commitment to speeding fiscal reform. If this reform is not approved, or if it results in less revenue than expected, there is a real risk of losing the investment grade rating. Nevertheless, it is worth remembering that if financial volatility increases, Colombia has international reserves estimated at nearly 145% of what is considered sufficient. Likewise, the Flexible Line of Credit (approximately 17.2 million dollars) granted by the International Monetary Fund strengthens the country's profile abroad. These resources, together with the international reserves, put the financial buffer at around 175% of what is considered sufficient.
- **Political risk.** Political stability could gradually decline over the rest of President Iván Duque's term. Governance challenges will return as a result of his Administration's high disapproval rates and as polarisation increases in lead-up to 2022 presidential and legislative elections. This will reduce the scope of dialogue between parties regarding the economic recovery agenda following the pandemic.

	Rating	Last changed	Outlook	Last changed
STANDARD & POOR'S	BBB-	11/12/17	Negative	26/03/20
Moody's	Baa2	28/07/14	Stable	23/05/19
FitchRatings	BBB-	01/04/20	Negative	14/11/18

■ Indicates that the country has "investment grade".
□ Indicates that the country does not have "investment grade".

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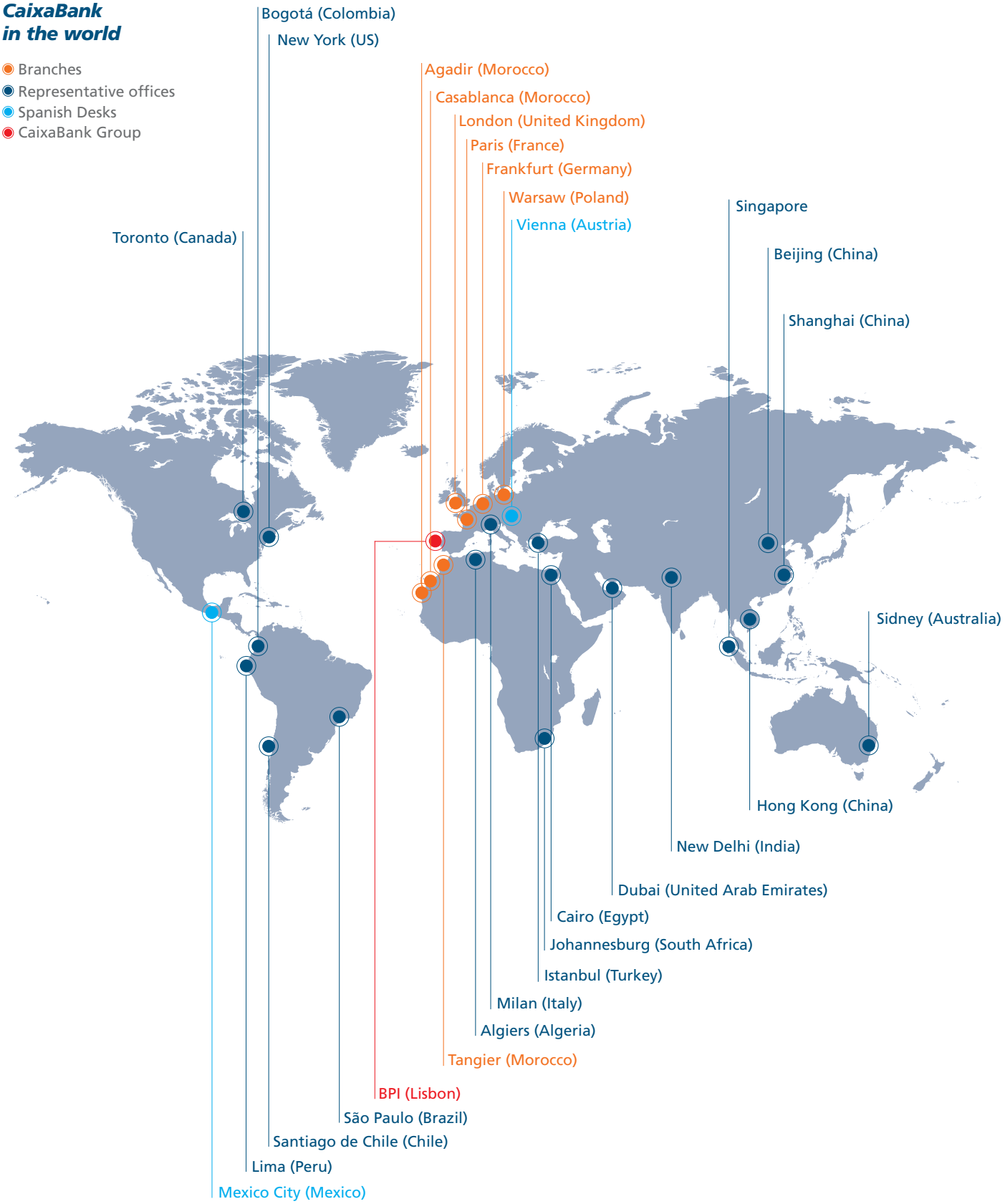

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