Macro scenario - Colombia

May 14, 2024

Gradual easing to continue

- Although base effects should contribute to the disinflationary process, risks related to the lagged effect of El Niño, the adjustment of diesel prices, and weaker COP dynamics persist. Monetary policy remains highly contractionary, but elevated global uncertainty associated with the Fed's repricing and geopolitical tensions could limit more aggressive cuts in the short term. We still expect BanRep to lower the policy rate to 8.75% by year-end (300 bps below the current level) and to 6% at the end of 2025 (5.5% neutral), with 50-bp cuts in the near term.

Pension reform moves forward in Congress

The pension reform was approved in the Senate and will now go to the Lower House. The second debate of the Pension Reform proposal in the Senate Plenary was concluded despite social protests against the proposal in late April. The Senate approved the allocation of the contributions for income levels up to 2.3 times the minimum salary (an estimated 70%-80% of total contributions) to the Colpensiones state pension fund; the remainder will go to private pension fund administrators. According to the reform, the Central Bank will be the administrator of the resources directed to the public pension fund, an arrangement that may be unique. The reform will now go to the seventh commission of the Lower House, where it will have to be approved before June 16 to allow the government to call for an extraordinary session after June 20. If approved, the reform would become effective on July 1, 2025. The proposal is likely to face less resistance in the Lower House and is therefore expected to be approved.

Uptick in unemployment

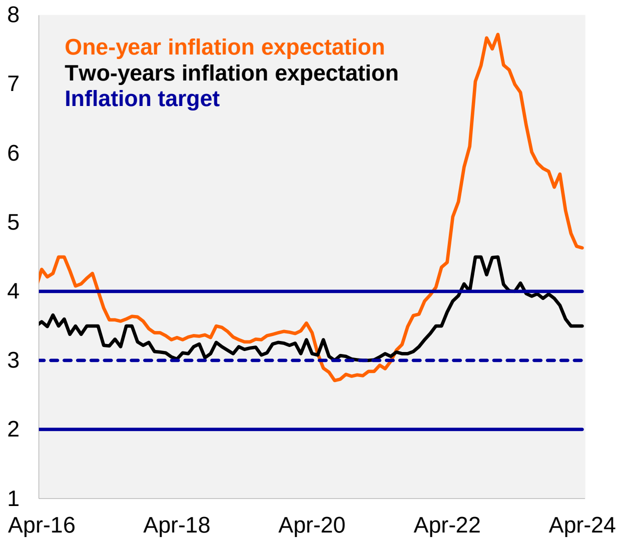
Activity posted a sequential decline in February, but overall it has exceeded expectations at the start of the year, driven by better performance of primary activities and some service sectors. The coincident activity indicator (ISE) fell by 1.6% SA from January to February, partly reversing the surprising 3.3% gain in January. As a result, activity increased by 2.5% YoY (from 1.9% YoY in January). Activity was boosted by agriculture, services and public administration, while manufacturing, construction, and financial and insurance activities were a drag during the period. The unemployment rate trended up in the first quarter, with the national unemployment rate at 11.3% (up 1.3 pp YoY), while the urban unemployment rate came in at 10.8% in March (up 0.3 pp YoY).

A repeat decision

In a divided vote, the BanRep board cut the policy rate by another 50 bps to 11.75%, as expected. In a repeat of the March meeting, there were two dissenting votes, once again arguing for a cut of 75 bps and another for 100 bps. The communiqué highlighted the consolidation of the downtrend in inflation, while noting the outlook for a broadly stable and above-target inflation in the market. Central Bank Governor Leonardo Villar highlighted the tightening of global financial conditions and signaled that the upcoming decisions would be data-dependent and consistent with a return of inflation to the 3% target by mid-2025. According to the central bank analyst survey, the one-year inflation expectations dropped by 3 bps to 4.63%, while the two-year inflation outlook remained stable at 3.5% (3% target). On the monetary policy front, analysts expect the interest rate to end 2024 at 8.25% and to end 2025 at 5.5%.

In the central bank's monetary policy report, released after the April decision, Banrep's technical staff revised its GDP growth forecast up and outlined an interest rate path that, on average, would be above analyst expectations (8.25% by yearend). Despite the upward revision of activity expectations, the pace of the disinflation process was faster than expected in 1Q24, leading to a downward revision of the headline and core inflation forecasts for 2024. Regarding monetary policy, the central bank staff's baseline scenario implies a policy rate path that is, on average, somewhat above analyst expectations of 8.25% for December, calibrated in order to consolidate the convergence of inflation to the 3% target in 2025.

Inflation expectations stall at high levels



Source: Banrep, Itaú.

Global financial conditions will play a key role in MP

Higher-than-expected activity at the start of the year led to the 20-bp upward revision of our 2024 GDP print, to 1.2% in 2024 (from 0.6% in 2023). The lagged effect of a contractionary monetary policy, along with a gradual disinflationary process and local political uncertainty, will limit any significant rebound, resulting in below-potential growth of 2.6% next year.

Weak domestic demand will keep the current account deficit (CAD) low this year. Our CAD forecast remains at 3.0% of GDP (2.7% in 2023) – in line with this century's average. We continue to expect an exchange rate of COP 4,000/USD for YE24, supported by still-high interest rates, but there is upside potential given the tighter global financial conditions and rising uncertainties surrounding the economic policy.

The disinflationary process will continue. More moderate effects of the El Niño phenomenon, together with still-favorable COP dynamics, could help to support the disinflationary process. We still see year-end inflation at 5.2% and 3.0% for 2024 and 2025, respectively. There continues to be an upside bias to our forecasts, given the government's announcement of an adjustment in diesel prices at some point during the year.

Amid tighter global financial conditions, we expect BanRep to maintain a cautious stance. We expect BanRep to continue with a 50-bp cut at the next monetary policy meeting in June. Downside surprises in inflation dynamics and a convergence of inflation expectations would play a key role in allowing for an acceleration in the cutting pace. For now, we maintain our forecast of an 8.75% rate for YE24, still well above the nominal neutral rate of around 5.5% and the analysts survey of 8.25%, and more consistent with the central bank's signaling. For YE25, we estimate a rate of 6% on expectations of a slow pace of easing by the FED.

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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	**1.2**	1.0	**2.6**	2.6
Nominal GDP - USD bn	323	270	322	345	364	**429**	428	**449**	448
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	5,308	6,272	6,659	6,976	**8,143**	8,127	**8,431**	8,414
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	-14.3	-9.9	**-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									
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**	59.5	**60.1**	60.2

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

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