Colombia

Baa3 (stable)/BBB- (pos)/BBB- (pos)

Moodys/S&P/Fitch

- **Economic outlook:** GDP growth softened in 2012 relative to the year before, although less than expected. Inflation remains below target and will probably not reach the 3% mark until next year. After last cut, end of the easing cycle is very near. The government is committed to implementing policies to slow down the appreciation process.
- **Main risks:** Weaker global growth, softer external demand and/or terms of trade. Stumbles in the peace process with the FARC. Reappearance of social unrest ahead of next year's elections.

Macro view

March inflation a shade below expectations

The official statistics office DANE reported that consumer prices rose by 0.21% MoM, 1.91% YoY in March, slightly below expectations of a 0.26% increase as per Bloomberg's survey. Annual inflation, however, rose by 8bp relative to February. During 1Q13, accumulated inflation has been 0.95%, 52bp less than in 1Q12. Communications led the increases at 1.85% MoM, followed by health and transportation services. Prices of food and beverages rose by 0.17%, while education, housing and entertainment posted monthly decreases. We expect annual inflation to continue edging higher over the coming months, although possibly not reaching the 3% medium term target level until 2014.

Higher than expected growth

DANE reported that GDP expanded by 3.1% YoY during 4Q12, slightly above expectations of a 3.0% increase as per Bloomberg's survey. All sectors exhibited inter-annual increases during 4Q12 with the exception of manufacturing, which shrank by 3.1% YoY. On a seasonally adjusted basis, GDP climbed by 1.8% QoQ, thus recovering from the 0.7% drop observed during 3Q12. Construction led the quarterly expansion with an increase of 10.6% QoQ, while agriculture and manufacturing experienced a decrease of 0.5% QoQ and 1.5% QoQ, respectively. During 2012, GDP rose by 4.0%, as the 3Q12 figure was revised upwards to 2.7% from the original estimate of 2.1%. Still, the expansion fell far short of the (revised) 6.6% of 2011, and also below potential which the Finance Ministry believes to be near 4.8%. Within aggregate demand, private consumption expanded by 4.4%, investment increased by 5.7% and exports climbed by 5.3%. Imports, in turn, rose by 8.0%.

BanRep minutes

BanRep released the minutes of the March 22 monetary policy meeting, explaining the rationale behind the surprising 50bp reduction in the policy rate. BanRep indicated that the revised economic growth figures showed a sharp deceleration in 2012 (4% for the whole year) relative to the strong performance of 2011 (6.6%). The slowdown was mainly due to softer investment, while exports decelerated markedly during 4Q12. Growth in Colombia's trading partners is also expected to weaken, so that external demand is likely to remain rather soft. During 1Q13, the deterioration in consumer and business confidence suggest that private consumption will probably grow at a slower pace. Therefore, chances are that the economy will continue expanding at below-potential rates, without making full use of its installed capacity. Meanwhile, all inflation indicators are currently running well below target. BanRep highlighted that the easing cycle has been reflected in lower interest rates on loans and deposits across the domestic financial system, although the drop in inflation resulted in a much lower reduction in real interest rates. The rate of credit expansion continued to slow down, although local firms have increased their bond indebtedness. All things considered, BanRep decided to implement the large cut "to make macroeconomic policy consistent with economic growth close to potential". That is, the Bank explicitly indicated that, as inflation is not a concern at this juncture, is focusing on economic activity. We are of the idea that after the latest move the easing cycle is close to its completion, although a final residual cut of 25bp cannot be ruled out. This is particularly the case given that the expected acceleration in inflation will reduce short term real interest rates further.

Indeed, during a recent interview with RCN Radio, Finance Minister Mauricio Cardenas indicated that, after the recent 50bp reduction in the policy rate, BanRep "is getting closer to the end of what it can do" in terms of injecting monetary stimulus to prop economic activity. He added that the larger than expected cut was meant to convey the signal to the market that monetary policy "was playing its last cards". The Minister also said that the domestic financial sector "has not helped" to reflect the lower policy rates on reduced market interest rates, thus suggesting that the authorities are not comfortable with the transmission mechanism of monetary policy and leaving the door open for policy announcements geared towards lowering market rates. Cardenas also said that the government hopes to see the exchange rate near the COP1900/USD level soon, hinting that the economic team will continue pushing for a weaker currency.

Cardenas said that the authorities should do "everything they can" to curb peso appreciation and protect the country's exporters. Those measures could include more aggressive FX intervention. Cardenas went on to say that President Juan Manuel Santos wants the economic team to be "more audacious, more creative" to avoid excessive COP strength. He also indicated that the government will soon announce a stimulus package for agricultural producers. BanRep's Governor Jose Uribe also indicated that he would welcome a weaker exchange rate and acknowledged that additional intervention measures are a possibility.

Unemployment remains high

DANE reported that the urban unemployment rate came out at 12.3% in February, down 80bp relative to January and exactly in line with expectations as per Bloomberg's survey. The figure corresponds to an average of the 13 largest cities in the country. At the national level, the jobless rate was 11.8%, down 30bp from the previous month. Colombia's unemployment rates remain at the top among major Latin American economies, and with the exception of a brief pause last November, it has been consistently in the double digit range, which suggests that structural problems in the country's labor market still exist. In addition, given the expectation that GDP will expand at below potential rates, chances are good that the jobless rate will remain relatively high during the current year.

Large C/A deficit

BanRep reported a current account deficit of USD3.58bn during 4Q12, resulting in an imbalance of USD11.4bn during the entire year, or roughly 3.7% of GDP. The current account deficit was more than offset by a capital account surplus of USD14.7bn during 2012. FDI inflows totaled USD15.8bn during the year. The accumulated increase in international reserves was USD5.4bn.

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Colombia: Deutsche Bank Forecasts

	2011	2012F	2013F	2014F
National Income				
Nominal GDP (USD bn)	266.8	297.4	313.9	344.9
Population (mn)	49.3	50.4	51.0	51.7
GDP per capita (USD)	5,413	5,902	6,155	6,671
Real GDP (YoY%)	6.6	4.0	4.2	5.0
Priv. consumption	7.0	4.0	4.1	5.0
Gov't consumption	4.0	3.9	3.9	3.8
Gross capital formation	13.0	6.0	10.0	11.0
Exports	25.0	13.0	13.0	12.0
Imports	28.0	20.0	19.0	17.0
Prices, Money and Banking				
CPI (Dec YoY%)	3.7	2.4	2.8	3.2
CPI (avg%)	3.4	3.1	2.6	2.9
Broad Money	19.0	14.0	14.0	15.0
Bank credit	21.0	16.0	13.0	15.0
Fiscal Accounts (% of GDP)				
Consolidated budget balance	-2.0	-1.4	-1.2	-1.1
Interest payments	3.1	3.1	3.0	2.9
Primary Balance	1.1	1.7	1.8	1.8
External Accounts (USD bn)				
Exports	56.9	64.0	69.0	75.0
Imports	54.7	62.0	69.0	76.0
Trade balance	2.2	2.0	0.0	-1.0
% of GDP	0.8	0.7	0.0	-0.3
Current account balance	-7.0	-8.5	-9.8	-11.0
% of GDP	-2.6	-2.9	-3.1	-3.2
FDI	14.8	15.3	15.0	15.0
FX reserves	32.3	39.0	49.0	55.0
COP/USD	1939	1767	1820	1770
Debt Indicators (% of GDP)				
Government debt	39.3	38.9	38.4	38.1
Domestic	27.5	27.6	27.5	27.6
External	11.8	11.3	10.9	10.5
Total external debt	22.5	21.5	20.7	20.0
in USDbn	60.0	64.0	65.0	69.0
Short-term (% of total)	8.0	7.0	7.0	7.0
General				
Industrial production (YoY%)	6.0	6.0	7.0	8.0
Unemployment (%)	10.0	9.9	9.9	9.5
Financial Markets (eop)	*Current*	*3M*	*6M*	*12M*
Overnight rate (%)	3.3	3.3	3.3	3.5
3-month rate (%)	4.3	4.3	4.3	4.5
COP/USD	1817	1840	1840	1810

Source: DB Global Markets Research, National Sources