BBVA RESEARCH

Colombia Economic Outlook

Second Quarter 2014
Economic Analysis

- **The global recovery continues,** notwithstanding the mild slowdown in China and its impact on demand for basic goods.
- **The Colombian economy will grow by 4.7% and 4.8% in 2014 and 2015 respectively,** thanks to sustained domestic demand and the US recovery.
- **Inflation will trend to the upside in 2014 and 2015 but within the long-term target range,** and expansionary monetary conditions will normalise toward a neutral position in 2015.
- **A mild devaluation of the Colombian peso in 2014 and 2015,** as long-term macroeconomic conditions consolidate.

Index

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1. Summary

The global recovery continues, but with a slowdown in China's growth. The US has maintained a sustained growth path, notwithstanding the impact of an unusually adverse winter. Short-term indicators point to a more robust second-quarter start than the first, and support 2.5% growth for the US in 2014 and 2015. For its part, the Chinese economy reveals signs of slowing, which leads us to a downward revision of its growth to 7.2% and 7.0% in 2014 and 2015, close to half a percentage point less than expected three months ago.

In contrast, growth in Colombia picked up at the end of 2013 and an optimistic performance is maintained for 2014. The Colombian economy grew 4.3% in 2013, slightly above our forecast of 4.1%, thanks to the improved behaviour of consumption (private and public) and the upward revisions to the first quarters.

We expect a growth of 4.7% over 2014, with an equivalent growth in private consumption, but with a more positive balance for investment (5.9%), both residential and non-residential**. The first half of the year will have slightly higher growth (5.1%) than the second half (4.4%).**

The greater weighting of Colombia in public debt indices, announced by J.P. Morgan in March, entails higher dollar inflows into the economy. Furthermore, confidence in the country improved, which reversed the depreciation and local equity market losses, while raising the value of public debt TES (Treasury Securities).

We have cut the 2015 growth forecast from 5.1% to 4.8%. The adjustment is due to the scheduling delay in the fourth generation (4G) infrastructure works, the start of the projects having been moved from the first to the second half of 2015. The growth determinants in that year will be private consumption, non-residential private investment and exports. For the medium term (from 2016 to 2018), we stand by our growth forecast of over 5%.

The current account deficit would drop to 3.2% of GDP in 2014 from 3.4% in 2013, as a result of greater external demand from developed countries, which would make up for the lower prices of basic goods. **For 2015, we anticipate a lower current account deficit (2.9% of GDP**), in spite of a strong rise in imports. Foreign direct investment (FDI) will remain the main source of deficit financing, although with a greater contribution of portfolio equity.

In 2014 and 2015, we expect a fiscal deficit in line with the downward path imposed by the fiscal rule. However, meeting the 2015 path target requires greater tax revenues, due to the inflexibility of expenditures, regional transfers and the ambitious infrastructure plan, which limits the option of achieving the adjustment via lower investment.

Inflation in 2014 and 2015 will come in at 3.4%, remaining within the target range (2-4%). Prices within the food and regulated items group have risen more than expected since the end of 2013, and have been accompanied by steadily climbing core inflation.

Monetary policy will be less expansionary in 2014 and neutral at the end of 2015. We expect a monetary policy rate of 4.25% by year-end, with further increases totalling 100 basis points taking it to 5.25% in 2015. The pace of international reserves accumulation should remain at USD1bn per quarter over 2014.

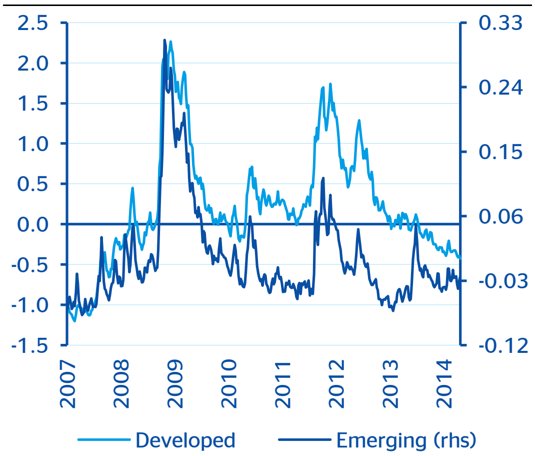
Low average devaluations are expected for 2014 and 2015. The favourable differentiation of the Colombian economy, the consequent capital inflows and the earlier-than-expected hike in the monetary policy rate lead us to expect an average depreciation of the Colombian peso of 4.6% for 2014 and 1.1% in 2015.

2. The deceleration in China and the Fed's tighter monetary policy will define the global scenario

The global recovery continues, but the improvement is being hampered by the deceleration in the EMs

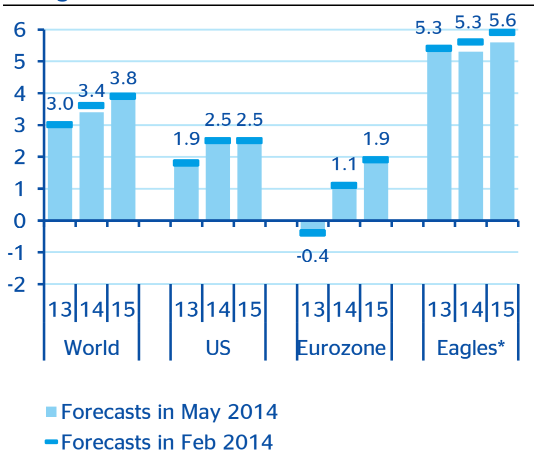
The global economic cycle remains robust at the start of 2014. According to our estimates, in the first quarter of 2014 global GDP has accelerated very slightly to around 0.8% QoQ. We expect this pace to be maintained for the first part of the year. In the wake of this sustained global recovery is the cyclical improvement in the DMs, which has offset the deceleration in some EMs in Asia and Latin America. Meanwhile, in the last few months the financial markets have performed very differently in the two regions, and with more differentiation between the EMs. Capital flows, asset prices, interest rates and financial tension indicators have fundamentally performed in line with the outlook for rate hikes in the US, and, in the case of EMs, depending on the outlook for deceleration in China and idiosyncratic factors. Asset prices in EMs have recovered in the last few months, particularly in March and April, while financial tensions have waned after the spike at the beginning of 2014 (Figure 2.2).

Figure 2.1
BBVA Research financial tensions index in DMs and EMs



Source: BBVA Research

Figure 2.2
GDP growth forecasts (%)



*EAGLEs is the group of emerging economies which will contribute most to world GDP in the next 10 years. The group contains China, India, Indonesia, Brazil, Russia, Turkey and Mexico.
Source: IMF and BBVA Research

Our assessment of the global scenario has a downward bias compared with our valuation three months ago, which is reflected in the adjustments to our forecasts (Figure 2.2). After growing at 3.0% in 2013, global GDP will start to accelerate again in 2014 and 2015 at around 3.4% and 3.8% respectively. By areas, we have not made significant changes to our forecast for expansion in US activity and the eurozone. The downward pressures in our forecasts are the result, therefore, of what we believe will happen in the EMs, in 2014 and 2015, in both Asia and Latin America, as a result of concerns over economic slowdown in China. Risks continue to be to the downside in the short- and medium-term. Some factors with a global impact could make themselves felt more intensely than expected in the base scenario on a short-term time horizon, such as a tighter monetary policy on the part of the Fed, reduced growth of the global demand stemming from economic slowdown in China or on an (even lower) scale of macro-economic repercussion, the geopolitical risks derived from Eastern Europe.

In the developed economies, the US overcomes the impact of an unusually cold winter and the perspectives for an improvement in the eurozone have increased

US GDP has maintained steady growth at the beginning of 2014 in spite of the impact of unusually adverse weather conditions. In the labour market, employment has increased by an average of 178,000 jobs in 1Q14, in line with the print in 4Q13, and the unemployment rate has fallen to 6.7% of the labour force, a smaller than expected fall because the increase of the population available to work. As a result, the Fed has pressed ahead with the announced moderation in its balance-sheet expansion. In this context, we are expecting the Fed to complete its exit from the asset-purchase programme towards the end of the year, and the market to focus on a possible change in inflation trends as it anticipates the start of interest-rate hikes in a scenario of a gradual acceleration in GDP growth. Growth in 1Q14 reached 0.1% annualised. The leading indicators point to a more robust start to the second quarter than to the first. Altogether, we are maintaining our forecast for US growth at 2.5% in 2014, and the same in 2015 (Figure 2.2). The forecast has upside risks if the improvement in confidence provides additional incentives to corporate investment and job-creation.

For Europe, our short-term models point to an acceleration of around 0.5% QoQ, although the boost from the external sector could moderate in the coming months due to: i) euro appreciation, with a slight impact on growth but clearly differentiated by country; ii) the reduced demand from China, also with diverging direct effects; and iii) geopolitical risks in the East if the crisis in Ukraine continues. Altogether, we maintain our forecasts for the eurozone in 2014 at 1.1%, and 1.9% in 2015 (Figure 2.2), in a scenario of contained financial tensions and fiscal and monetary policies that do not put a brake on growth.

Finally, among developed economies, there is slightly more uncertainty about the growth outlook for Japan, which has had a QE programme underway since January 2013, together with fiscal stimuli to return to having inflation and favouring consumption and investment. We have revised downwards our outlook for growth in 2014 for Japan by four basis points to 1.1%, and we are maintaining our estimate for 2015 at 1.3%.

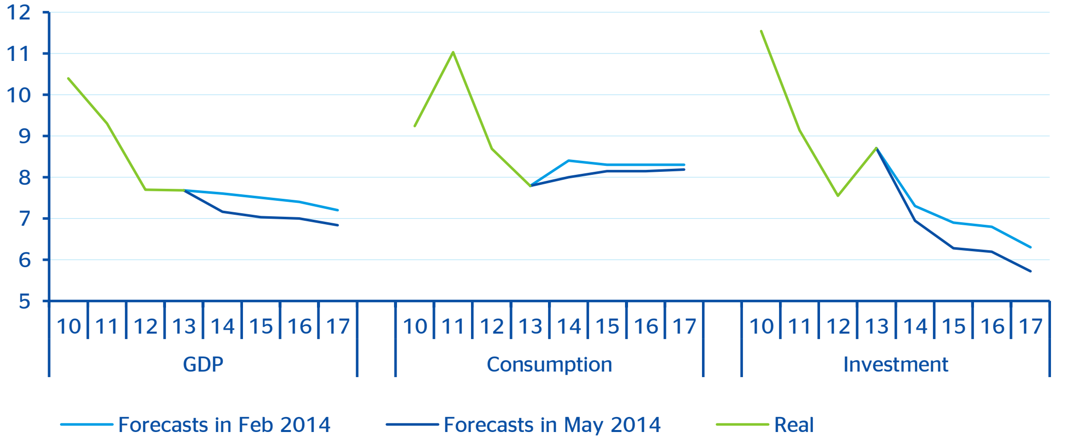
In China, the deceleration that began at the Chinese New Year is here to stay, in an environment of lower-than-expected inflation

In line with our forecasts in our last quarterly report, uncertainties about the cyclical strength of the Chinese economy have materialised, with a deceleration in activity during the first quarter of 2014. The latest data from indicators on both domestic and foreign demand show the loss of momentum in the cycle, more so in investment than in consumption, in an environment of lower-than-expected inflation. At the same time, the authorities are starting to introduce measures to deal with the weaknesses arising from economic policy decisions taken in the last few years to support growth in the short term. This has involved postponing the deleveraging of local governments and companies, and continuing to approve infrastructure projects and excess installed capacity which are unlikely to be profitable while families, who are financing the process, are receiving negative real interest rates on their savings. This is an inefficient allocation of resources, which also encourages the development of financial systems in parallel with the more regulated one and which may be a source of problems in the future. To this end, regulations on the non-banking financial sector, shadow banking and environmental protection are all being toughened.

In view of this, we have revised Chinese growth downwards to 7.2% and 7.0%, in 2014 and 2015 respectively, around half a point less than we forecast three months ago (Figure 2.3). The increasing importance of China as a source of world demand in the last few years is undeniable. But the differentiation between areas is unchanged, with higher exposures in

Southeast Asia, some South American and African countries and, among developed economies, Germany. According to our estimates, the impact on world growth of each point of Chinese growth lost is around 0.4pp, principally as a result of lower demand from China itself. Note also that the expected adjustment in the local scenario is limited, and clearly not enough to unleash episodes of global financial uncertainty.

Figure 2.3
China: Growth forecasts (%)



Source: BBVA Research

In summary, there are two factors with a global impact on the forecast horizon: the tightening of the Fed's monetary policy, and lower growth of Chinese demand, with macro-economic repercussions that are clearly differentiated between economies. As outlined above, the sudden perception by the market that the tightening by the Federal Reserve of the monetary cycle was imminent with the withdrawal of quantitative easing, raised financial volatility in emerging economies. There was a clear differentiation between different areas, however, with greater volatility in those exchange rates whose exposure to foreign funding is greater. On the other hand, also among emerging economies, it is the Asian economies which are most exposed to a reduction in Chinese demand, with the further addition to the list of a few raw materials exporters, such as Chile. All these factors can be shown in a map of vulnerabilities where differentiation is a vital factor.

3. An optimistic economic performance for 2014 and 2015

Colombia's increased weighting in J.P. Morgan’s indices whets foreign investor appetite for the country

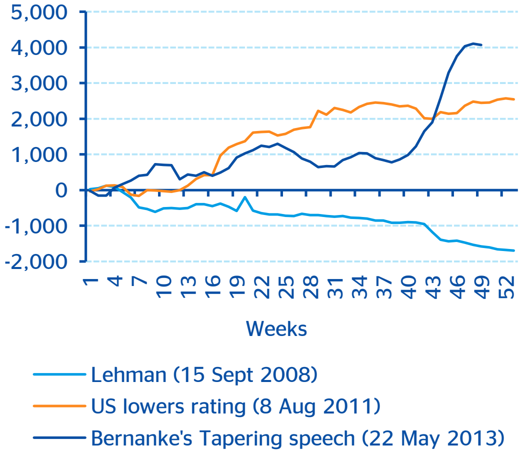
The start of 2014 featured a capital shift from emerging countries to developed markets, from which Colombia was partially spared (See Figure 3.1). While the country did experience this capital exit for three weeks, it was not as sharp as in other emerging countries. The flow subsequently normalised and, since mid-February, has taken on a new dynamism. From 17 February to 18 March portfolio equity inflows totalled USD1.04bn, a level not seen since mid-2011 of USD260mn per week on average. Thanks to emerging markets' positive differentiation of Colombia, the peso completely corrected the 5% depreciation seen from 21 January to 17 February over the following 30 days (See Figure 3.2). For its part, the equity market fell 5.4% over the first two months of the year, although this was mainly due to local factors. However, its fall also completely corrected by the end of April (See Figure 3.3).

On 19 March, J.P. Morgan announced the reweighting of Colombia's peso-denominated sovereign debt instruments in two of its emerging market benchmark indices (GBI-EM Global Diversified and GBI-EM Global). With this announcement, Colombia's weighting rose from 3.2% to 8.0% in the GBI-EM Diversified, and from 1.8% to 5.6% in the GBI-EM Global. The new reweighting will be gradually introduced from May to September and, according to some analysts, will translate into additional capital inflows ranging from USD4bn to USD10bn in 2014. These are significant figures, as they equate to 36% and 90% of last year's net portfolio inflows.

The effects of the J.P. Morgan announcement have already made themselves felt, as USD2.207bn in portfolio equity flowed in within a one-and-a-half month period (from 18 March to the end of April), a figure equal to 68% of all of this year's inflows to date. Furthermore and as described above, the peso devaluation of early this year completely reversed, as did the losses in the equity market (See Figure 3.2 and 3.3). Moreover, yields on Colombian treasury bonds dropped significantly over the different maturities (e.g., the 10-year fell 80 basis points from 7.1% to 6.3%), and foreigners' sovereign bond holdings rose (See Figure 3.4). The latter had already doubled since the end of 2012, until reaching 6% of the total TES balance in February, thanks to the change in the tax regulation approved in that year, which cut the tax on foreigners' returns on holdings of local debt securities from 33% to 14%. With J.P. Morgan's reweighting, foreign investor holdings of sovereign bonds rose to 8% in March, and may continue to increase toward the levels expected by the Ministry of Treasury (15%), to the extent that international investors reallocate their portfolios.

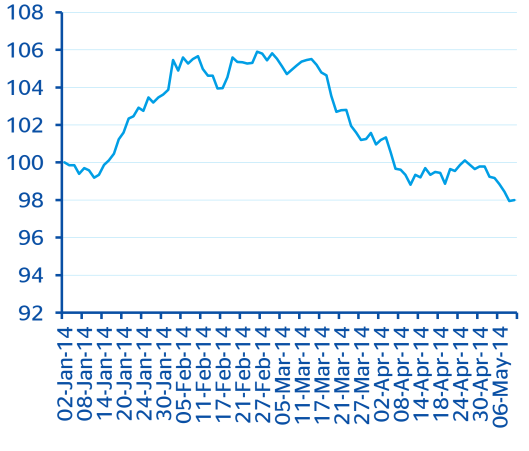
However, the Colombian central bank's board of governors has opined that the capital inflows expected from Colombia's increased weighting in J.P. Morgan indices might have been overblown. One of the arguments is that the value calculation of the index-referenced funds (USD195bn) may be lower in an environment of normalising international monetary conditions, after the reduction in the Fed's pace of bond purchases and the anticipated rise in interest rates in 2015. Thus measured, capital inflows would be lower and there would consequently be less of an appreciation in local markets.

Figure 3.1
Colombia net portfolio inflows (cumulative in USD mn)



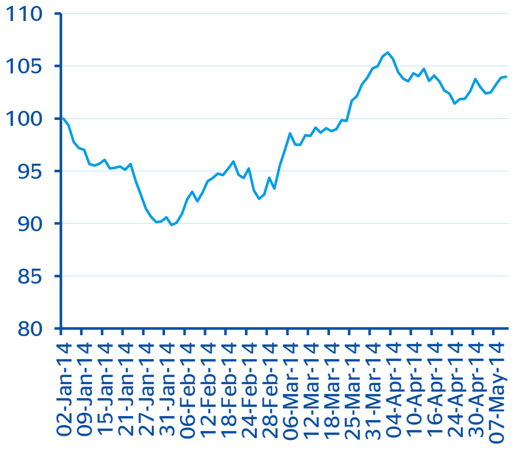
Source: Bloomberg and BBVA Research

Figure 3.2
2014 exchange rate evolution January 02 = 100



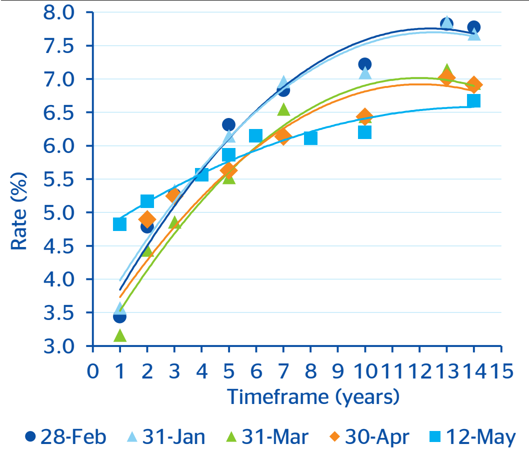
Source: Bloomberg and BBVA Research

Figure 3.3
Evolution of COLCAL (Stock Index) in 2014 January 02 = 100



Source: Bloomberg and BBVA Research

Figure 3.4
Domestic public debt yield curves



Source: Bloomberg and BBVA Research

Growth picked up at the end of 2013

The Colombian economy grew 4.3% over 2013, slightly above our 4.1% estimate of three months ago. The growth data published for 2013 show a strong expansion in consumption (private and public), supported by some upward revisions to 2013 first quarter consumption and exports. In total, final consumption growth consolidated at 4.7%, pointing to outstanding dynamics in public consumption (6.0%) and exports (5.3%), thanks to a greater contribution of oil.

However, had it not been for the upward revisions to prior quarters, lower growth would have been recorded for 2013, even equal to our 4.1% estimate, given that fourth quarter dynamics were slightly below our expectations (0.8% vs. 1.3% YoY expected).

Notwithstanding the mild slowdown in the fourth quarter, the main source of growth in 2013 came from the rise in construction investment (10.2% yearly), a result which lies in contrast with the low growth in non-residential gross fixed capital formation (0.9%). The latter was directly related to the sectorial balance, where only the manufacturing industry had a downturn in activity over 2013, and the transportation sector had tepid growth. Nevertheless, both sectors still have extensive investment options and will surely grow in the medium term, with an industrial recovery and investment in infrastructure.

Growth determinants transition in 2014

Consumption and investment in construction are the pillars of the first half. We expect average growth of 5.1% over the first half of 2014, driven by the pick-up in construction and robust growth in private consumption. Over the first half of 2014, investment in construction will have the highest quarter-over-quarter growth rate among all GDP components by demand, although its annual increases will not be as outstanding as those obtained in 2013, when it had a more favourable statistical basis. This scenario will materialise because the construction sector reached its maximum level of permitting and starts at the end of 2013, which means that work at most of the sites would be coming to an end over the first six months of 2014. And this is the stage that most contributes to added value, according to the measurement methodology of DANE (National Statistics Department).

Furthermore, the annual growth rate of the sector's leading indicators (cement production and distribution) rose significantly to double-digit levels from an average of under 4% in 2013. This positive behaviour does not only relate to construction, as it also suggests a significant growth in public works, notwithstanding the validity of the Guarantees Law. This is because the government is now better prepared to deal with that Law's restrictions, so much so that the percentage of national budget resources earmarked as at March 2014 is identical to the value earmarked one year ago, when there were no restrictions.

Furthermore, trade data as at February reveal an intensive pace of growth in consumption. Retails sales grew an annualised 6.6% over the first two months of the year and also gained momentum, from 6.5% in January to 6.7% in February. Plus, the household confidence indicator remains firmly in the optimistic range, in spite of a seasonal setback in February which failed to alter the stable trend the indicator had been maintaining. In year-on-year terms, March confidence came in above its levels at the start of 2013. In structural terms, the positive behaviour of consumption can be associated with improved social indicators and poverty reduction, as shown in Box 1.

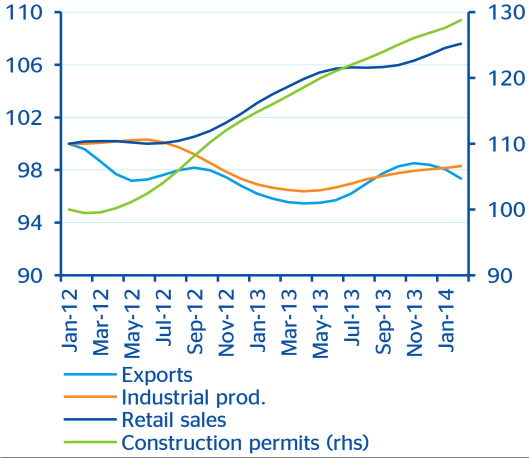
Overall, the economy seems to have picked up speed in the first quarter of this year compared with the close of 2013. Year-on-year growth will rise from 4.9% in 4Q13 to 5.3% in 1Q14, retreating back to 4.9% in 2Q14. Furthermore, the quarter-on-quarter variation will speed up, from 0.8% to 1.6% and 1.6% in the three successive periods. This will be possible in spite of the slowdown in exports over the first half, the lower oil price, the restrictions on coal supply and low industrial exports.

The industrial sector will remain the greatest factor of uncertainty. For the first time in quite a while, however, the surprises could come in on the positive side. February industrial growth data could provide an additional boost to first half growth, if the industrial recovery that we expected for the second half of this year consolidates ahead of time. The import data for industrial intermediate and capital goods, which recently adopted an upward trend, and the positive industrial confidence data for March, would support the surprise and improve the outlook for non-residential private investment.

Industry and exports will be growth's main support for the second half of 2014. We expect average growth of 4.4% for the second half. Non-residential investment, the consolidation of the industrial recovery (assisted by greater external demand) and the start-up of some mining sector investment projects (expansion of ports for coal shipments) will play a decisive role. Moreover, the improved economic balance of the US and Europe, within the context of the current trade agreements with each of them, will drive the expansion of exports. Nevertheless, we have reduced our optimism over the positive impacts of the foreign sales agreements, after identifying some competitiveness problems Colombia's industry faces (See: Industrial Competitiveness has dropped since 2008 (available in Spanish)).

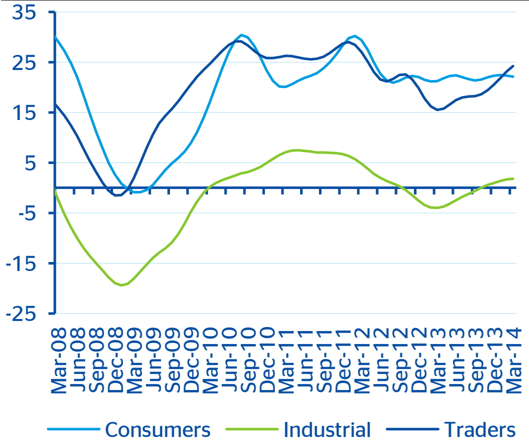
For 2014 overall, we expect growth of 4.7% with equivalent growth in private consumption, but with a more positive balance in the case of investment (5.9%), both residential and non-residential. On the other hand, foreign trade will make a more negative contribution to growth than in 2013, as we have cut the outlook for exports.

Figure 3.5
Leading indicators of the Colombian economy
Seasonally adjusted index, Jan 2012=100



Source: DANE and BBVA Research

Figure 3.6
Business and household confidence
Seasonally adjusted index

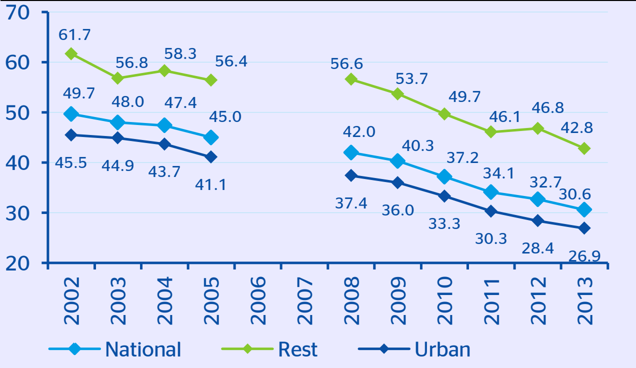


Source: Fedesarrollo and BBVA Research

Box 1. Achievements in poverty reduction made possible by the macroeconomic environment

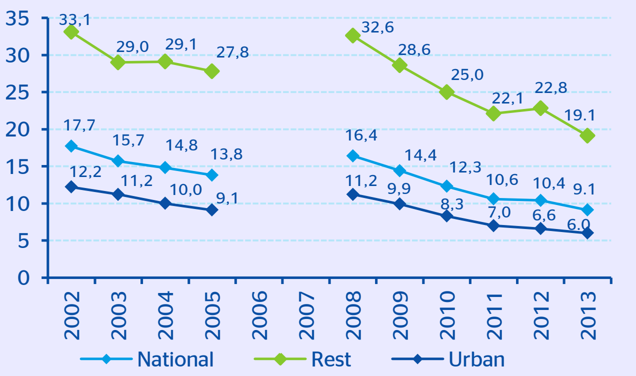
Between 2012 and 2013, the number of Colombians in conditions of poverty dropped by over 800,000. Poverty measured by income thus fell from 32.7 to 30.6% of the population, a 2.1pp drop (Figure B.1.1). Moreover, the number of people living in extreme poverty fell by 556,000, from 10.4% to 9.1% of the population (a 1.3% drop, Figure B.1.2).

Figure B.1.1
Poverty by region (2002-13). Percentage



*Impact of poverty: percentage of the population with an insufficient per-capita household income to achieve an adequate standard of living, by geographical area. . **All others: refers to rural area, ***Main district: geographical area defined by an urban perimeter.
Source: DANE and BBVA Research

Figure B.1.2
Extreme poverty by region (2002-13). Percentage



*Impact of extreme poverty: percentage of the population with an insufficient per-capita household income to reach the subsistence level, by geographical area. **All others: refers to rural area, ***Main district: geographical area defined by an urban perimeter.
Source: DANE and BBVA Research

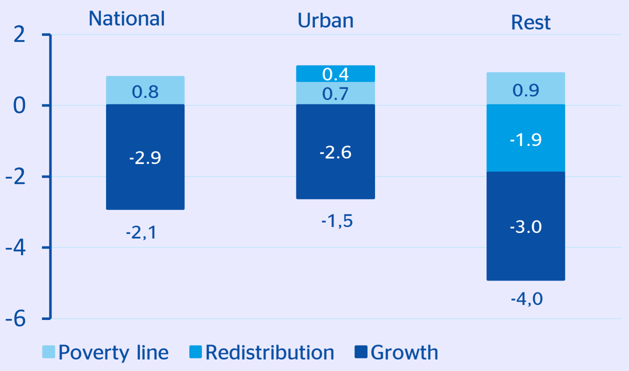
The decline in the poverty and extreme poverty indicators is mainly explained by the rise in people's income, which according to DANE contributed 2.9pp to the net 2.1pp year-on-year drop in poverty, and accounted for almost all of the reduction in extreme poverty (Figures B.1.3 and B.1.4).

Another important aspect in terms of poverty is the cost of the basic basket of goods. The higher the prices of its components, the lower the number of people that can access them and the higher the number of people in poverty conditions. Between 2012 and 2013, the mild rise in the cost of the basic basket of low-income persons allowed poverty through this conduit to rise to a lesser degree than in years with higher inflation. Indeed, the adjustment of the poverty line[1], that is, of the cost assigned to the basic basket, accounted for only 0.8pp of the rise in poverty which, as previously mentioned, was more than made up for by the 2.9pp reduction contributed by growth in economic activity (Figure B.1.3). What is more, in the case of extreme poverty the rise in the price of the basic food basket was practically zero between 2012 and 2013, and its effect on this type of poverty was thus zero (food inflation, for example, for low-income persons came in at -0.1% between 2012 and 2013) (Figure B.1.4).

At the national level, the change in poverty and extreme poverty between 2012 and 2013 was explained by the two aforementioned effects, the income effect and the poverty line (cost) effect, with the income redistribution effect playing a near-neutral role from one year to the next (Figures B.1.3 and B.1.4). However, it is interesting to note the strong impact income redistribution has on the poverty data at the rural level. Sure enough, between 2012 and 2013, income redistribution accounted for 3pp of the 4pp drop in rural poverty, and for 2pp of the total 3.7pp contraction in extreme poverty. The strong decline in rural poverty was to a large extent explained by a redistribution effect that took place in that region, which helped to close the gap between the countryside and the city, a gap that had widened in 2012 (Figures B.1.1 and B.1.2). Note that the narrowing of the gap occurred at both the extreme and total poverty levels.

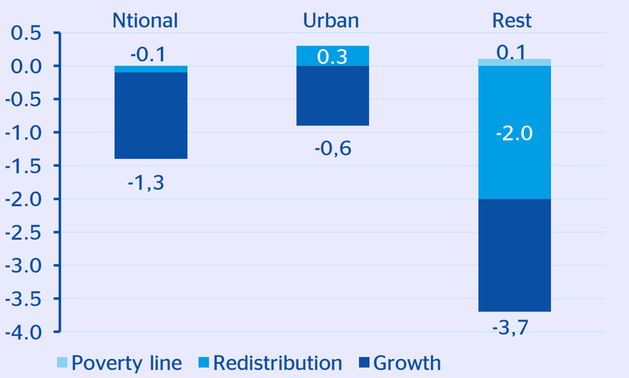
1: The poverty line is adjusted annually for the inflation of low-income persons, which was historically low between 2012 and 2013, at 1.5%.

Figure B.1.3
Breakdown of changes in poverty 2012-13 by region. In percentage points



*All others: refers to rural area, **Main district: geographical area defined by an urban perimeter.
Source: DANE and BBVA Research

Figure B.1.4
Breakdown of changes in extreme poverty 2012-13. In percentage points



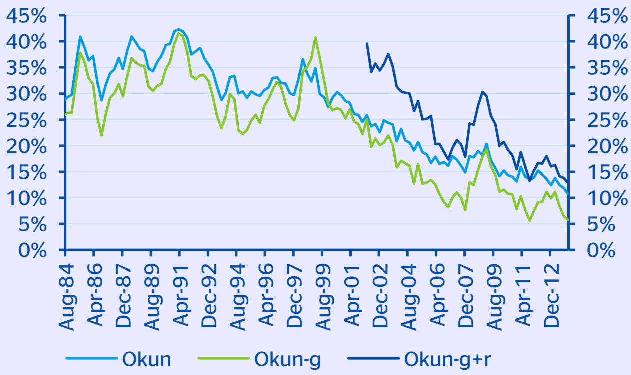
*All others: refers to rural area, **Main district: geographical area defined by an urban perimeter.
Source: DANE and BBVA Research

Declining trend in the Misery Index

In simple and intuitive terms, the Okun Index, which is derived by adding the unemployment rate to the inflation rate[2], is akin to an indicator of the well-being of a country's population. Thus, low values on the index would reflect better macroeconomic performance via lower unemployment and/or inflation rates. This index remained stable over the 1980s and 1990s at around 30pp, and subsequently experienced a significant fall, reaching an average of 12pp in 2013 (Figure B.1.5). The foregoing reflects positive macroeconomic management in terms of monetary policy, fiscal discipline and progress in unemployment.

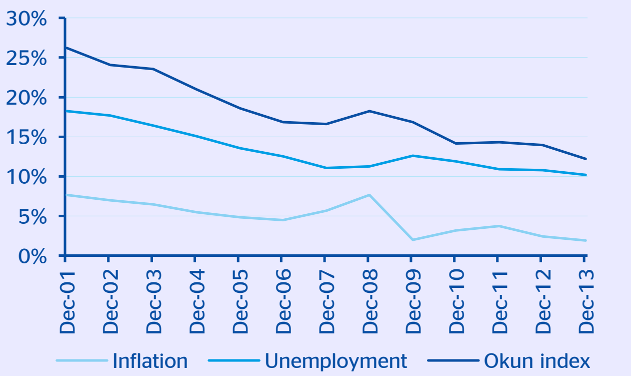
In recent years, the index shows the drop in inflation since mid-2009, which is explained by prudent monetary policy and by other factors, such as the appreciation of the exchange rate, which has resulted in low inflation rates for tradable goods. For its part, the unemployment rate has displayed a downward trend, reaching a historically low level for 2013 of 10% (average) in the main seven cities.

Figure B.1.5
Colombia Okun Index. Quarterly percentages for seven cities



Source: DANE, Banco de la República and BBVA Research

Figure B.1.6
Okun Index, unemployment rate and inflation rate. Annual average percentage for seven cities.



Source: DANE and BBVA Research

Misery Index variations

The Okun Index can be seen as a function of well-being and, in this regard, a falling index reflects better living conditions and, possibly, improved poverty indicators. Alternatives to the Okun Index have been proposed, such as by Barro (1999), who believed it

2: The Misery Index has a quarterly frequency. The unemployment rate of seven cities was used, as it is the most extensive series available. The quarterly inflation rate is a simple average of the monthly inflation rate.

appropriate to add the growth rate and long-term interest rate to the index, proposing that these variables provide additional information in terms of well-being. Through surveys that report on people's level of satisfaction in 12 European countries and the US, other authors, such as Di Tella et al. (2001) conclude that unemployment and inflation effectively constitute a part of the function of well-being, and are negatively related thereto. For their part, Di Tella et al. (2001) and the IADB (2009) argue that, on the margin and given changes in the unemployment rate, a proportionally greater change in the inflation rate would be required to maintain the same level of well-being. In this sense, the relative cost between unemployment and inflation would not be a one-to-one relationship, as the Okun Index assumes.

Even when subtracting the economic growth rate from our Okun Index (i.e., Okun-g), the conclusion remains that the population is better off today than in the 1980s and 1990s (see Figure B.1.5). Furthermore, lower levels of the index are seen beginning in the third quarter of 2006, which were interrupted by the bankruptcy of Lehman Brothers, from the fourth quarter of 2008 to the third quarter of 2009. The lowest levels of the index in historical terms are seen in the third quarter of 2011 and in the third and fourth quarters of 2013 (Figure B.1.5). In this last quarter, the unemployment rate came in at 8.9% (seven cities), the inflation rate at 1.8% (YoY) and economic growth at 4.9%, placing the Okun and Okun-g Indices at historical lows (Figure B.1.6).

For its part, when adding the long-term interest rate (r) to, and subtracting the growth rate (g) from, the Okun Index (i.e., Okun-g+r), a value similar to the Barro Misery Index (BMI) is obtained. As with other indexes, the BMI reached historical lows in December of 2013, confirming the positive performance of the Colombian economy over the last years, which is also reflected by the declining trend in long-term interest rates.

Conclusions

The achievements in matters of poverty reduction have been considerable, and a large share thereof may have been due to active public policies. However, none of this would have been possible had there not been a supporting macroeconomic policy. The challenge consists in consolidating the accomplishments and reducing poverty even further. To prevent the progress in terms of poverty from reverting, it is indispensable to maintain robust economic growth, keep prices stable and low and consolidate the improvements in employment. Colombia has done a good job in reaching historically low levels on the Misery Index in 2013.

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Growth in 2015 will be robust, but below our previous forecast

We have cut the 2015 growth forecast from 5.1% to 4.8%. The adjustment is mainly due to the scheduling delay in the fourth generation (4G) infrastructure works which, according to our estimates, moves the start of the projects from the first to the second half of 2015, as explained in Box 2. We also expect lower growth in exports, due to the cut to our oil price forecasts and the manufacturing industry's lower use of free trade agreements. Nevertheless, these are marginal effects compared to the impact that the delay in 4G works will cause.

For their part, growth determinants will continue to be private consumption (growing 4.8% annually), non-residential private investment (7.0%) and exports (8.4%). The first relates to the more favourable structural conditions of the Colombian population, with significant reductions in poverty and a rise in the middle class (See Box 1). The latter two are explained by the recovery in industry, which in 2015 will register its first growth rate above 4% since 2011, and greater external demand.

Growth in the medium term (2016-18) will come in over 5%

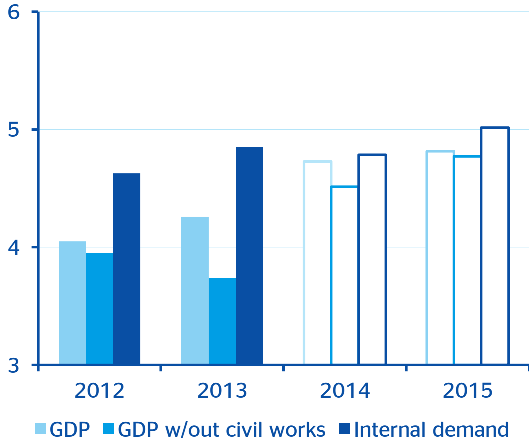
Notwithstanding the delay in the 4G public works and its negative impact on potential GDP, we expect a growth rate in excess of 5% between 2016 and 2018. What is more, annual growth of 5.2% will be seen in 2017 and 2018. This growth will be supported by three pillars. The first is consumption, the continued expansion of which will be assisted by the growth in the middle class. The second is the external sector, which we expect will be more dynamic thanks to greater global growth and better use of free trade agreements. The third is the higher investment that the execution of the 4G works will bring. Regarding the latter, although the 4G plans represents USD25bn in investment (6% of current GDP), our baseline scenario is built upon an execution that ranges from 50% to 60% of the budgeted amount. Lastly, the culmination of the peace process will entail the inclusion of new areas in agricultural and mining production, which will benefit economic growth. Nevertheless, the evident improvements in security over the last decade have meant that part of the peace dividend has already been verified in terms of investment and private initiative.

The risks to growth remain the infrastructure plan and potentially tardy recovery of industrial activity

Our growth scenario assumes that the works on the 4G infrastructure plan will begin in the second half of 2015. A further delay in the works plan would be detrimental to the materialisation of next year's growth, and to the expansion of potential GDP to levels of more than 5% over the following years. This is due to the impact this lower public investment would have on the capital accumulation required to speed up potential GDP.

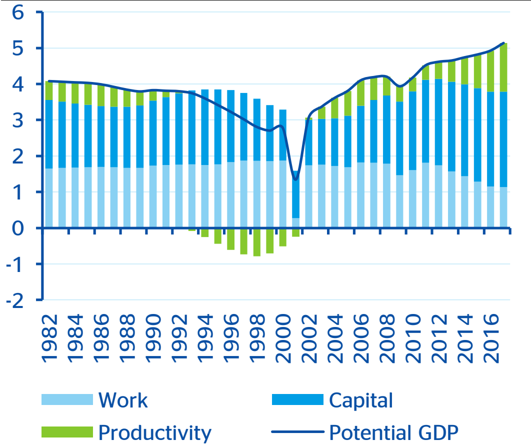
Second, and as a potential consequence of the backwardness in infrastructure, the industry's competitiveness might remain low for a longer period than we estimated (we believe a growth in excess of 4% will materialise in 2015). However, the normalisation of the exchange rate toward more structural levels has reduced the probability of this risk versus our estimate of three months ago.

Figure 3.7
Domestic demand and GDP growth annual variation. %



Source: DANE and BBVA Research

Figure 3.8
Potential GDP: breakdown of growth determinants. %



Source: BBVA Research

Box 2. Fourth generation (4G) highway concessions: progress notwithstanding, aspects remain to be fine-tuned

Recognising the importance of transportation infrastructure in productivity and economic growth, and given the backwardness and low quality of highway infrastructure in Colombia, President Santos' administration embarked upon the task of implementing an ambitious plan of highway concessions. Colombia's experience with highway concessions dates back to the 1990s, when a constitutional reform involved the private sector in the rendering of public services, such as healthcare, pensions and infrastructure, and the first generation highway concessions arose. Three more concessions followed, including the current fourth generation roadway concessions, or "4G".

Fourth generation highway infrastructure plan (4G): Regulatory and institutional information and aspects to be fine-tuned

The ambitious 4G plan consists of close to 30 announced projects that have different levels of maturity, involve work on over 8,000km of highways and entail a total investment of COP47trn.

The main 4G regulatory legislation includes the concessions law or Public-Private Partnerships Act (APP) (Law 1508 of 2012) with its implementing regulations (Decree 1467 of 2012 and 100 of 2013), and the Infrastructure Act (Law 1682 of 2013). The intention with this legislation was to set forth a clear regulatory framework that would apply to concessions in specific terms, and provide greater safeguards to both the project-executing public agency and the private investor interested in participating. The new regulatory framework is results-focused, requires greater project structuring and improves incentives for involved agents, among other features. Furthermore, the Infrastructure Law and its implementing regulation enabled overcoming the problems that existed in matters of management and acquisition of tracts of land, and conflicts with the networks. The 4G contract is more robust than its predecessors in terms of improved assignment and inclusion of hitherto overlooked risks. An important change in this regard is that the current contract includes the legal concept of Acts of God, which applies to property taxes, environmental permits, network interferences and delays in prior consultations with affected communities, among others (the issue of prior consultation was a considerable bottleneck in 3G).

With respect to government entities, the creation of the National Infrastructure Agency (ANI) represented an important step forward, given that it is a public agency specifically tasked with APP projects. Another significant advance was the transformation of Financiera Energética Nacional S.A. (FEN) into Financiera de Desarrollo Nacional (FDN). Indeed, the FDN's role is fundamental, in the sense that it has the authority to mobilise the resources of multilateral agencies, cover project risks through bonding and fund investment companies or projects, among other aspects. Likewise, the creation of the National Authority of Environmental Permitting (ANLA) and the Intersectorial Infrastructure Commission (CII) constituted important breakthroughs.

The progress notwithstanding, aspects remain to be overcome. Bottlenecks appear to persist in matters of environmental permits, and with regard to the consultations with affected communities by infrastructure works.

Furthermore, there have been doubts as to how to deal with the case of a works interruption at a functional unit with a progress level of less than 40% (recognition of private investment is not clear under this scenario). Moreover, in the event of a works interruption at a functional unit with a minimum progress level of 40%, the time that elapses between the interruption of the works and the time at which ANI recognises the special compensation due to the concessionaire (ANI recognises payment when the functional unit's works time schedule is met) seems a bit long. The question over ANI's payment timeframes also occurs when there are cost overruns. Nevertheless, the remaining problems are being worked on. For example, there has been talk of FDN offering products, such as a liquidity guarantee to mitigate certain risks, like overruns in construction costs or deadlines, by increasing the project's resources upon such occurrences.

Progress on the projects

Nine projects are currently in a tender process, grouped under the so-called "First Wave" of 4G projects. These nine projects feature four Early Victories[3] (Victorias Tempranas) and the Prosperity Motorways[4] (Autopistas de la Prosperidad). These projects have a value of COP10.2trn and cover roughly 1200 km (Figure B.2.1). The four Early

3: Girardot – Pto. Salgar, Mulalo – Loboguerrero, Cartagena - Barranquilla and Briceño – Cáqueza.
4: North Connection, Magdalena River 2, Pacific Connection 1, Pacific Connection 2 and Pacific Connection 3.

Victories are in different regions of the country. For their part, the Prosperity Motorways are in the Department of Antioquia.

Table B.2.1
4G First Wave - project list

No. Projects	Total Investment (COP trn)	km
9. First Wave		
Girardot-Honda-Puerto Salgar	0.85	200
Loboguerrero-Mulaló	1.13	45
Cundinamarca Eastern Beltway	1.08	213
Cartagena-Barranquilla Prosperity Beltway	0.96	153
North Connection Motorway	0.95	145
Magdalena River Motorway 2	1.33	144
Pacific Connection Motorway 1	1.74	49
Pacific Connection Motorway 2	0.88	98
Pacific Connection Motorway 3	1.26	142
Total	**10.2**	**1189**

Data as at 8 May
Source: ANI

The nine First Wave projects passed the concessionaire prequalification stage, and six of them are awaiting the submission of bids. The hearings for Girardot-Puerto Salgar and Pacific Connection Motorways 1 and 2 were held on 11, 15 and 29 April respectively. Of the 10 prequalified concessionaires for each of the projects, two submitted bids for the first two projects, and one for the third.

In the case of Girardot-Puerto Salgar, the bidding concessionaires were a) Mario Alberto Huertas/Constructora Meco S.A. Sucursal Colombia with respective stakes of 75% and 25%; and b) Infraestructura vial Puerto Salgar, with stakes held by six companies, including a local company (Carlos Alberto Solarte Solarte) with a 15% stake.

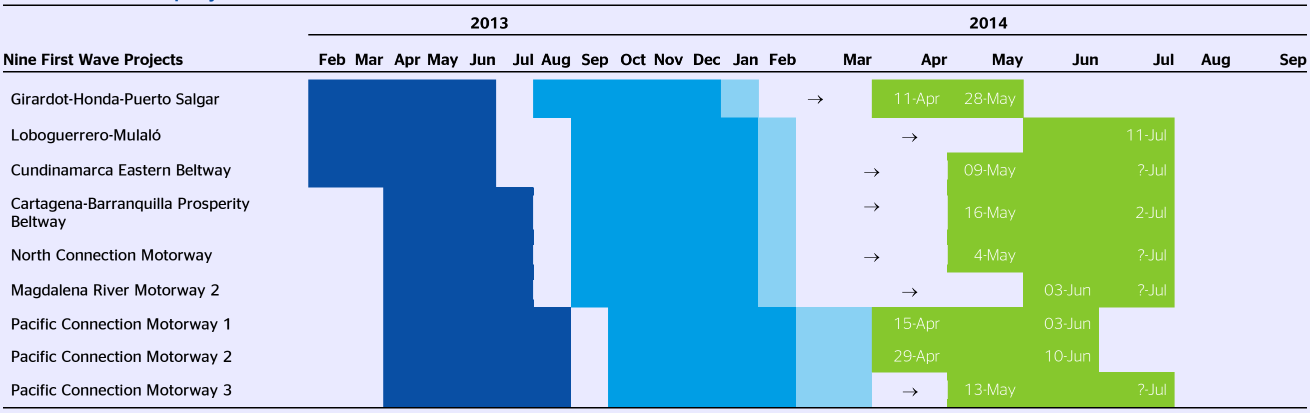
The bidders at the Pacific 1 hearing were Autopista Conexión Pacífico 1 (Pacific Connection Motorway 1) (constituted by Estudios y Proyectos del Sol S.A., Episol S.A.S and Iridium Colombia Concesiones Viarias S.A.S); and Infraestructura Vial para Colombia (the same as Infraestructura vial Puerto Salgar). It should be noted that one of the concessionaires submitted bids for the two aforementioned projects.

In the case of the Pacific Connection Motorway 2, the bidding consortium was P.S.F. Concesión La Pintada, constituted by Odinsa (25% Lider), Mincivil (21%), El Condor (21%), Termotécnica (14%), ICEIN (9%) and Mota Engil (10%). It is a mainly local consortium, with a lengthy track record. Notwithstanding the soundness of the bidding consortium, it is still disheartening that there was only one bidder from among the 10 prequalified concessionaires (OHL, Odinsa, Andrade Gutiérrez, Acciona, Mario Huertas, Sacyr, Odebrecht, Graña y Montero, Iridium (ACS) and KMA).

Project schedules

According to the preliminary execution schedule for the 4G First Wave, the last of the nine projects should have been awarded in March, while most of the award hearings were to be held in February (Figure B.2.2). However, there have been considerable delays, and most of the award hearings have been rescheduled for July 2014, as shown in Figure B.2.2. In this sense, and depending on the project, the schedule has been delayed by four to five months.

Figure B.2.2
4G First Wave - project list



Prequalification Tender Award Last dates estimated by the government for award process
Data as at 8 May.
Source: ANI

The First Wave schedule has been amended on several occasions. On 15 April 2014, the proposal was that bid submission hearings would be held once a week. The inability to meet these timeframes served as confirmation of their excessive brevity, and the bid submission dates were thus postponed for Pacific 3 (from 25 April to 13 May) and Magdalena 2 (from 2 May to 3 June) (Figure 2). It should be emphasised that it is a highly demanding agenda for ANI, which will have to analyse eight projects concurrently in June.

4G: highly demanding in terms of resources

In terms of resources, the 4G programme is demanding at all levels, not only with respect to ANI which, as previously mentioned, will be in a process of awarding eight projects at the same time. Therefore, the programme requires mobilising resources from different sources. Indeed, the fact that the projects are spaced with so little time in between leads to a considerable pressure on resources. For example, a consortium could become incapable of participating in more than two projects, due to the equity requirements that would entail. The pressure has become even greater since some prequalified concessionaires withdrew. In this regard, the number of prequalified concessionaires that can submit bids has dropped.

This pressure for resources means that the participation of a higher number of prequalified concessionaires and the availability of more sources of financing (among other resources) are crucial. The only concessionaires that have submitted bids to date are those with a primarily local focus and expertise. It would be advisable for international concessionaires to participate as well, particularly those with the most solid worldwide reputations. Doing this requires improving the contracts and solving the aforementioned issue of bottlenecks or, failing this, reaching agreements on these aspects. In this regard, and to mitigate pressure for resources, the government has sought to make all sources of financing available. Thus, the government's dollar contribution to the concessionaire was raised to 50% for the Pacific 2 project. The change seeks to reduce the risk of exchange rate volatility and is part of the effort to attract more foreign financing.

With respect to 4G financing, the proposal is for a system in which the concessionaires contribute 25% (the minister has announced that this percentage will be cut to 15%) of the resources as equity, and 75% is financed with debt. According to estimates for the First Wave only, the banks would be capable of contributing 30% or more (in the event of taking a more active position in the infrastructure plan) of the required debt resources for this wave. For its part, according to the government, the FDN would provide 15% of the resources (to do this, it had to increase the FDN's threshold of exposure to a single creditor from 10% to 40%). After the construction stage is completed and the maintenance and operation stage has begun, the loan would be repaid by issuing bonds to be purchased by institutional investors, such as pension funds. However, the ability for international investors to participate from the start of the projects has also been sought. Pension funds may participate, in accordance with their investment limits, through private equity funds. Nevertheless, it seems that the resources from the disposal of ISAGEN (COP5trn) would be of fundamental importance, at least for the financing of the second wave.

Conclusions

Investment in transportation infrastructure is of paramount importance to increasing the country's productivity and economic growth. As a result, President Santos' administration initiated an ambitious roadway concessions programme, called the fourth generation (4G). Notwithstanding the institutional and regulatory advances and the greater soundness of the contracts, scheduling delays have resulted in only one or two concessionaires submitting bids for each project, and in some of the prequalified concessionaires deciding to withdraw. This situation has prompted questions over the adequacy of these advances to start a programme of the scope of 4G. There is a desire to continue to do things the right way, and this would seem to require less haste, so that contractual aspects that still need fine-tuning can be fine-tuned, or agreement can be reached on said aspects. At any rate, the delays in the projects' execution schedule appear to reflect that the market and an appropriate contract structure are what determine the 4G schedule.

4. External and fiscal accounts: under control, but with need for adjustment

The current account deficit will narrow in 2014 and 2015

We expect a slowdown in exports over the first quarter of 2014, due to industrial weakness and the drop in mining shipments (coal, gold and emeralds). This is in spite of an exchange rate that is more devalued and closer to its structural levels, which reveals that the problem is mainly on the side of supply and not demand. Therefore, we have decided to increase our expectation for the current account deficit with respect to our estimate of three months ago (3.0% of GDP), although we maintain our view of a declining trend in the medium term.

With this adjustment, the current account deficit would come in at 3.2% of GDP in 2014, versus the 3.4% registered in 2013. The mild improvement would be supported by greater external demand (mainly in the second half of 2014), the recovery of coal exports beginning in April, the low remittances of dividends abroad and lower imports due to their elasticity to currency devaluation. These factors more than make up for the lower price of commodities in 2014 and the supply restrictions (coal exports) of early this year.

FDI will remain the main source of current account deficit financing over the next years. However, as we mentioned in the second section of this publication, we also expect record portfolio investment inflows, which will require an ongoing accumulation of international reserves on the part of the central bank. Our estimates suggest that reserves will rise by over USD5bn this year.

For 2015, we anticipate a lower current account deficit (2.9% of GDP), notwithstanding the strong rise in imports. The improved result will be driven by the recovery of industrial exports, the low growth in remittances of dividends abroad and the rise in remittances from workers in foreign countries as a result of the global recovery.

Finally, a fair share of the expansion we expect from the economy is supported by greater investment, which will help to further improve the current account balance in the medium term. According to our growth scenario, this should occur to a larger degree from the second half of 2014.

Fiscal accounts in line with the structural deficit of 2.3%

In 2013, Colombia met the decreasing structural deficit target imposed by the fiscal rule. For 2014, we expect the government to end with a deficit of 2.3% of GDP, in accordance with the rule's mandate. Nevertheless, as we mentioned in January, very tight fiscal accounts can be expected for 2014, due to lower income tax receipts. The February 2014 Financial Plan (PF14) reflects this situation, with COP4trn less in income tax revenue than the amount projected by the government in the Medium Term Fiscal Framework (MFMP) of June, from COP18.8trn to COP14.9trn. Consequently, and with a 2.3% deficit in 2014, the government's projections for this year show a strong adjustment in the National Central Government's (GNC) transfer expenditures versus the June projection, with respect to the CREE (Business Contribution to Fairness Tax), pensions and other transfers (which mainly include the expenditure on the consolidation of the Mandatory Healthcare Plan's taxation- and subsidy-based regimes).

Based on the latter, there does not seem to be any room for further cuts in operating expenditure in the short term. Under this scenario, the most flexible expenditure variable is investment and, in fact, the June MFMP used it as an adjustment variable, with levels of around 2% of GDP between 2014 and 2018 (versus the levels of 3.0% and 2.9% of GDP observed in 2012 and 2013 respectively). However, using investment as an adjustment variable does not seem plausible when considering that the country is currently engaged in an ambitious highway investment plan, which requires considerable resources. In fact, without having started the bulk of the 4G plan investment, the latest government projections show a 2014 investment expenditure of 2.9% of GDP (versus the 2% they had announced in June – it should be noted that a part of this increase was financed with the reform conducted in 2013 to keep the 4x1000 tax in force).

Given the downside inflexibility of expenditure and the declining deficit target for 2015 imposed by the fiscal rule, it is indispensable to pass a tax reform that will enable replacing the revenues that will cease to be collected in 2015, from both the 4x1000 tax (the rate will drop from 4x1000 to 2x1000 in 2015 - Law 1694 of 2013) and the wealth tax. Furthermore, given that a lower oil price trend than that of January is being considered, revenues from this item will provide less of a buffer to the reduction in revenues from the aforementioned taxes (for its part, the government assumes the oil price at USD100 per barrel in the budget). It should be noted that the higher impact of lower oil prices on tax revenues does not occur in the same year as the one in which prices drop (2014), but rather from 2015 forward, given that the government's dividend revenues for the current year are mainly determined by the results of the prior year.

According to our estimates, the reform, which should be underway after the new administration takes office, will have to increase revenues from 1.0% to 1.3% of GDP so as to replace the revenues that will no longer be collected from the 4x1000 and wealth taxes. 1.3% of GDP would be enough to cover the total repeal of the 4x1000 in 2018.

Although the fight against informal labour has been emblematic of the Santos administration, the temptation persists to keep the 4x1000 at its current level, even though this tax encourages the use of cash, promotes informality and works to the detriment of financial and social inclusion. However, the advantages are that the tax is easy to collect, easy for the government to manage and has low political opposition, judging by the ease with which its extension was proposed in 2014. Therefore, precedents in this regard already exist in the Santos administration, and the Democratic Centre's 2014 presidential candidate has not revealed any inclination to refrain from repealing the 4x1000.

The wealth tax was temporarily introduced in 2002, justified by the security crisis the country was experiencing. It is a tax that was enacted during times of crisis because, although it is a direct and, in that sense, progressive tax, it taxes wealth, which was already taxed at the time it was created, and falls mostly on companies, taxing investment and capital accumulation (Salazar, 2013).

We believe that tax reform alternatives should be analysed not only from a perspective of collection and ease of processing, but also in terms of fairness and efficiency. For example, an alternative to the 4x1000 in terms of collection, fairness and lower effects on informality is to tax dividends, which are exempt in Colombia. However, it is clear that the political economy of this type of reforms can be more complex than that of perpetuating the 4x1000.

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5. Inflation will trend to the upside in 2014 and 2015, but within the target range

Supply shocks increased first quarter inflation

So far this year, the behaviour of inflation has been dominated by the evolution of food prices, which have presented steady rises with annual variations of 1.2%, 1.8%, 2.2% and 2.4% over the first four months of 2014, exceeding our expectations. The price of regulated items (especially the cost of utilities) has also driven the inflation of the last months, although with less strength. These dynamics led April inflation to come in at 2.72% YoY, the highest annual variation of the last 17 months, thus raising our inflation forecast for 2014.

Core inflation (the indicator most linked to demand factors) has been rising and gaining traction in 2014, in line with stronger economic activity. In all of last year's quarters, our core inflation indicators averaged less than 2.5%: 2.43% in 1Q13, 2.38% in 2Q13, 2.45% in 3Q13 and 2.39% in 4Q13, recording a historical low in this indicator's annual growth at the close of 2013 (2.4%). In January of this year, core inflation broke its 2013 momentum to climb gradually, achieving an average growth of 2.61% by April. These data reveal that the economy's demand is on the rise, and confirm the positive results that most of the economic indicators have shown to date. It should be remembered that headline inflation ended up below the bank's target range over the course of last year, and registered lower growth than core throughout 2013, due to the lower price of food and the tax reform, which reduced the prices of some goods and services. This pattern is breaking down in 2014, and headline and core inflation grew at similar rates in April.

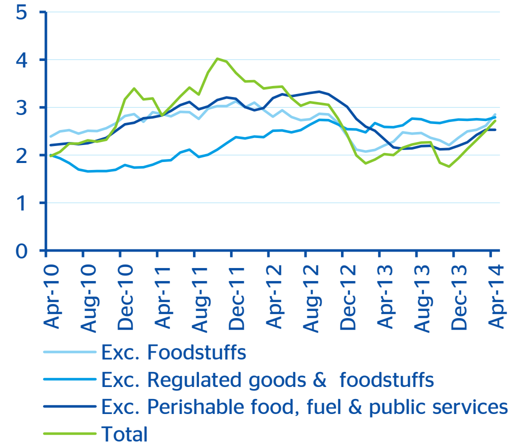
On another note, the inflation of tradable goods, which account for 26% of the CPI, has picked up speed over the last months, driven mainly by the devaluation of the exchange rate. In April, this group of goods registered an annual variation of 1.83% YoY, 85bp above its mark of one year ago, reaching its highest variation since the end of 2009. Notwithstanding last year's devaluation, this component has not exerted greater pressure on inflation, due to its low growth rates. Given that we do not expect significant changes in the exchange rate for the rest of year, this component, assuming no strong rises in the prices of some grains, should not grow at rates other than those recorded in April.

Inflation will be slightly above the midpoint of the target range

Due to the aforementioned supply shocks, we have raised the inflation forecast to 3.4% for December 2014, which represents a 50bp rise versus our forecast of three months ago. With this change, year-end inflation would be slightly above the midpoint of the target range (2-4%).

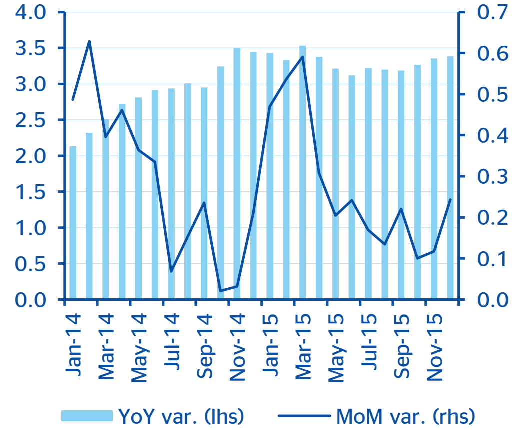
For the coming months, we expect annual variations of around 3.0%, which will increase in the last quarter, due to the base effect created by the fall in food prices in Q4'13, which will lead 2014 to close with an inflation of 3.4%. Nevertheless, there are risks that could cause inflation to come in higher than our forecasts. On the one hand, there is a latent risk in connection with the conflict in the Ukraine which, were it to escalate, could translate into higher corn and wheat prices, products of which Colombia is a net importer. On the other, the probability of an *El Niño* effect for 2014 has risen over the last days. According to statements by the Director of IDEAM (the country's meteorology institute), Colombia could experience its impacts between the last quarter of 2014 and the first of 2015. Nevertheless, in addition to the fact that there are yet no indications as to the event's magnitude, the Director of IDEAM maintains that the phenomenon could "consolidate or, also, decouple." It is worth emphasising that none of these events would cause inflation to come in above the target range.

Figure 5.1
Headline inflation and measures of core inflation, annual variation, %



Source: DANE and BBVA Research

Figure 5.2
Projection of annual and monthly inflation, %



Source: DANE and BBVA Research

A mild upward adjustment to 2015 inflation

In 2015, we expect inflation to remain in the middle of the central bank's target range, with an average inflation of 3.3% and a close of 3.4%, which represents a 30bp rise versus our last forecast (3.1%). Although we are cutting the 2015 growth forecast from 5.1% to 4.8%, consumption growth remains practically unchanged. The interest rate hikes initiated by the central bank in April will help to support the demand pressure that accompanies the narrowing of the output gap, which we hope will occur at the start of 2015.

6. Monetary policy will be less expansionary in 2014, and neutral at the end of 2015

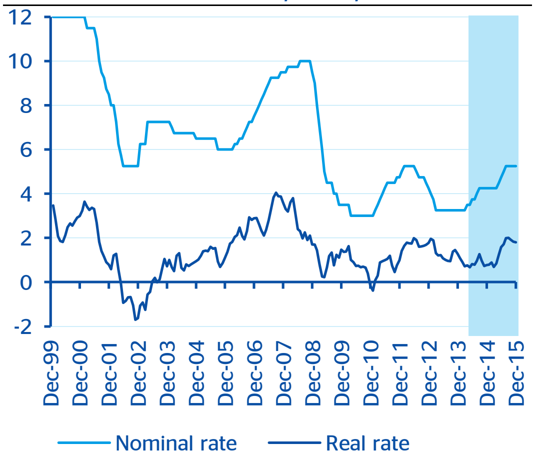
El Banco de la República, Colombia's central bank, raised its monetary policy rate by 25 basis points to 3.50% at the end-of-April meeting, thus embarking upon the path of normalising the country's monetary conditions. This change of stance reflects the soundness of the Colombian economy and the robust performance of activity observed since the second half of 2013. Most of the market anticipated that the normalisation of monetary conditions would begin at the end of the second quarter.

Four factors supported the rise in the monetary policy rate. First, a greater-than-expected pace of acceleration in inflation over the last four months, which led to a greater drop in real interest rates (Figure 25). Second, a robust domestic consumption growth, leading to low and declining unemployment rates, which reached 25-year lows. Third, the higher growth rates in measures of core inflation, which had remained stable during 2013. Fourth, the gradual rises in the monetary policy rates, which reduce the likelihood of sharper rises going forward.

We expect three additional increases to the monetary policy rate over the year (an additional 75bp), to the extent that inflation converges toward its long-term target (3.0%) and growth keeps its dynamism. However, we have adjusted the monetary policy rate trend. The new trend presents pauses in monetary policy rate increases in May and July, and projects the monetary policy rate reaching 4.25% after the central bank's September meeting. From that month forward, we expect an extended break in rate increases until 2015, resulting from less dynamic economic growth in the second half of 2014.

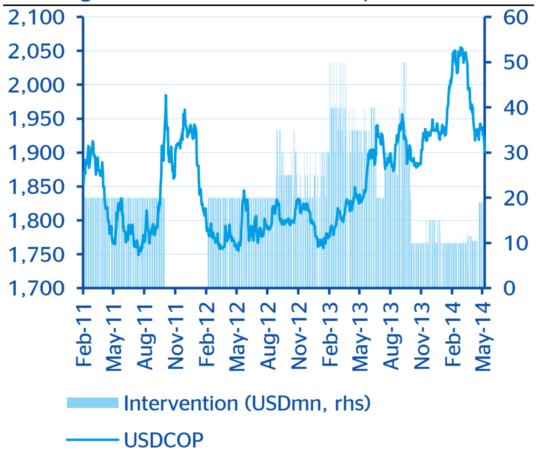
In 2015, the favourable economic growth and the start-up of the construction phase of the infrastructure concessions in the second half of the year lead us to forecast the need for an additional 100bp increase over the year. The monetary policy rate would close 2015 at 5.25%, an interest rate that BBVA Research feels to be neutral, which means that the country's monetary conditions would be neither driving nor restricting the dynamism of economic growth.

Figure 6.1
Nominal and real Monetary Policy Rate, %



Source: Banco de la República and BBVA Research

Figure 6.2
Central bank daily USD purchases and nominal exchange rate (USD mn and COP per USD)



Source: Banco de la República and BBVA Research

The pace of international reserves accumulation will remain at USD1bn per quarter over 2014

Finally, we expect the central bank's accumulation of international reserves in 2014 to remain unchanged at the pace observed so far this year (Figure 26). This means an accumulation of up to USD1bn per quarter over the year, for a potential total accumulation of USD4bn. This policy is due to several factors. On the external front, the anticipated higher capital inflows into the country arising from J.P. Morgan's announcement that it will increase Colombia's weighting, increase the country's macroeconomic vulnerability. Furthermore, the vulnerability of some emerging economies has heightened, which increases the likelihood of a potential contagion, although it remains low for Colombia. On the domestic front, the expected growth in GDP requires a higher level of international reserves, to maintain the ability to hedge against external shocks. The recent revaluation of the currency has reduced a cost component of the reserves accumulation, to wit, the central bank's dollar purchase price. The higher latent vulnerability, the growth of the economy and the cheaper cost of insurance (purchase of international reserves) make it sensible to continue the process of international reserves accumulation.

However, the central bank's intention to normalise the country's monetary conditions will require the dollar purchases to be sterilised through the sale of treasury bonds or the issuance of monetary control securities. This could increase the central bank's losses over 2014, and alter the calculation of the costs and profits resulting from the higher levels of international reserves.

7. Tables

Table 7.1
Annual macroeconomic forecasts

	2012	2013	2014e	2015e
GDP (% YoY)	4.2	4.3	4.7	4.8
Private Consumption (% YoY)	4.7	4.5	4.7	4.8
Public Consumption (% YoY)	5.1	6.0	4.1	3.6
Fixed Investment (% YoY)	7.6	5.7	5.9	6.3
Inflation (% YoY, eop)	2.4	1.9	3.4	3.4
Inflation (% average YoY)	3.4	3.2	2.9	3.3
Exchange Rate (vs. USD, eop)	1,767	1,930	1,960	1,980
Devaluation (vs. USD, eop)	-8.8%	9.2%	1.6%	1.0%
Exchange Rate (vs. USD, avg.)	1,797	1,869	1,955	1,977
Devaluation (vs. USD, avg.)	-2.7%	4.0%	4.6%	1.1%
Central Bank Interest Rate (%, eop)	4.25	3.25	4.25	5.25
FTD Interest Rate (% eop)	5.22	4.06	4.63	5.58
Unemployment Rate (%, eop)	10.40	10.22	10.32	10.12
Fiscal Balance (% GDP)	-2.3	-2.4	-2.3	-2.2
Current Account (% GDP)	-3.2	-3.4	-3.2	-2.9

Source: DANE, Banco de la República, Ministry of Treasury and BBVA Research Colombia

Table 7.2
Quarterly macroeconomic forecasts

	GDP (YoY)	Inflation (% YoY, eop)	Exchange rate (vs. USD eop)	Interest rate (%, eop)
Q1 12	6.1	3.4	1,766.3	5.25
Q2 12	5.2	3.2	1,792.6	5.25
Q3 12	2.5	3.1	1,803.2	4.75
Q4 12	2.6	2.4	1,793.9	4.25
Q1 13	2.6	1.9	1,809.9	3.25
Q2 13	4.0	2.2	1,909.5	3.25
Q3 13	5.4	2.3	1,919.4	3.25
Q4 13	4.9	1.9	1,934.1	3.25
Q1 14	5.3	2.5	2,022.2	3.25
Q2 14	4.9	2.9	1,900.0	3.75
Q3 14	4.5	3.0	1,945.0	4.25
Q4 14	4.2	3.4	1,960.0	4.25
Q1 15	4.1	3.1	1,969.0	4.25
Q2 15	3.9	3.1	1,977.0	4.75
Q3 15	5.1	3.2	1,987.0	5.25
Q4 15	6.1	3.4	1,980.0	5.25

Source: DANE, Banco de la República and BBVA Research

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