BBVA | RESEARCH

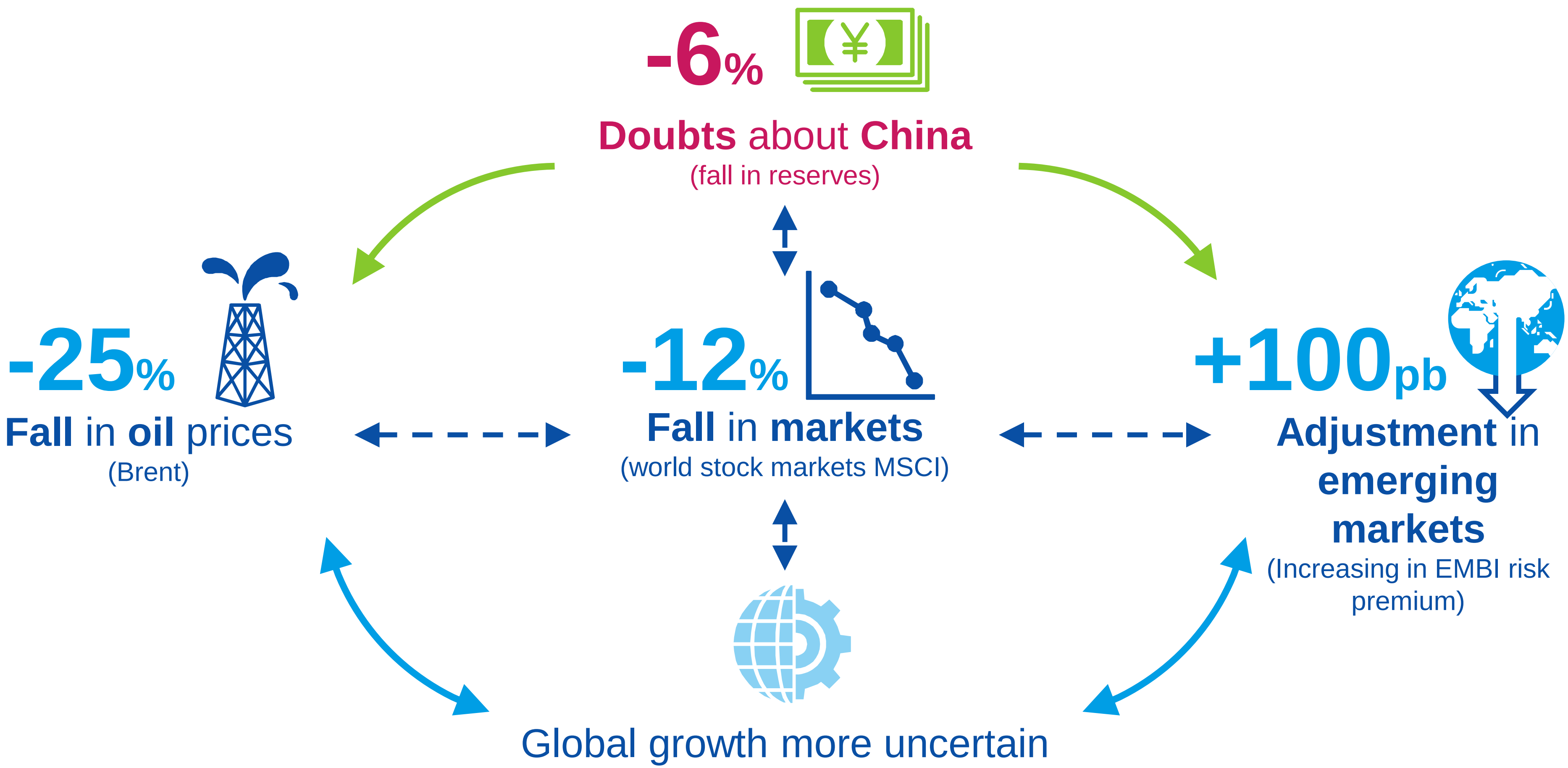
FIRST QUARTER
2016

Economic Outlook
Colombia

Global

Economic scenario

What's happening?



Source: BBVA Research. Trend observed since 10 Nov. 2015

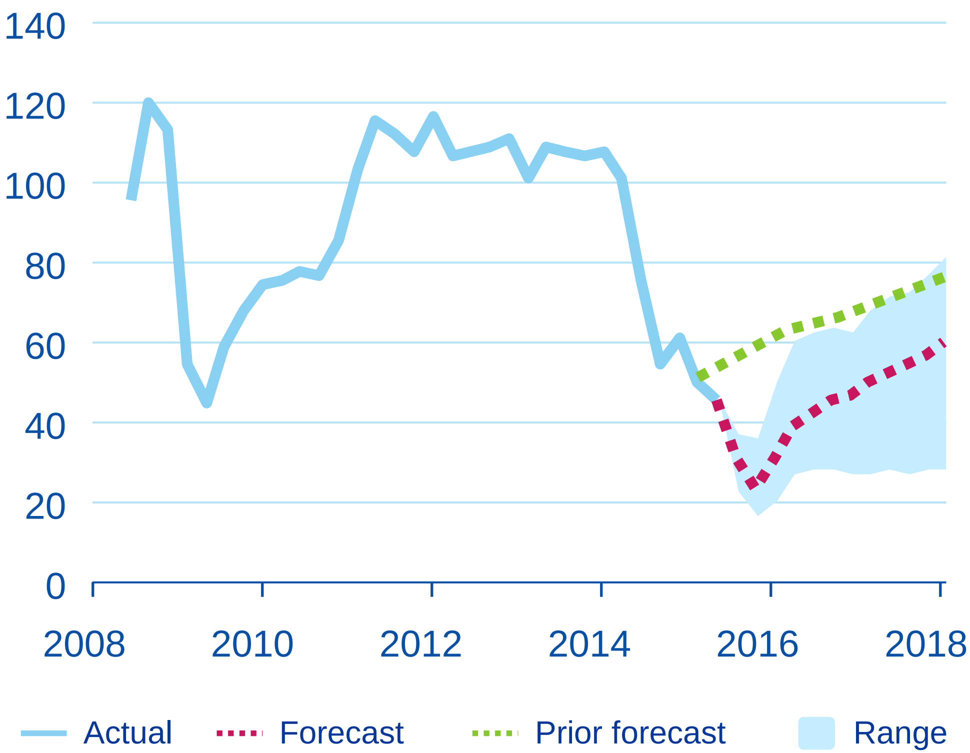
BBVA | RESEARCH

Falling oil prices

Cheaper oil is good news, but not for everyone

Movements in Oil Prices

(Brent, US$ per barrel)



Source: BBVA Research and Bloomberg

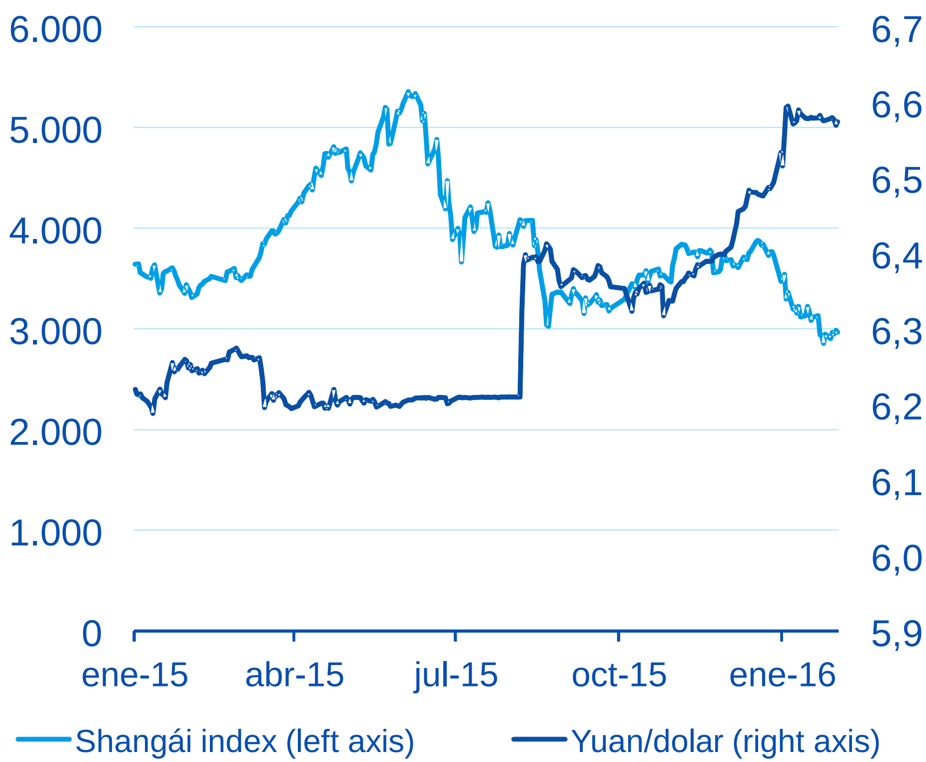
We have revised our oil price forecast significantly downwards

This increases buyers' disposable income and reduces that of oil producers

The fall began mainly as a result of **increased production. Uncertainties about economic growth have become more significant**

Doubts about China
The world's biggest economy is slowing down

Shangái Stock Exchange vs. YUAN
(index vs Yuan/dolar)



Source: BBVA Research and Bloomberg

China is going through an unprecedented process of change:

- Correcting imbalances that were accumulated to avoid the crisis of 2008-09
- Directing its growth towards consumption
- Strengthening the role of the market relative to that of central planning

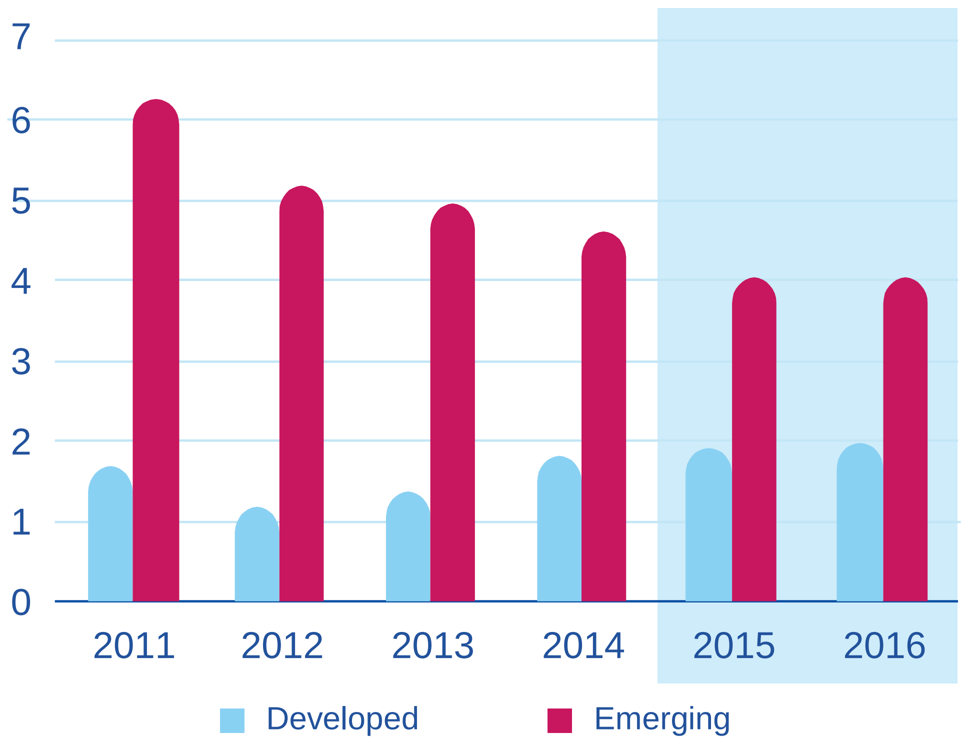
For all this to come about without financial volatility, with stable exchange rates and a **"soft" slowdown,** would be quite a feat. And there are doubts it can happen

Adjustment in emerging markets

Will their adjustment drag the developed economies along with them?

Growth in Developed Economies Compared with that of Emerging Economies

(%)



Source: BBVA Research and IMF

The developed economies are favored by **low commodity** prices and the support of their **central banks**

But their medium-term growth capacity was reduced by the crisis of 2008-09

The key continues to be **improving productivity**, and that cannot be achieved with demand policies (fiscal and monetary)

Fall in markets

What are the markets seeing?

Stresses in the financial markets
(BBVA Research Financial Stress Index))

Source: BBVA Research

1. Fed rate hike?

More gradual than expected by the market (and indeed by the Fed itself!)!

2. Worse recent data?

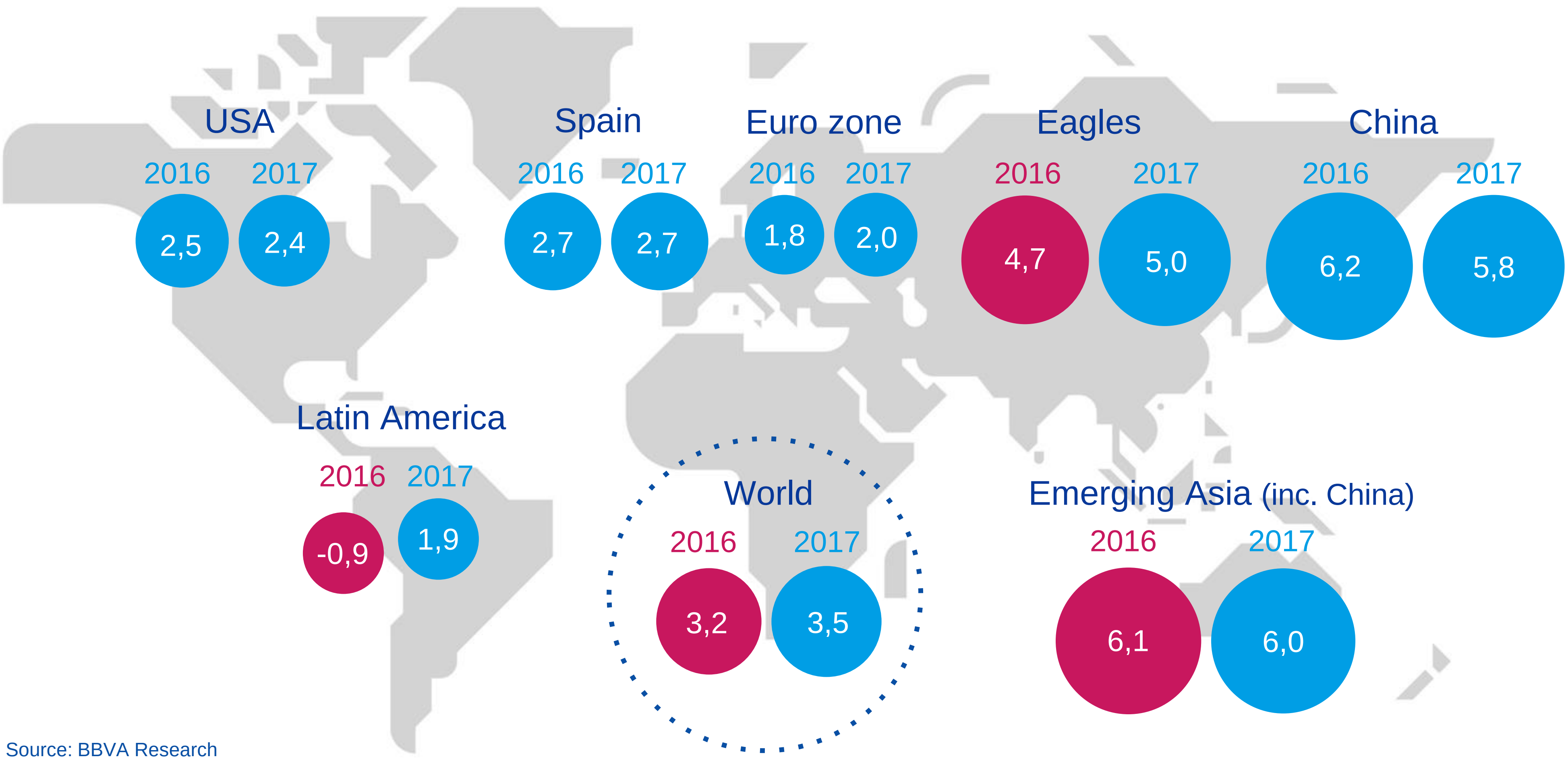
There are some negative surprises, but they are (so far?) in a small number countries

3. Greater risks?

Expectations of a sharp adjustment in growth. Effects of falling markets (oil, emerging market exchange rates) remain to be seen in a world with the prospect of falling activity

The world

Growth: weak and more vulnerable



Source: BBVA Research

Down First forecast for 2017 maintained Up

The world

What are the risks?

- Risk increases
- Risk unchanged
- Risk dimishes

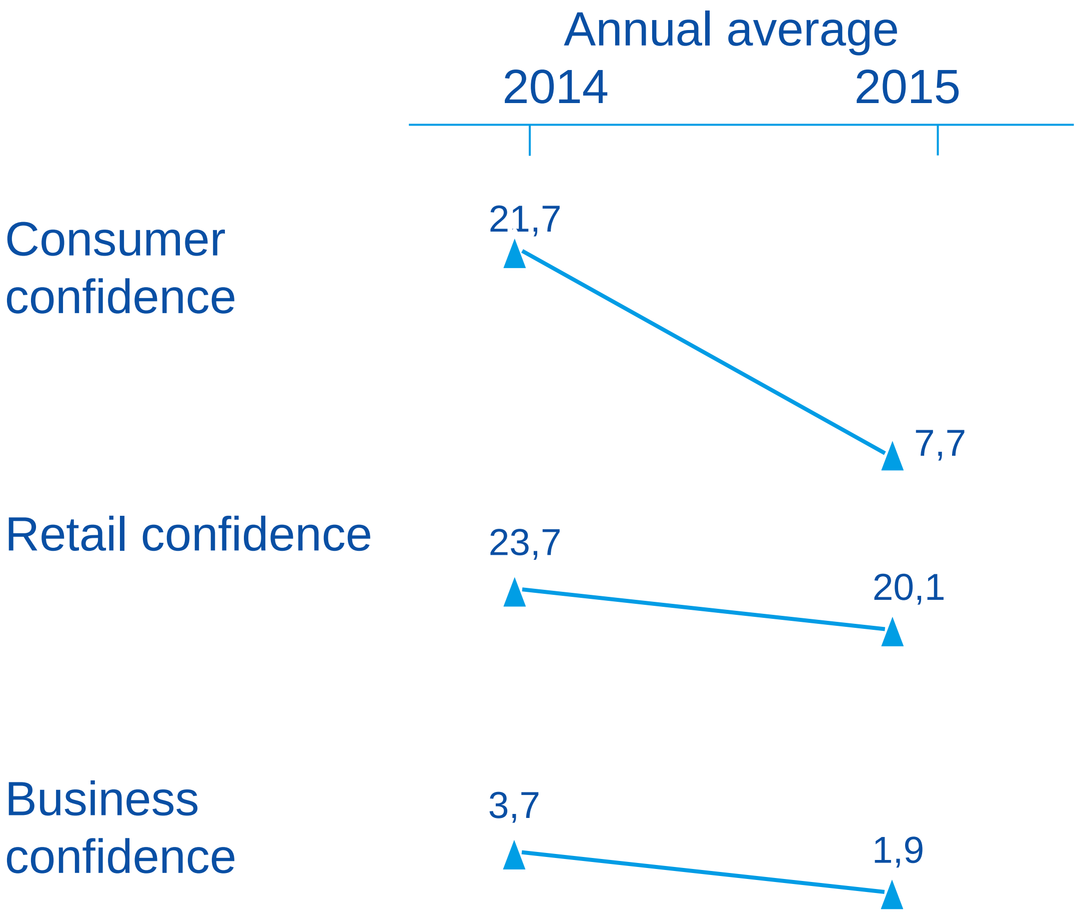
Source: BBVA Research

BBVA | RESEARCH

Colombia

Confidence

Low confidence helped to the demand adjustment



Confidence fell on a dimmer outlook for the general economic situation and a greater reluctance for spending in durable goods (e.g. cars)

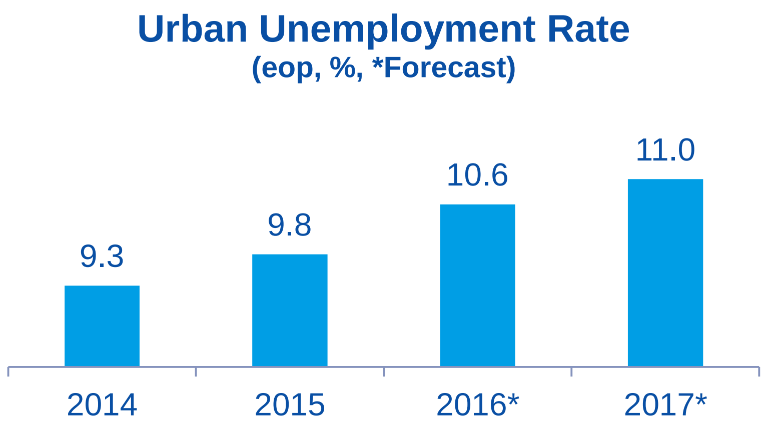
Retailers are optimist, but there are signs of lower sales in the regions, according to Fenalco

Managers are optimist about the short-term outlook

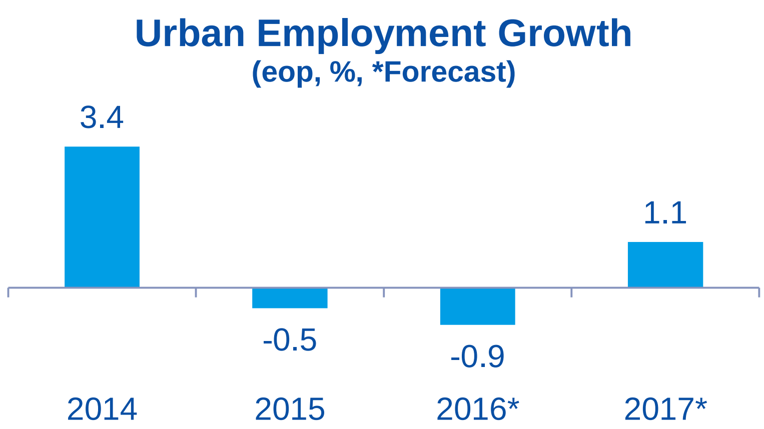
Source: BBVA Research and Fedesarrollo

Unemployment rate and consumer confidence

Unemployment dampens consumer confidence



The economy will be less able to absorb new labor force entrants, resulting in an increase in the unemployment rate

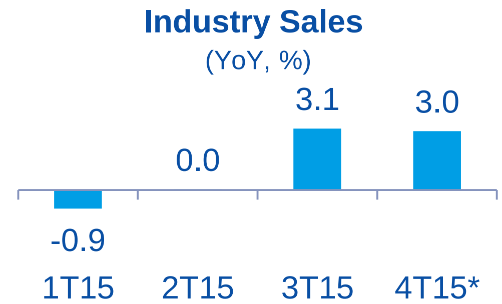


Employment in the main cities might decrease again in 2016. However, 4G, and employment in agriculture and industry in rural areas could offset this dynamic

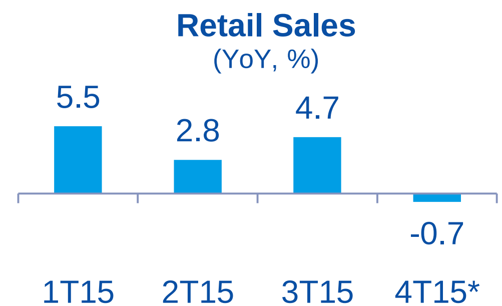
Economic trends

¿What does data tell us?

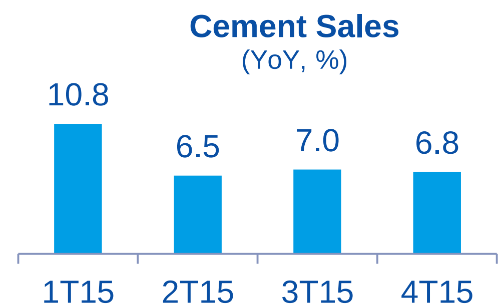
1. Managers anticipate increasing sales and more hiring in 1Q16. However, they are not willing to invest in increasing their installed capacity



2. Slow retail sales prints (even excluding vehicles), in line with lower consumer confidence and higher unemployment



3. Construction keeps momentum; though data shows a slight slowdown. 4G, low income housing and school building’s government programs will boost the sector

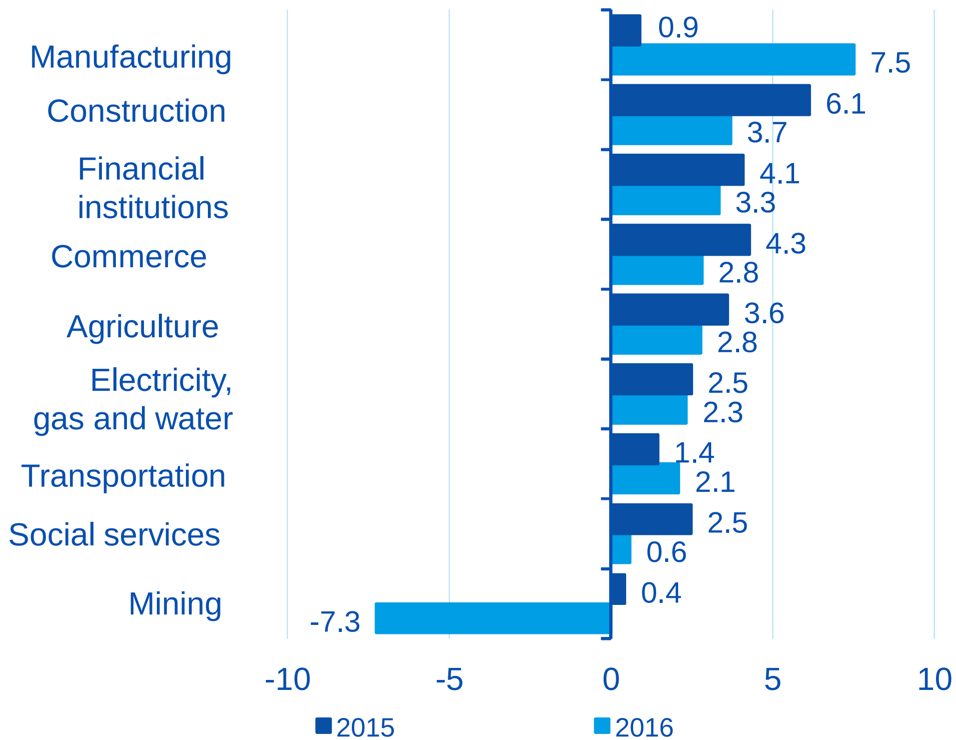


Source: BBVA Research and DANE. * October and November

GDP by sectors

Industry and Construction will be the leading sectors

GDP by Sectors
(YoY, %, forecasts)



Source: BBVA Research

1. Manufacturing growth

It will grow 7,5% YoY in 2016. REFICAR will contribute with 5pp to the total variation

2. Construction

Low income housing, school buildings and 4G infrastructure program

3. Mining will slide

Mining will decrease 7.3% YoY in 2016. Oil production will stay around 920,000bpd, down 80,000bpd of 2015 production

BBVA RESEARCH

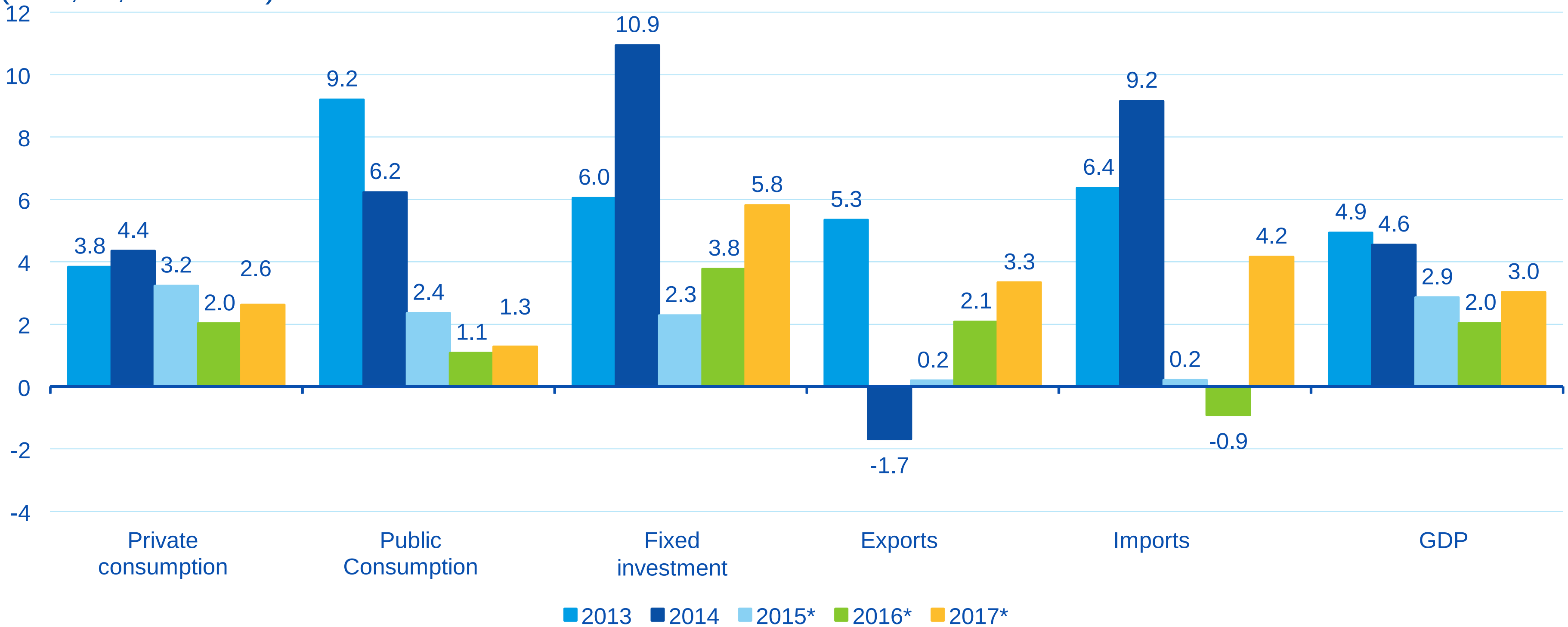
GDP by demand side

The divergence between consumption and investment

Consumption will slow on lower confidence and higher unemployment. Investment, on the other hand, will rise on the industry recovery and the construction momentum

GDP by Demand Side

(YoY, %, forecasts)



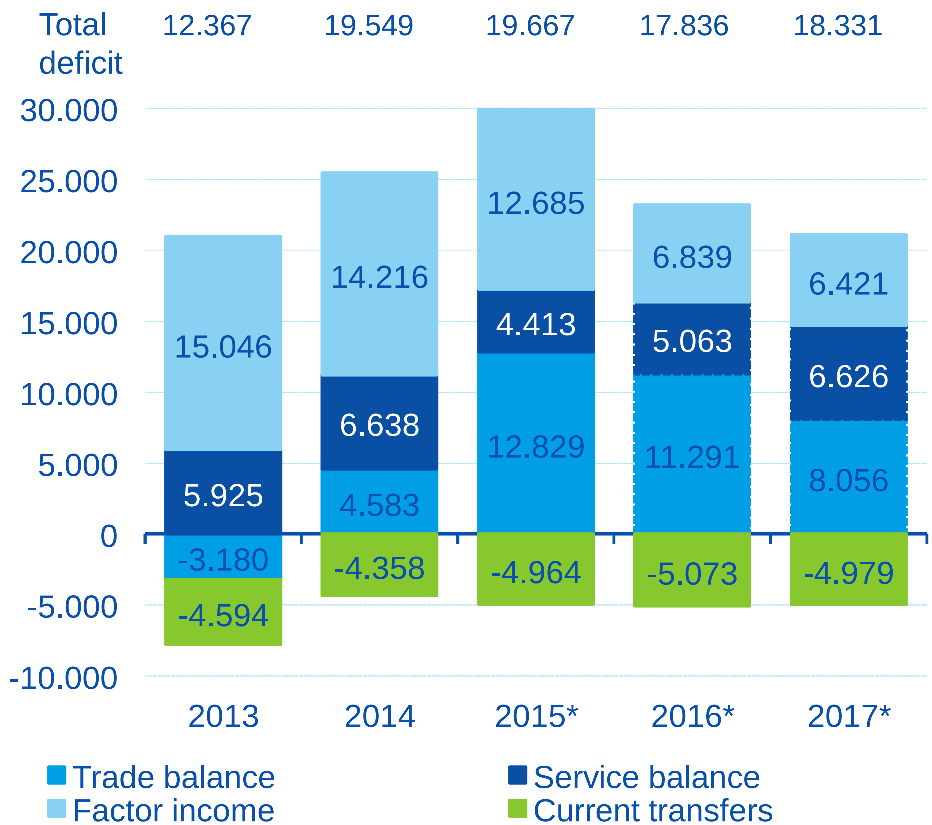
Source: DANE and BBVA Research

External balance

Current account deficit narrows gradually

Current Account Deficit and Sources of External Financing *

(Millions of dollars, *Forecasts)



Source: DANE and BBVA Research. * A negative number represents a surplus

The current account deficit will be partially funded by FDI in the coming years

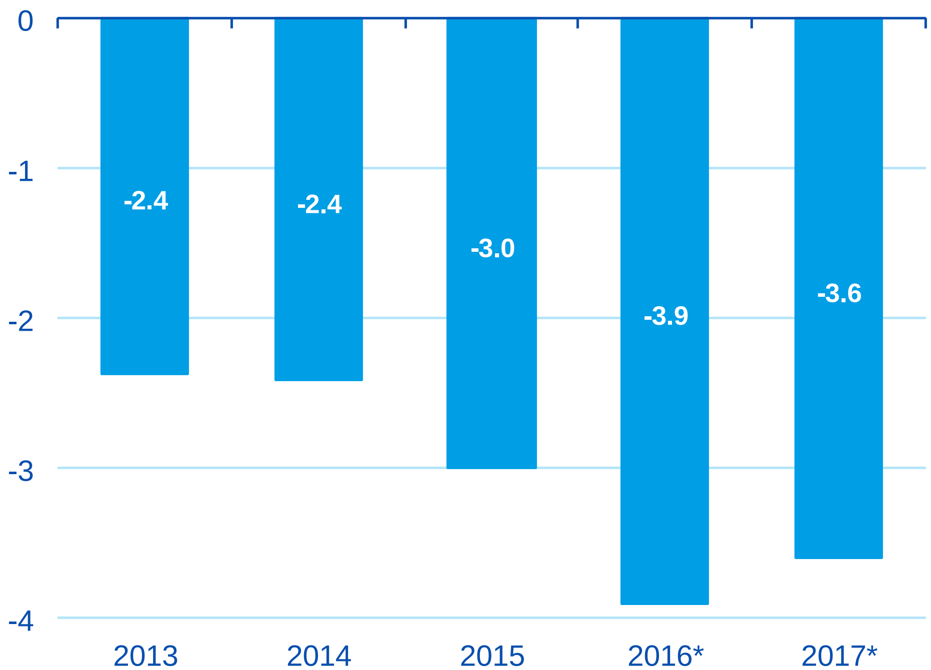
FDI will reach USD 12 billions in 2016 and USD 13 billions in 2017

There will not be changes in official reserves during 2016 and 2017

Central Government Balance

The Government is taking steps to reduce its deficit

Central Government Deficit
(% of GDP, *Forecasts)



Despite the ample deficit allowed by the fiscal rule, the Goverment will strive to limit it

Government spending will remain relatively flat. Strong adjustment in investment

We anticipate a tax reform bill in 2H16

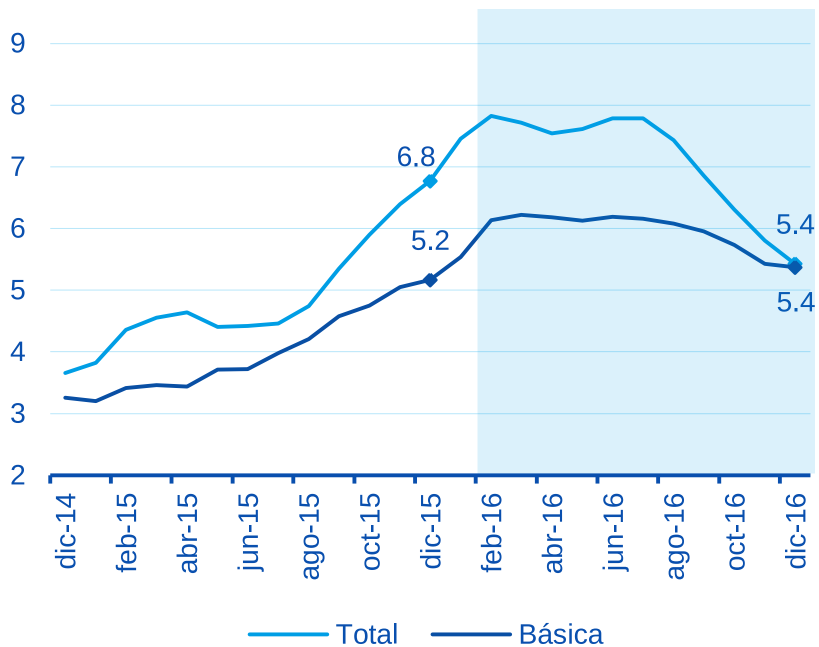
Source: DANE and BBVA Research

Inflation

Inflation pressures will continue in coming months

Inflation will remain above the central bank's target until 2017, with rates hovering near 7,7% in the 1H16.

Headline and Core Inflation forecasts
(YoY, %)



Source: DANE and BBVA Research

Consumer prices are anticipated to increase further in 1H16 reflecting mainly the exchange rate pass-through and the increase in food prices

Once these shocks fade away, inflation will start to converge slowly to the Banrep's target

We expect inflation (eop) to be 5,4% in 2016 and 3.7% in 2017

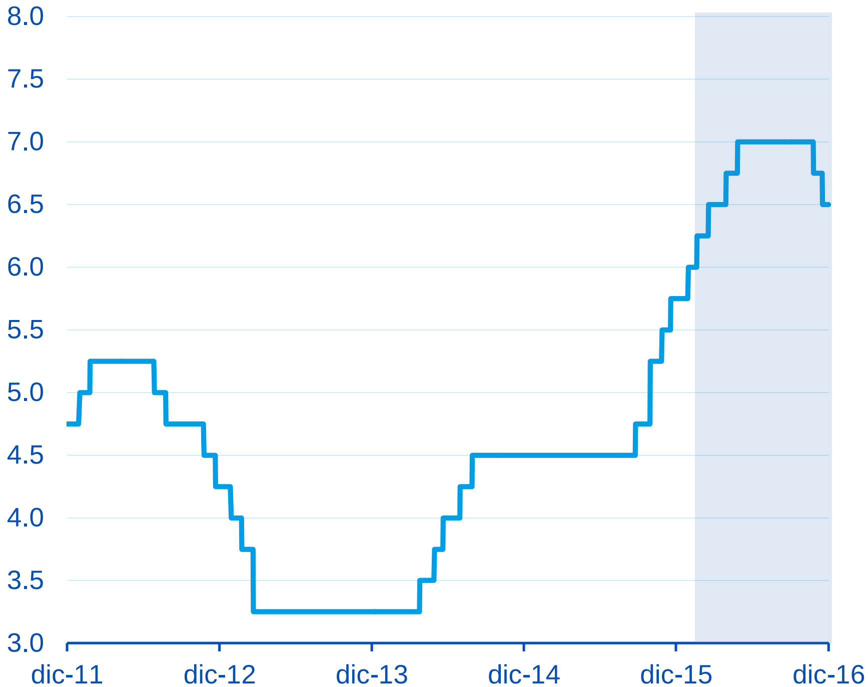
Monetary policy

The challenges for monetary and exchange rate policy

Banrep's challenge consists in taming inflation and anchoring inflation expectations, without causing a sharp adjustment of domestic demand

BanRep's Reference Rate

(%)



Source: BanRep and BBVA Research

We expect BanRep to react by increasing its benchmark rate up to 7.0%, seeking to fight growing inflation expectations

However, as demand growth slows, and inflation starts a downward trend in 2S16, BanRep would cut its rate to 6.5% by year-end

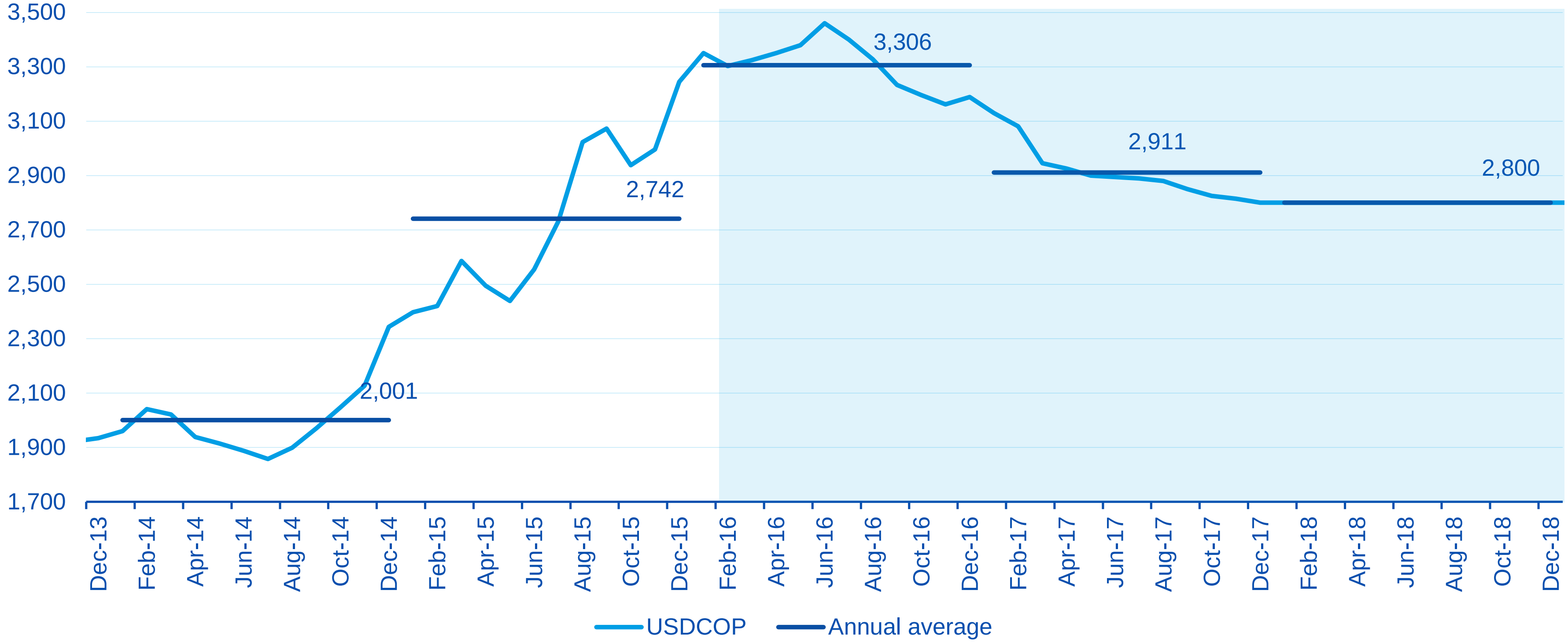
Exchange rate

The challenges for monetary and exchange rate policy

Although the exchange rate depreciation has fed inflation, it is necessary to preserve the current account sustainability.

Exchange Rate Forecasts

(COP per 1 USD)



Source: BanRep and BBVA Research

Conclusions

Colombian economy
Outlook

-42%
Fall in oil exports
(USD)

+77%
Exchange rate depreciation

~7 % of GDP
Current acount deficit in 2015-16

~4 % of GDP
Central Government deficit in 2016

Growth is adjusting to changing circumstances in a gradual and orderly way

Source: BBVA Research. Variations calculated from the end of 2013


Thank you

BBVA | RESEARCH

Contacts

Colombia

Juana Téllez
Chief Economist
juana.tellez@bbva.com

Team

Fabián García
Senior Economist
fabianmauricio.garcia@bbva.com

Mauricio Hernández
Senior Economist
mauricio..hernandez@bbva.com

María Claudia Llanes
Senior Economist
maria.llanes@bbva.com

José Vicente Romero
Principal Economist
santiago.munoz.trujillo@bbva.com

Juan Sebastián León
Intern
juansebastian.leon@bbva.com

www.bbvaresearch.com