BBVA | RESEARCH

3rd QUARTER

2016

Outlook Colombia

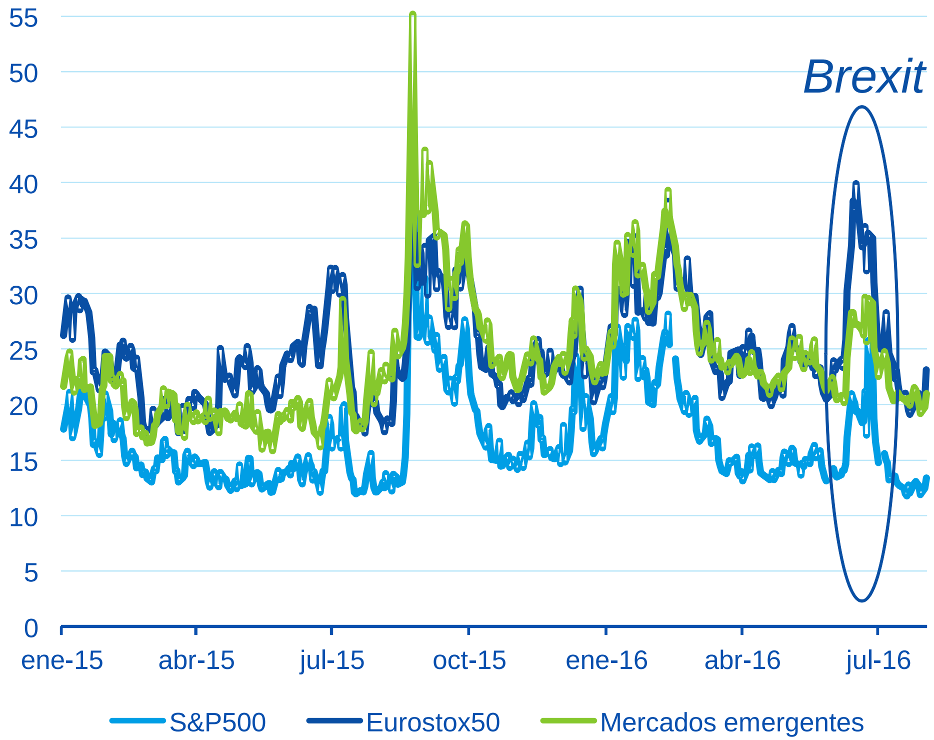
Global

Global volatility

Volatility falls on more dovish central banks

Implicit volatility in equity markets

(Relative index)



Flight-to-quality pushes yields on government securities to historical lows

36% of sovereign bond yields in the developed world have negative rates

Volatility above its long-term average could stay until October (on emerging markets it will depend on commodities prices)

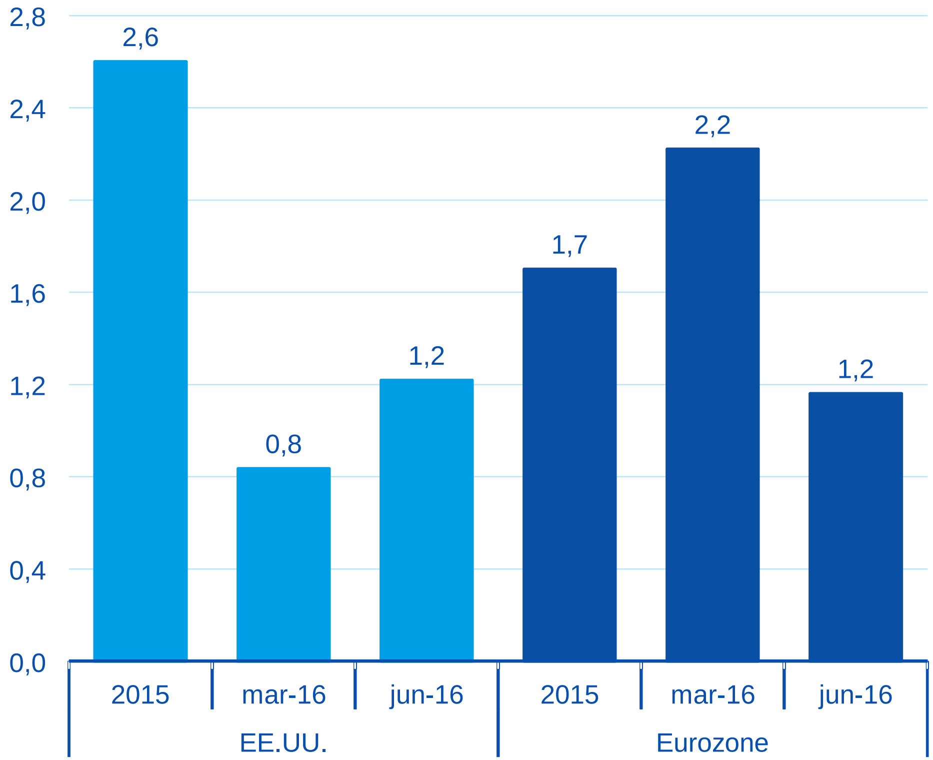
Source: BBVA Research and Bloomberg

Global growth: ¿What is happening?

Central banks are facing a weak growth environment

USA and EZ GDP growth

(Annualized QoQ variation, %)



Source: BBVA Research and Bloomberg

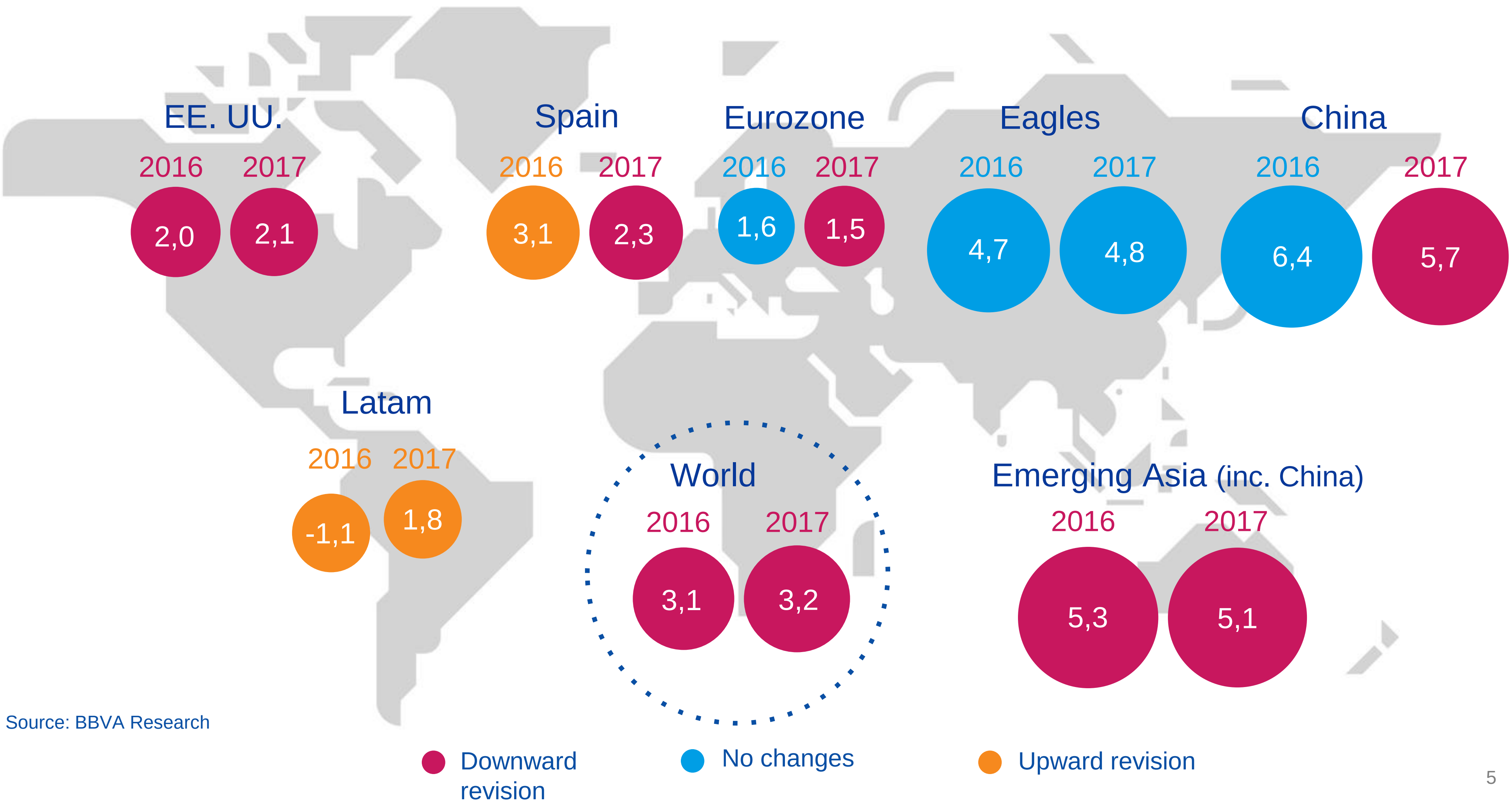
EZ decelerates and will grow at a slower rate due to Brexit.

Lackluster investment is dragging down GDP growth in USA...

…mainly in manufacturing and mining activities.

The world

Emerging economies lead global growth



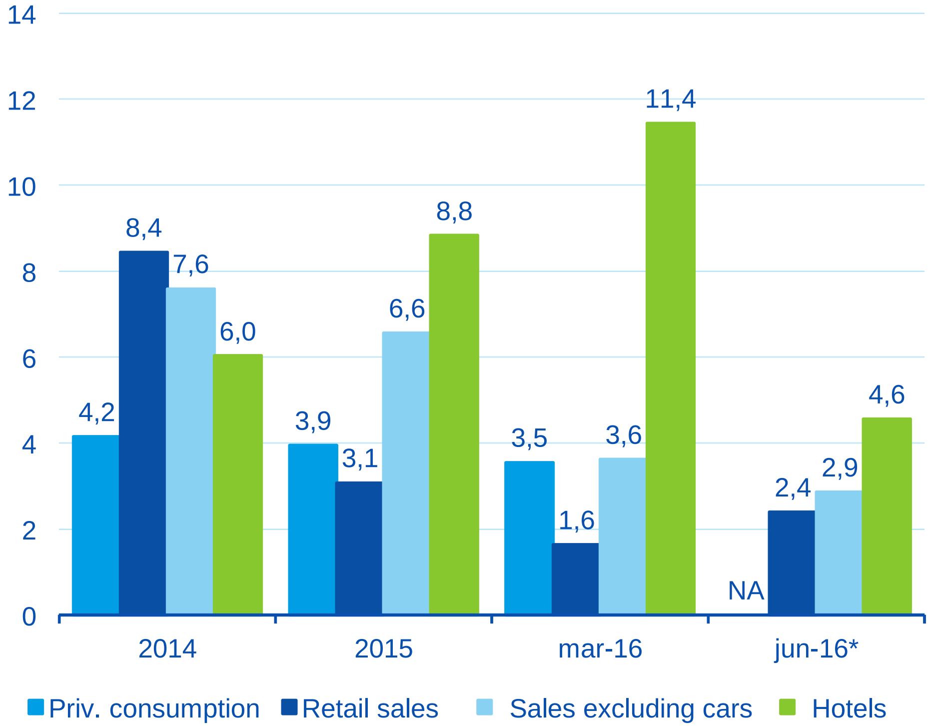
Source: BBVA Research

BBVA RESEARCH

Colombia

Economic growth
Slowing consumption

Household consumption and retail sales
(YoY growth, %, *Up to May, 2016)



Determinants of slowing consumption:

1. Low confidence. Anticipates weak durable-goods consumption

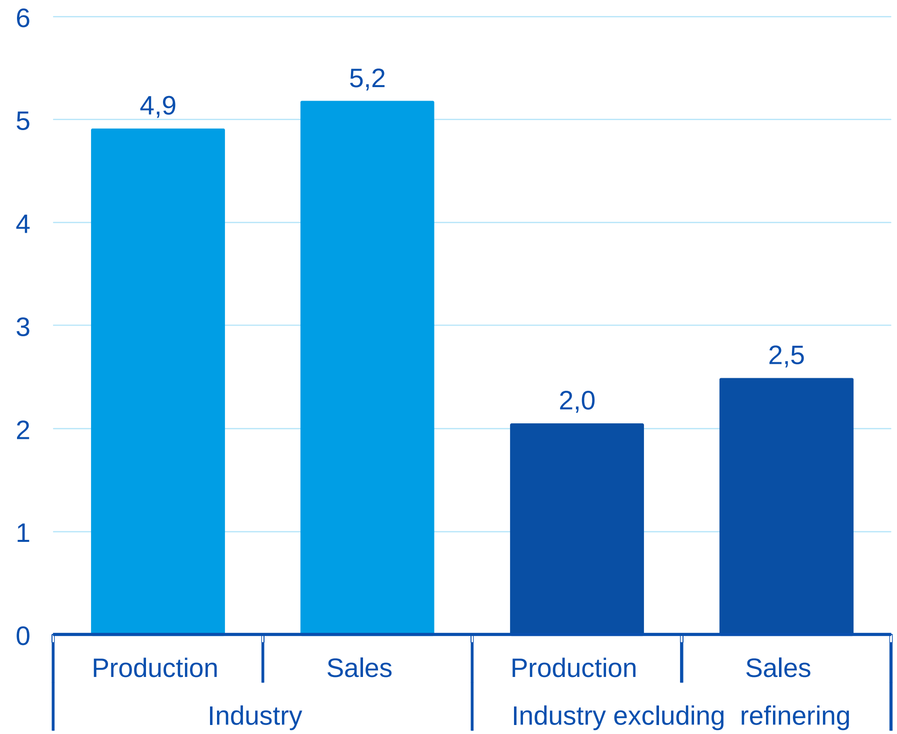
2. Interest rates. Rising headline inflation and its expectations

3. Terms of trade shock. Expenditure must adjust to the fall in the national income

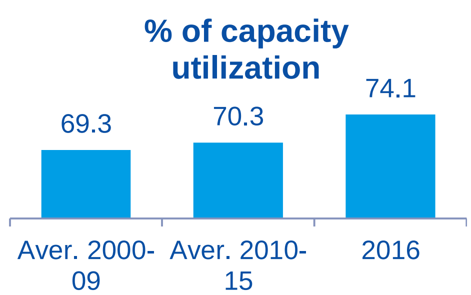
Source: BBVA Research and DANE

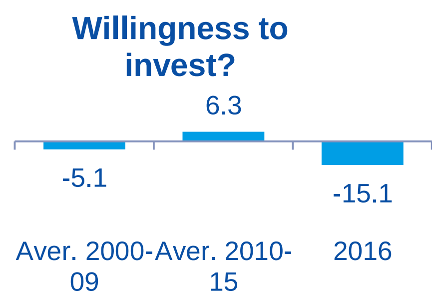
Manufacturing
Recovering but with rising bottlenecks

Industry: production and sales
(Average growth, YoY between Oct-15 an May-16, %)



Capacity utilization nearing milestone. Investment rate is decreasing and the willingness to invest is low





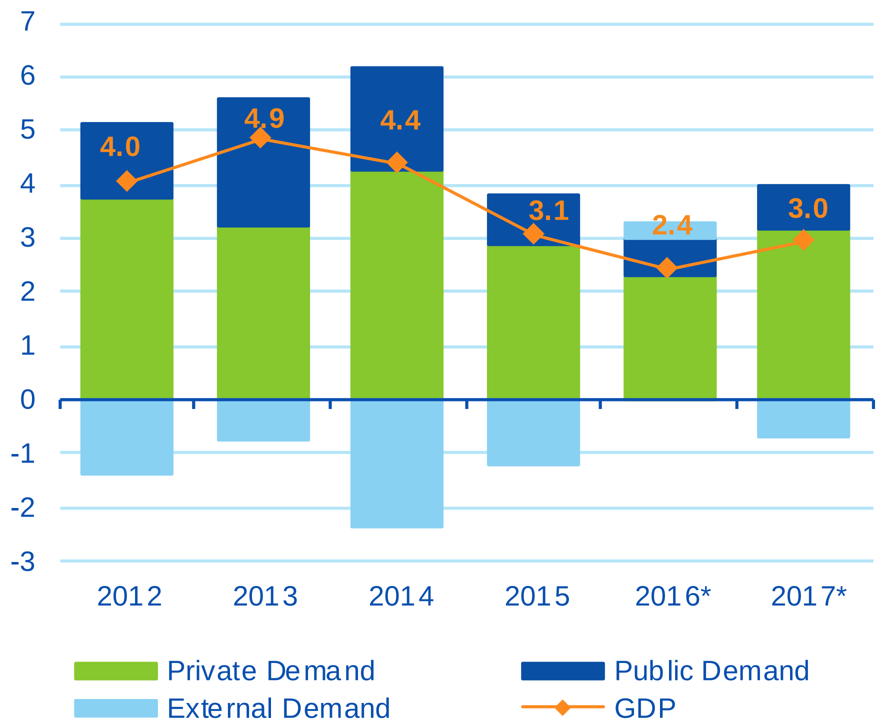
Source: BBVA Research and DANE

GDP by demand side

Growth in 2017 will rely on investment

GDP by demand side (contributions)

(YoY, %, *Previsiones)



1. External demand. With positive contributions in 2016 on lower imports

2. Private demand. Main driver of the GDP growth in 2016 and 2017. Investment is a key driver in 2017.

3. Public demand. In 2016 is expected to low on weak expenditure by local governments.

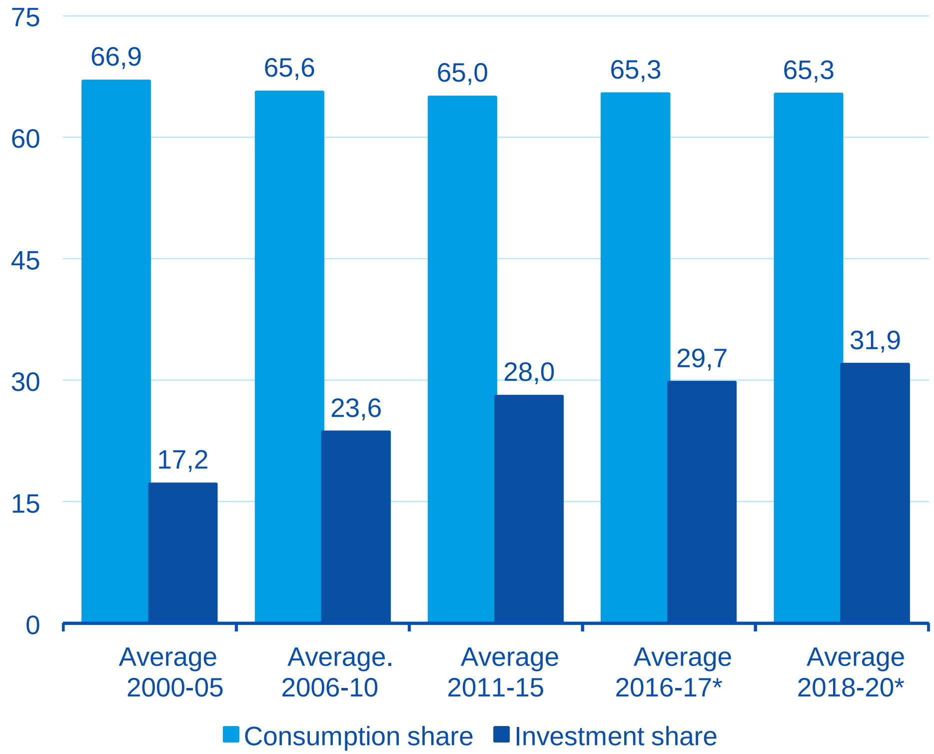
Source: BBVA Research and DANE

GDP by demand side

Long run: Higher investment driven by 4G projects

Consumption and investment shares

(% of GDP, %, *Forecasts)



1. Higher household savings and lower leverage. Consumption growing at the pace of GDP growth.

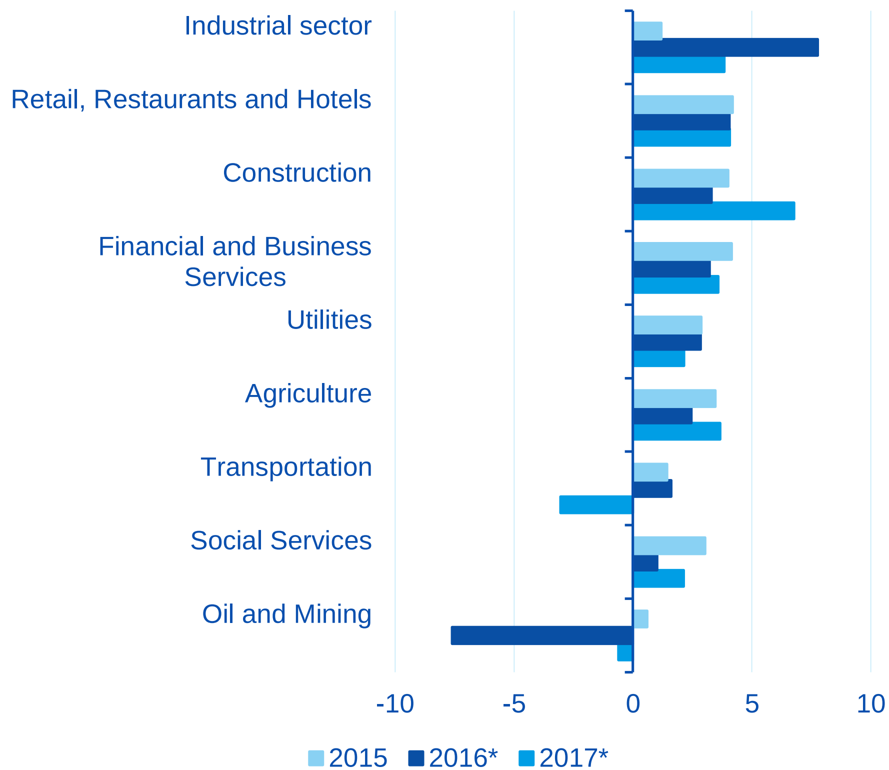
2. Higher investment requires savings

3. Higher potential output. Higher investment will mitigate the slowing population growth

Source: BBVA Research and DANE

PIB by supply side
Even growth across sectors

GDP by supply side
(YoY, %, *Forecasts)



Leading sectors

1. Industry. In 2016 y 2017 will grow above the GDP, even excluding oil refining

2. Construction. In 2017 will be driven by low value housing projects and the 4G infrastructure program.

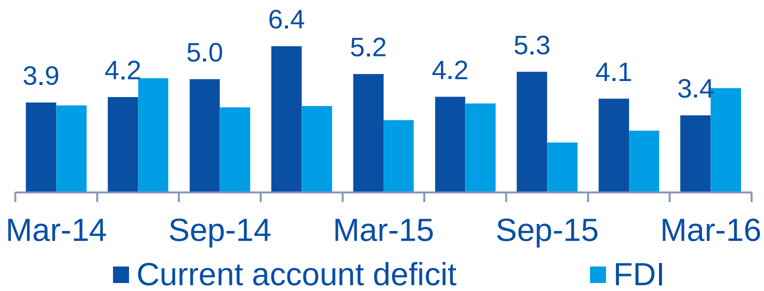
3. Agriculture. Gaining momentum starting in 2017 on weaker currency and better weather conditions

Source: BBVA Research and DANE.

Current account and FDI

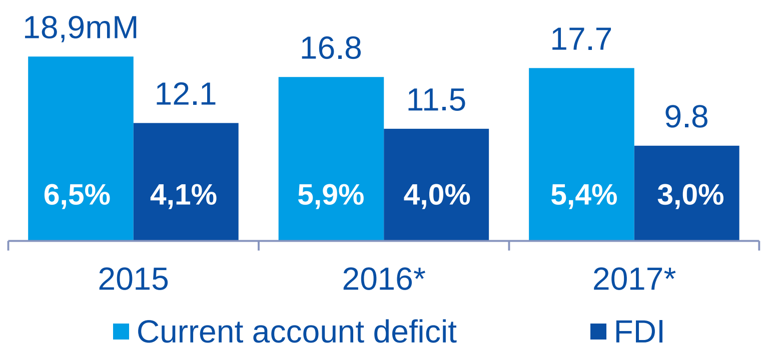
Current account deficit begin its reversal

Current account and FDI
(USD billions)



In 1Q16, the current account deficit reached its lowest value since 4Q13 (in levels). However, as % of GDP the current account still was high (5,6%) and was fully financed by FDI.

Forecasts
(USD billions and % of GDP)



Current account deficit will remain above 5% of GDP in 2016 and 2017. FDI loses momentum but still will finance 62% del current account deficit in 2016-2018 (on average).

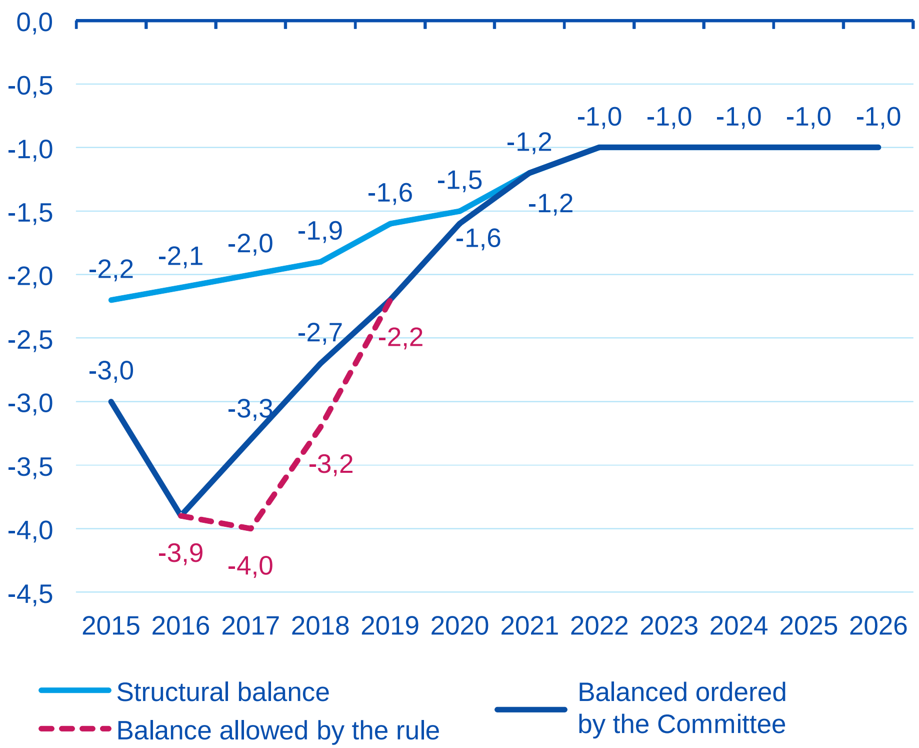
Source: BBVA Research and DANE

Central Government Balance

A faster adjustment it is required by the fiscal rule

Central Goverment Defict

(% of GDP, as forecasted by the 2016 Fiscal Framework)



To comply with the fiscal rule, the Government plans to cut investment

If investment is cut, the economy growth would be weaker in the future

It is imperative to increase the tax revenue in 2017 and not adjust investment as the government says. Our scenario incorporates a tax reform

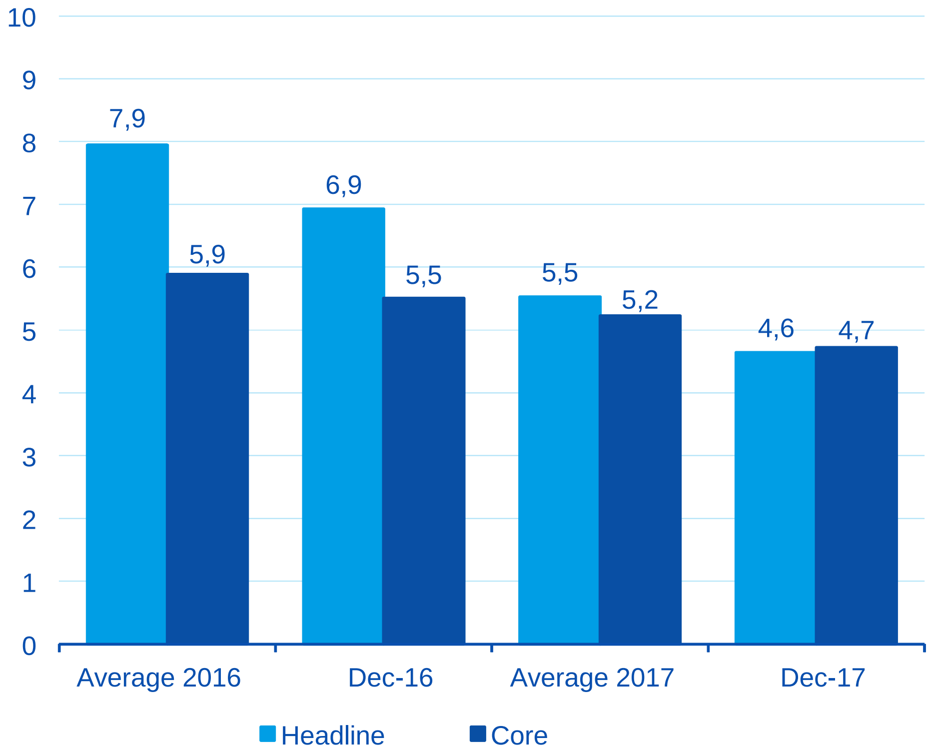
Source: BBVA and Ministry of Finance

Inflation

Inflation won't reach 3% target until 2018

Inflation rate

(YoY, %, *Forecasts)



1. Private demand. Consumption is growing above GDP

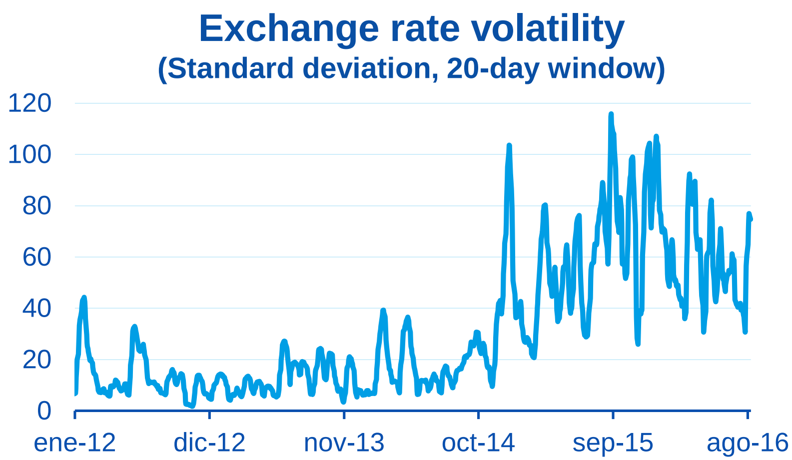
2. Industry bottlenecks. Sales growing above production at the same time that investment is decreasing

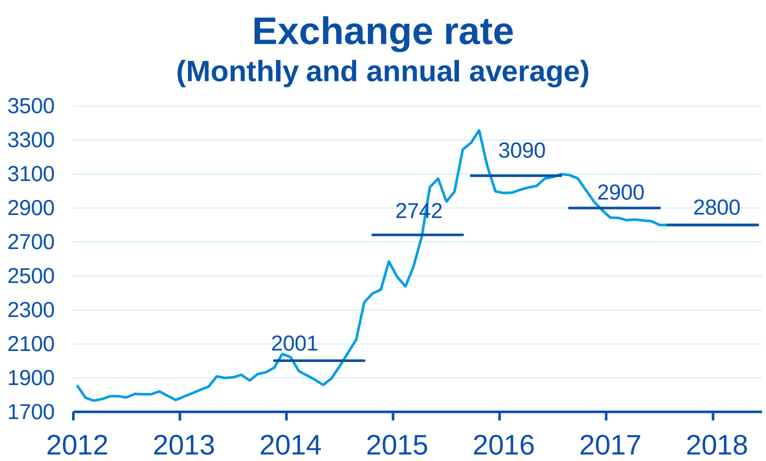
3. Temporary variables. El Niño and truckers strikes

Source: BBVA Research and DANE

Exchange rate

Exchange rate volatility continues





We expect a depreciation of 12,7% and a COP appreciation of 6,1% in 2016 and 2017

Lower current account deficit and higher oil prices explain the peso appreciation over the medium term

Source: BBVA Research and Bloomberg

Conclusions

Colombia Outlook

Takeaways

A gradual and well-ordered slowdown of the economy continues, reducing the macroeconomic imbalances

Macroeconomic vulnerabilities have diminished, though they have not disappeared

Market volatility in the wake of Brexit was offset by an expected more accommodating tone on the part of the Fed


BBVA RESEARCH
Thank you

Contacts

Colombia

Juana Téllez
Chief economist
juana.tellez@bbva.com
+57 1 347 1600 ext 11416

Equipo

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
josevicente.romero@bbva.com

Natalia Roa
Intern
angienatalia.roa@bbva.com

www.bbvaresearch.com