BBVA | RESEARCH

Fourth Quarter

2016

Economic Outlook:

Colombia


Global

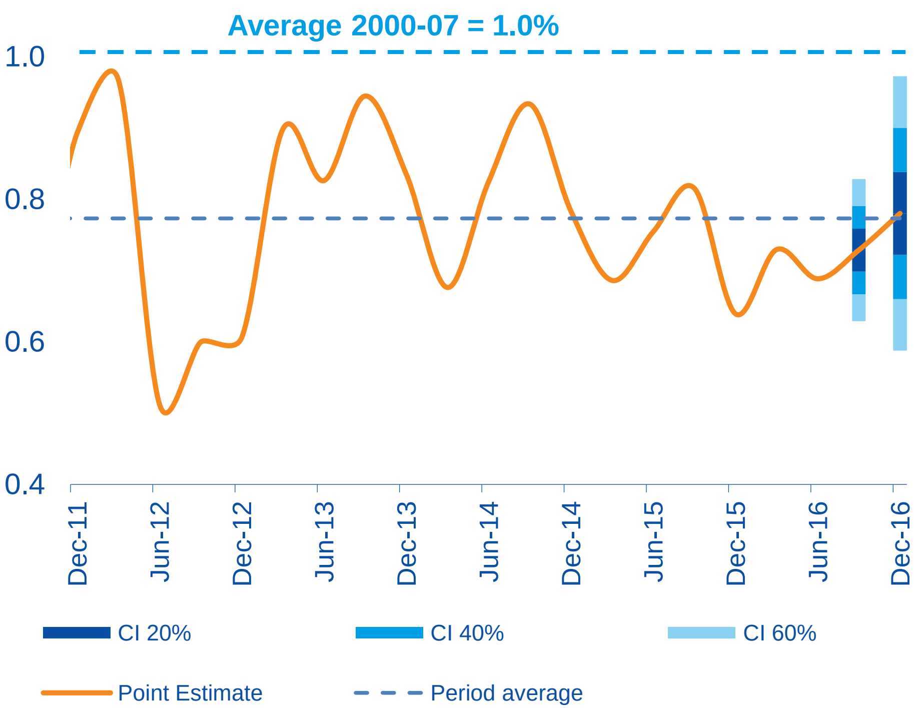
BBVA | RESEARCH

Global Growth

Global GDP growth is expected to improve slightly

Global growth

(QoQ annualized, %)



Source: BBVA Research

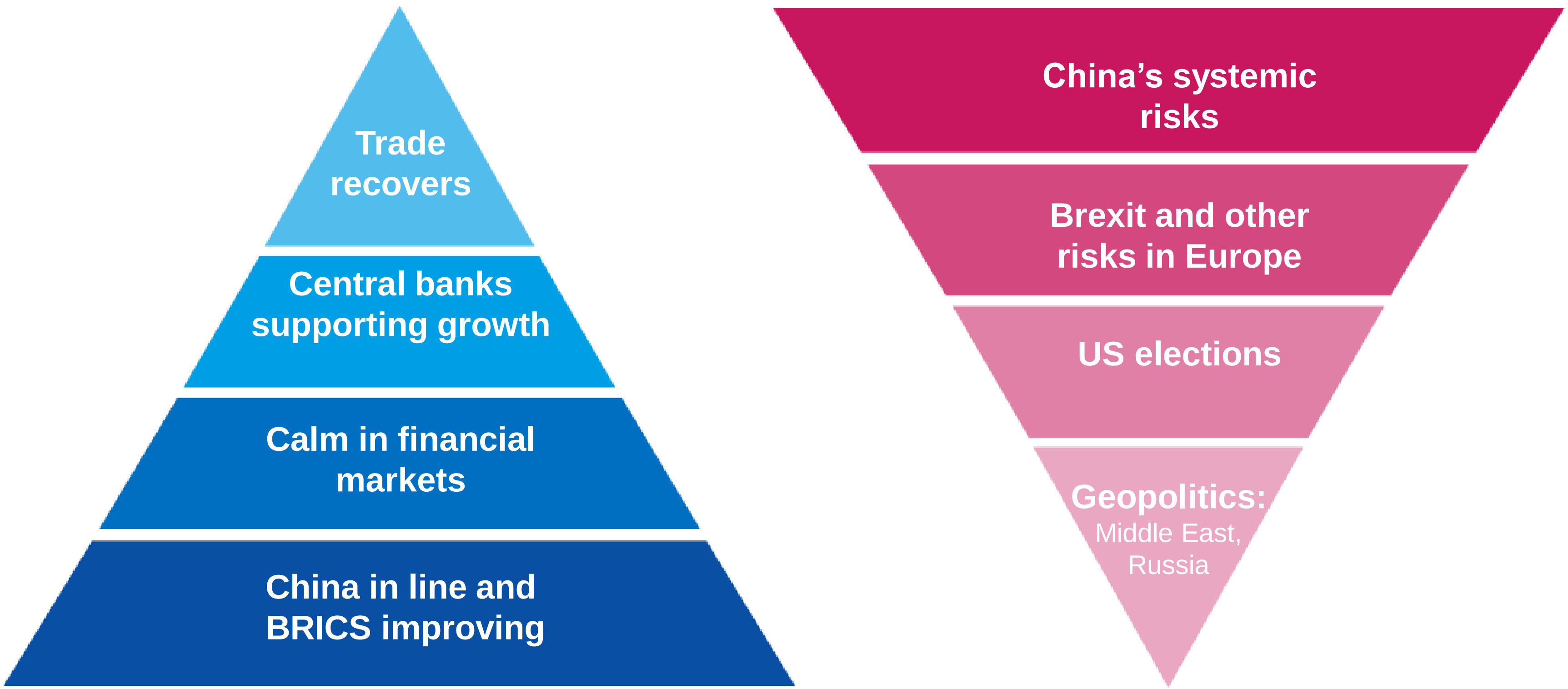
Retail sales suggest a strong momentum for consumption (not for investment)

Mixed signs from hard data so far, but confidence is recovering in many places

We slightly revised down 2016 GDP growth to 3.0%. In 2017, world output will increase to 3,2%.

Global Growth

Some good news, but higher risks



Global Growth

Pending issues weight in the recovery

Central banks and low rates

Low rates are here to stay, reflecting cyclical and structural issues

Monetary policies are very close to their limits absent any major shock

Coordination of the policy mix

Increasing calls for fiscal and structural policies to complement (an exhausted) monetary policy

US and Germany have some margin for fiscal expansion

Others on composition of expenditures

Protectionism and trade

Low global growth affects trade…

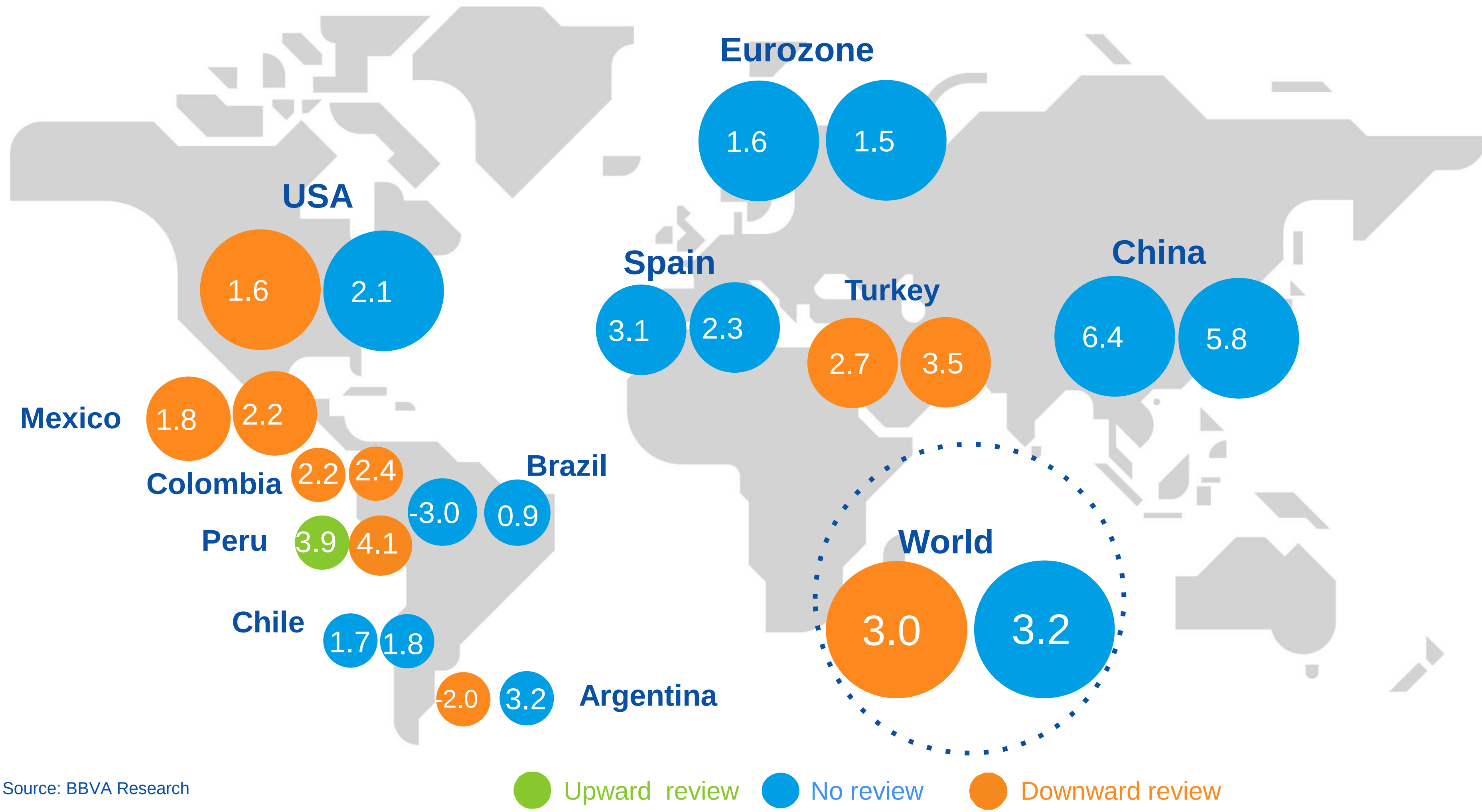
… but trade to GDP growth is lower than pre-crisis :

1. Contraction of high intensity trade goods (China)
2. Anemic global investment
3. Protectionism

Likely to recover slowly

Global Growth

Downward revision to previous 2016-17 GDP growth



Source: BBVA Research

Federal Reserve (FED)
It remains on course for an interest rate hike in Dec

FED outlook

Recent meetings balance

- FOMC postpones the next rate hike but minutes debunk concerns of a fractured committee, Sept meeting was "close call"
- Economic forecasts underlie growing divide on "new normal"
- Undershooting expectations for 2H16 could help justify further delays

What next?

- Policy uncertainty, global economic and financial developments and the strong USD could delay future rate increases
- Further discussion on normalization with low R*, productivity, … Opinions diverging on the risks to delaying normalization and proximity to steady state

Timeline

One hike in 2016 with a neutral bias

Two hikes in 2017

Fed funds rate:

Dec 16: 0.75%

Dec 17: 1.25%

Timeline Exit Strategy

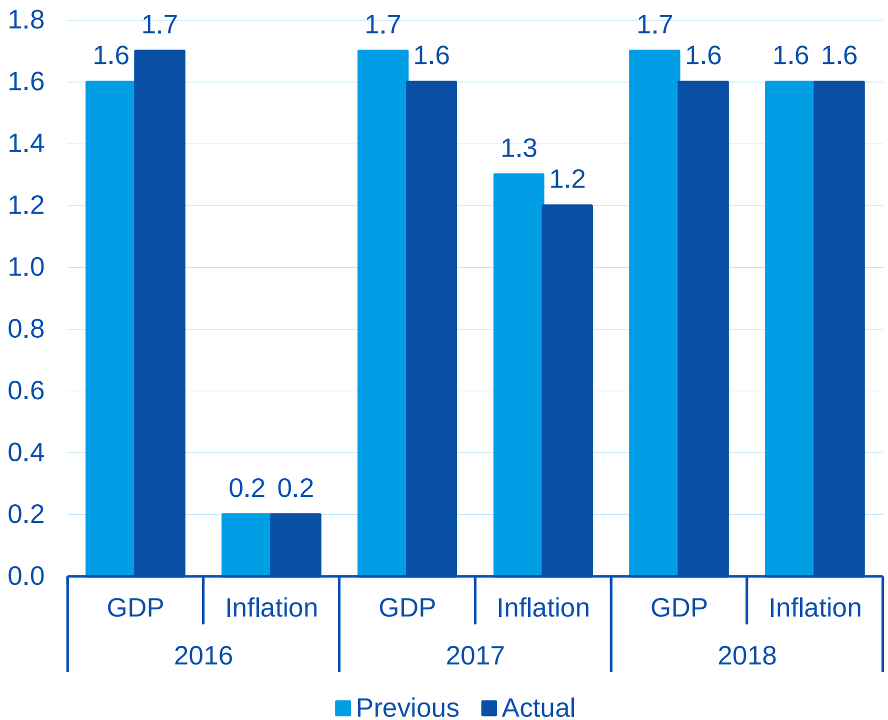
Nov 2016	**Dec 2016**	2017
No FFR Increase	**2nd FFR Increase**	Maintain reinvestment policy

BBVA RESEARCH

European Central Bank

ECB keeps stimulus program steady

BCE Macro Forecasts
(YoY, %)



Source: BBVA Research and Bloomberg

Bond-buying stimulus will continue until the end of March 2017, or beyond, if necessary

The governing council heard reports from staff committees on how to get around scarcity in different bond markets

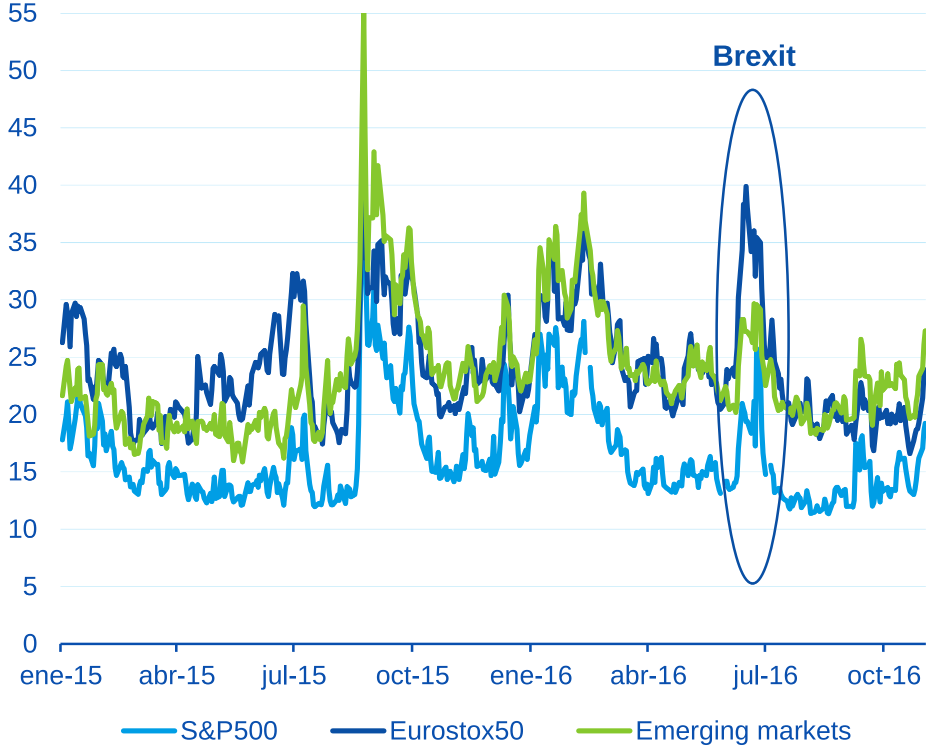
Economic growth risks declining

Financial Tensions

Subdued, but rising in DM and LatAm

Implicit Volatility in Stock Exchange

(Relative index)



Higher volatility in DM on weaker commodities prices

Negative yields on 1/3 of the developed world bonds

Volatility levels remain above long-run average

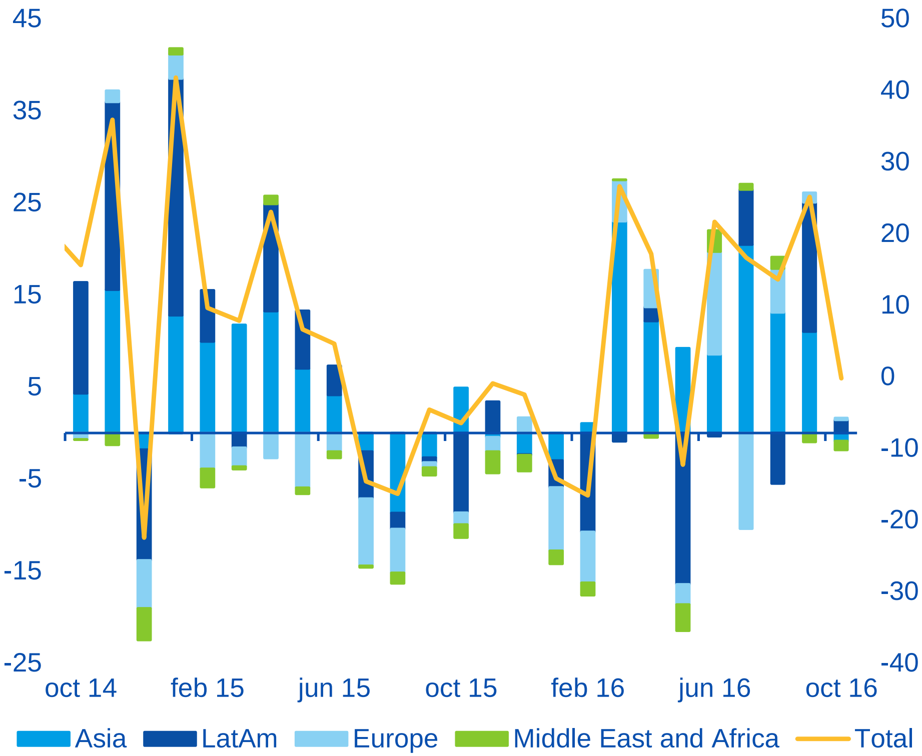
Source: BBVA Research and Bloomberg

Capital Flows

Slowing flows amid high volatiity

Capital Flows to Emerging Markets

(USD billions)



Source: BBVA Research and IIF

FED policy expectations affecting capital flows

Higher probability of FED hike is correlated with low flows

China has suffered from outflows

Preliminary data shows that capital inflows in Colombia are decelerating

Colombia

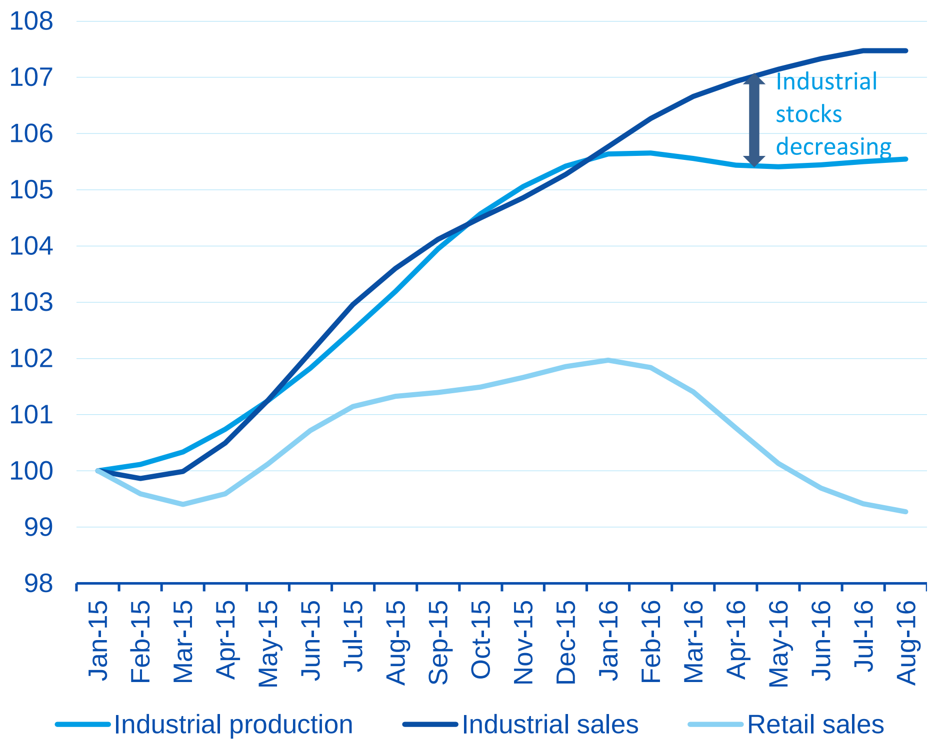
BBVA | RESEARCH

Leading Indicators

Manufacturing new orders keep rising…

Manufacturer's New Orders and Production Compared to Retail Sales

(Index JAN 15=100, seasonally adjusted)



Source: BBVA Research and DANE.

…despite weaker consumption

Decreasing stocks. Since October 2015 production is outpacing new orders

New orders grew 5.1% YoY on average since then, while production rose 4.6%

Investment near a tipping point. Non residential investment will rise in 4Q16, after having registered negative figures since September 2015. Trigger: high capacity utilization rate

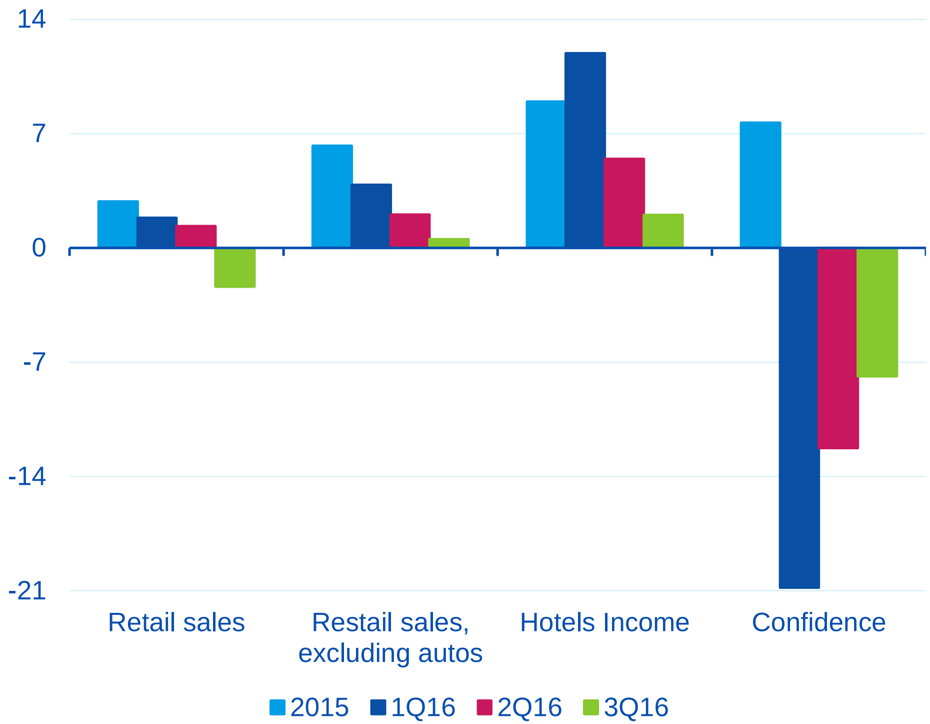
BBVA | RESEARCH

Leading Indicators

GDP dragged down by weak private consumption

Consumption Indicators

(Seasonally adjusted, Jan-15=100)



Slowdown was beyond retail sales

Services. Slowing after a strong first half

Cars sales and non-durable goods.

Weak confidence points to a further slowdown. Tax reform will also affect consumption, especially in 1Q17

Source: BBVA Research and DANE

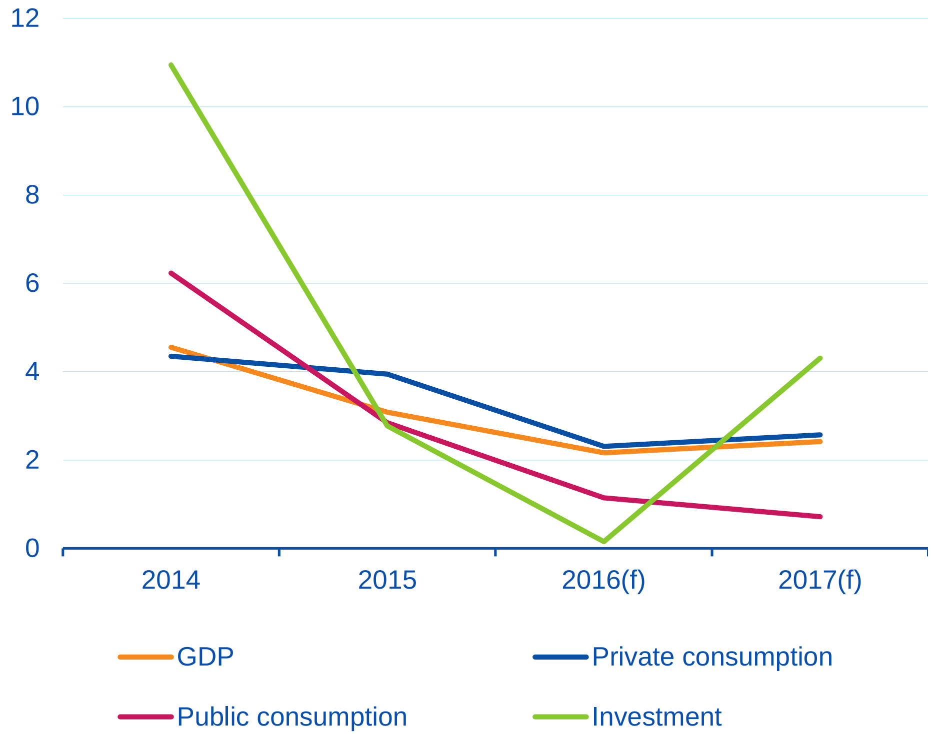
RESEARCH

GDP: Demand Side

Investment will be the main growth driver

GDP Demand Side Growth

(% YoY)



Source: BBVA Research and DANE

GDP growth: 2.2% in 2016 and 2.4% in 2017

1. Investment. 4G infrastructure program, industry and mining (due to higher prices)

2. Private consumption. Slight acceleration: from 2.3% in 2016 to 2.6% in 2017

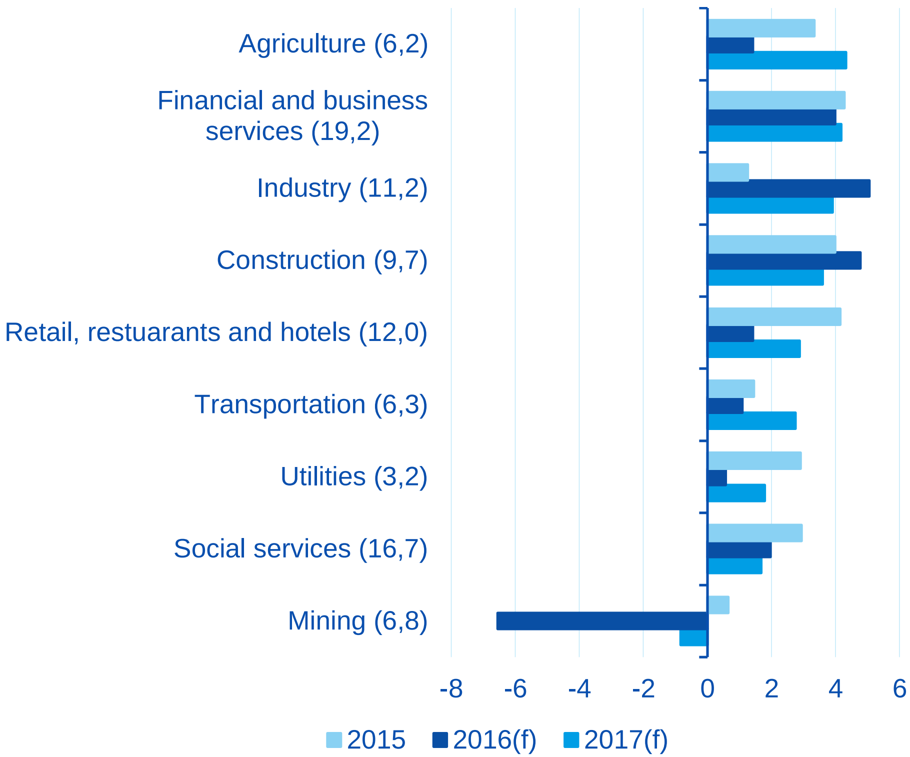
3. Consumption headwinds. Higher unemployment rate and tax reform

GDP: Supply Side

Leading sectors: agriculture, industry and construction

GDP Supply Side Growth[1]

(YoY, %)



Source: BBVA Research and DANE

[1] Sector weights in parenthesis

Growth in all sectors but mining

1. Agriculture. High prices and improved weather conditions

2. Construction. 4G infraestructure projects, and low and middle-income housing

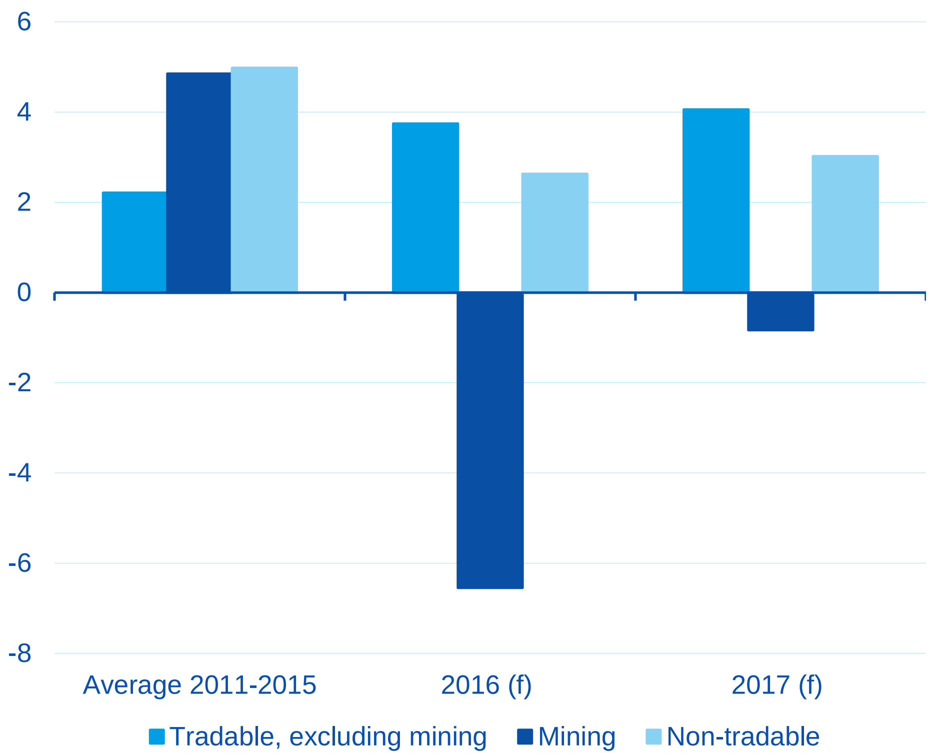
3. Manufacturing. Higher capacity utilization rate, imports substitution and better external demand

BBVA RESEARCH

GDP: Supply Side

Tradable sector gaining momentum

GDP Growth by Tradable and Non-tradable Sectors
(YoY, %)



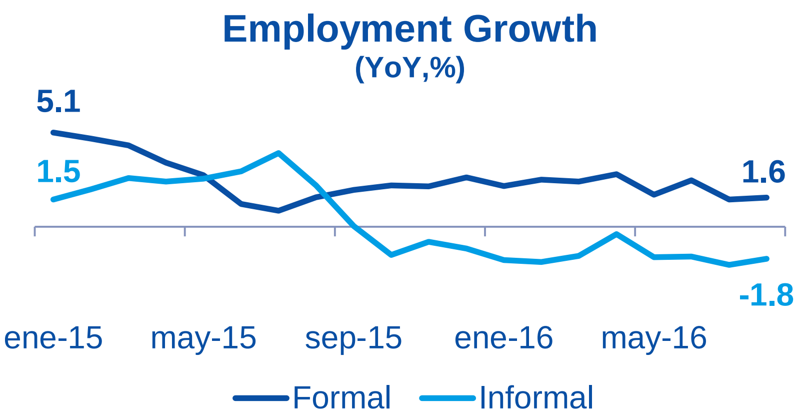
1. Industry share of GDP will increase 40bp between 2015 and 2017

2. Mining share of GDP will fall 130bp in the same period

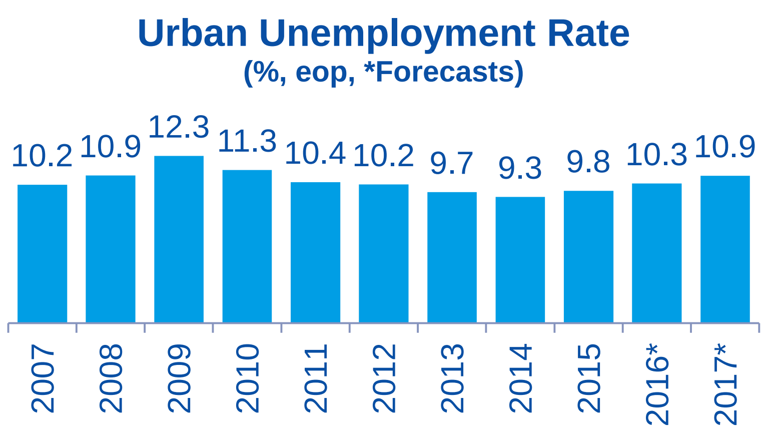
3. Construction share of GDP to a record of 7.5% of GDP

Source: BBVA Research and DANE

Labor Market
Rising formal employment



Labor-intensive sectors (agriculture, industry, construction) took advantage of the 2012 tax reform, which cut the non-wage costs



The forecast is for the unemployment rate to increase slightly over the next year, but at a lower rate compared to former negative economic cycles

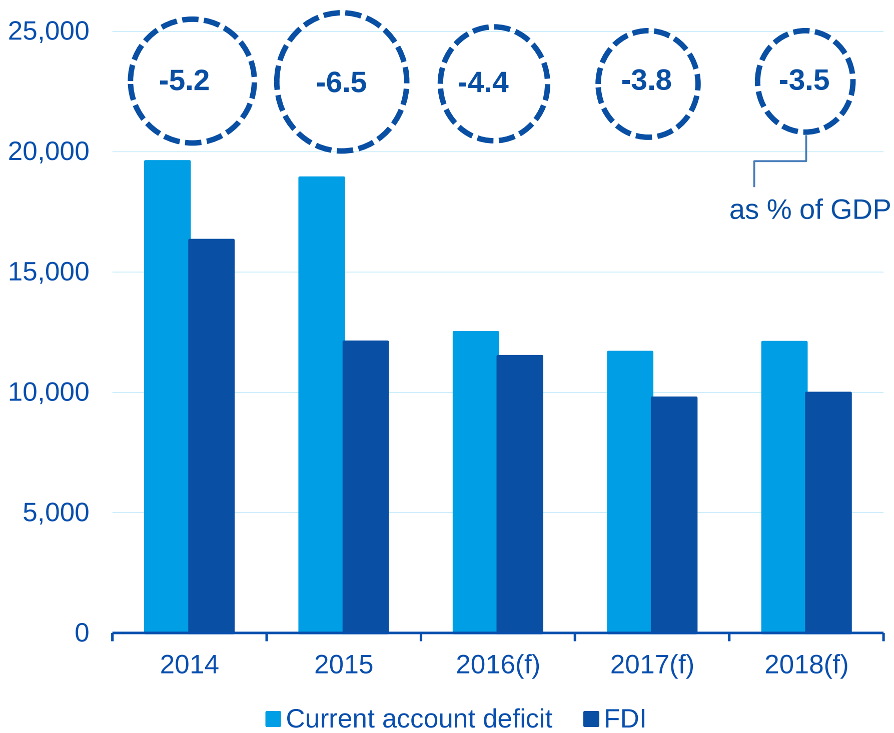
Source: BBVA Research, DANE

Balance of Payments

Current account deficit narrows faster

Current account deficit and FDI

(USD millions)



FDI is the main financing source

FDI financed 64% of the 2015 current account deficit. Between 2016-2018, it will finance 87%.

From 2017 onwards current account deficit will be below 4.0% of GDP

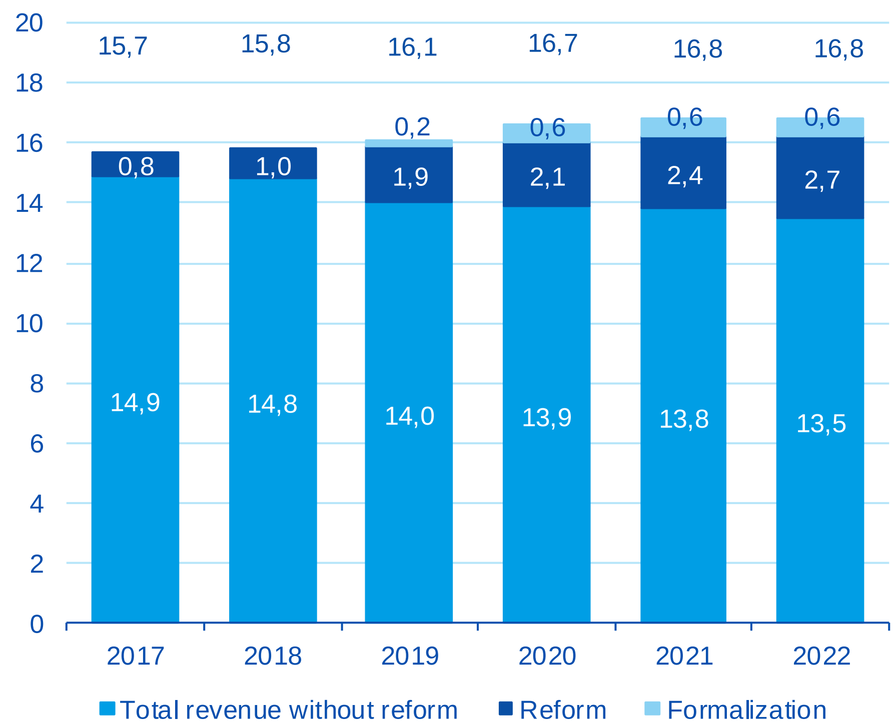
Source: BBVA Research and Banco de la República

Tax Reform Bill

Increases revenue through indirect taxes…

Government Revenue with and without Reform

(% of GDP)



…and some temporary taxes become permanent

VAT: increases the general rate from 16% to 19% since 2017. The basket of goods not paying VAT remains virtually unchanged.

Individuals: Simplifies and increases the progressivity of the tax regime

Corporations: simplifies the income tax system, changes the tax base and reduces rates since next year

Source: BBVA Research and Ministerio de Hacienda de Colombia

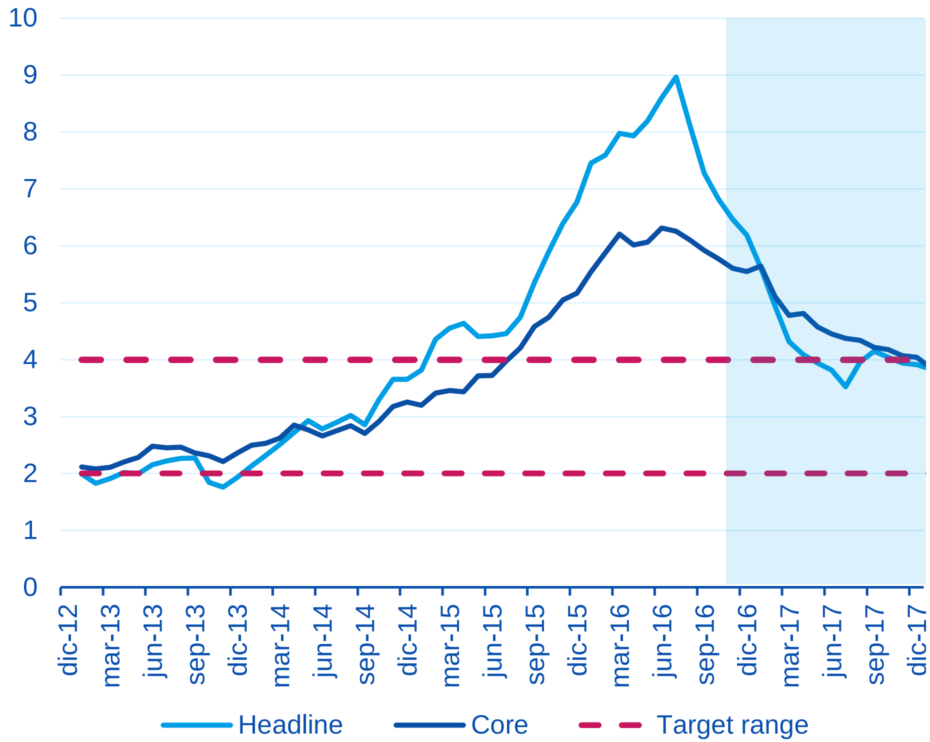
Tax Reform Bill

Revenue will increase gradually

Structural	Tax collection	Capital and employment incentives	Counter tax evasion
Rebalances the tax burden from corporations to individuals **Simplifies and increases the progressivity** of the tax regime for individuals **Provides relief and simplifies** the tax regime for corporations **Increases tax bases**	**Higher revenue:** tax revenue will increase gradually from 0,8% of GDP in 2017 to 2,7% of GDP in 2022 **More formality** will bring additional revenue of 0,6% of GDP from 2020 onwards	**Lowers the cost of capital**. Full VAT refund for capital goods purchases **Fosters formality:** Corporate's payroll taxes exemption is kept over workers with salaries of less than ten minimum wages; introduces a monotax and discourages the use of cash	**Criminal punishment** for tax evasion **Other measures**. New rules for Non-Profit Institutions, introduces international information exchange schemes and forces the disclosure of aggressive tax planning in accordance with OECD guidelines

Inflation
It will reach the target over the second half of 2017

Headline and core inflation
(YoY, %)



Source: BBVA Research and DANE

Drivers

Weather. The cost of food and power is dropping on improved weather conditions

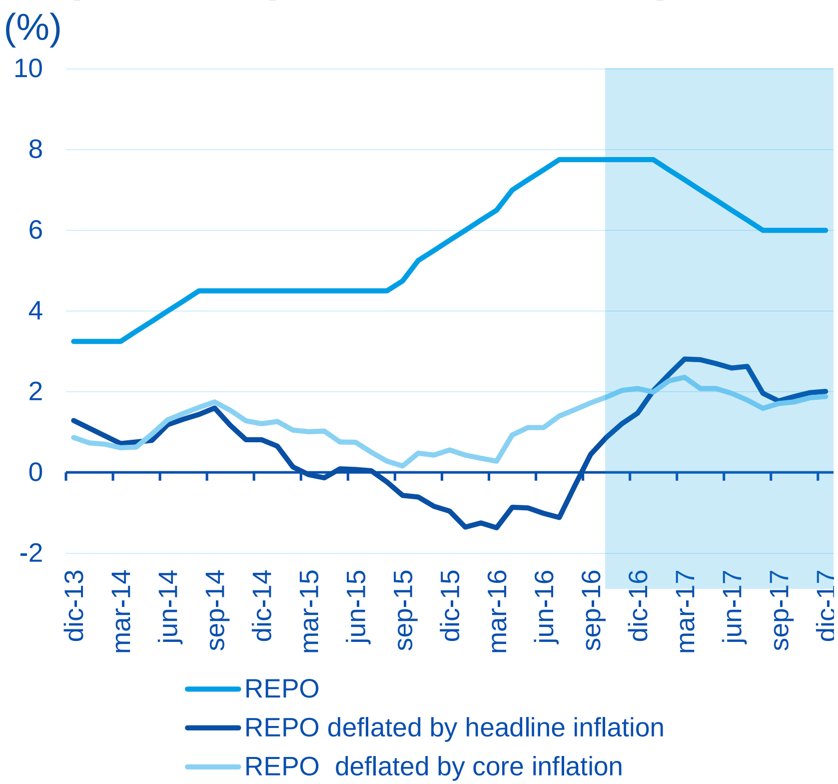
Exchange rate. Stronger COP (compared to 1H16 levels) is helping to reduce the price of imported goods and inputs

Demand. Slowing consumption is helping to close the gap between national income, which fall due to the slump in oil prices, and spending

Monetary Policy

BanRep will have more room to cut rates

Repo Rate (nominal and real)



2017 forecast: 6.00% (eop)

Inflation and GDP forecasts were downward revised in 2017. Yet inflation will be closed to the top range of its inflation target (2%-4%). Deflated by inflation, the Repo rate will stay around 2% over the 2S17

Source: BBVA Research, Banco de la República and DANE

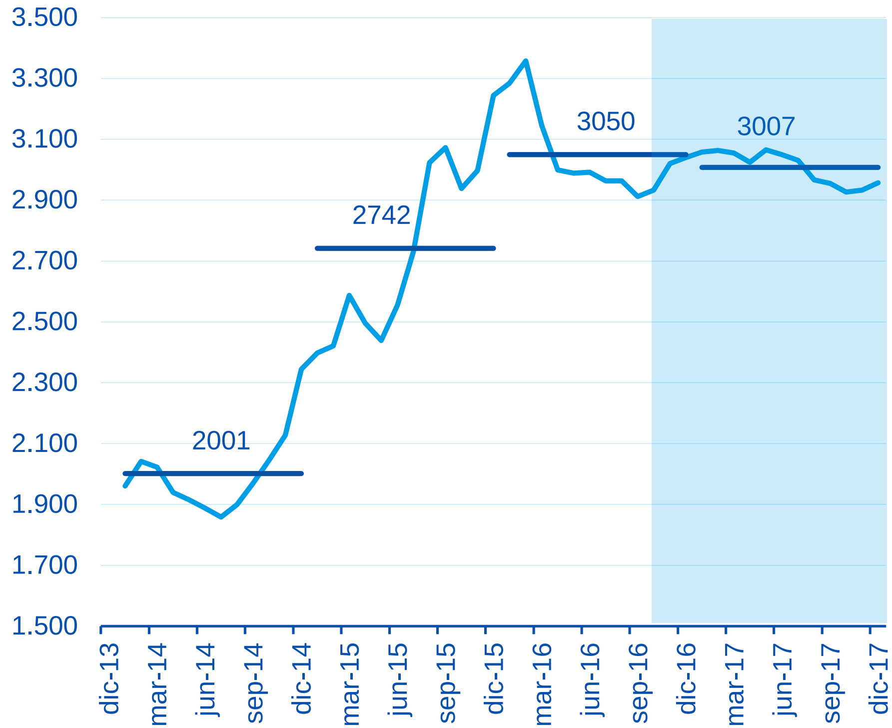
BBVA | RESEARCH

Exchange Rate

The volatility of the exchange rate will continue

Exchange rate

(COP/1USD)



Long-run value: $2.850/1USD

Weakening factors. FED's monetary stance, lower portfolio capital inflows, uncertainty over the future of peace accord and the effects of the tax reform

Strengthening factors. Narrower current account deficit, the economy strength (it weathered the fall in oil prices quite well)

Source: BBVA Research and Banco de la República

Conclusions

Takeaways

2016 will be the year when much of the economy’s adjustment to lower oil prices will have completed

A good balance between production and spending will continue in the medium term, thanks to the fact that consumption will continue to grow at about the same rate as GDP

BBVA RESEARCH

Thank you

BBVA | RESEARCH

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

Natalia Roa
Intern
angienatalia.roa@bbva.com

www.bbvaresearch.com