Uncertainty

Growth accelerating

Investment

Infrastructure

Manufacturing

4G

#SituaciónColBBVA

Growth

Target inflation

Banco de la República

Tax Reform

Economic Policy

BBVA RESEARCH

ECONOMIC OUTLOOK

COLOMBIA

FEBRUARY 2017

GLOBAL SCENARIO

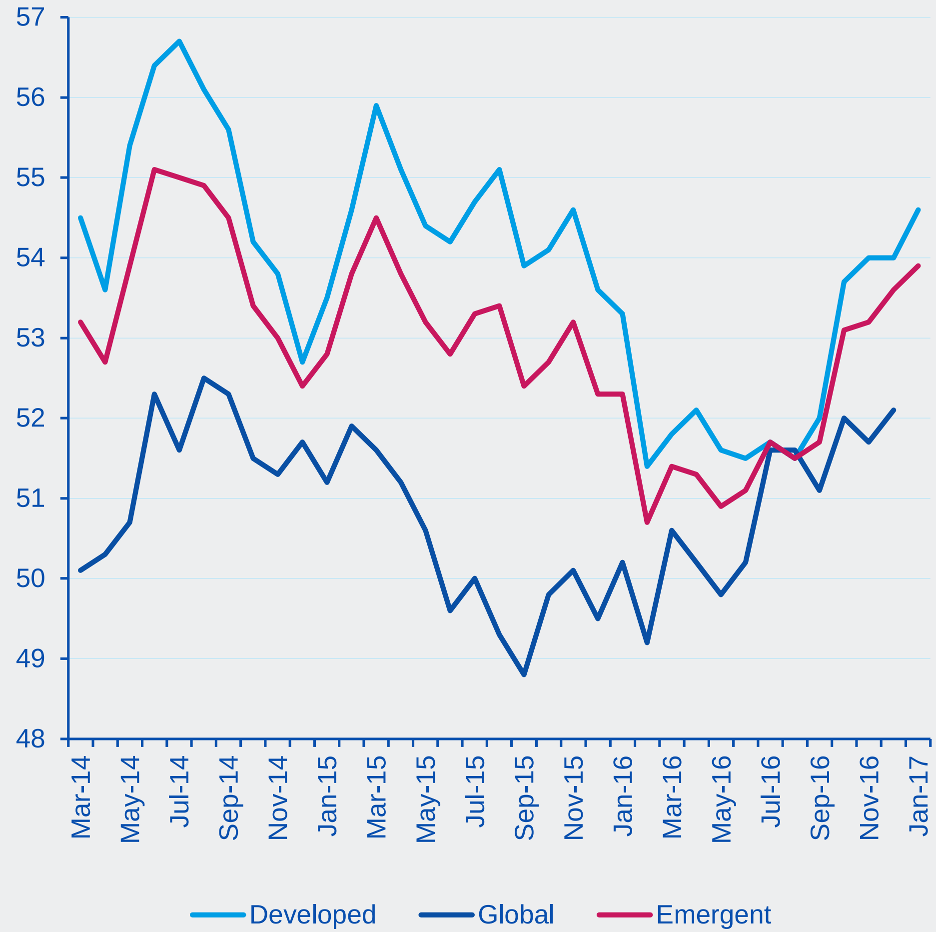
MANUFACTURING

Industry recovering due to more global trade

- **Confidence is noticeably improving, manufacturing production is rising and world trade recovering**
- **Improvements in trade are stronger in Asia and to a lesser extent in Europe.** In Latin America exports continue to have a negative trend

Stronger recovery in developed countries. Exports from the US could be affected by the appreciation of the dollar

MANUFACTURING PRODUCTION INDEX
(PMI, 50 = neutral, Level ± 50)



Source: BBVA Research based on Bloomberg data

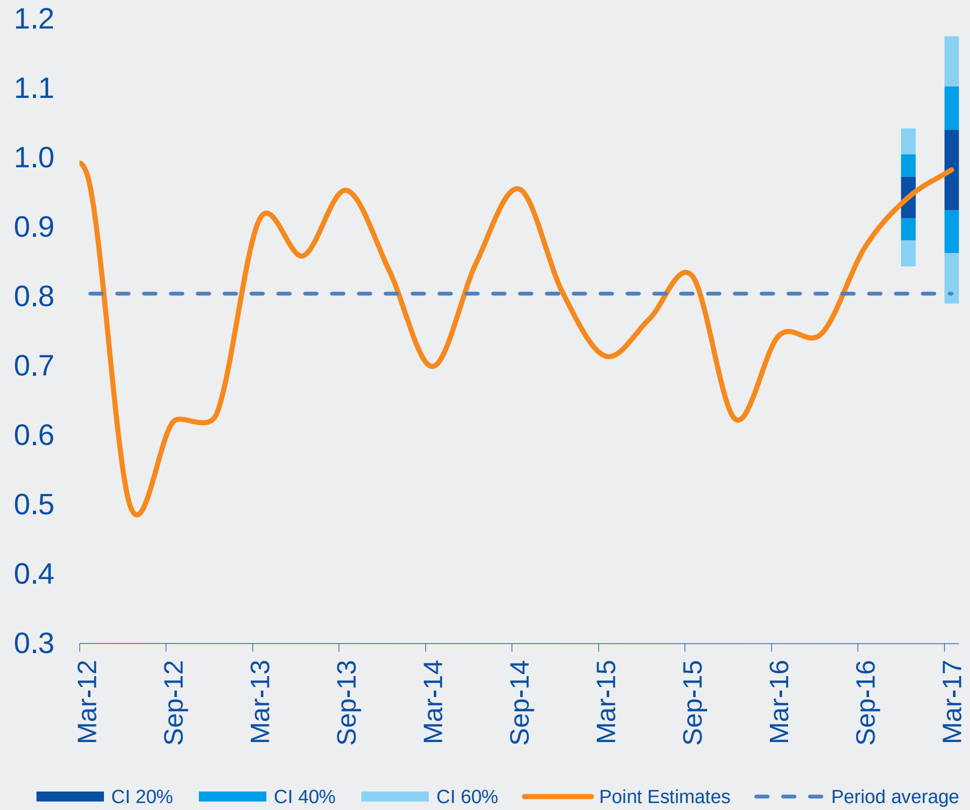
GLOBAL GROWTH

Gradual acceleration, especially in developed countries

- **Growth worldwide accelerated** mainly due to the USA, UK, China and India, and in the industrial sector.
- Recovering growth, higher prices for commodities and possible fiscal support around the world have replaced the deflationary concerns of a few months ago with expectations of higher inflation

At the close of 2016, global growth was higher than the average for 2011-2016

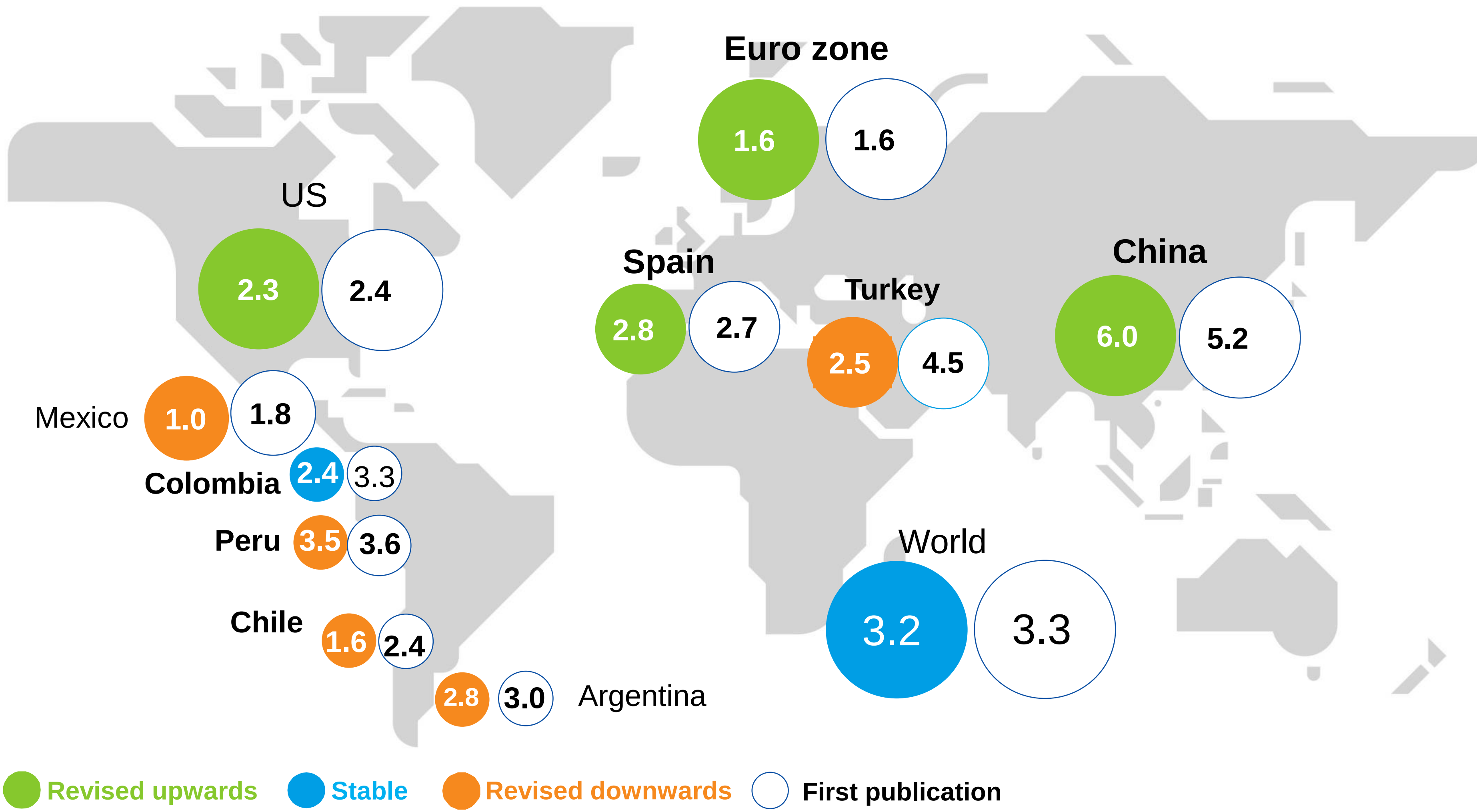
GLOBAL GROWTH
(Quarterly variation, %)



Source: BBVA Research

GLOBAL GROWTH

Global GDP is gradually accelerating (2017-18)



Source: BBVA Research

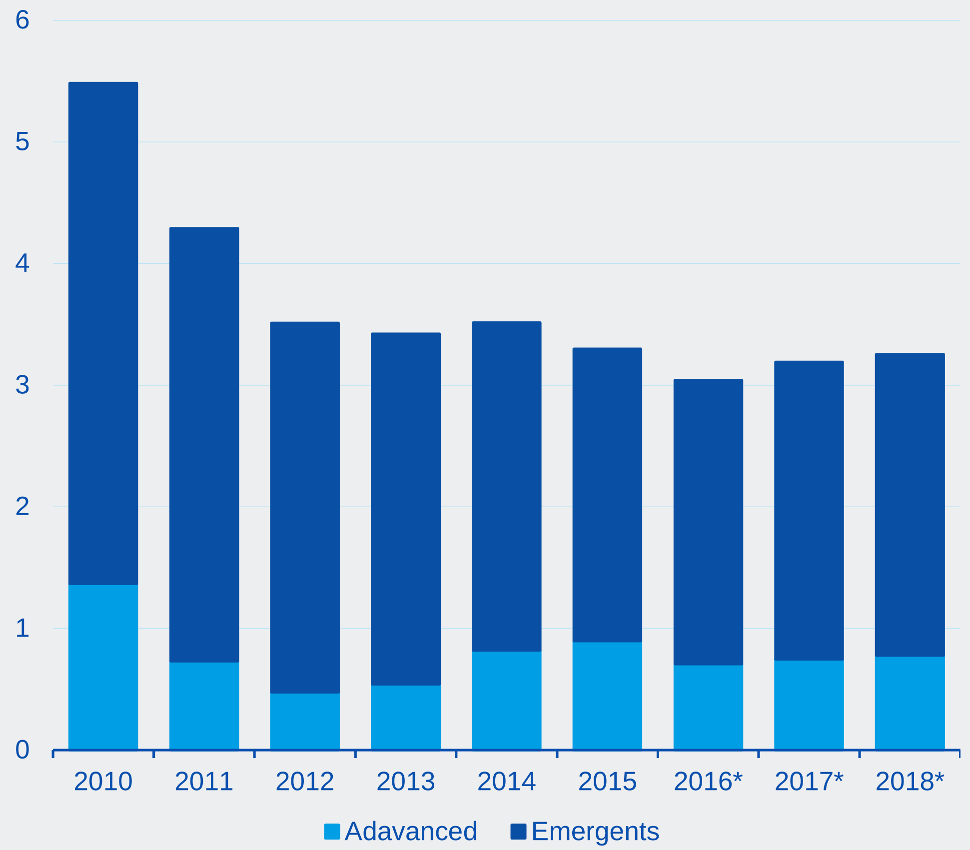
GLOBAL GROWTH

Emerging countries will continue to gain weight in global GDP

- **Gradual increases in global interest rates are better beneficial** for the future growth of emerging countries
- **Recovering prices for raw materials** are helping the external balance of emerging exporting countries

The convergence of global economic growth is led by Asia, as it will continue to grow by more than 5% (with and without China)

GLOBAL GROWTH
(Quarterly variation, *Forecasts)

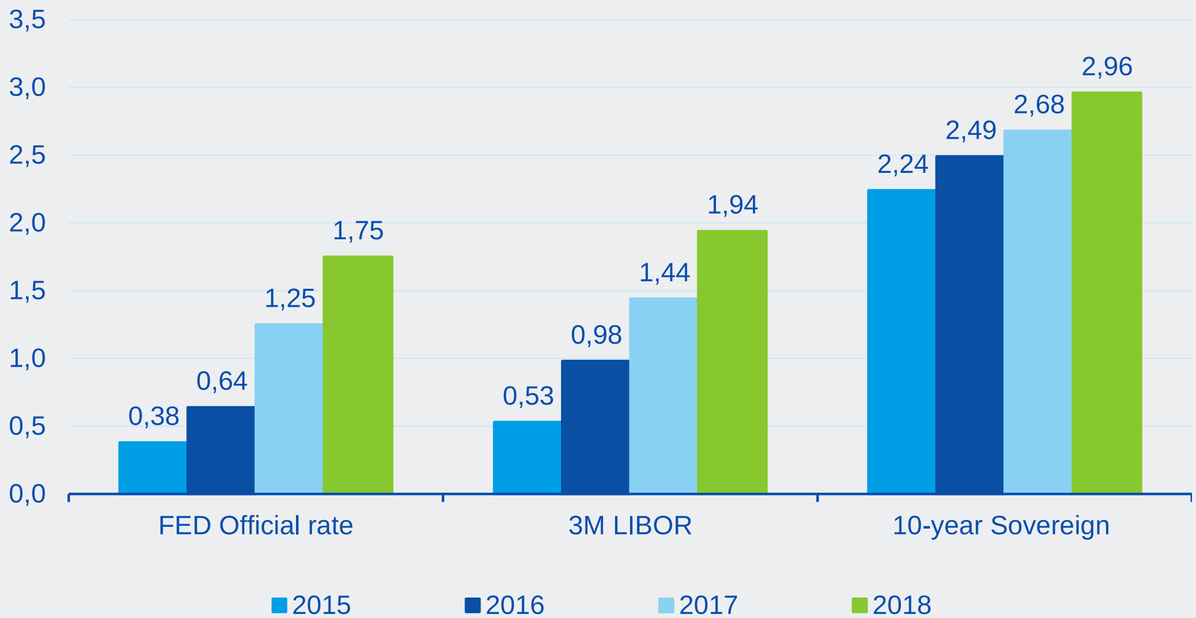


Source: BBVA Research

US INTEREST RATES

Gradual increase in interest rates

US INTEREST RATES
(End of period, percentage,*Forecasts, %)



- **Two increases in the FED rate, each year,** are expected in 2017 and 2018
- **Gradual increases** will be **beneficial for adjustments in emerging markets**
- Also, the FED balance will not start to drop before 2018

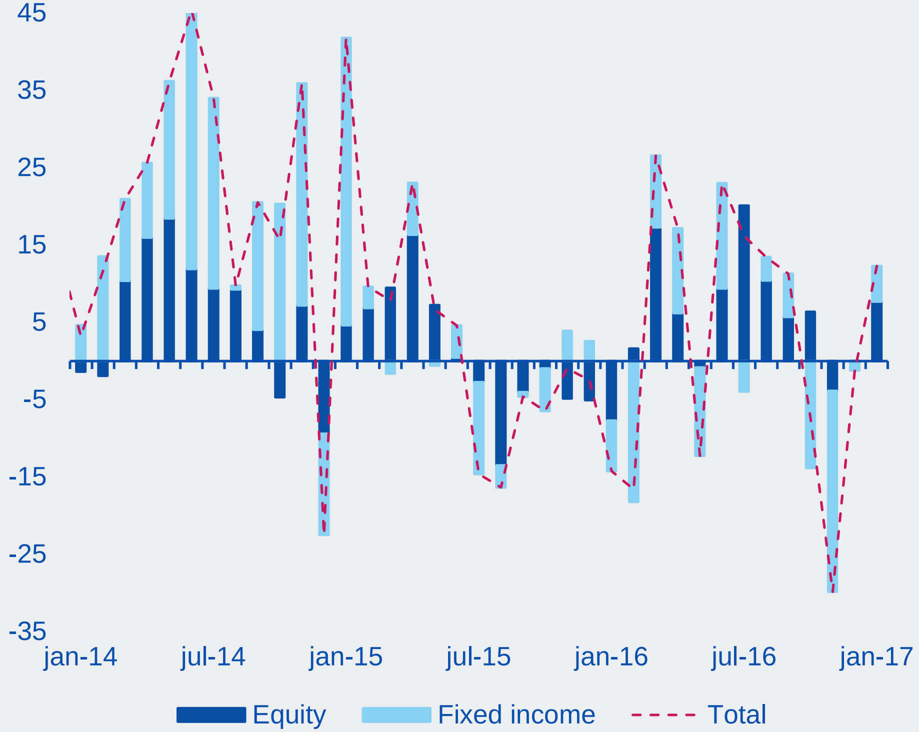
Source: BBVA Research

CAPITAL FLOWS

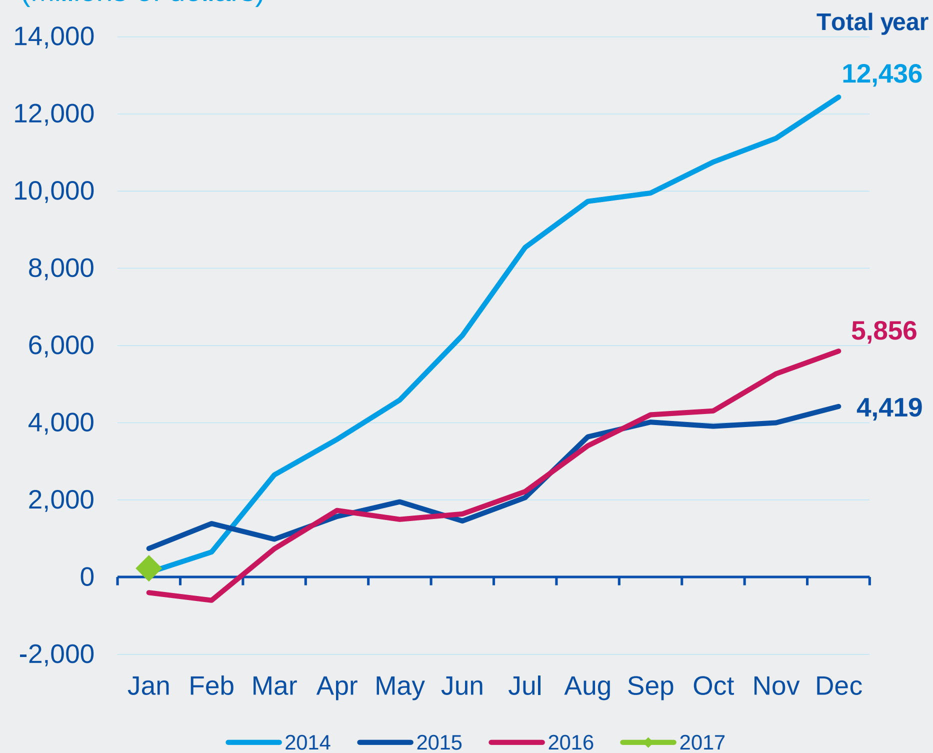
Entry of capital to emerging countries reactivated

- But **uncertainty remains about the future.** This year we expect less inflow than in 2016

CAPITAL FLOWS TO EMERGING COUNTRIES
(Thousands of millions of dollars)



CAPITAL INFLOW FROM NON-RESIDENTS
(Millions of dollars)

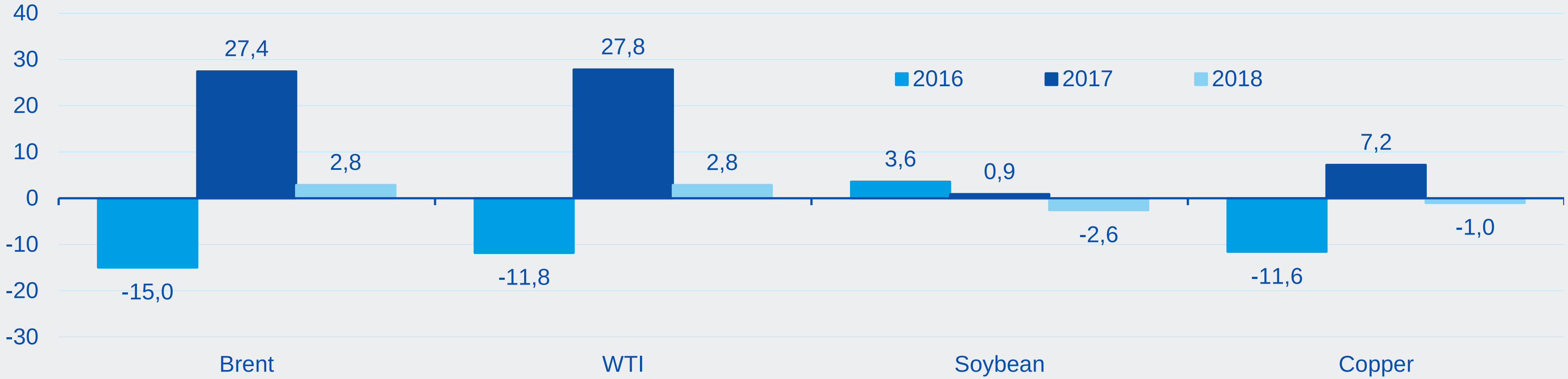


Source: BBVA Research based on data from Banco de la República and the IIF

COMMODITIES

Recovery of oil prices continues

COMMODITIES PRICES
(Annual price variation, %,*Forecasts)

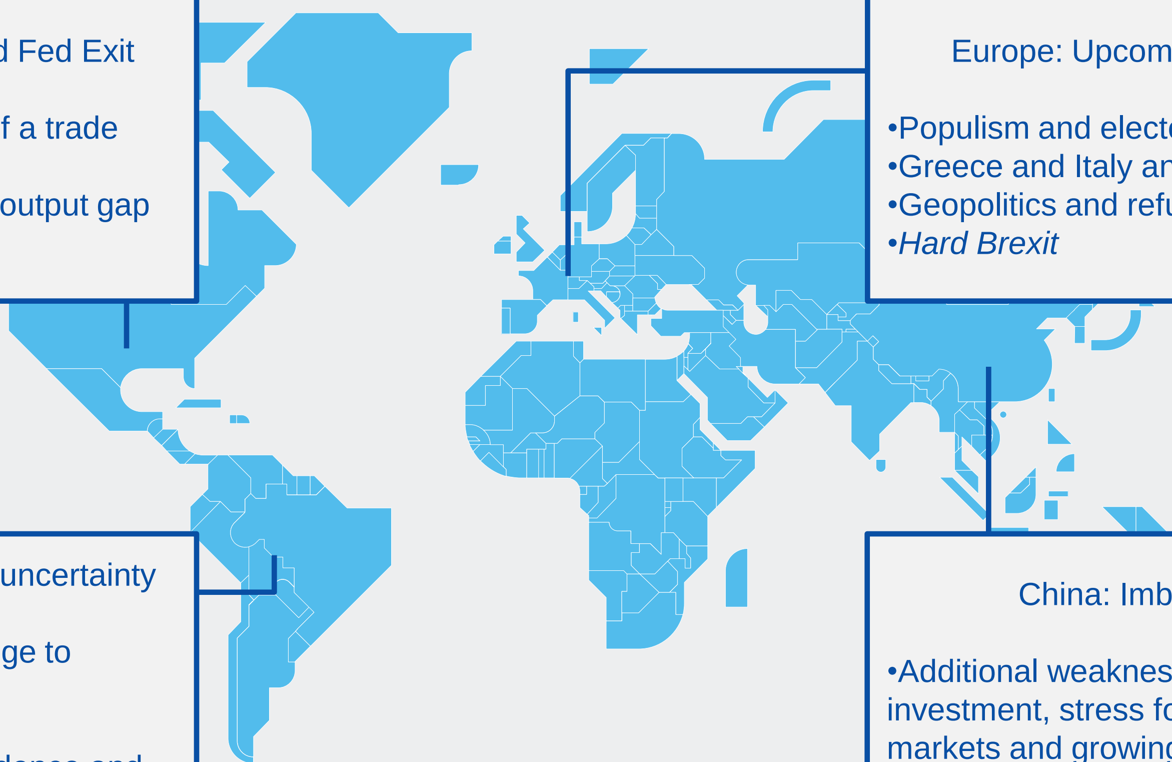


- Signs of a **more balanced market** as global inventories start to fall
- **Growth in demand for oil is stronger** than growth in supply
- US production will continue to grow. So, this year the **price of Brent crude will be $57** a barrel on average and, in the long term, $60

Source: BBVA Research

GLOBAL RISKS

With an impact on all regions



US: Protectionism and Fed Exit

•Protectionism and risk of a trade war
•Tax stimulus without an output gap
•Long-term growth

Europe: Upcoming elections

•Populism and electoral cycle
•Greece and Italy and their banks
•Geopolitics and refugees
•*Hard Brexit*

Latin America: Political uncertainty

•External financing, change to populist macro policies
•Greater market volatility
•Sluggish business confidence and investment plans

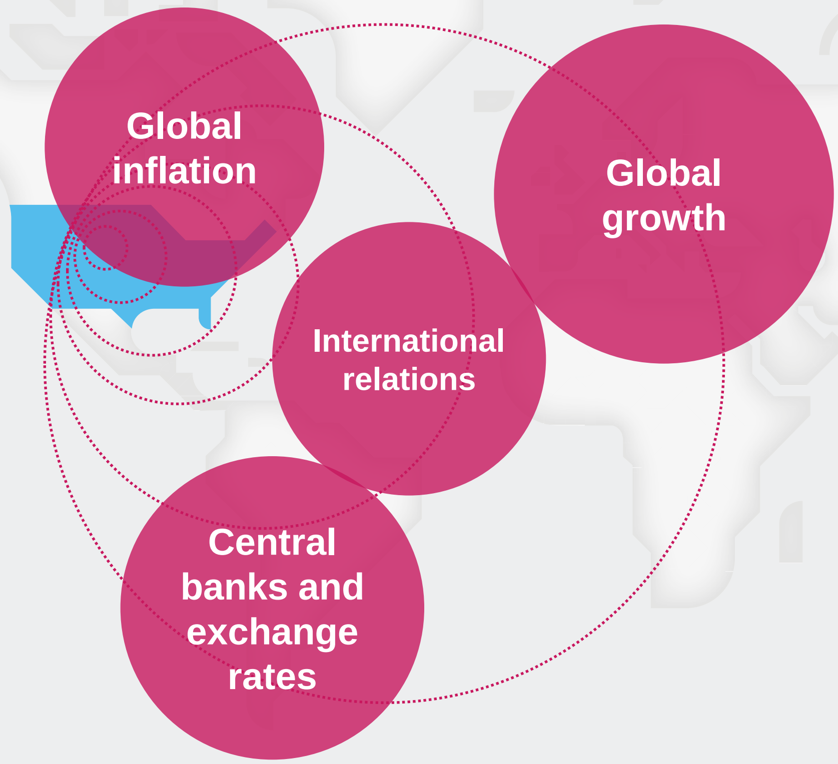
China: Imbalances

•Additional weakness of private investment, stress for financial markets and growing regional disparity

Source: BBVA Research

GLOBAL RISKS

US politics and their global effect



- **Priorities of fiscal policy?** Tax cuts in the face of higher spending
- **Impact on growth and inflation of fiscal stimulus?** Physical expansion with a reduced growth margin
- **What will the protectionist measures be?** When will they be applied? What will their impact be?
- **What will be the reaction of other countries** (such as China)?
- **Which sectors will be deregulated** and how?
- What impact will Trump have on **potential growth**?

Source: BBVA Research

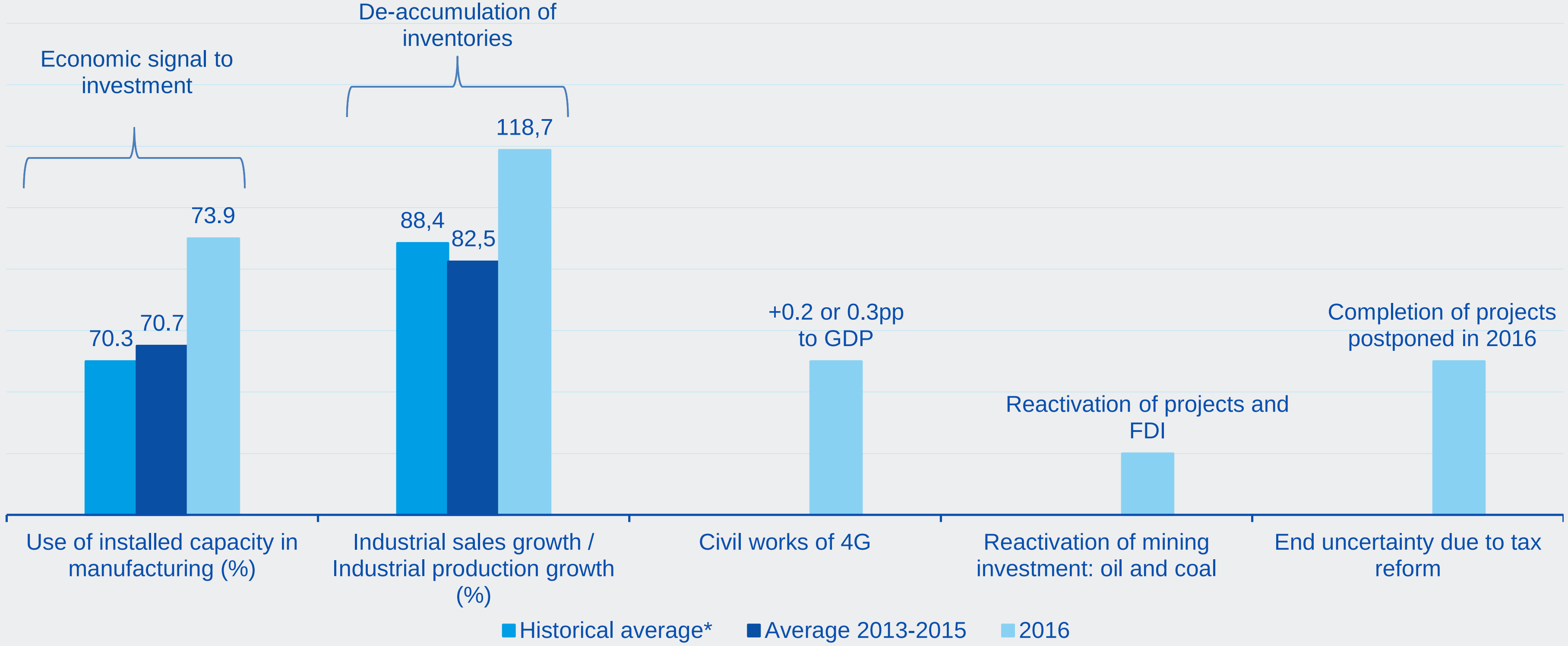
COLOMBIA


246,307
518,801
17,614,472
2,030,796
689,510
2,564,323
1,164,892
934,228

LEADING INDICATORS

Signs of investment recovering

FIXED INVESTMENT ACCELERATION FACTORS IN COLOMBIA
(Percentages and valuations,*Historical calculations since 1990)



Source: BBVA Research based on data from DANE and Fedesarrollo

LEADING INDICATORS

Low growth in private consumption will continue this year

Low growth in consumption helps internal adjustment: more savings, smaller current-account deficit, deleveraging of homes and less pressure on inflation

Upward-trending factors

Financial burden down from 22.2% in 2015 to 19.0% in 2016.

Reduction in inflation and gradual reduction in interest rates

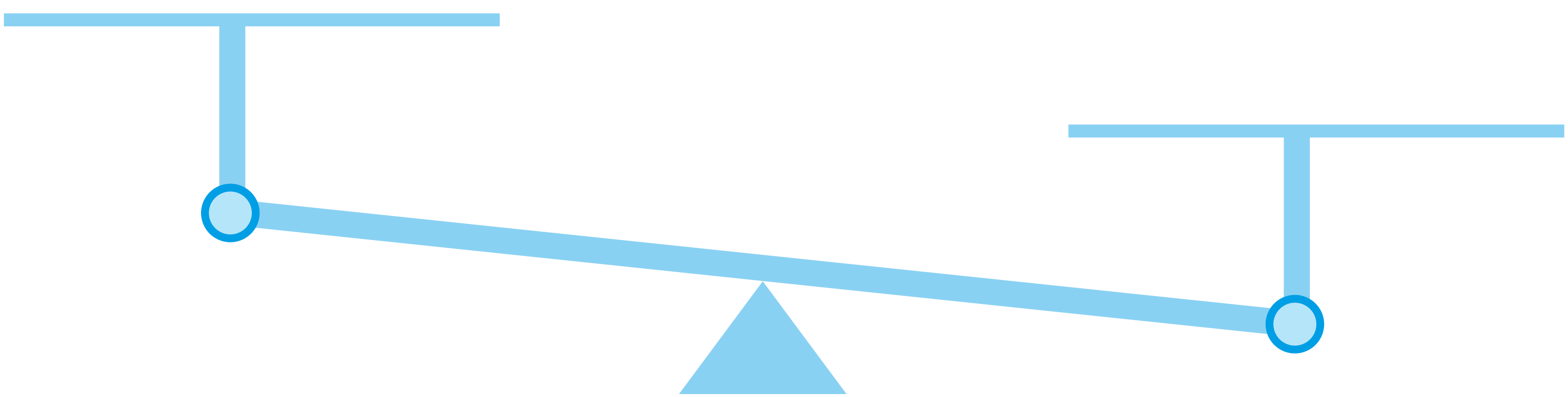
Exchange rate stable

Downward-trending factors

Tax effect in 1H (mainly higher VAT)

Labour market deteriorating

Low consumer confidence continues

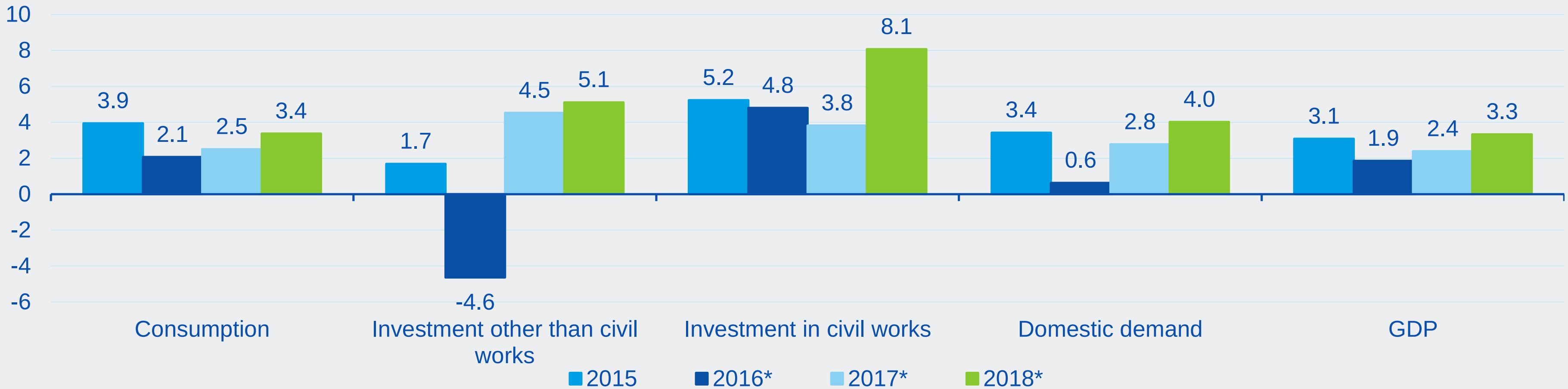


Source: BBVA Research

FORECASTS FOR INTERNAL DEMAND

Investment boosting internal demand and GDP

ECONOMIC GROWTH: CONSUMPTION, INVESTMENT AND INTERNAL DEMAND
(Annual variations, %,*Forecasts)



- **Exports will not make a considerable positive contribution to GDP before 2018**
- **Households will have 2 different rates**: very moderate spending in 1H and gradual acceleration starting in 2H
- **Internal demand will grow more than GDP in 2017** due to investment. It will accelerate considerably in 2018 if infrastructure investment projects materialize

Source: BBVA Research forecasts and data observed by DANE

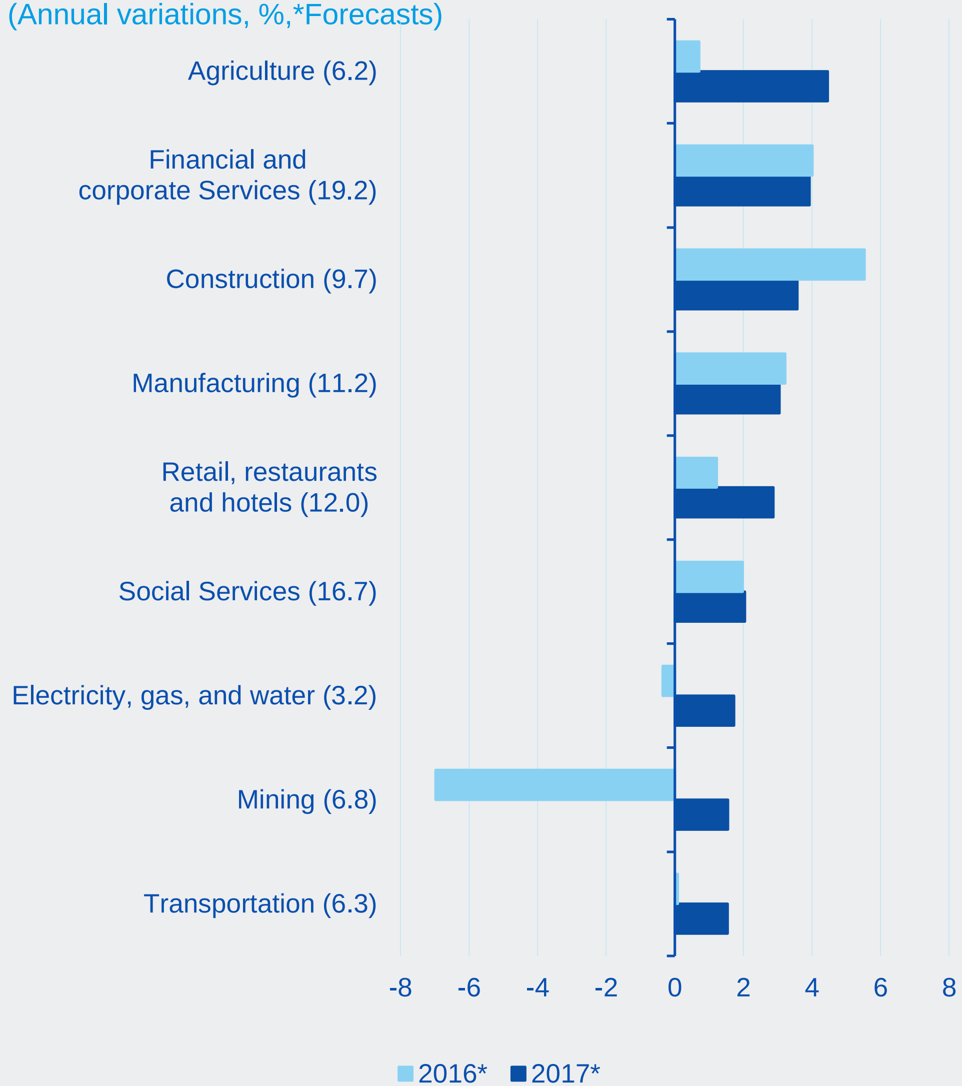
SUPPLY SIDE

Favourable dynamic for the tradable sectors in 2017

- In 2017, industry and agriculture together will grow by 3.6%, more than the 2.9% growth of the non-tradable goods sectors
- In 2018, growth will be more balanced among all the groups of sectors, with a significant rebound by the sectors supplying internal demand, such as retail and construction

More balanced sectoral growth makes the country's dynamic more sustainable in the long-term. Devaluation is key for booting a favourable trend in industry

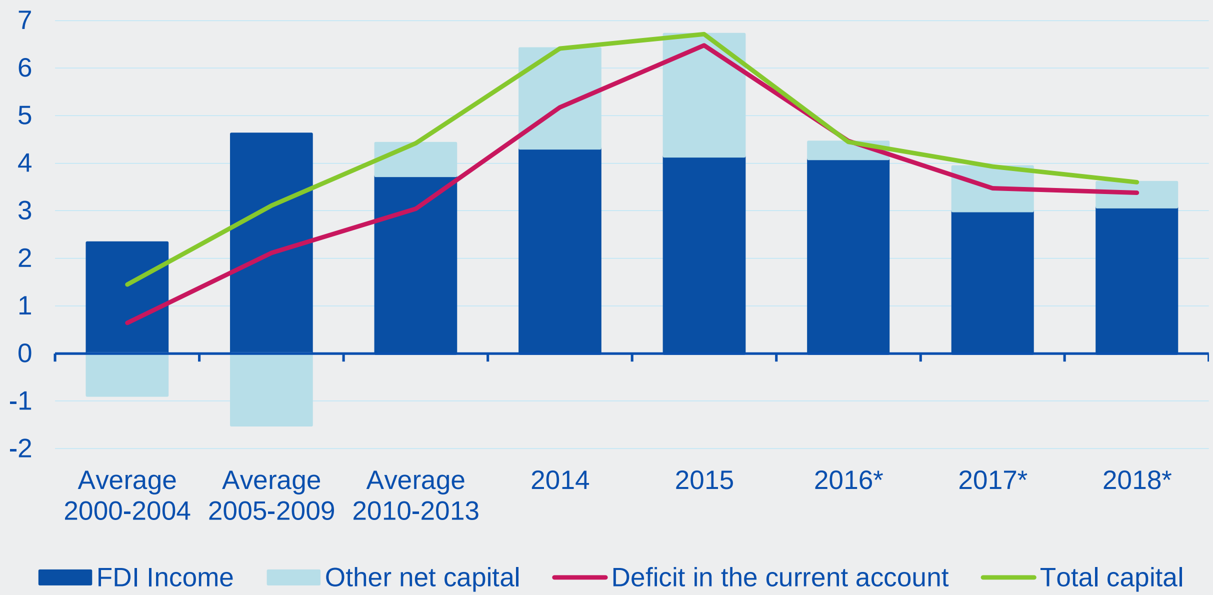
SECTORAL GDP
(Annual variations, %,*Forecasts)



CURRENT ACCOUNT DEFICIT

A lower deficit reduces external vulnerability

CURRENT ACCOUNT DEFICIT AND FINANCING
(% of GDP,*Forecasts)



- **During 2016-2018 the economy will have less pressing external financing needs,** beneficially reducing its vulnerability to external shocks
- The current account deficit will fall, more than the expected lower income from direct foreign investment

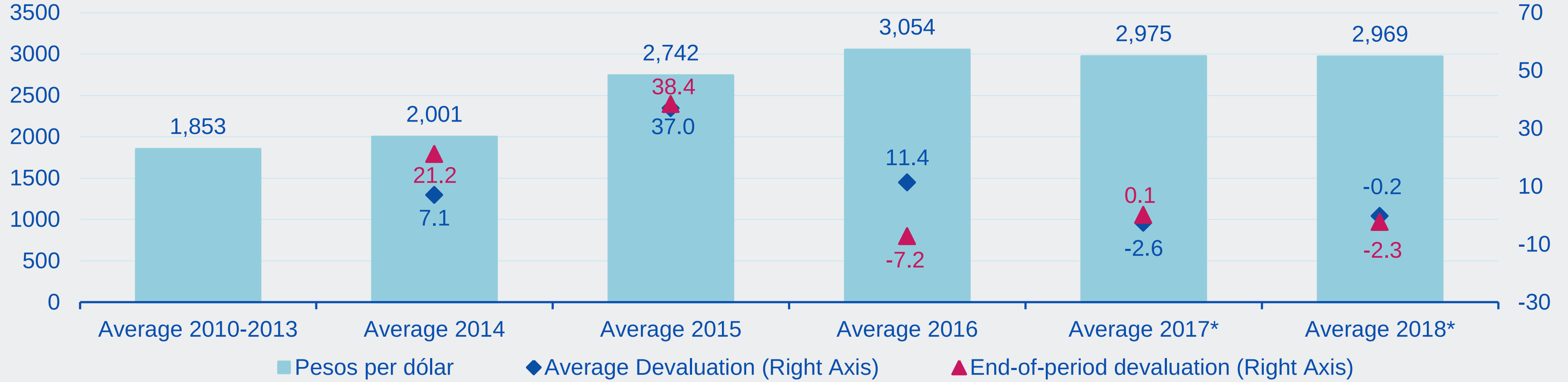
In dollar terms, the reduction in the current account deficit is more noticeable It will go from around $19 billion in 2014-2015 to below $11.5 billion in 2017-2018

Source: BBVA Research based on data from Banco de la República and own forecasts

EXCHANGE RATE

In the long term the trend is toward appreciation

EXCHANGE RATE
(Pesos for 1 USD and average annual variation, %, *Forecasts)



- **Very moderate and gradual appreciation:** Higher oil prices, end of the current account deficit, and an appetite for keeping foreign capital in country
- **It will be moderated by**: higher external rates of interest (FED exit), together with some lower internal rates. **This will lead to high levels of volatility**
- **In 2018, levels will be similar to 2017.** Then the rate of exchange will continue to gradually converge to a level close to equilibrium

Source: BBVA Research based on data from Banco de la República and own forecasts

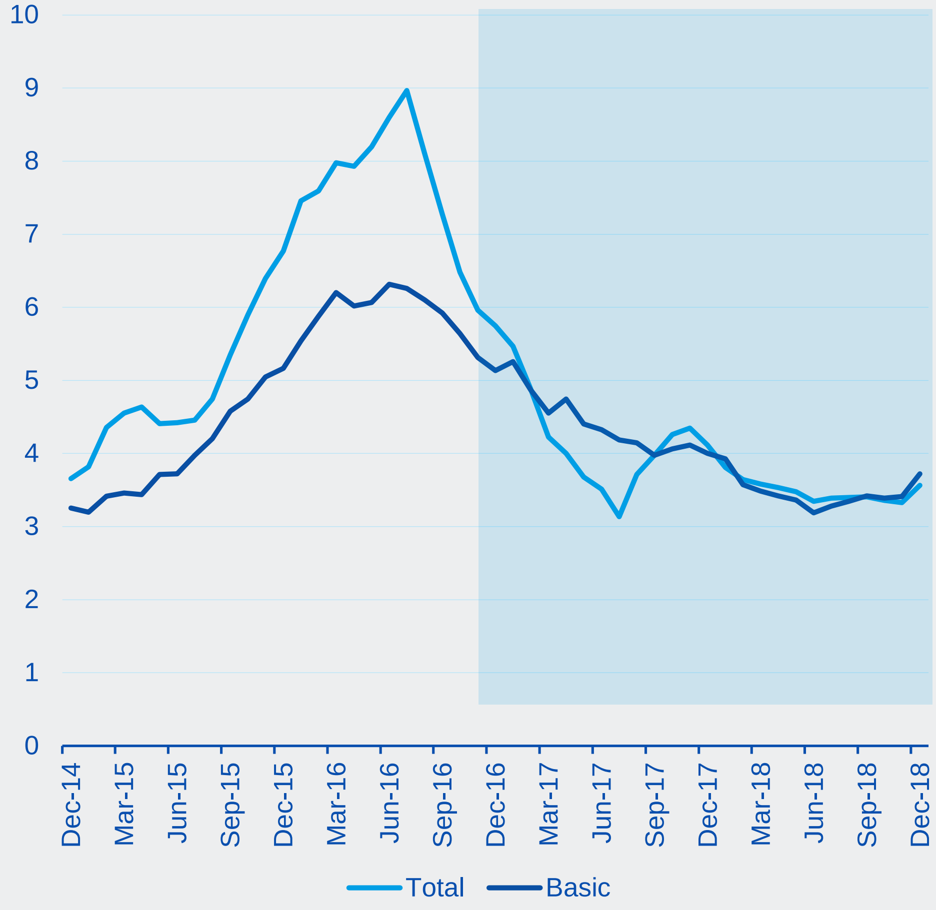
INFLATION

On the right track, but cautiously during 2017-2019

- The exchange rate, better climate and weak demand will take inflation to the target range in mid-2017, although it will end the year on an upward path
- In December inflation will be 4.1%. The 24-month expectations for market inflation are around 4%.

In 2018, price inertia linked to previous inflation will continue to weigh on the lowering of inflation. It will reach BanRep's target point of 3.0% in 2019.

RATE OF INFLATION
(Annual variation, %,*Forecasts)

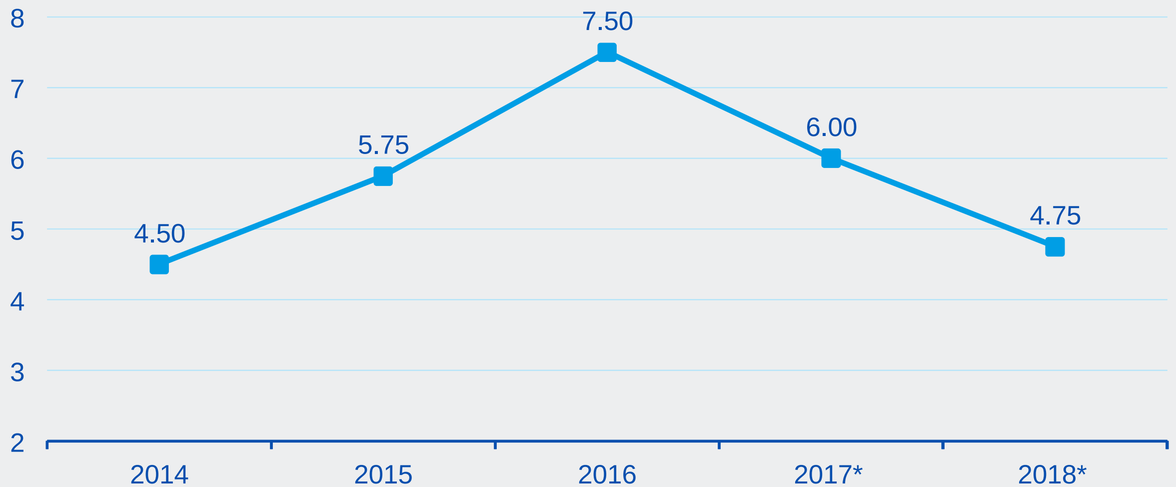


Source: BBVA Research based on data from DANE and own forecasts

MONETARY POLICY RATE

There is room for BanRep to cut rates

MONETARY POLICY RATE
(Effective annual interest rate, %, end of period, *Forecasts)



- The Central Bank has room to cut the interest rate by 150 basic points in 2017 and 125 basic points in 2018.
- These cuts will take the real intervention rate (nominal rate discounting inflation) to neutral levels that will neither stimulate nor contract economic activity

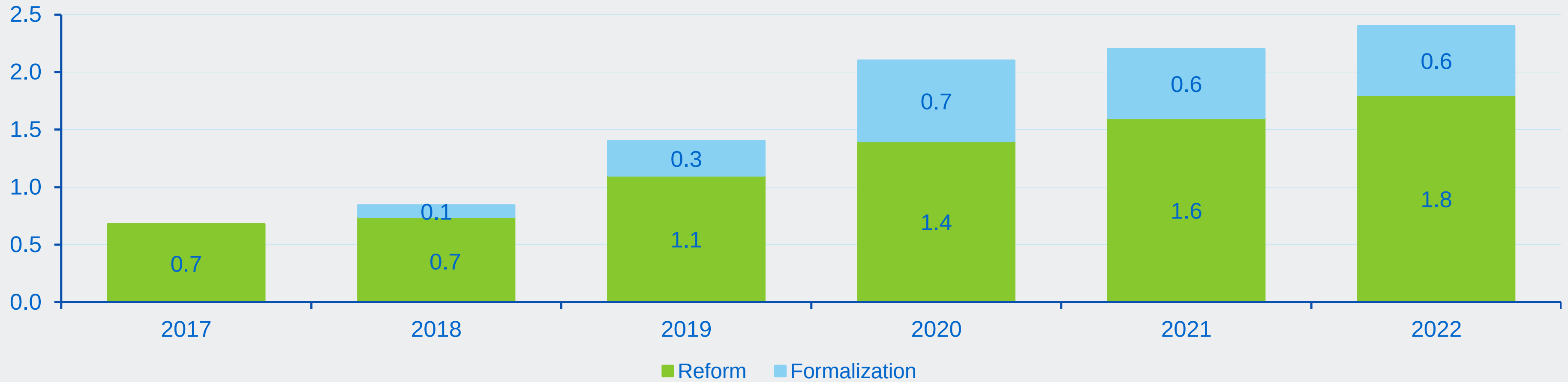
Central Bank will be watching the trend of inflationary prospects The first few months of 2017 will be more uncertain due to the impact of tax reform and inflationary inertia

Source: BBVA Research based on data from Banco de la República and own forecasts

FISCAL POLICY AND TAX REFORM

Reform will increase taxes gradually

GROSS REVENUE WITH TAX REFORM
(% of GDP, Government forecasts)



- Government estimates collection due to the reform at 0.7% of GDP in 2017, increasing in subsequent years
- It marginally rebalances the tax burden of individuals and companies, simplifies systems, increases the bases and changes the tax/income reference for companies
- It replaces transitory taxes with permanent ones, fights tax evasion and promotes formalisation. It increases rates for indirect taxes

Source: BBVA Research with data from the Ministry of Finance

THANK YOU