BBVA Research

Colombia Outlook

Fourth Quarter 2019

Creando Oportunidades

Research

01

Global economy: uncertainty and political and commercial tensions limit global growth and alter financial markets

Key messages

The effects of commercial tensions are already seen in growth. The global economy will grow at a slower pace in 2019 an d2020, even though we don’t expect a recession in the main economies

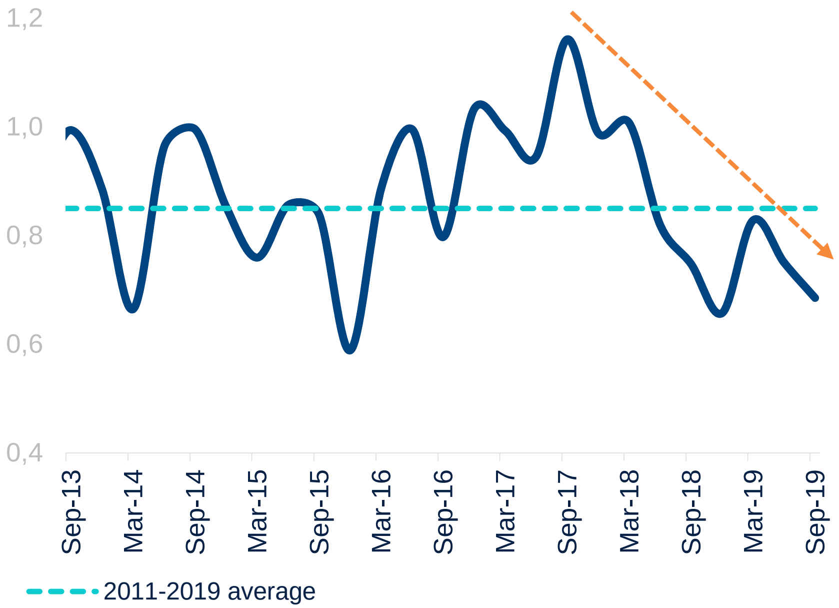
A rate reduction cycle and other accommodative policies have started. The Federal Reserve will reduce another 25bp in 2019. On the other hand, the European Central Bank could reduce rates further and display policies that expand the current balance.

Global growth will moderate to 3,2% in 2019 an d3,1% in 2020. Below the observed in 2018 of 3.7%

Global context will continue to be particularly complex and difficult for emerging economies. Risk and volatility have stabilized at high levels, despite the countercyclical monetary policy and their rate reductions. We expect further reduction in commodity prices.

Global growth continued to weaken

WORLD GDP GROWTH
(FORECASTS BASED ON BBVA-GAIN % QOQ)

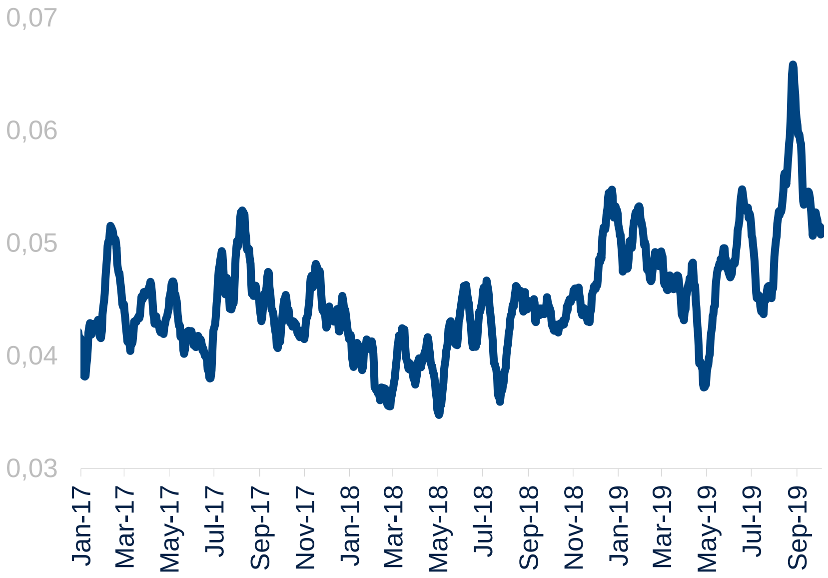


Source: BBVA Research

- Recent evidence confirms that uncertainty and protectionism are negatively affecting growth.
- The ongoing growth slowdown has been sharper than expected, especially in China and Europe.
- Exports and the manufacturing sector remain particularly weak…
- ... and there are signs that this weakness is beginning to affect the service sector.

Uncertainty has increased sharply in August and remains high despite the recent moderation

ECONOMIC UNCERTAINTY INDEX
(TONE OF THE NEWS ON ECONOMIC UNCERTAINTY WEIGHTED BY COVERAGE, 15-DAY MOVING AVERAGE)

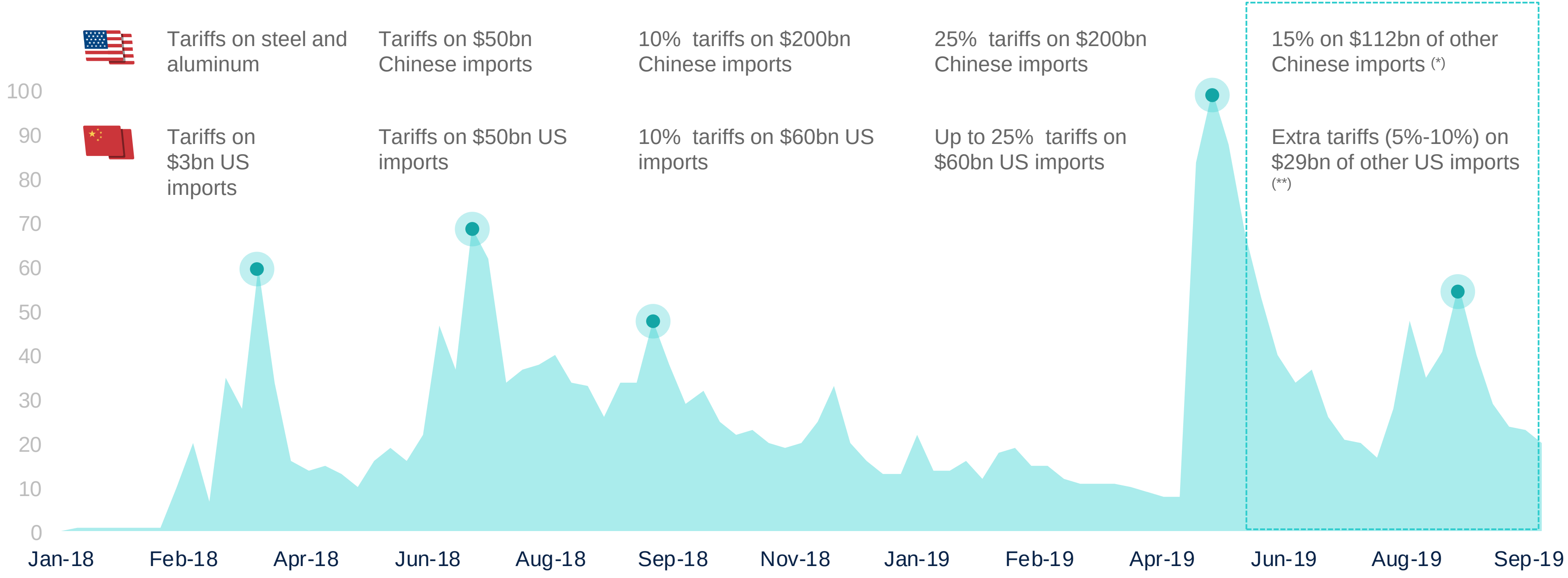


Source: BBVA Research and GDELT

- High uncertainty due to:
  - trade and technological tensions
  - Brexit
  - political and geopolitical turbulences
- The impact on confidence adds to the effects of the structural slowdown in China and the cyclical moderation of the US economy.

The new protectionist measures have fueled trade tensions

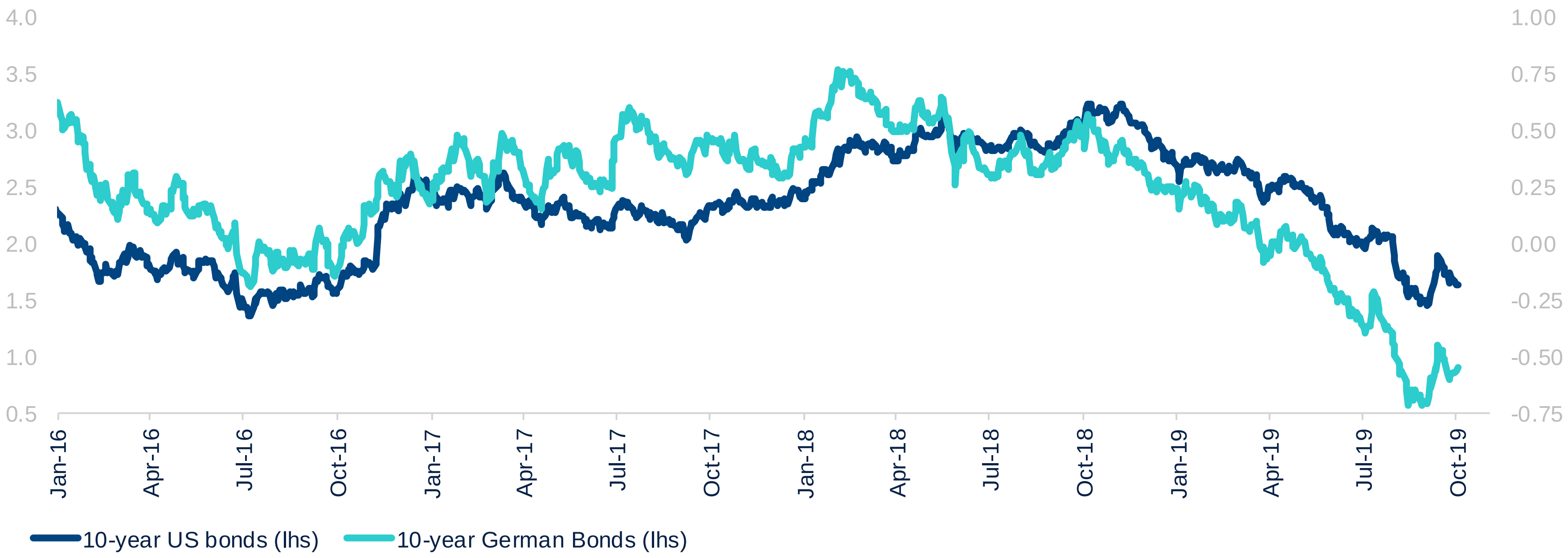
TRADE WAR INDEX: WORLDWIDE GOOGLE SEARCHES ABOUT THE TOPIC “TRADE WAR” (INDEX: 0 TO 100)



(*) And till Dec-19: a further 5% tariff (to 30% from 25%) on USD250bn and 15% on the rest of Chinese imports. (**) And till Dec-19: extra tariffs (5%-10%) on $46bn of other US imports.
Source: BBVA Research and GDELT

In financial markets, the flight-to-safety mood continues to prevail

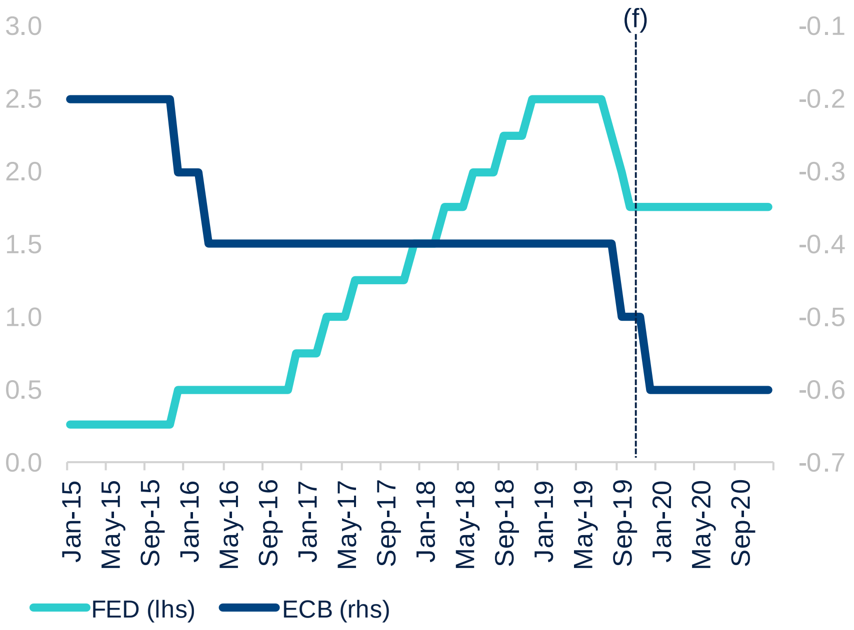
SOVEREIGN DEBT YIELDS
(%)



Source: BBVA Research, Bloomberg

The central banks have announced further monetary stimuli in the last few months

FED AND ECB: INTEREST RATES *
(%, END OF PERIOD)



* In the case of the ECB, deposits interest rates.
Source: BBVA Research

- Fed: a 50bps reduction in rates in recent months and at least an additional 25bps cut in October.
- ECB: an aggressive monetary package
  - a 10bps cut in deposit rates
  - a two-tiered system for bank deposits
  - a new quantitative easing program
  - a more favorable TLTRO-III
- In Europe, another 10bps cut in deposit rates is likely.
- China and other emerging countries: more aggressive reduction in interest rates.

A sharper slowdown of the world economy

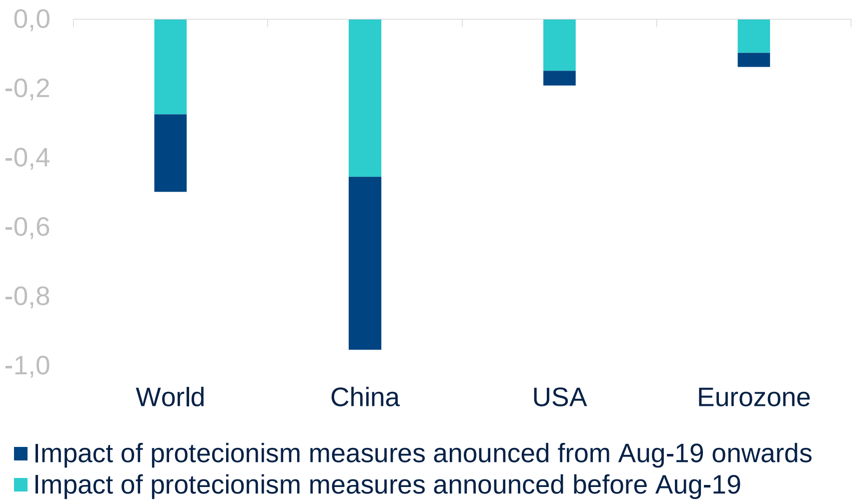
	USA	Mexico	Latam	Eurozone	Spain	Turkey	China	World
2019	2.3 (downward)	0.2 (downward)	0.7 (downward)	1.1 (unchanged)	1.9 (downward)	0.3 (unchanged)	6.0 (unchanged)	3.2 (downward)
2020	1.8 (downward)	1.3 (downward)	N.A.*	0.8 (downward)	1.6 (downward)	3.0 (upward)	5.6 (downward)	3.1 (downward)

- Upward revision
- Unchanged forecast
- Downward revision

* Non available as we have not yet a definitive forecast for Argentina.
Source: BBVA Research

This sharper slowdown is to some extent related to persistent protectionist tensions

IMPACT ON GDP OF THE PROTECTIONISM
(IMPACT ACCUMLATED IN TWO YEARS, PP)

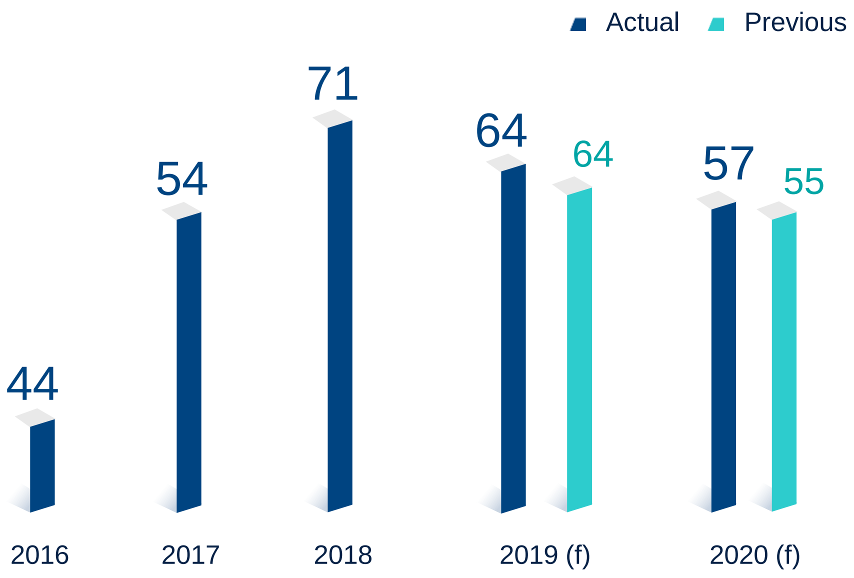


* Direct and indirect impact. **Protectionism measures announced before Aug-19**: US: 25% tariff increase on steel, 10% on aluminum, 25% on $250bn China imports. China: 25% on USD110bn US imports **Protectionism measures announced from Aug-19 on** (to be implemented, in case of no trade agreement, till Dec-19): US: a 5% extra tariff on $250bn and 15% on $300bn China imports. China: extra tariffs (5%-10%) on $75bn US imports.
Source: BBVA Research

- The revisions in GDP forecasts are broadly in line with the estimated impact of adopted protectionism measures.
- Specially in China, the impact has been smoothed by countercyclical policies.
- In the Eurozone the deterioration has been even larger thanks to lower export to the United Kingdom (Brexit) and problems in the automobile sector.
- Risks: if the US and China don’t reach a trade agreement and the protectionist escalation continues, there would be an additional negative effect on the global economy.

Oil: prospects for weaker growth pressure prices downwards

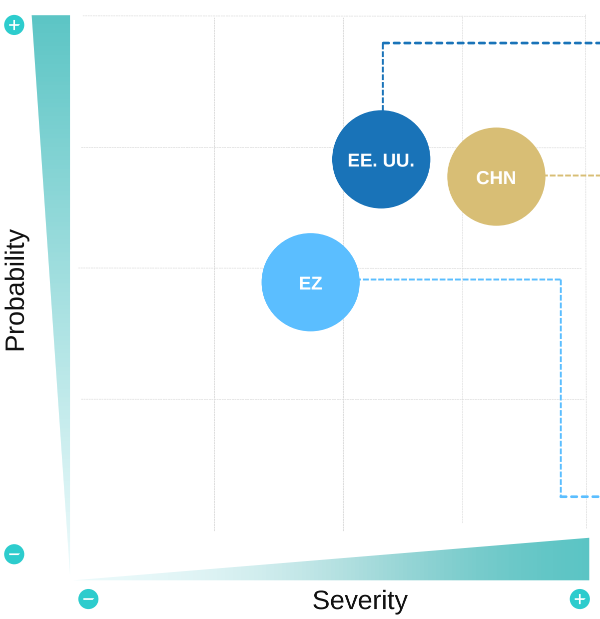
BRENT OIL PRICES
(US DOLLARS PER BARREL, ANNUAL AVERAGE)



(f) Forecast.
Source: BBVA Research

- Slight upward revision of short-term forecasts and risk that an escalation of tensions in the Middle East will end up driving oil prices up.
- In any case, prospects for price moderation going forward are maintained, given the relative strength of supply in an environment of lower demand.

Global risks continue to increase, mainly due to tensions between China and the US



Source: BBVA Research

Economic recession: higher

Protectionism: high

Protectionism: high

Disorderly deleveraging: higher

Geopolitical tensions

Recession: higher

- *Brexit*, Italy

Protectionism: still contained but increasing

The risk of geopolitical turbulence in the Middle East has also increased.
Financial vulnerabilities can amplify the severity of risks.

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02

The Colombian economy will continue to consolidate its growth, at a slow pace, in a context of strong external headwinds

Key messages

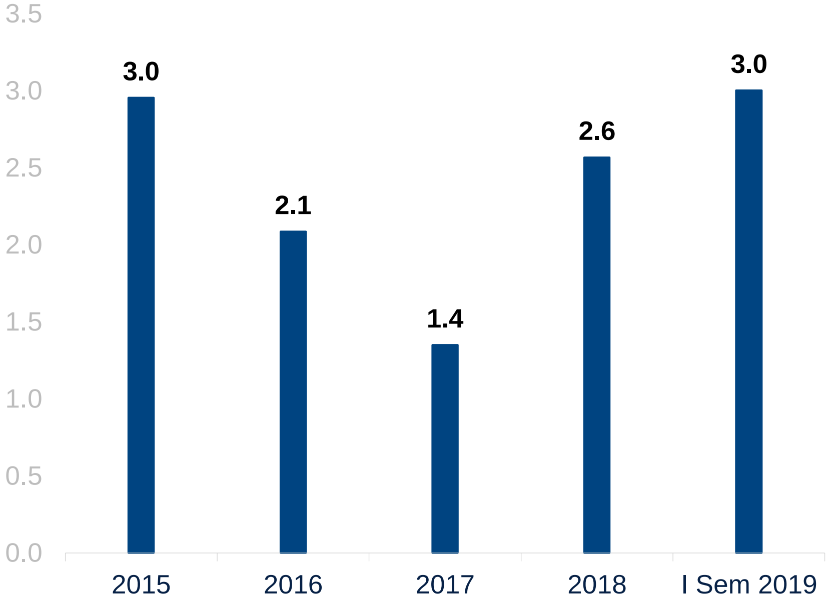
Most recent data reflect a gradual recovery in growth. Internal demand is showing an important recovery on the back of both private consumption and investment. This impulse is partially compensated by the external demand which contributes negatively, on the hand of an important growth rate in imports.

For 2020, private consumption will continue supporting activity, though moderating somewhat its momentum. Investment growth will for the first time in the last 5 years surpass GDP growth, supported by better housing construction numbers. We expect a more moderate rate of growth for exports and imports, this allows us to achieve a 3.0% GDP growth.

On the sector level, we find a generalized recovery in 2020, excluding Government and Entrepreneurial services, product of the needed austerity to fulfill fiscal goals. Growth consolidation is achieved in two stages: sectors that already overcame the low levels of growth product of the oil price shock (mining and industry), and those sectors that accelerate their growth rate from 2018 to 2020 but still grow below the last 5 year average (construction).

The economy is still in a gradual and ordered recovery process, reaching a 3.0% growth in the first half of 2019

GDP*
(ANNUAL VARIATION, %)

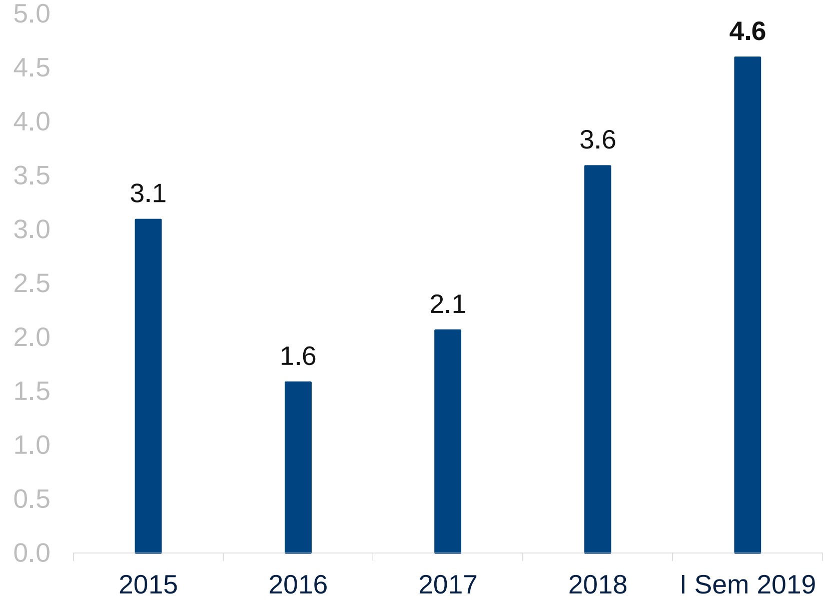


* Based on the original series.
Source: BBVA Research with DANE data

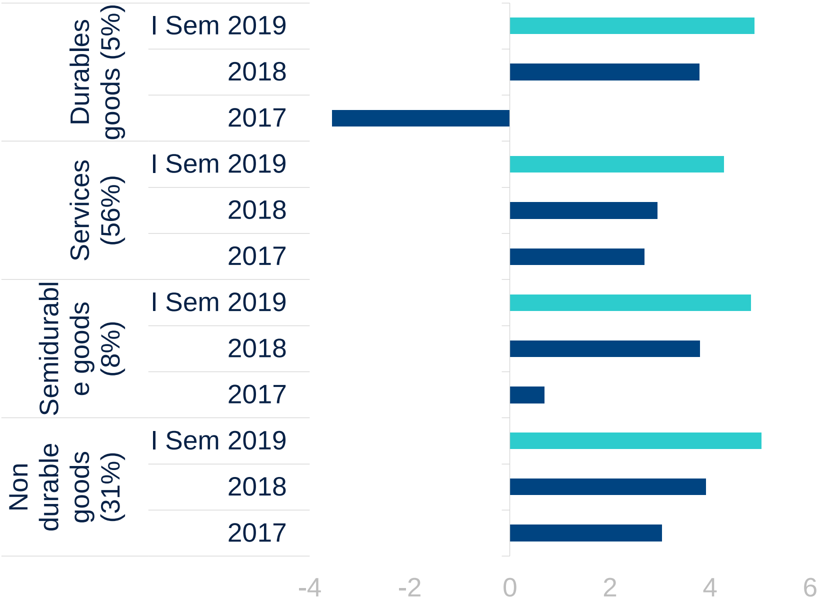
- The recovery is related to an acceleration of internal demand.
- Both consumption as investment support the acceleration observed in the first semester, meanwhile external demand has a negative contribution.
- The gradual recovery is attained in the midst of a difficult external environment and high volatility in financial markets.

Household consumption has contributed significantly to GDP recovery, observed in all components

HOUSEHOLD CONSUMPTION*
(ANNUAL VARIATION, %)



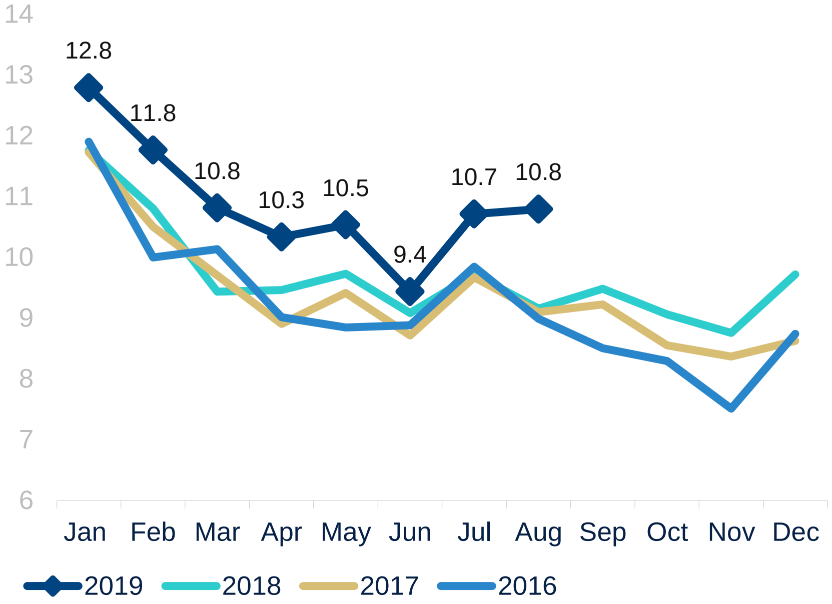
HOUSEHOLD CONSUMPTION, BY TYPE*
(ANNUAL VARIATION , %)



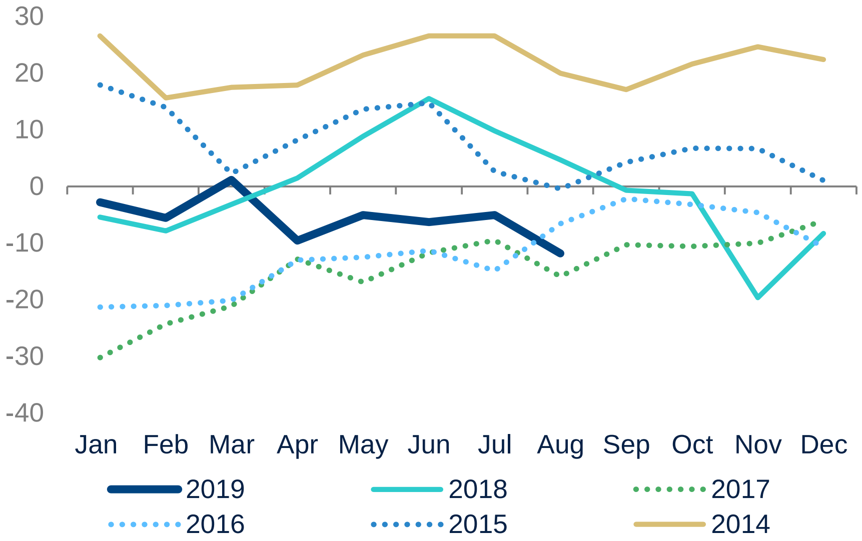
* Based on the original series.
Source: BBVA Research with DANE data

Though its recent behavior cannot be explained by traditional macroeconomic fundamentals

NATIONAL UNEMPLOYMENT RATE
(% OF LABOR FORCE)



CONSUMER CONFIDENCE
(BALANCE)



Source: BBVA Research with DANE and Fedesarrollo data

Some hypothesis on the recent household consumption behavior that may explain the macro decoupling

Higher leveraging

There is an acceleration in consumer credit.

Immigrant population

According to DANE, new migrant population in the last 12 months account for almost 770 thousand, pushing non durable goods and some services consumption.

Growth of Low Cost Stores

The expenditure in this line of stores has grown significantly in the last couple of years. This may be causing a “formalization” and “visualization” effect of household expenditure.

Expenditure patterns

Change in household expenditure patterns towards experiences and services more than goods.

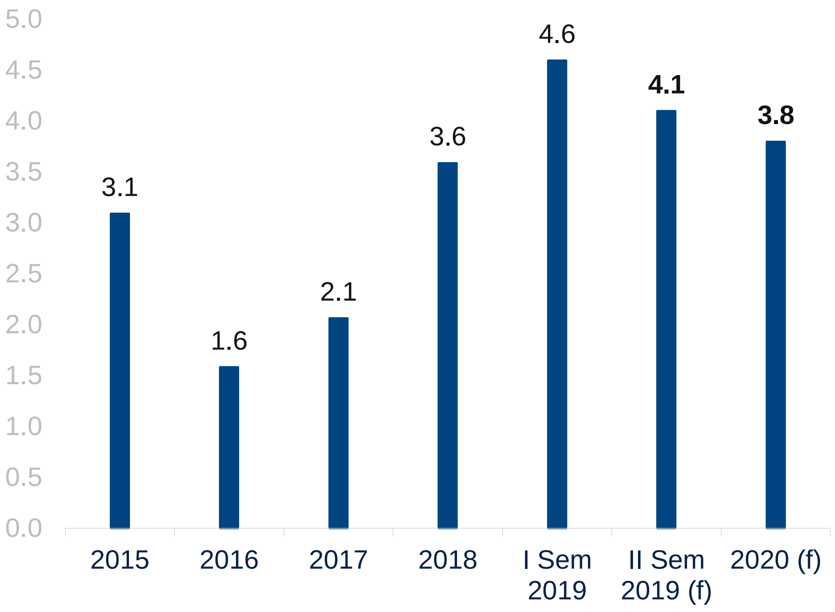
Improvement in household income

The increase in minimum wage above caused inflation.

Source: BBVA Research

For the remaining of 2019 and 2020 we expect some moderation in consumption growth, though it will continue growing above GDP

HOUSEHOLD CONSUMPTION*
(ANNUAL VARIATION, %)

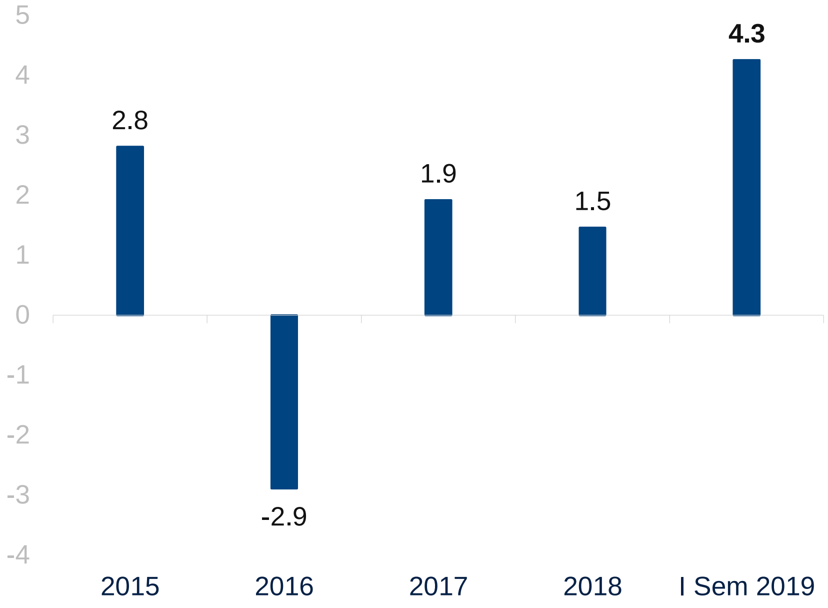


(f) Forecast. * Based on the original series.
Source: BBVA Research with DANE data

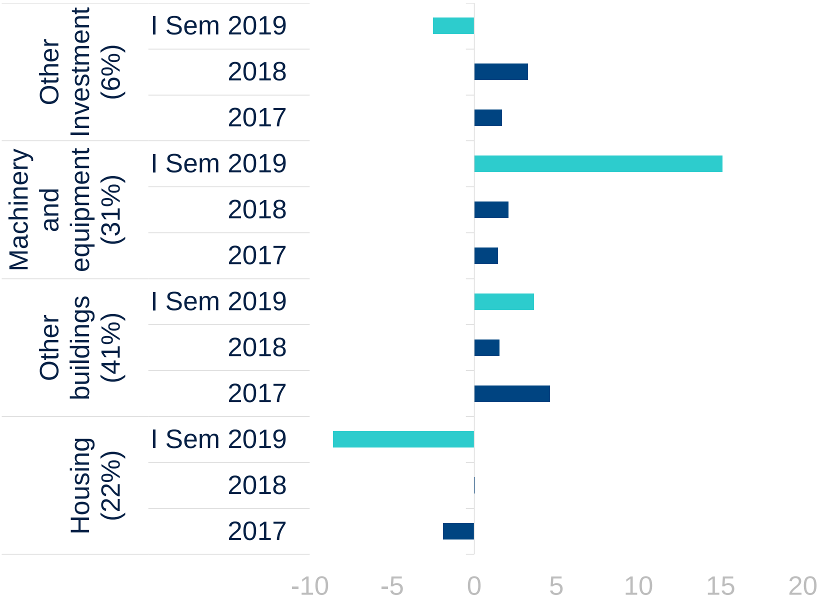
- We expect that some of the described hypothesis will fade gradually and allow for a deceleration of consumption, still growing above GDP.
- Labor market deterioration and weak consumer confidence will limit household expenditure looking forward.
- In the same direction, exchange rate depreciation must moderate expenditure in imported consumption goods.

Investment had a significant recovery in the first half of 2019 on the back of machinery and equipment and civil works…

FIXED INVESTMENT*
(ANNUAL VARIATION, %)



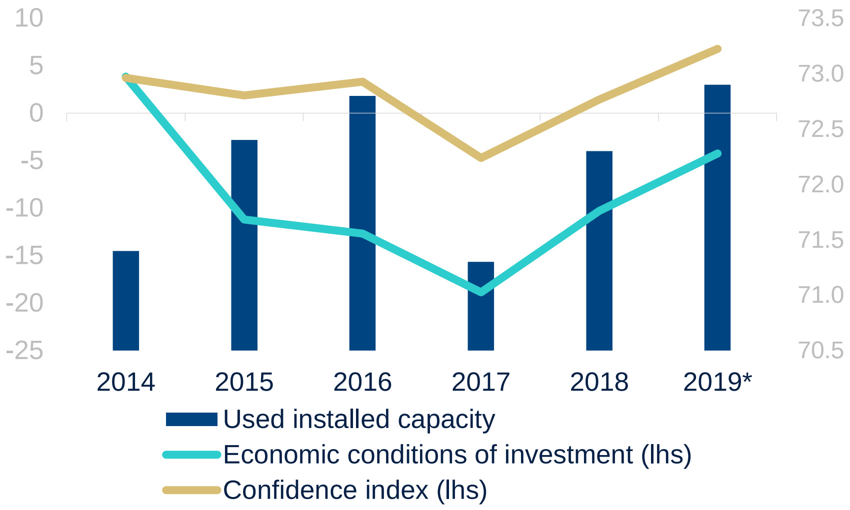
FIXED INVESTMENT, BY TYPE*
(ANNUAL VARIATION, %)



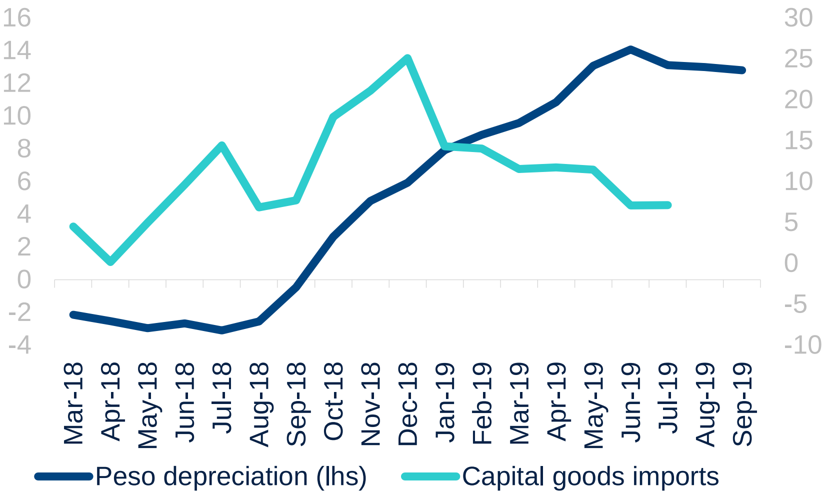
* Based on the original series.
Source: BBVA Research with DANE data

…in this case, its behavior has been accompanied by fundamentals: financing law, end of regional governments, confidence and others

INDUSTRIAL CONFIDENCE, CAPACITY UTILIZATION
(BALANCE AND %)



EXCHANGE RATE AND CAPITAL GOOD IMPORTS
(ANNUAL DEPRECIATION AND VARIATION, %)

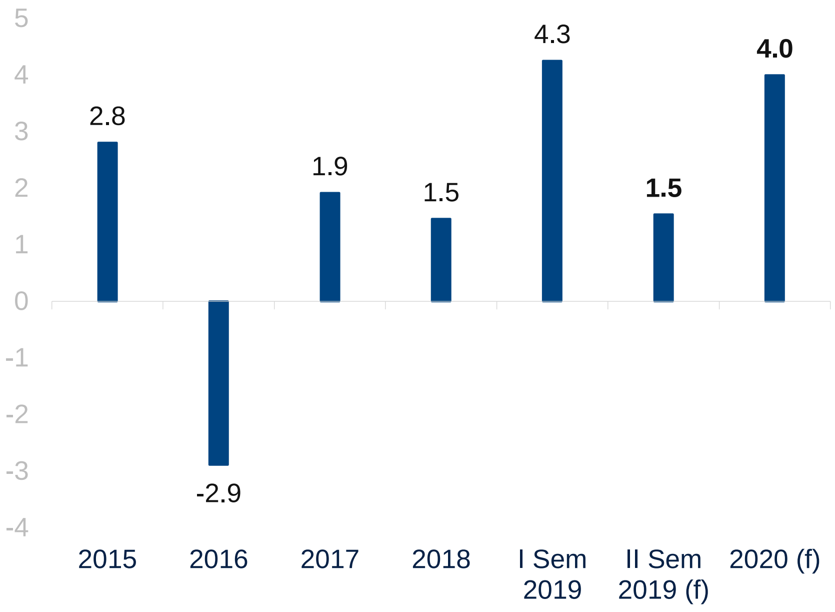


*Data for August 2019
Source: BBVA Research with DANE, Fedesarrollo, ANDI and Bloomberg data.

Though, the accumulated depreciation and the deceleration of imports in the margin point to a moderation of investment for the rest of 2019.

For 2020 we expect investment growth to surpass GDP growth on the back of housing construction

FIXED INVESTMENT*
(ANNUAL VARIATION, %)

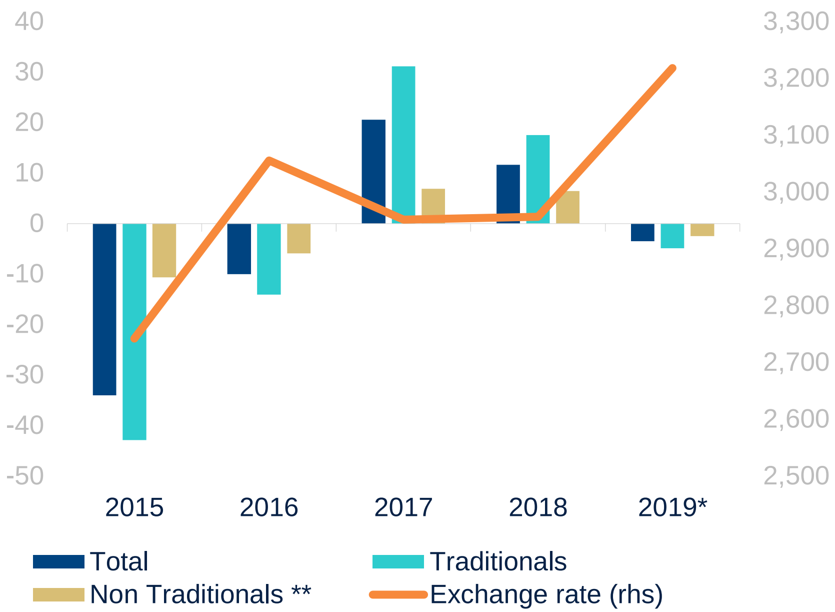


(f) Forecast. * Based on the original series.
Source: BBVA Research with DANE data

- Uncertainty surrounding the Financing Law and the significant Exchange rate depreciation might have slowed investment in machinery and equipment decisions in the second half of 2019.
- Housing construction will grow in 2020, in part because of the base effect, but also by structural factors pertaining inventory reduction. This will contribute to an important investment acceleration in 2020.
- Regional government expenditure in investment will slow in most municipalities on the back of the discussion of new development plans mandatory by law in the first part of the new government.

Exports contract in 2019 by the effects of lower prices and lower global growth, despite the good performance in the exchange rate

EXPORTS IN USD AND EXCHANGE RATE
(ANNUAL VARIATION, %, PESOS PER DOLLAR)

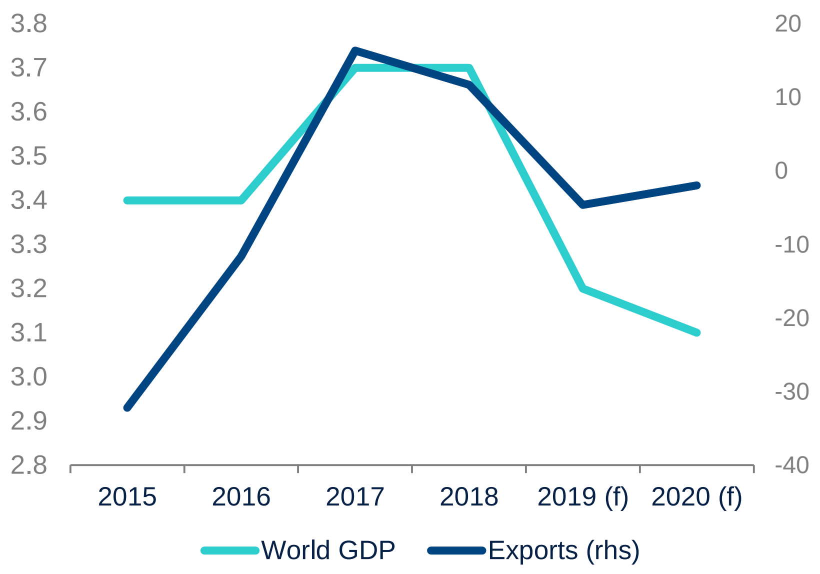


* Data to August. ** Excluding emeralds and gold.
Source: BBVA Research with DANE and Bloomberg data

- Lower global growth and the worst perspectives of our regional trade partners, limit the growth potential of our exports.
- The fall in oil and coal prices in hand with lower export quantities in coal pressure traditional exports downward.
- Depreciation has not been able to compensate the effects of lower international demand. In particular, some value chains have not changed their dependency of imported materials, thus limiting their ability to extract gains from the depreciation.

The deceleration in global and internal demand make both exports and imports decelerate in 2020

EXPORTS AND GLOBAL GROWTH
(ANNUAL VARIATION, %)

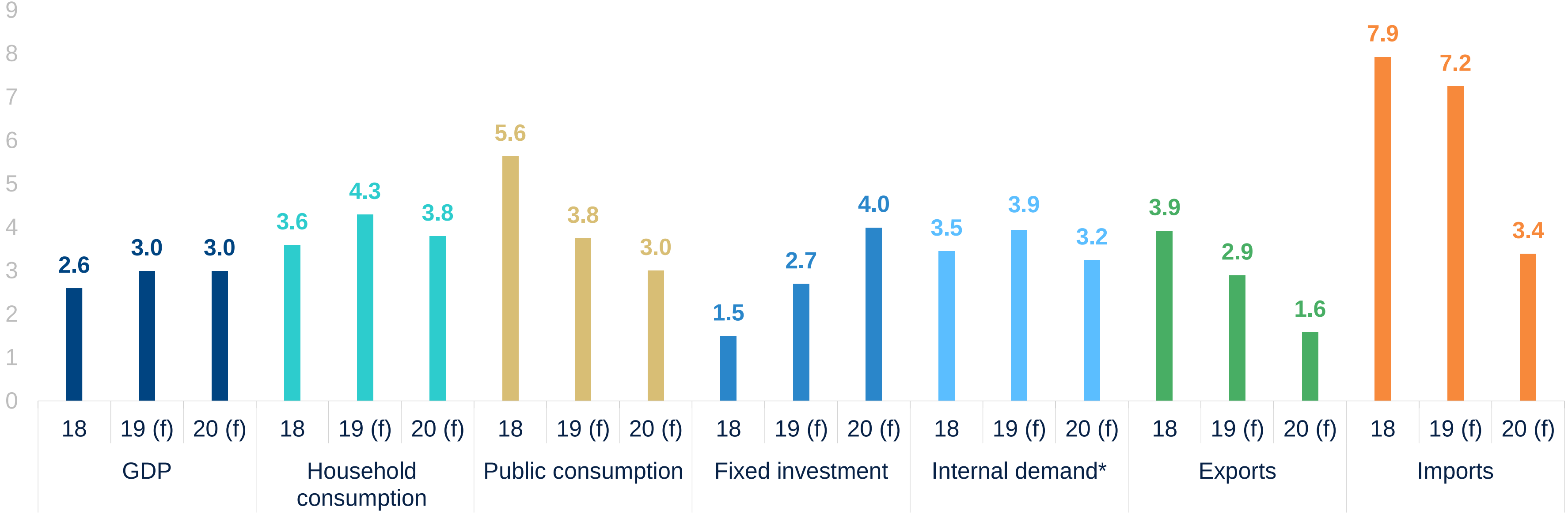


IMPORTS AND INTERNAL DEMAND*
(ANNUAL VARIATION, %)

(f) Forecast. * Based on the original series, includes statistical discrepancy
Source: BBVA Research with Banco de la República and DANE data.

All in all, GDP will remain growing at 3.0% in 2019 and 2020

GDP AND ITS MAIN COMPONENTS**
(ANNUAL VARIATION, %)

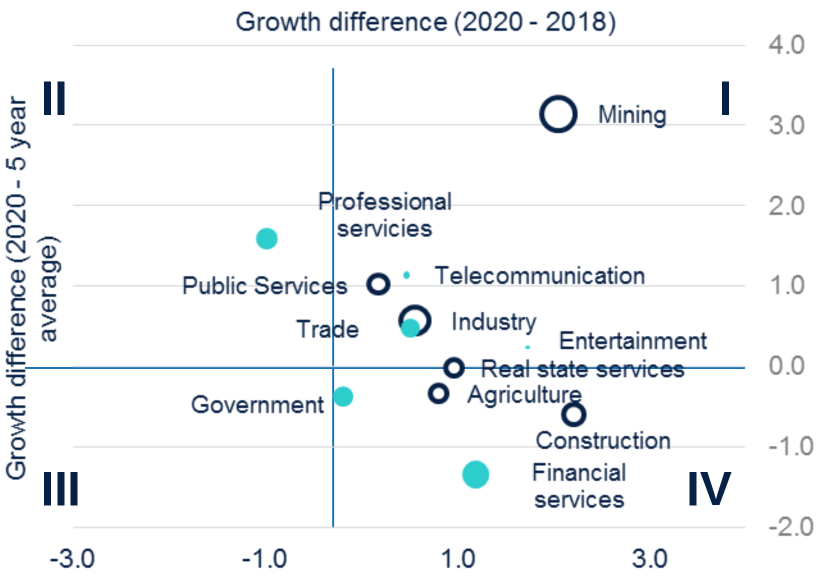


(f) Forecast. *includes statistical discrepancy; ** Based on the original series
Source: BBVA Research with DANE data

At sector level, we expect a generalized growth acceleration between 2018 and 2020

SECTORIAL PERFORMANCE MAP

(DIFFERENCE IN ANNUAL VARIATION, %)



- Sectors in the first quadrant have come out of the GDP valley product of the oil Price shock and are accelerating relative to 2018.
- Sectors in the fourth quadrant accelerate relative to 2018 but are still to surpass growth average of the past five years, thus still short of overcoming the shock period.
- Government and entrepreneurial services decelerate in 2020, product of the needed austerity to achieve fiscal goals.

Size of the bubble corresponds to the difference between sector GDP and overall GDP in 2020. Colored bubbles signal sector growth is above GDP growth
Source: BBVA Research with DANE data

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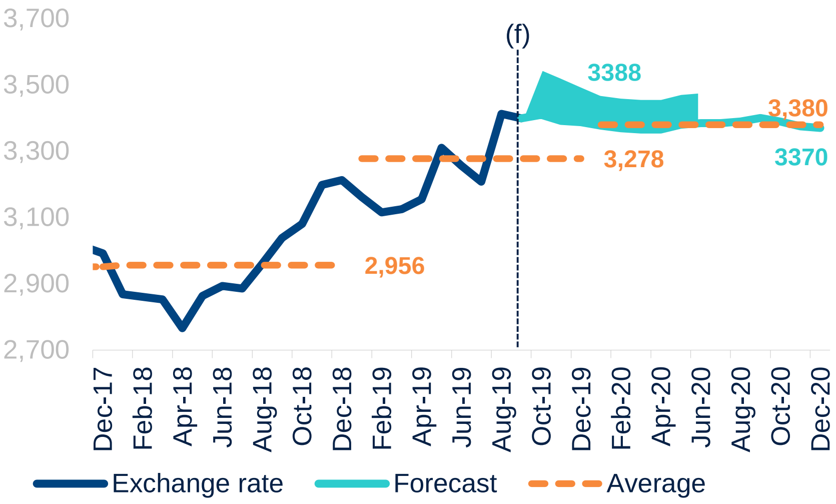
03

The exchange rate has been the shock absorber against the difficult external scenario. There might be some additional effect to be seen on inflation

FX depreciation has been generalized in the regional level, we expect an average depreciation of 3.0% in 2020

COLOMBIAN EXCHANGE RATE

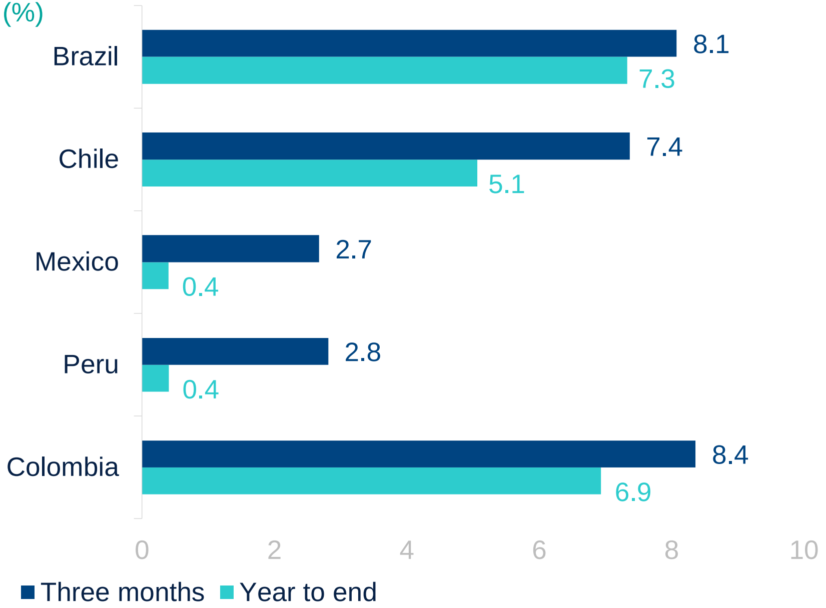
(PESOS PER DOLLAR)



Source: BBVA Research with Banco de la República and Bloomberg data

REGIONAL FX DEPRECIATION

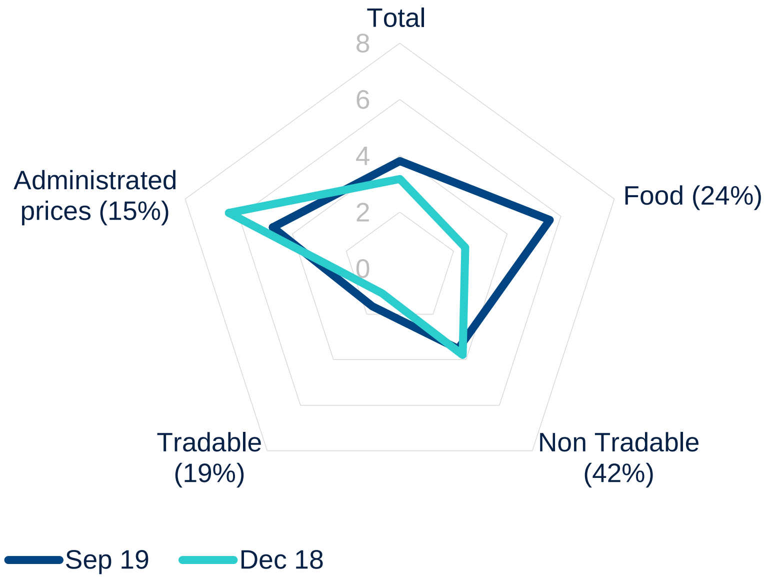
(%)



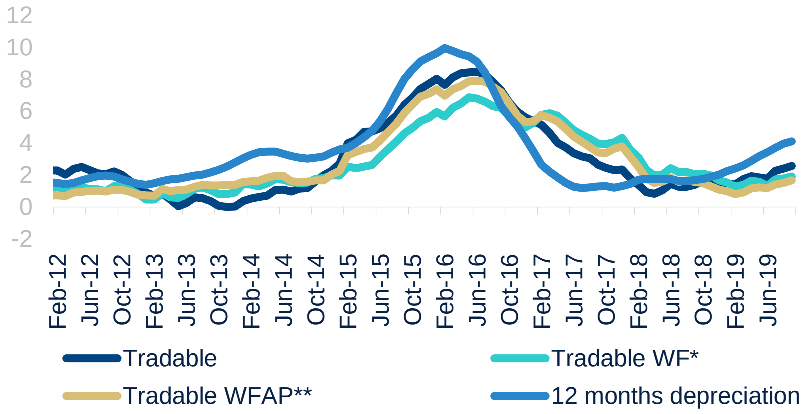
The Exchange rate will close 2019 at 3,388 pesos per dollar (3,278 on average) and for the end of 2020 it will stand at 3,370 pesos per dollar (3,380 on average)

Though, the pass through to inflation has been limited and most of the upward trending in inflation is explained by foodstuffs.

ANNUAL INFLATION COMPARED
(ANNUAL VARIATION, %)



EXCHANGE RATE AND TRADABLE INFLATION
(ANNUAL VARIATION, %)

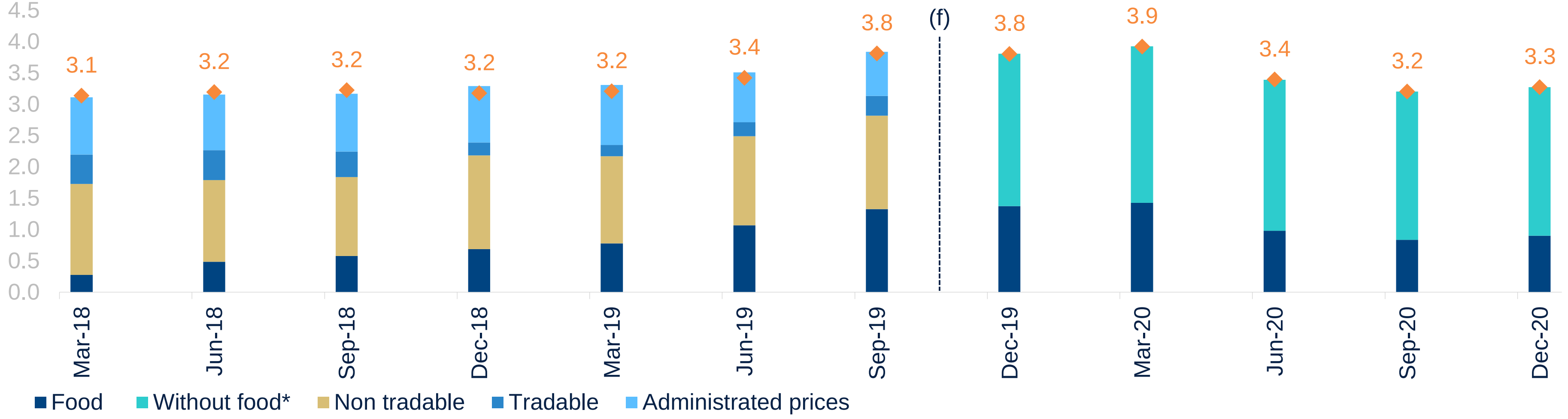


	Current Value	Recent minimun Value		bp change (inf tot)	PT to Inf Total (%)
Tradable	2.6	0.8		175 (67)	4.6
TradableWF*	1.9		1.3	63 (18)	1.6
Tradable WFAP**	1.7		0.8	85 (22)	2.0
Depreciation	10.6	-4.0	-0.5		

*: Tradable without food
**: Tradable without food and administrated prices
Source: BBVA Research with DANE and Bloomberg data

Headline inflation will continue in the upper part of the target range until IQ of 2020, in part due to the pass-through of the Exchange rate

INFLATION BY COMPONENTS
(ANNUAL VARIATION %)



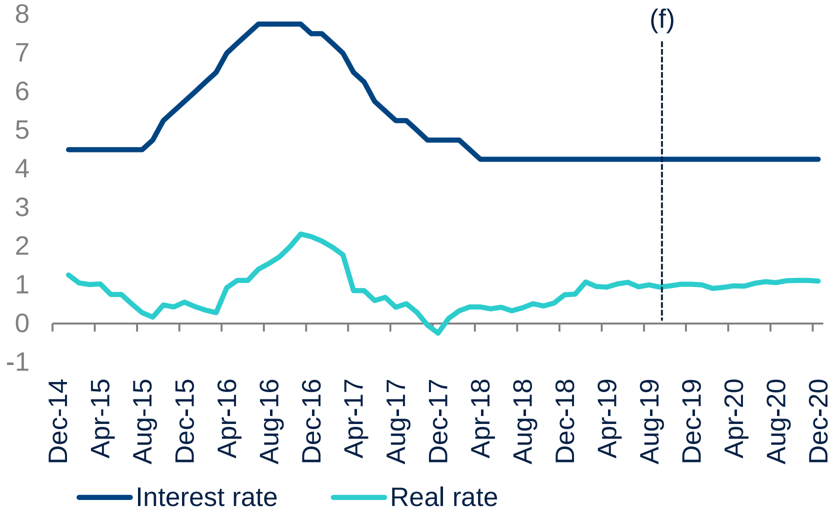
(f) Forecast; * Corresponds to BanRep classification.
Source: BBVA Research with DANE data

Headline inflation will close 2019 at 3.8%, and 2020 at 3.3% once the effects of foodstuffs fades, specially.

Monetary policy rates will remain stable until early 2021 in line with the slow recovery and high inflation in the Colombian economy

POLICY INTEREST RATE

(E.A., %)



Source: BBVA Research with Banco de la República data

OTHER CENTRAL BANKS INTEREST RATES

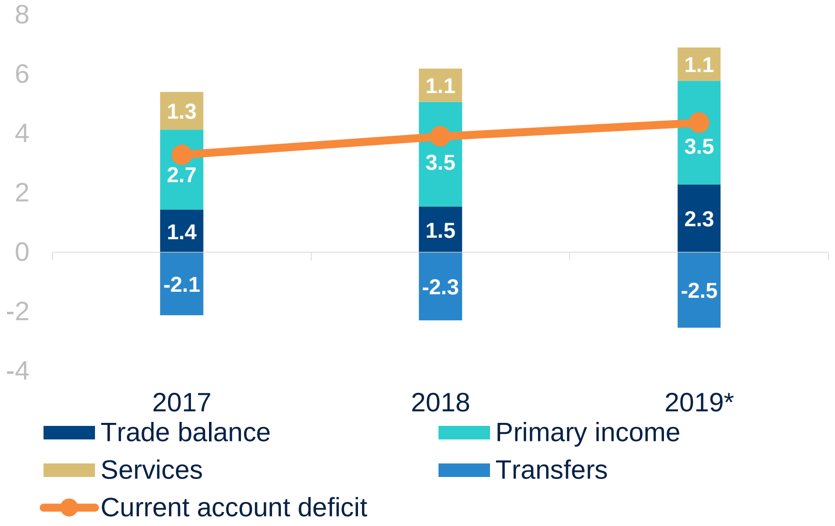
(E.A., %)

	2018	2019 (f)
United States	2.50	1.75
China	4.35	4.10
Euro zone	0.00	0.00
Turkey	24.00	15.50
Japan	-0.10	-0.10
India	6.25	5.75
Hong Kong	2.75	2.00
Romania	2.50	2.50
Argentina	59.25	65.00
Brazil	6.50	4.75
Chile	3.50	2.34
Colombia	**4.25**	**4.25**
Mexico	8.25	7.00
Paraguay	5.25	4.75
Peru	2.75	2.50
Venezuela	6.00	5.00

The stability of the interest rate in Colombia contrasts with the stance of most central Banks that have reduced rates in the last year.

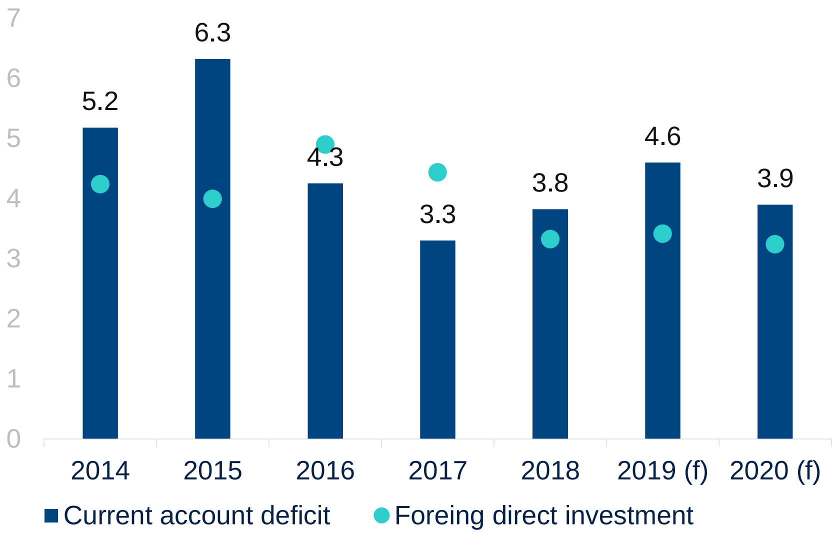
The current account deficit has increased product of greater revenues remitted and a deterioration in the commercial balance

CURRENT ACCOUNT DEFICIT COMPONENTS
(% OF GDP)



* Data to June
Source: BBVA Research with Banco de la República data.

CURRENT ACCOUNT DEFICIT AND FDI FORECAST
(% OF GDP)



Even though the deterioration is significant, it is still financed mostly by foreign direct investment and the worst commercial balance is in a good part explained by capital good imports, which imply a mid term greater GDP.

Methodological changes to fiscal deficit calculation are more lenient to the government and allow them to achieve fiscal targets in 2019 without selling assets and 2020 with a small missing revenue

CENTRAL GOVERNMENT BALANCE 2018-2021
(% OF GDP)

	Government scenarios			
	2018	2019 (f)	2020 (f)	2021 (f)
Total Revenue	**15.4**	**16.6** ↘	**16.5**	↘ **16.5**
Tax revenue	13.9	14.3	14.2	14.3
Non tax revenue	1.5	2.3	2.3	2.3
Total expenditure	**18.4**	**19.0** ↘	**18.7**	↘ **18.4**
deficit	**-3.1**	**-2.4**	**-2.2**	**-1.8**

Includes profit from BanRep for 0.2% of GDP in 2019 and 0,7% of GDP in 2020, this reduces the need of asset sales. The rest of the adjustment is made via expenditure

This are the changes:

- Don’t take into account for part of the expenditure within the deficit, this implies an adjustment of expenditure accounting.
- Incorporate BanRep profit as non tax revenues (capital resources).
- This allows to cover part of the missing resources and expenditure adjustment or asset sales could be lower

Source: BBVA Research with Minhacienda data from the Fiscal Mid Term Plan of 2019 and act 11 from March of 2019 of the Fiscal Rule Expert Committee

Principal macroeconomic variables

TABLE A1. MACROECONOMIC FORECAST

	2015	2016	2017	2018	2019 (f)	2020 (f)
GDP (% y/y)	3.0	2.1	1.4	2.6	3.0	3.0
Private consumption (% y/y)	3.1	1.6	2.1	3.6	4.3	3.8
Public consumption (% y/y)	4.9	1.8	3.8	5.6	3.8	3.0
Fixed investment (% y/y)	2.8	-2.9	1.9	1.5	2.7	4.0
Inflation (% y/y. eop)	6.8	5.7	4.1	3.2	3.8	3.3
Inflation (% y/y. average)	5.0	7.5	4.3	3.2	3.5	3.5
Exchange rate (eop)	3149	3001	2984	3250	3388	3370
Devaluation (%. eop)	31.6	-4.7	-0.6	8.9	4.2	-0.5
Exchange rate (average)	2742	3055	2951	2956	3278	3380
Devaluation (%. eop)	37.0	11.4	-3.4	0.2	10.9	3.1
Policy interest rate (%. eop)	5.75	7.5	4.75	4.25	4.25	4.25
Tasa DTF (%. eop)	5.2	6.9	5.3	4.5	4.5	4.5
Fiscal balance Central National Government (% GDP)	-3.0	-4.0	-3.6	-3.1	-2.4	-2.2
Current account (% GDP)	-6.3	-4.3	-3.3	-3.8	-4.6	-3.9
Unemployment urban rate (%. eop)	9.8	9.8	9.8	10.7	11.1	10.4

(f) Forecast.
Source: BBVA Research with DANE, BanRep and MinHacienda data.

Principal macroeconomic variables

TABLE A2. MACROECONOMIC FORECAST

	GDP (% y/y)	Inflation (% y/y. eop)	Exchange rate (vs. USD. eop)	Policy interest rate (%. eop)
Q1 16	2.3	8.0	3.022	6.50
Q2 16	2.0	8.6	2.916	7.50
Q3 16	1.7	7.3	2.880	7.75
Q4 16	2.3	5.7	3.001	7.50
Q1 17	1.4	4.7	2.880	7.00
Q2 17	1.3	4.0	3.038	5.75
Q3 17	1.5	4.0	2.937	5.25
Q4 17	1.2	4.1	2.984	4.75
Q1 18	2.0	3.1	2.780	4.50
Q2 18	2.9	3.2	2.931	4.25
Q3 18	2.6	3.2	2.972	4.25
Q4 18	2.7	3.2	3.250	4.25
Q1 19	3.1	3.2	3.175	4.25
Q2 19	3,0	3.4	3.206	4.25
Q3 19	2.8	3.8	3.462	4.25
Q4 19	3.3	3.8	3.388	4.25
Q1 20	2.9	3.9	3.365	4.25
Q2 20	3.1	3.4	3.385	4.25
Q3 20	2.1	3.2	3.400	4.25
Q4 20	2.8	3.3	3.370	4.25

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