Colombia Outlook

First Quarter 2020

Global growth has remained relatively low throughout 2019
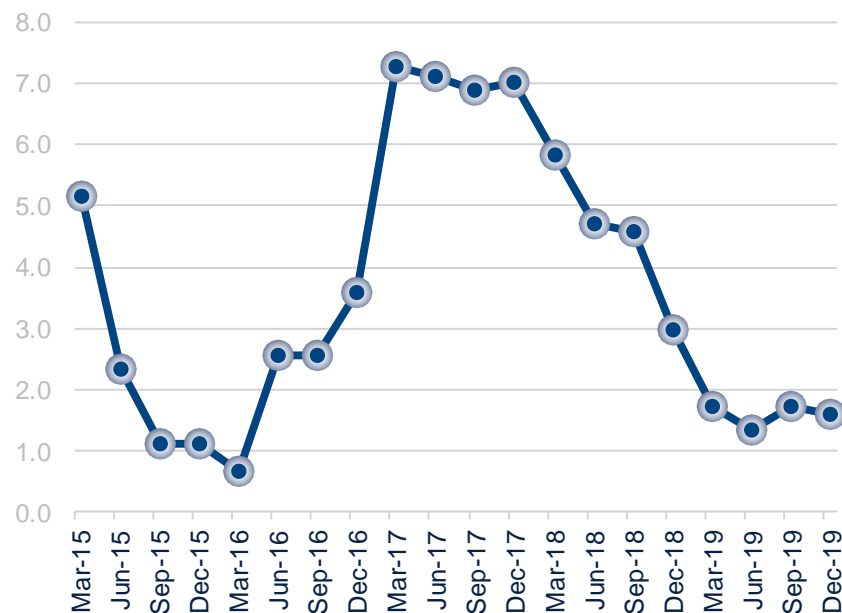
WORLD GDP GROWTH*
(% Q/Q)
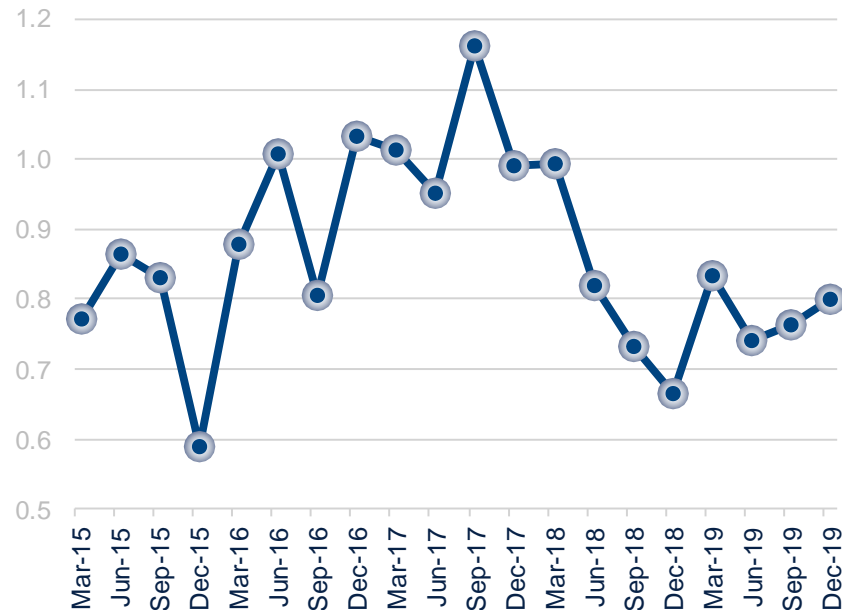
* Estimations based on BBVA-GAIN model.
Source: BBVA Research

- The world economy expanded around 0.75% in quarterly terms throughout 2019, below what was observed in previous years.

- In addition to the high uncertainty, the structural moderation of China and the cyclical slowdown of the US were behind the weak global growth in 2019.

- In any case, global growth has been slightly higher than expected in the second half of the year.

Signs of stabilization: the slowdown of both exports and services as well as the contraction in manufacturing seem to be over

EXPORTS*
(% Y/Y, ANNUAL GROWTH AVERAGE IN EACH QUARTER)

PMI INDICATORS
(HIGHER THAN 50: EXPANSION; LOWER THAN 50: CONTRACTION)

Global PMI - Manufacturing   Global PMI - Services

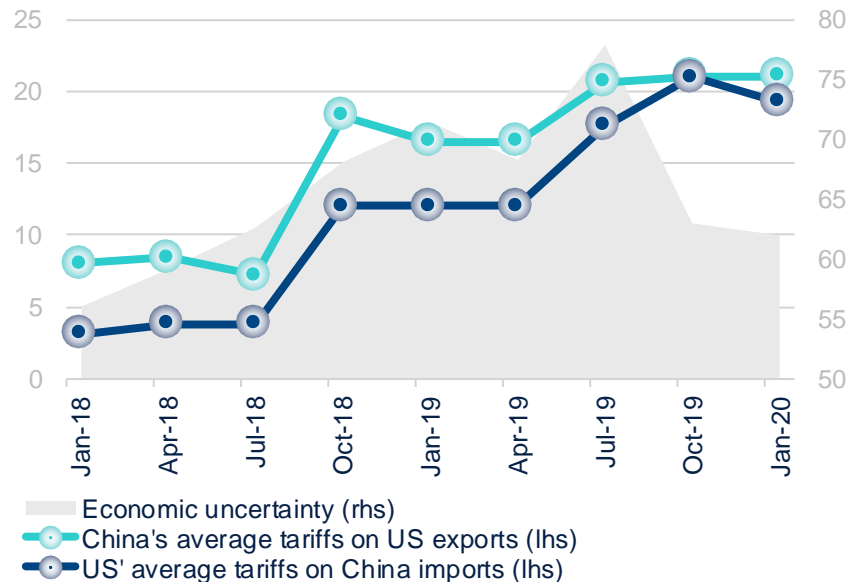* 4Q19 average only includes Oct/19 and Nov/19 data.
Source: BBVA Research
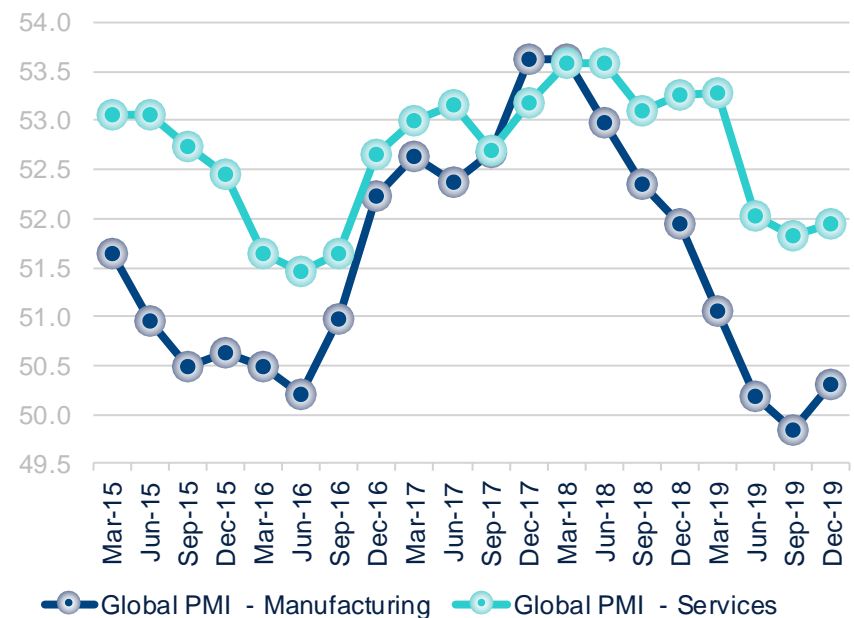
Source: BBVA Research based on Haver data

The trade agreement between the US and China has significantly reduced uncertainty, but not protectionism levels

TARIFFS AND ECONOMIC UNCERTAINTY*
(%, INDEX: 0 TO 100)

■ Economic uncertainty (rhs)
━○━ China's average tariffs on US exports (lhs)
━●━ US' average tariffs on China imports (lhs)

* Average tariffs at the beginning of each quarter. BBVA Research Index of Economic Uncertainty: tone of the news about economic uncertainty; quarterly average (except 1Q20: average until January 9, 2020).
Source: BBVA Research, PIIE

◾ **US-China "phase one" trade deal is positive news, but partial:**

- Import tariffs will continue to be high despite the announced reductions.

- We are still far from a definitive solution to structural problems.

◾ **The risk of disorderly *brexit* in the short-term has disappeared**, contributing to reduce global uncertainty, but it can resurface in the second half of the year.

Financial markets exhibit a better mood

SOVEREIGN DEBT YIELDS AND EQUITY VOLATILITY
(%, INDEX)

Source: BBVA Research based on Haver data
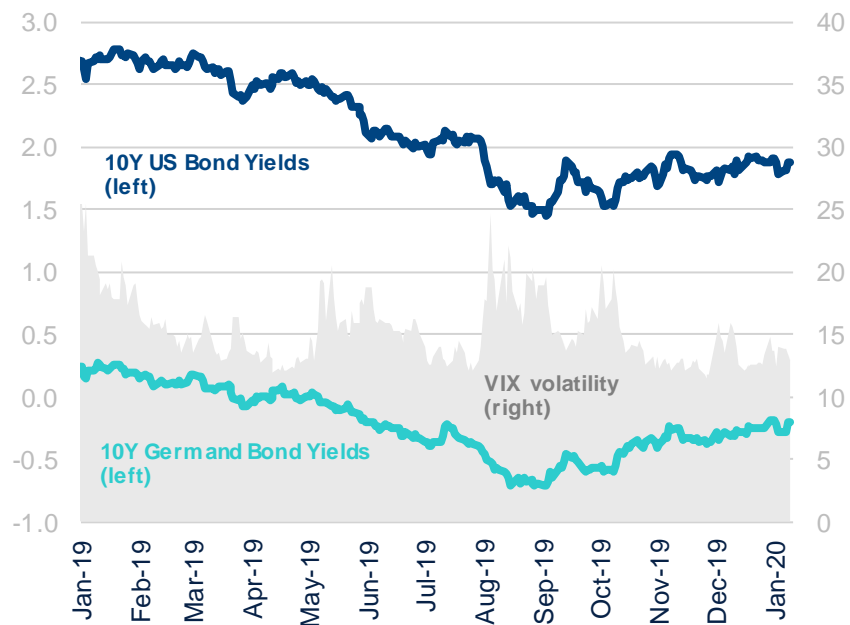
The recent improvement of the global environment has spurred some optimism in the financial markets:

- Volatility reduction

- Recovery of long-term rates

- Stock Market improvement

- Increased appetite for risk

The environment will favor a soft landing of global growth

LOWER TRADE TENSIONS

- **US-China positive but partial deal.**

- **Protectionism** will continue to be a source of concern, also in other regions.

- **A less disruptive *brexit*,** at least in the short-term.

COUNTER-CYCLICAL POLICIES

- The expansionary tone of **monetary policy** will be maintained, following recent rate cuts.

- A limited **fiscal stimulus** in Europe and somewhat greater in China.

LIMITED FINANCIAL VOLATILITY

- Volatility will be limited by the **actions of central banks.**
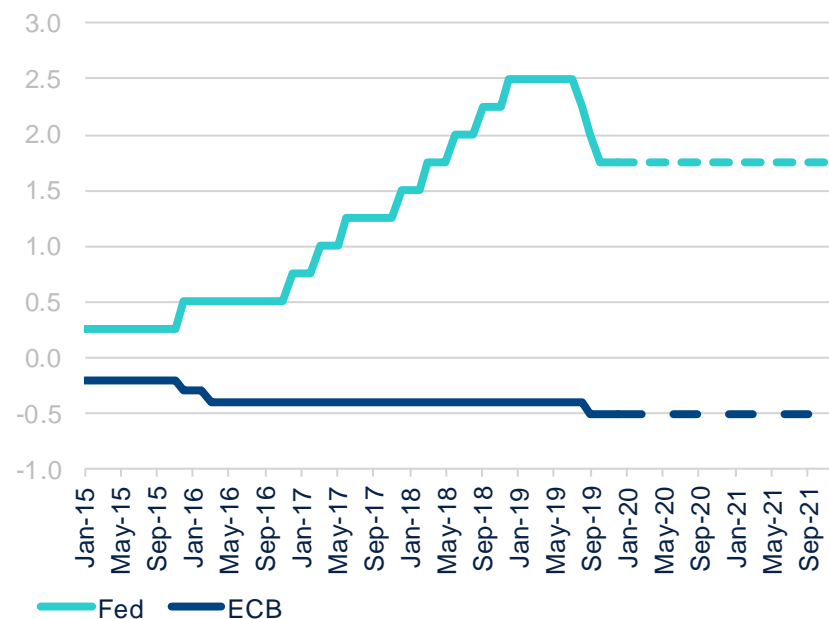
- Some **appetite for risk.**

COMMODITY PRICES UNDER CONTROL

- **Oil prices** around 61 dollars in 2020-21

- Relative **weakness of demand** and **increase in the supply of non-OPEC countries.**

Pause at both the Fed and the ECB: no prospects for changes in interest rates on the horizon

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

Fed   ECB

* In the case of the ECB, deposits interest rates. Forecasts from Jan/19 onwards.
Source: BBVA Research

- **Fed:** the relative resistance of the economy improves the balance of risks and generates the conditions for a long monetary pause.

- **ECB:** growth stabilization and the communication by the new presidency reinforce the expectations of interest rate stability.
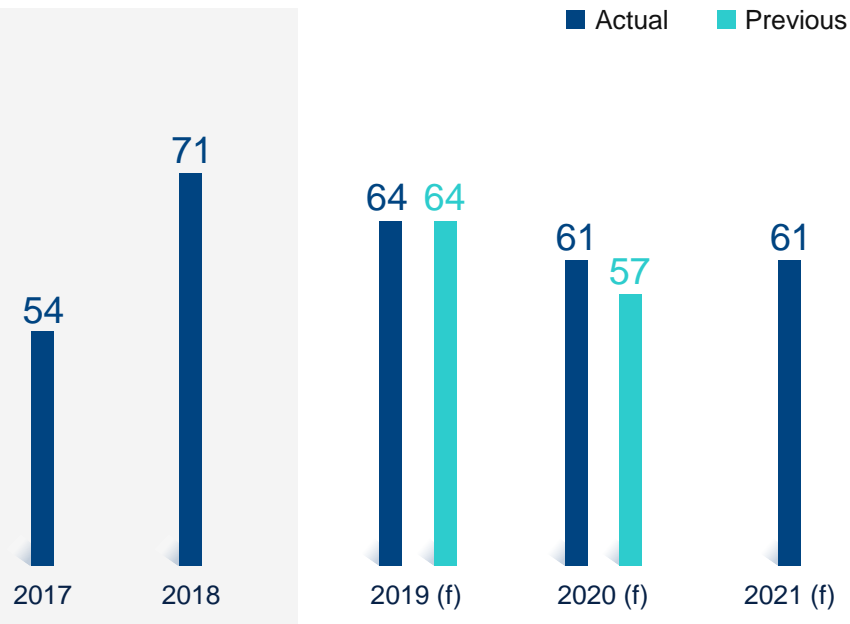
Oil: prices are expected to decline, despite rising geopolitical tensions in the Middle East

OIL PRICES
(USD PER BARREL, ANNUAL AVERAGE)

■ Actual   ■ Previous

2017: 54
2018: 71
2019 (f): 64 / 64
2020 (f): 61 / 57
2021 (f): 61

(f) Forecast.
Source: BBVA Research

- An expansion of the supply by non-OPEC countries in a context of weak demand supports prospects for price moderation.

- 2020 price forecast was revised upwards mainly due to OPEP's new production cuts.

- The escalation of tensions in the Middle East represents a risk: an oil price of $ 70 in 2020 would reduce world growth by one or two decimal points, with a greater impact on Europe.

Global growth will converge to 3.2% in 2020 and 3.3% in 2021

	USA	Latam	Mexico	Eurozone	Spain	Turkey	China	World
2018	2.9	1.6	2.1	1.9	2.4	2.8	6.6	3.6
2019	2.3	0.6	0.0	1.2	1.9	0.8	6.1	3.2
2020	1.8	1.4	1.5	0.9	1.6	4.0	5.8	3.2
2021	2.0	2.1	2.0	1.2	1.9	4.5	5.5	3.3
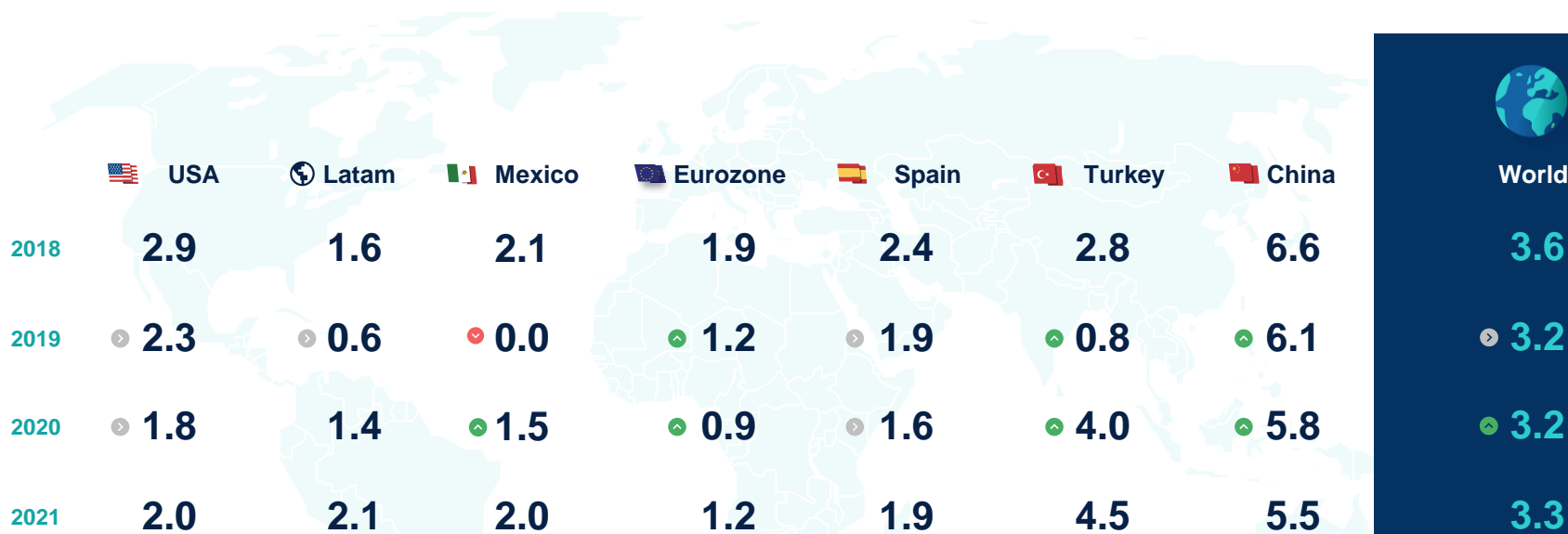
Upward revision
Unchanged forecast
Downward revision

Source: BBVA Research

USA: the prospects of a smooth deceleration ahead remain in place

GDP GROWTH
(%)

● Actual ● Previous

2.2%

2.9%

2.3%
2.3%

1.8%
1.8%

2.0%

2017   2018   2019 (f)   2020 (f)   2021 (f)

(f) Forecast.
Source: BBVA Research
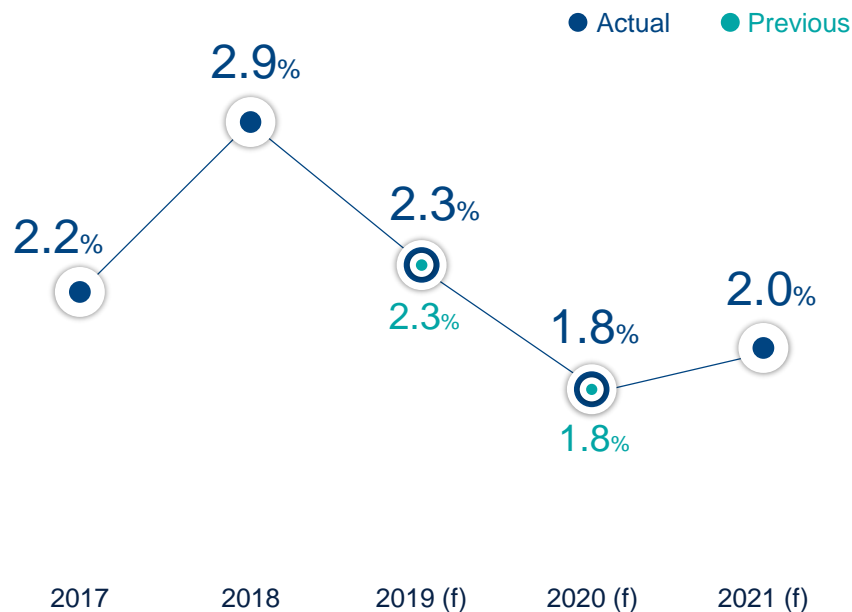
- **Private consumption** shows strength, in contrast with the weakness of **investment.**

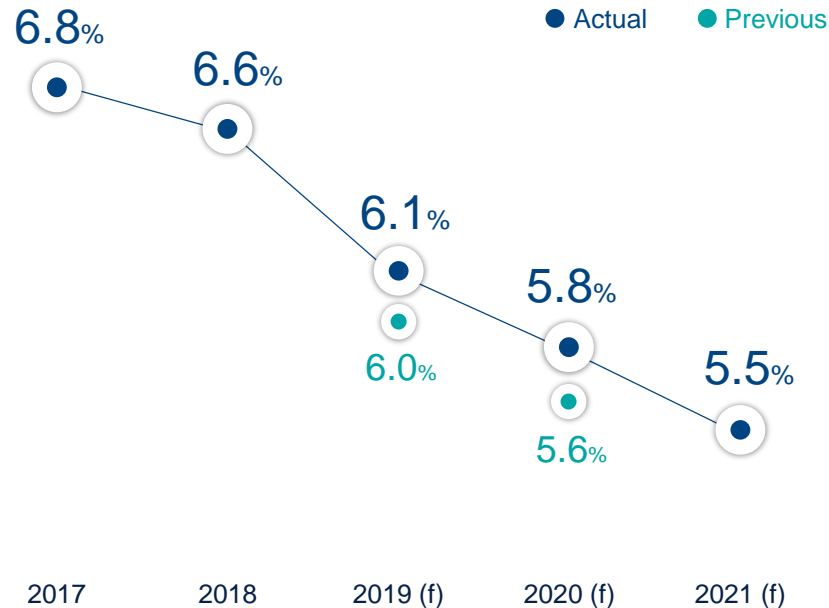- **Inflation** will remain close to 2.0%, with more balanced risks.

- **Probability of recession** has declined.

- The **2020 presidential elections** may increase political and geopolitical tensions.

China: growth slowdown, somewhat slower than expected

GDP GROWTH
(%)

● Actual   ● Previous

6.8%

6.6%

6.1%

6.0%

5.8%

5.6%

5.5%

2017   2018   2019 (f)   2020 (f)   2021 (f)

(f) Forecast.
Source: BBVA Research

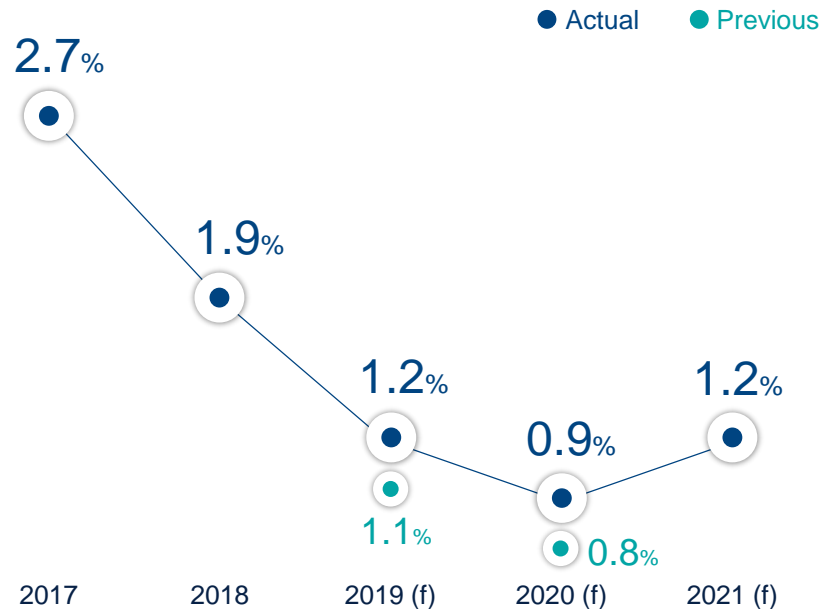- A generalized economic slowdown is still in place

- Upward revision of the forecast for 2019: the recent growth deceleration has been smoother than expected.

- Small upward revision of 2020 GDP growth forecast:

  - Improved relation with the US.

  - Greater willingness to increase the fiscal stimulus.

- Monetary stimulus: gradualism moving forward, in a context of temporarily high inflationary pressures.
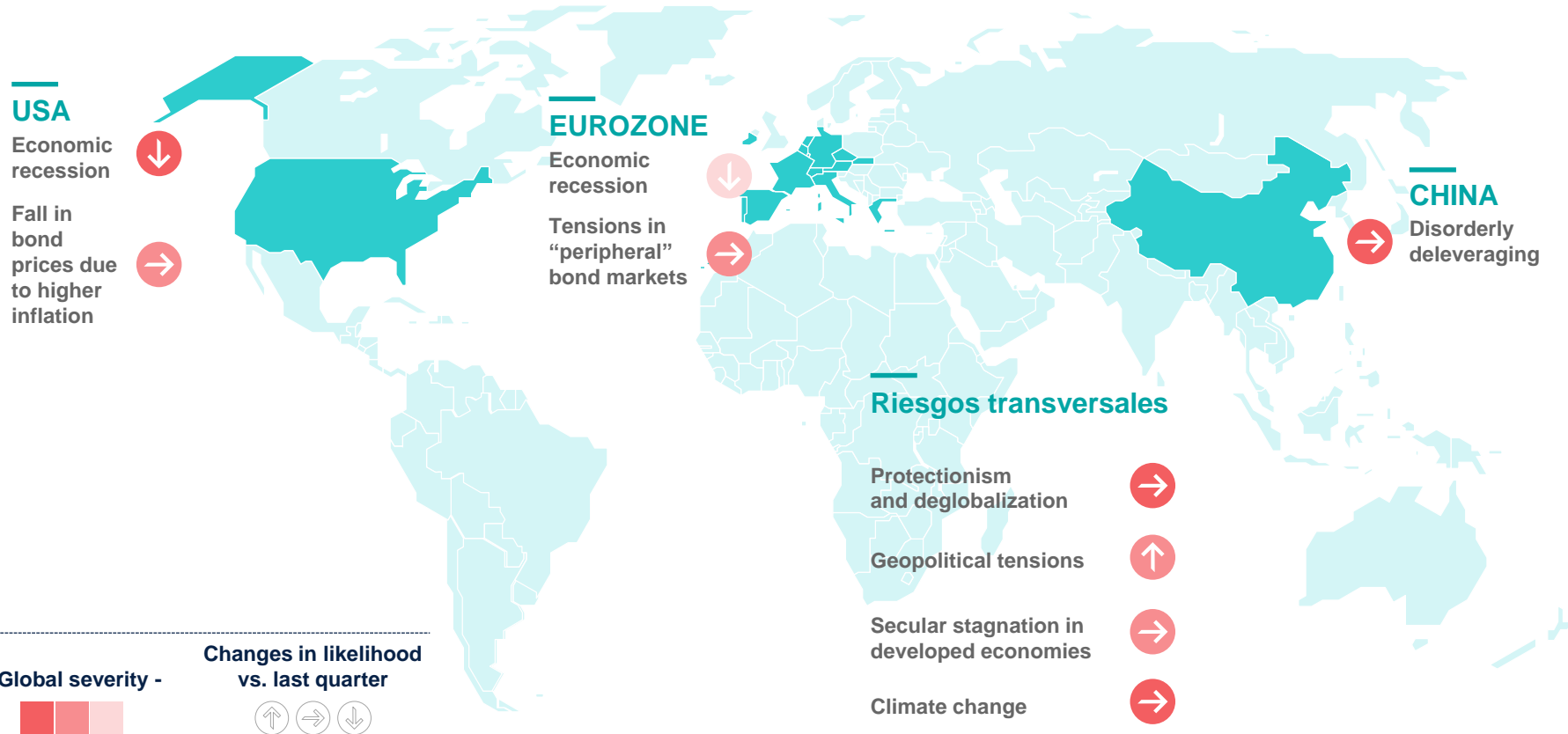
Eurozone: slightly upward revision of growth forecasts, due to better than expected incoming data

GDP GROWTH
(%)

● Actual   ● Previous

2.7%

1.9%

1.2%

0.9%

1.2%

1.1%

0.8%

2017   2018   2019 (f)   2020 (f)   2021 (f)

(f) Forecast.
Source: BBVA Research

▲ **Growth is stabilizing** at low levels.

▲ The **economic dynamism will increase from mid-2020**, partly due to higher exports.

▲ The **growth divergence** among large countries will be reduced, mostly due to a better performance in Germany.

▲ **Inflation** will remain very low, despite the strong monetary stimulus and some fiscal support.

Reduction in the cyclical global risks, but not in the structural ones

USA
Economic recession
Fall in bond prices due to higher inflation

EUROZONE
Economic recession
Tensions in "peripheral" bond markets

CHINA
Disorderly deleveraging

Riesgos transversales
Protectionism and deglobalization
Geopolitical tensions
Secular stagnation in developed economies
Climate change

+ Global severity -

**Changes in likelihood vs. last quarter**

02

Colombia: growth is set to continue consolidating in 2020 and 2021 with a better balance between its components

In 2019, GDP acceleration was supported by household consumption and non-construction investment

GDP*, COMPONENTS** AND IT CONTRIBUTION TO THE CHANGE IN GROWTH
(ANNUAL VARIATION, CONTIBUTION IN PP TO THE CHANGE IN GROWTH, %)

■ 2018   ■ 2019 (f)   ● Contribution to the change in growth between 2018 and 2019 in percentage points (rhs)
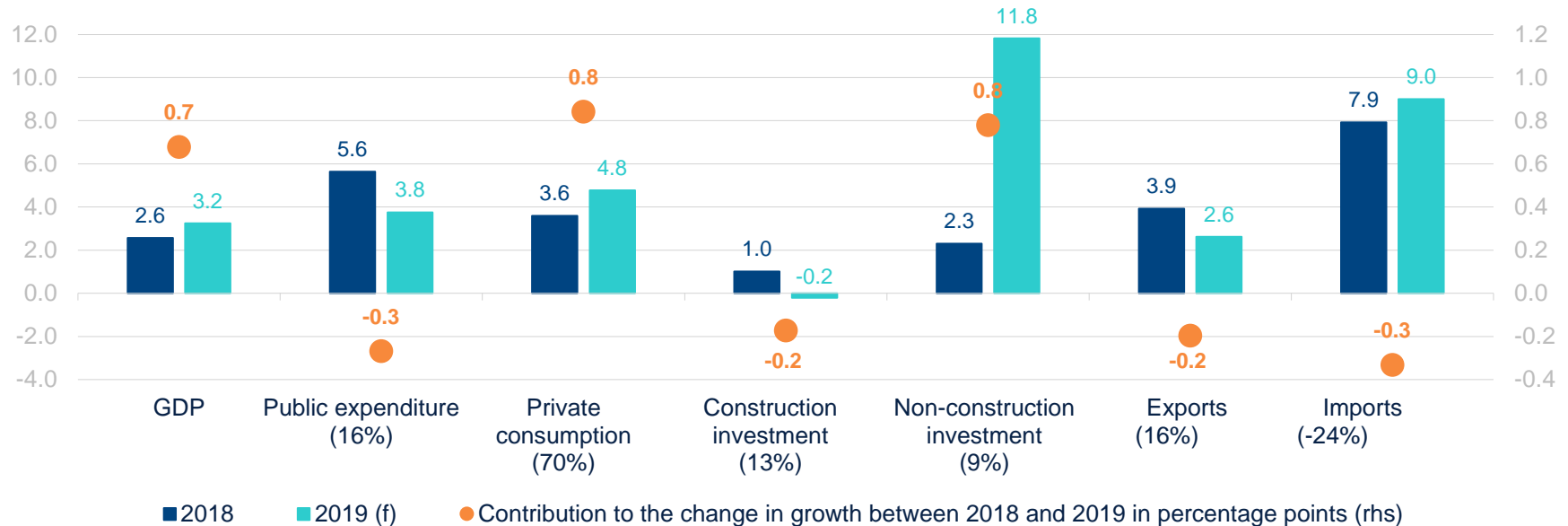
* With non seasonally adjusted series; ** Weight of each component of GDP in parenthesis; (f) Forecast.
Source: BBVA Research with DANE data

All types of consumption showed a strong performance in 2019

HOUSEHOLD CONSUMPTION* AND ITS COMPONENTS
(ANNUAL VARIATION, %)

2016 **2017** **2018** **2019 (f)**
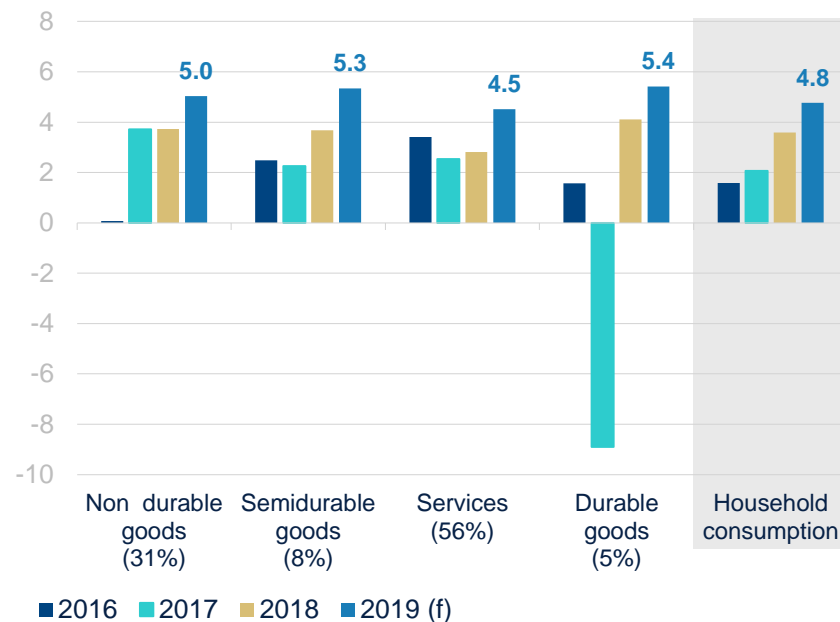
* With non seasonally adjusted series. (f) Forecast.
Source: BBVA Research with DANE data

FACTORS THAT SUPPORTED CONSUMPTION PERFORMANCE

Immigrant expenditure

Greater leveraging
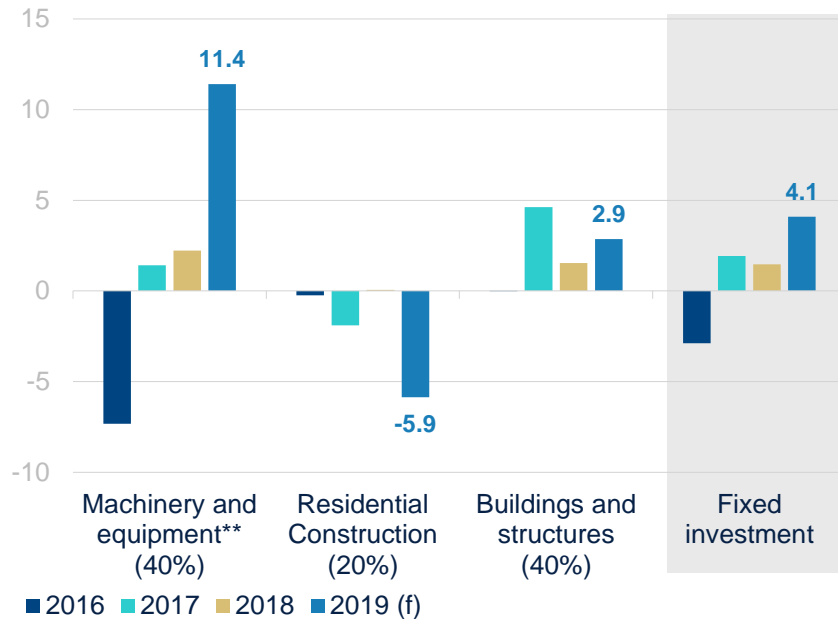
Remittances growth

Expenditure patterns

Social support networks

Within investment, the dynamic of machinery and equipment compensated the weak performance of housing construction

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

11.4

4.1

2.9

-5.9

Machinery and equipment** (40%) | Residential Construction (20%) | Buildings and structures (40%) | Fixed investment

■ 2016 ■ 2017 ■ 2018 ■ 2019 (f)

FACTORS THAT EXPLAIN THE PERFORMANCE OF INVESTMENT

Export sector weakness ⊖

Financing law benefits ⊕

Real state market adjustment ⊖

One-time expenditure ⊕

Increase in capacity utilization ⊕

* With non seasonally adjusted series. ** Includes other investment; (f) Forecast.
Source: BBVA Research with DANE data

Internal demand grows, once again, above GDP, driving the recovery but at the same time pressuring the macroeconomic balance

GDP*, INTERNAL DEMAND AND CURRENT ACCOUNT**
(ANNUAL VARIATION AND % OF GDP, %)
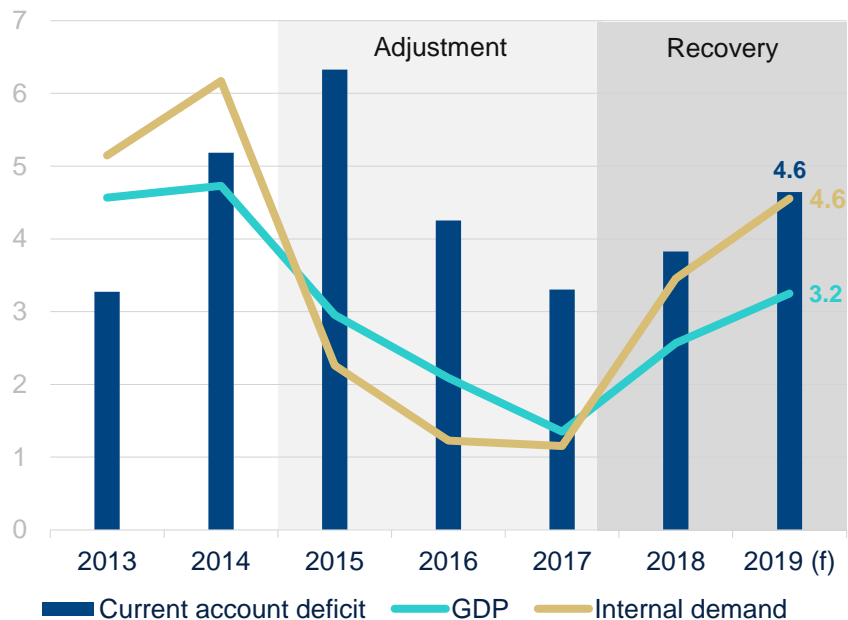
- In the period between 2015 and 2017 the economy underwent a macro adjustment, with the internal demand growing below GDP and as a consequence the current account deficit narrowed.

- From 2018, the economy started a period of recovery based on the internal demand growing above GDP. This restarts the pressure on the current account deficit.

* With non seasonally adjusted series. ** Includes statistical discrepancy; (f) Forecast.
Source: BBVA Research DANE and BanRep data

For 2020 and 2021, investment will gain relevance while household consumption will moderate gradually

HOUSEHOLD CONSUMPTION* AND FIXED INVESTMENT
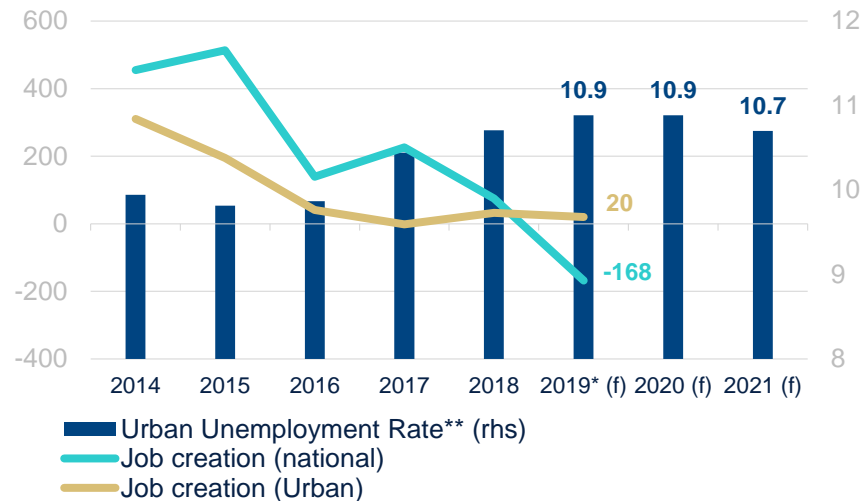(ANNUAL VARIATION, %)
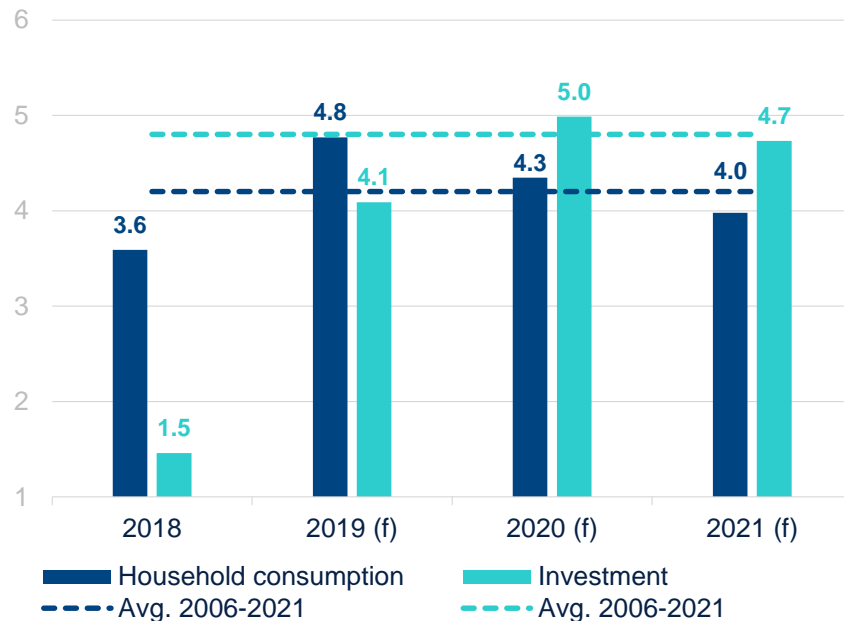
Despite the lower growth of household consumption, it will still grow above GDP

Investment will continue to recover on the back of the performance of its lagging components

Household consumption
Avg. 2006-2021
Investment
Avg. 2006-2021

* With non seasonally adjusted series; (f) Forecast.
Source: BBVA Research with DANE data

The moderation in private consumption is explained, among other things, on the weakness of the labor market and consumer confidence

UNEMPLOYMENT RATE AND JOB CREATION
(% OF LABOR FORCE, THOUSANDS OF PEOPLE)

- Urban Unemployment Rate** (rhs)
- Job creation (national)
- Job creation (Urban)

CONSUMER CONFIDENCE
(AVERAGE OF ANSWER BALANCE, %)

Consumer confidence showed a deterioration in 2019 and during 2019 mostly driven by the weak balance in the country component

- Total confidence
- Country component
- Household component

* Data to November and unemployment rate projected to December. ** Average end of quarters; (f) Forecast.
Source: BBVA Research with DANE and Fedesarrollo data
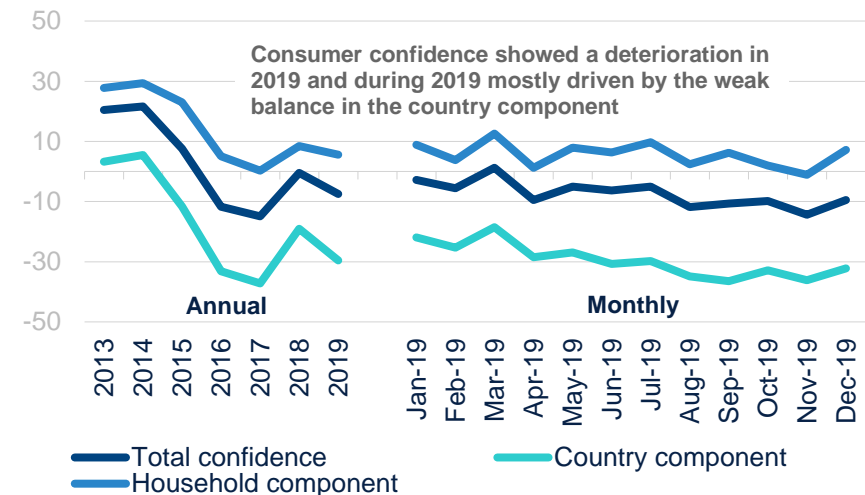
Urban job creation completes four years in low levels. At the national level, job creation turned negative in 2019

On the contrary, retailers and industrial confidence and tax benefits will boost investment

INDUSTRIAL AND RETAILERS CONFIDENCE
(BALANCE OF ANSWERS, %)

Avg. 80-19   2017   2018   2019

SOME TAX BENEFITS
(GROWTH LAW)

◼ Gradual reduction in corporate tax rate (from 33% in 2019 to 30% in 2022).

◼ Capital good VAT discount.

◼ 50% of ICA (local sales tax) discount.

◼ Presumptive income rate reduction.

Source: BBVA Research with Fedesarrollo data

A rebalancing in investment, with a recovery in housing construction and a moderation in machinery and equipment in 2020 and 2021

INVESTMENT*, COMPONENTS AND CONTRIBUTION TO CHANGE IN GROWTH
(ANNUAL VARIATION, CONTRIBUTION IN PP TO THE CHANGE IN GROWTH, %)

■ Annual variation (lhs)   ● Contribution to the change in growth in pp (2019 to 2020)
● Contribution to the change in growth in pp (2020 to 2021)
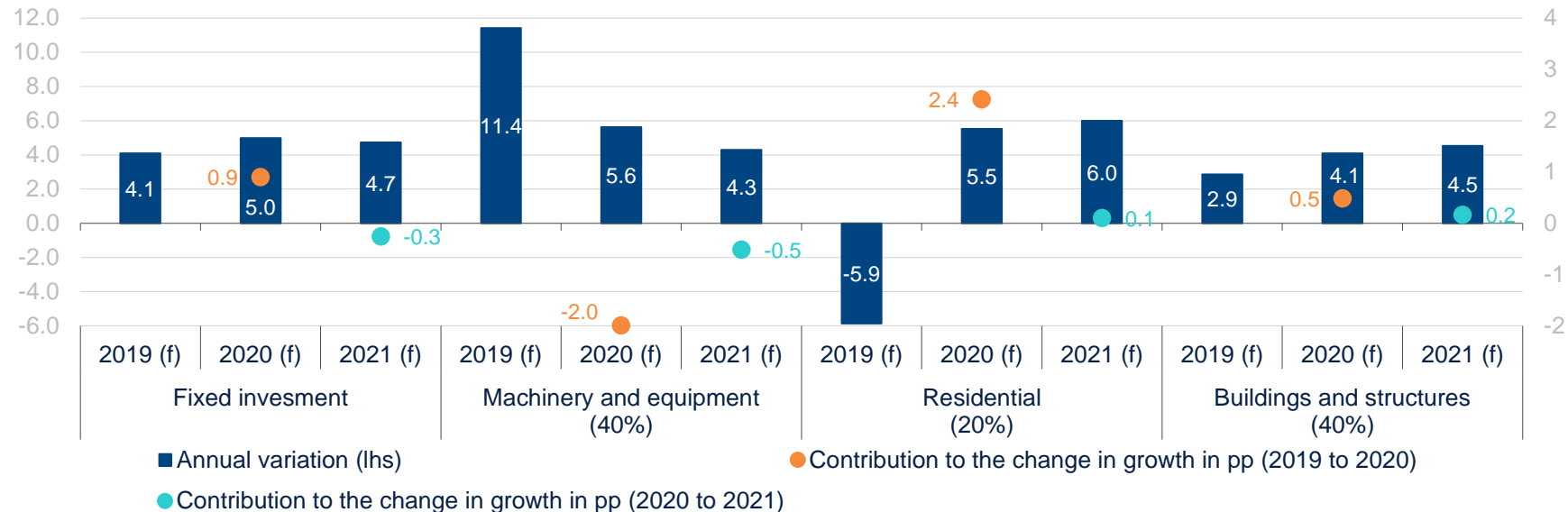
* With non seasonally adjusted series; ; ** Weights in each component of fixed investment in parenthesis; (f) Forecast.
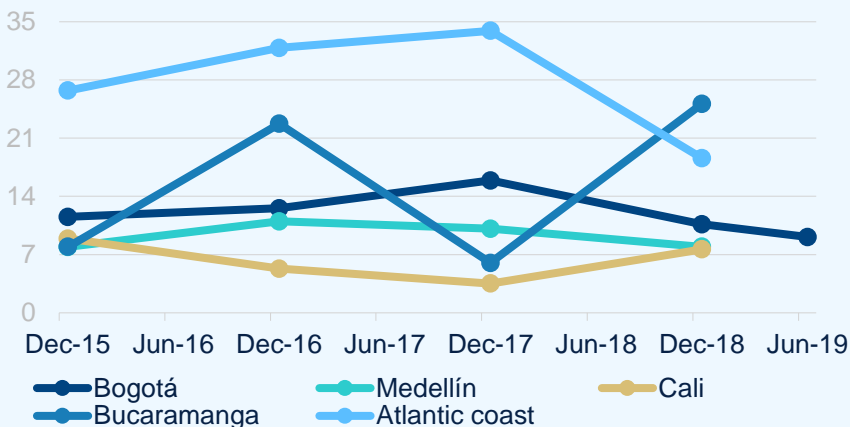Source: BBVA Research with DANE data

Building construction will be boosted by higher office demand and better new housing rotation

OFFICE VACANCY INDEX BY CITY
(% OF TOTAL OFFICE SUPPLY AVAILABLE)

The Atlantic coast and Bucaramanga have vacancies above equilibrium, and improving for the Atlantic coast.

Cali remains with vacancies in equilibrium.

Bogotá and Medellín returned to equilibrium levels.



Legend: Bogotá, Medellín, Cali, Bucaramanga, Atlantic coast

HOUSING INVENTORY ROTATION
(MONTHS NEEDED TO SELL CURRENT AVAILABLE SUPPLY)

Legend: Social housing, Non social housing, Total

Source: BBVA Research with JLL and Camacol data
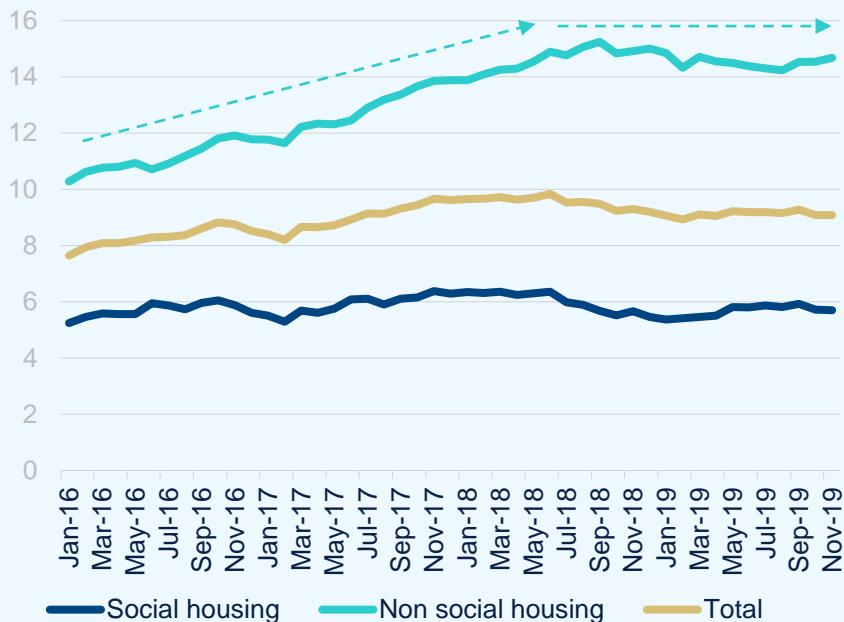
New construction starts stabilized in 2019, showing a change in trend and a small hike in the end of year…

TOTAL CONSTRUCTION AND CONSTRUCTION STRATS
(MILLION OF SQUARE MEETERS)

Housing starts   Total starts   Total work in progress
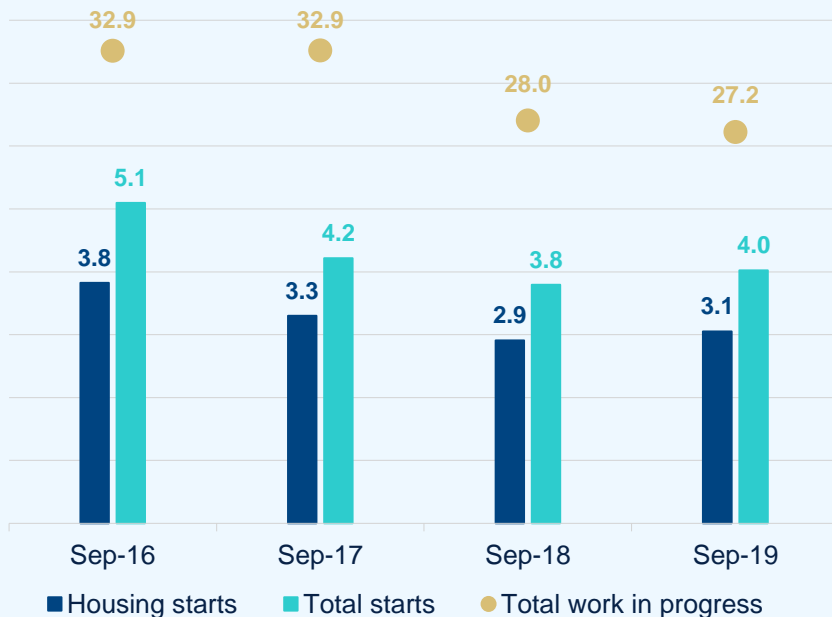
- …nonetheless, total stock of constructions does not show an annual increase yet.

- Looking forward, total constructions in process should increase gradually because:

  - The supply adjusted downward in 2018 and part of 2019, but has stabilized.

  - Housing sales in 2019 grew 10.5% (La Galería Inmobiliaria).

  - Newly paralyzed construction has started to fall.

  - Stocks have stopped growing.

  - Interest rates remain low.

Source: BBVA Research with DANE data

In particular, house purchasing capacity (by Price and interest rate) improved in 2019 and could extend its recovery

CAPACITY* AND EFFORT* INDEX
(YEARS AND % OF INCOME)

Capacity index (lhs, # years)
Effort index (rhs, % of monthly income)
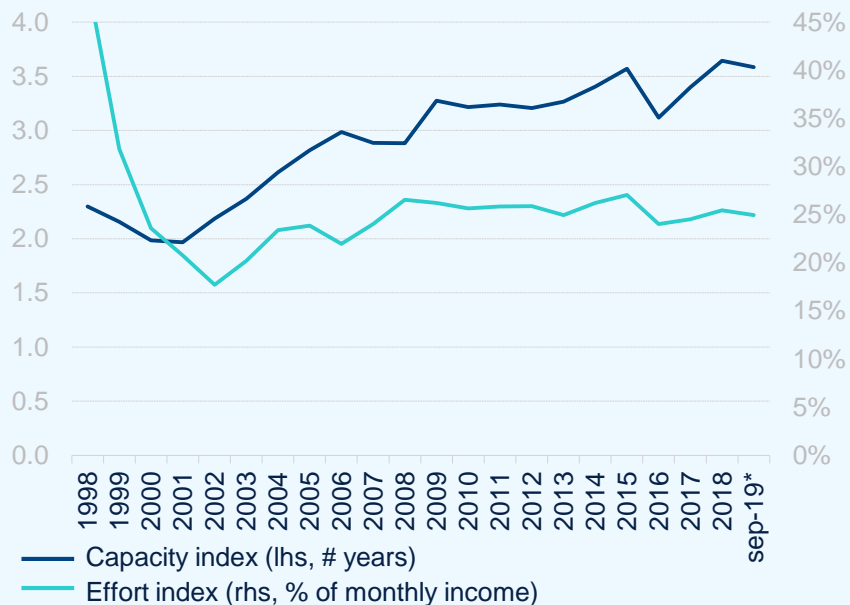
* Capacity index: years of annual income needed to purchase a house.
** Effort index: first installment of the mortgage relative to the income
Source: BBVA Research with DANE, Asobancaria, Superfinanciera and BanRep data

Capacity could increase because of:

- BanRep interest rate will remain stable and only increase 50bp in 2021

- Household income sustains its growth

- Housing prices grew in 2019 below CPI inflation allowing to stabilize average values for the main cities

Housing real price growth

New
(BanRep)   >   **-1.0**%
Oct-19

Used
(BanRep)   >   **-1.6**%
Jun-19

Civil Works, though we expect them to decelerate in 2020, will grow above GDP

Will decelerate

Will help with growth

Municipality's and Governor's expenditure

Rural roads

Airports

On going concessions

New projects: massive transport

Harbors

CIVIL WORKS*
(ANNUAL VARIATION, %)

11.1%

5.5%

5.3%

mar-19	jun-19	sep-19	dec-19 (f)	mar-20 (f)	jun-20 (f)	sep-20 (f)	dec-20 (f)	mar-21 (f)	jun-21 (f)	sep-21 (f)	dec-21 (f)
8.5	13.9	13.0	9.1	6.4	5.4	5.1	4.9	4.9	5.2	5.4	5.6
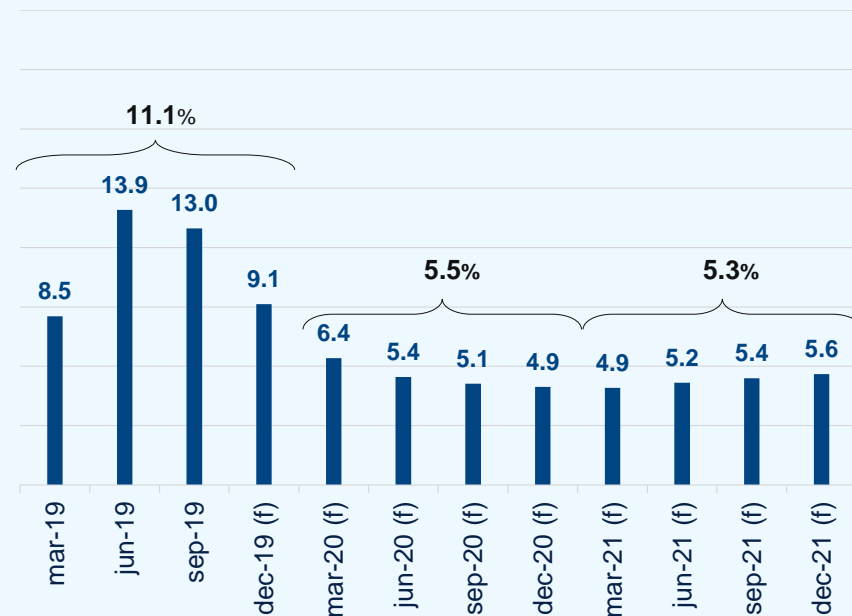
* With non seasonally adjusted series; (f) Forecast.
Source: BBVA Research with DANE data

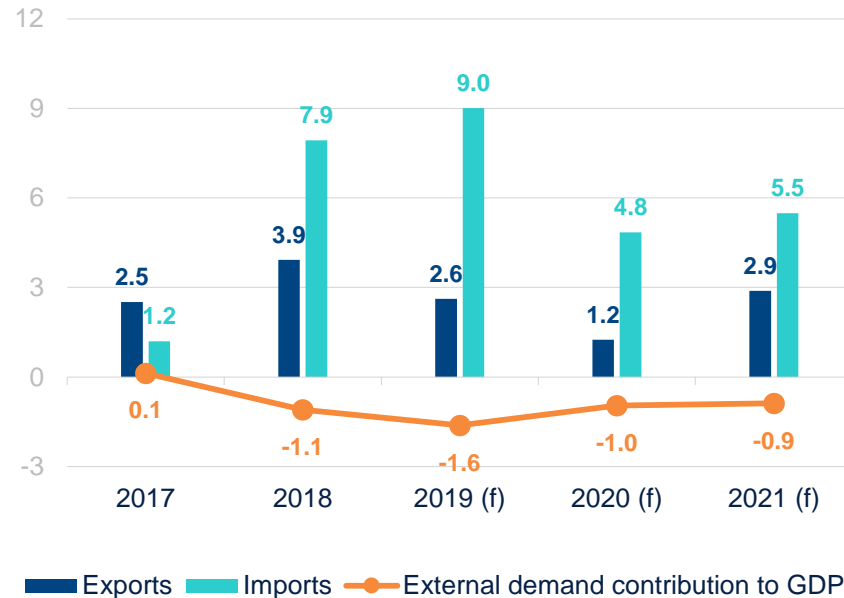# Imports and exports will decelerate in 2020 but will accelerate again in 2021. External demand negative contribution to GDP will reduce

EXPORTS*, IMPORTS* AND EXTERNAL DEMAND
(ANNUAL VARIATION, CONTRIBUTION IN PP TO GDP GROWTH, %)

	2017	2018	2019 (f)	2020 (f)	2021 (f)
Exports	2.5	3.9	2.6	1.2	2.9
Imports	1.2	7.9	9.0	4.8	5.5
External demand contribution to GDP	0.1	-1.1	-1.6	-1.0	-0.9

Legend: ■ Exports ■ Imports ●— External demand contribution to GDP

The rebalancing of investment and moderation of private consumption allow for a deceleration in imports
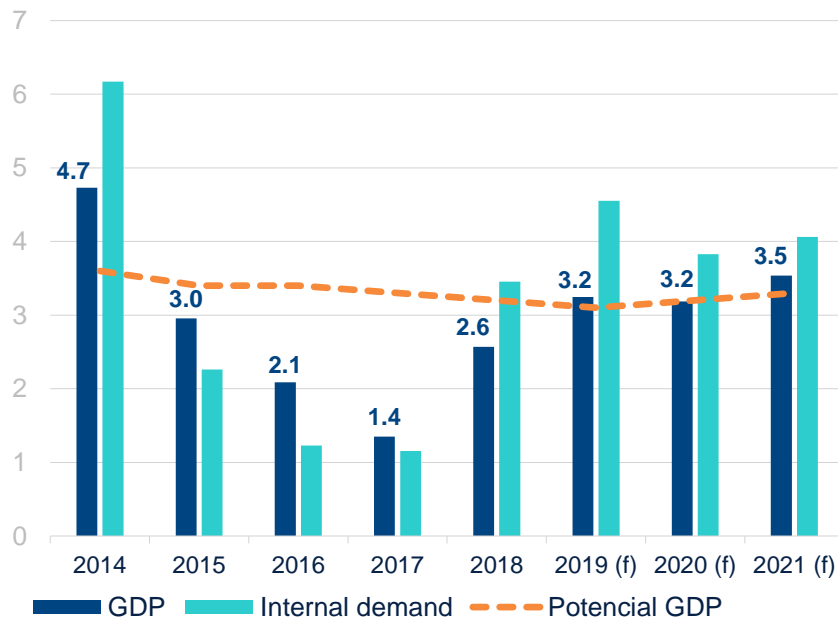
Low global growth and expected reductions in raw material prices, limit the performance of exports

* With non seasonally adjusted series; (f) Forecast.
Source: BBVA Research with DANE (National Accounts) data

GDP growth reaches potential GDP growth from 2019

GDP* POTENTIAL GDP** AND INTERNAL DEMAND***
(ANNUAL GROWTH, %)

GDP values: 2014: 4.7, 2015: 3.0, 2016: 2.1, 2017: 1.4, 2018: 2.6, 2019 (f): 3.2, 2020 (f): 3.2, 2021 (f): 3.5

Legend: GDP — Internal demand — Potencial GDP

- Growth is for the first time since 2014 above potential GDP growth

- Despite this, there is an accumulated growth debt from the period between 2015 and 2018 that requires the economy to consolidate a higher growth rate tan that of potential GDP

- Despite internal demand growing above GDP between 2018 and 2021, the difference between both reduces, contributing to improve the macro balance
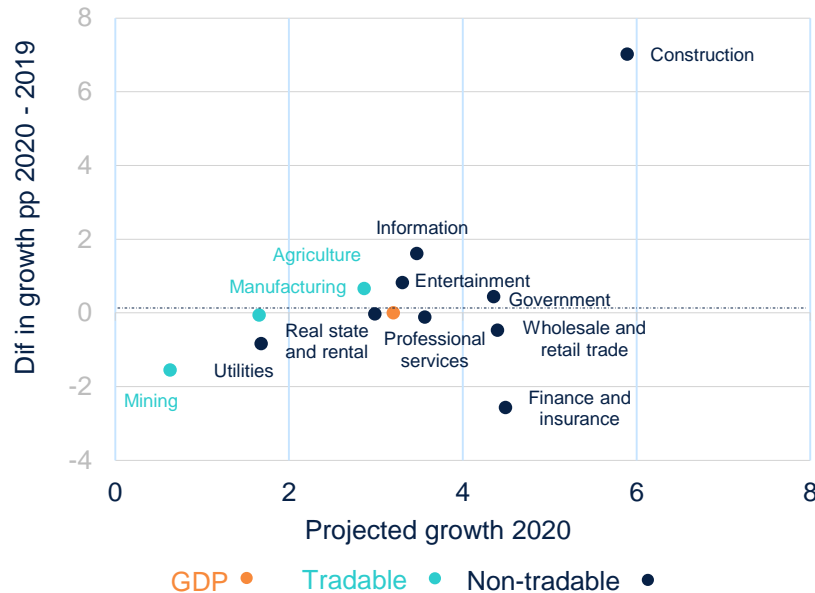
* With non seasonally adjusted series. ** Does not include migration or Census adjustments. *** includes statistical discrepancy; (f) Forecast.
Source: BBVA Research with DANE data

At the sector level, construction will lead growth in 2020 and 2021. Tradable sectors will remain lagging until 2021

SECTOR PERFORMANCE
(ANNUAL VARIATION, DIFFERENCE IN GROWTH, %)

In construction, there is a healthy growth in civil Works and housing construction accelerates.

The retail sector will continue to show a good performance in hand with consumption growth.

Within tradable sectors, mining will grow less because of a weak coal sector performance.

The industry will continue to show a low growth affected by the export sector, while agricultura will improve marginally.

* With non seasonally adjusted series
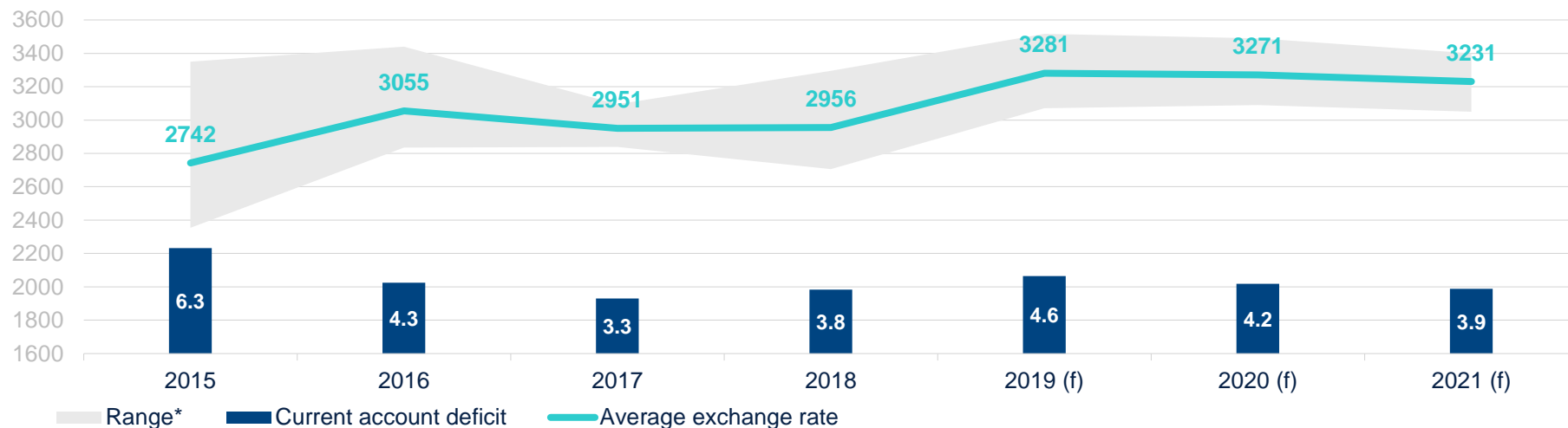Source: BBVA Research with DANE data

03

Inflation will recede gradually in 2020 and 2021. The exchange rate that will stabilize in high levels. The Central Bank will leave rates unchanged in 2020 and the first hike will take place in 2021

Colombian peso depreciated 11% in 2019. It will remain high for 2020 and 2021 with an annual appreciation of 0.3% and 1.2%, respectively

EXCHANGE RATE, DAILY RANGE AND CURRENT ACCOUNT
(PESOS PER DOLLAR FOR THE AVERAGE OF THE YEAR, % OF GDP)

Legend: Range*   Current account deficit   Average exchange rate

Data points:
- 2015: 2742, deficit 6.3
- 2016: 3055, deficit 4.3
- 2017: 2951, deficit 3.3
- 2018: 2956, deficit 3.8
- 2019 (f): 3281, deficit 4.6
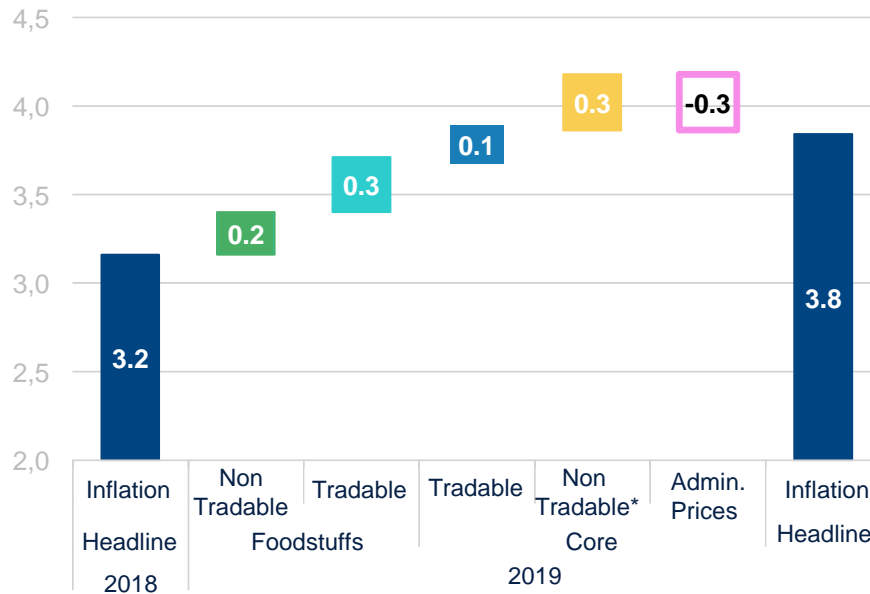- 2020 (f): 3271, deficit 4.2
- 2021 (f): 3231, deficit 3.9

* The range corresponds to the difference between the highest and lowest daily average negotiation values for each year; (f) Forecast.
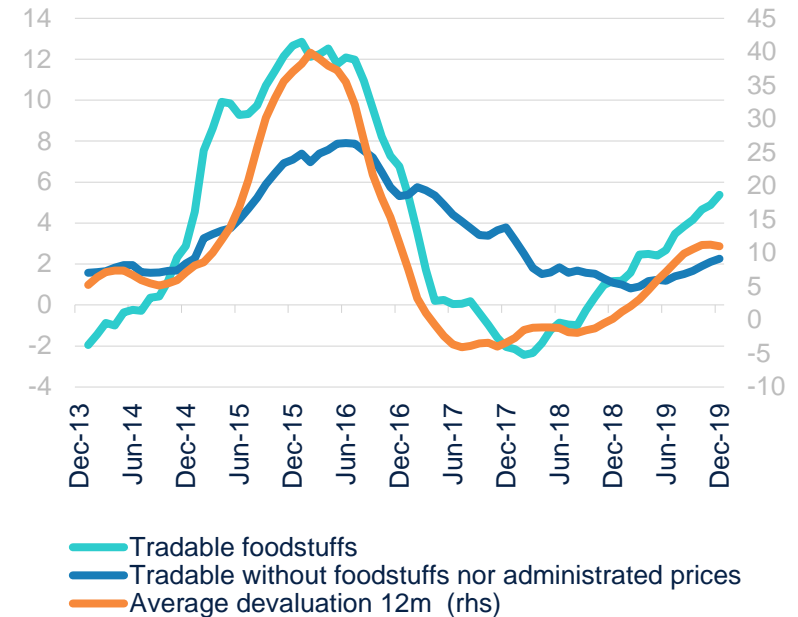Source: BBVA Research with BanRep data

The range of the Exchange rate is correlated with the size of the external deficit, amongst other things. We expect this range to moderate gradually

In 2019 inflation accelerated because of food prices and the Exchange rate pass-through

INFLATION AND ITS ACCELERATION BY COMPONENTS
(ANNUAL VARIATION, CONTRIBUTION TO THE ACCELERATION PP, %)

TRADABLES INFLATION AND DEPRECIATION
(ANNUAL VARIATION, %)

Tradable foodstuffs
Tradable without foodstuffs nor administrated prices
Average devaluation 12m (rhs)

* Contribution to non tradables is explained by the increase in weight for the 2018 basket (+45bp), with fixed weights the deceleration of non tradable inflation has a negative contribution (-13bp).
 Source: BBVA Research with DANE and BanRep data

Inflation will moderate in 2020 closing at 3.4% thanks to food prices. For 2021 inflation will continue converging towards the target

TOTAL, CORE AND FOOD INFLATION
(ANNUAL VARIATION, %)

Legend: 2018, 2019, 2020 (f)
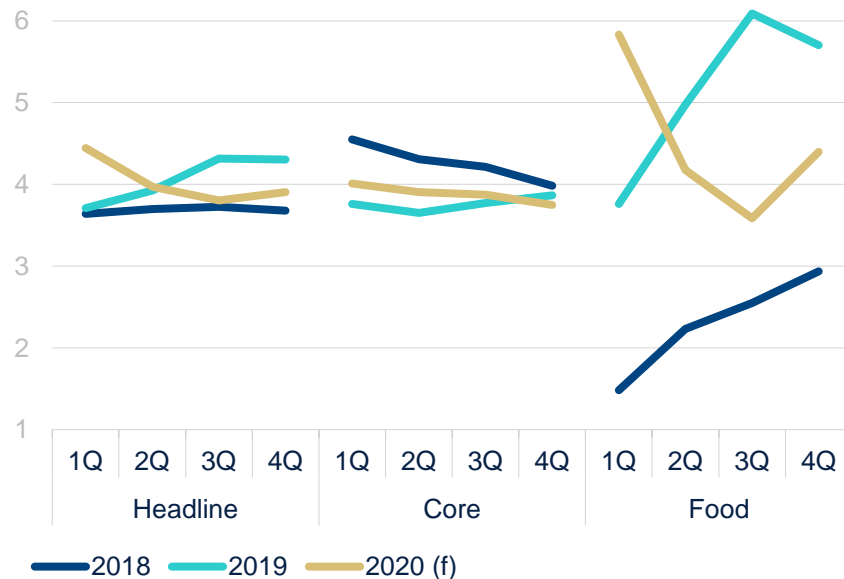
- In the first quarter of 2020 inflation will be pressured by a lagging effect of the Exchange rate on prices.

- Inflation persistence and indexation will also affect inflation due to the acceleration of inflation and the increase of minimum wage.

- Risk to this scenario are to the upside given possible additional effects of climate related effects on food prices, a stronger Exchange rate pass-through than currently observed and stronger cost-push inflation from wage related origin
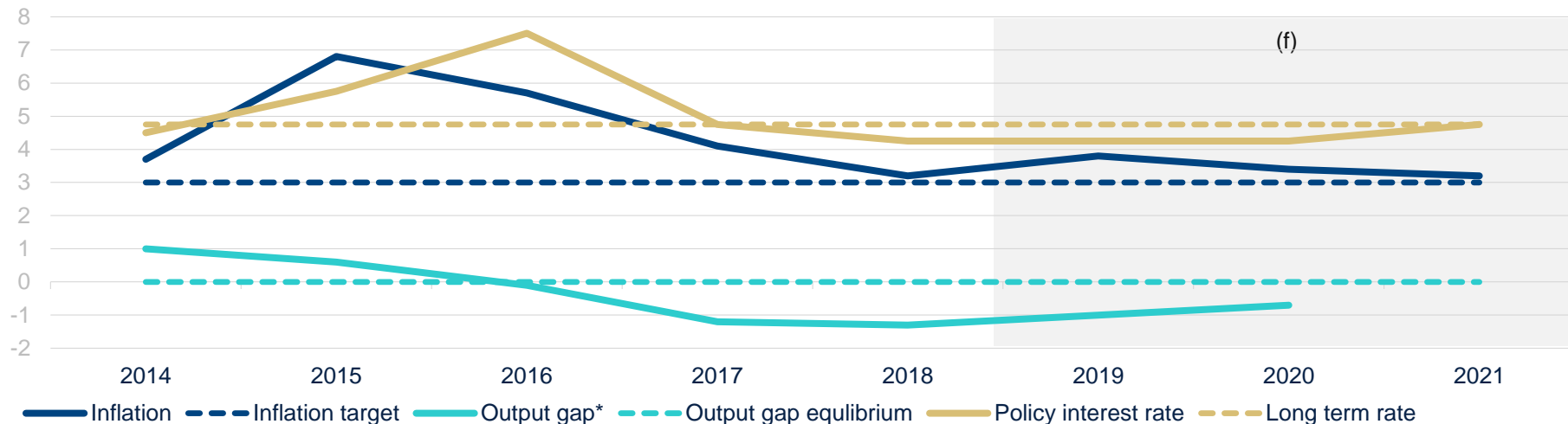
(f) Forecast.
Source: BBVA Research with DANE data

The Central Bank will leave interest rates unchanged at its current level of 4.25% for 2020 and will raise them in the first quarter of 2021

INFLATION, OUTPUT GAP* AND POLICY RATE
(ANNUAL VARIATION, % OF GDP, %)

Legend: Inflation — Inflation target — Output gap* — Output gap equilibrium — Policy interest rate — Long term rate

*Corresponds to the output gap published by Banco de la República in their November 2019 Monetary Policy Report; (f) Forecast.
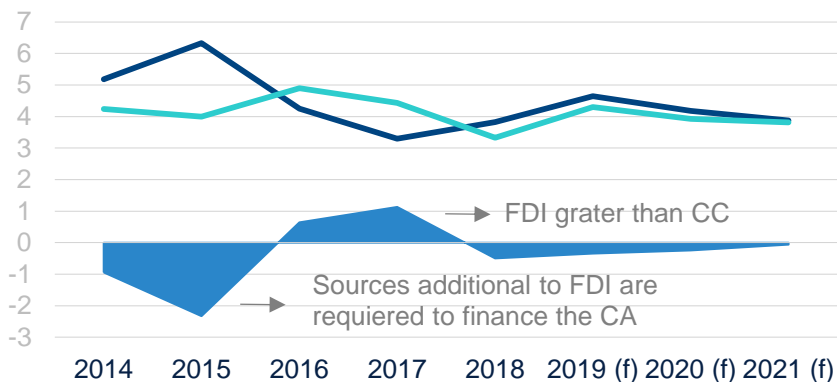Source: BBVA Research with DANE and BanRep data.

The prolonged stability in rates is derived from conflicting factors: negative output gap and unemployment favoring rate reductions and inflation, depreciation and the external imbalance favoring rate hikes

Despite the high current account deficit, most of its financing is achieved with direct foreign investment

CURRENT ACCOUNT DEFICIT AND FINANCING
(% OF GDP)

FDI grater than CC

Sources additional to FDI are required to finance the CA

- Financing gap: FDI-CA
- Foreign direct investment -FDI-
- Current account deficit -CA-

(f) Forecast
Source: BBVA Research with BanRep data

PORTFOLIO INFLOWS
(YEAR TO DATE, USD BILLION)

Portfolio flows are more volatile than direct investment flows
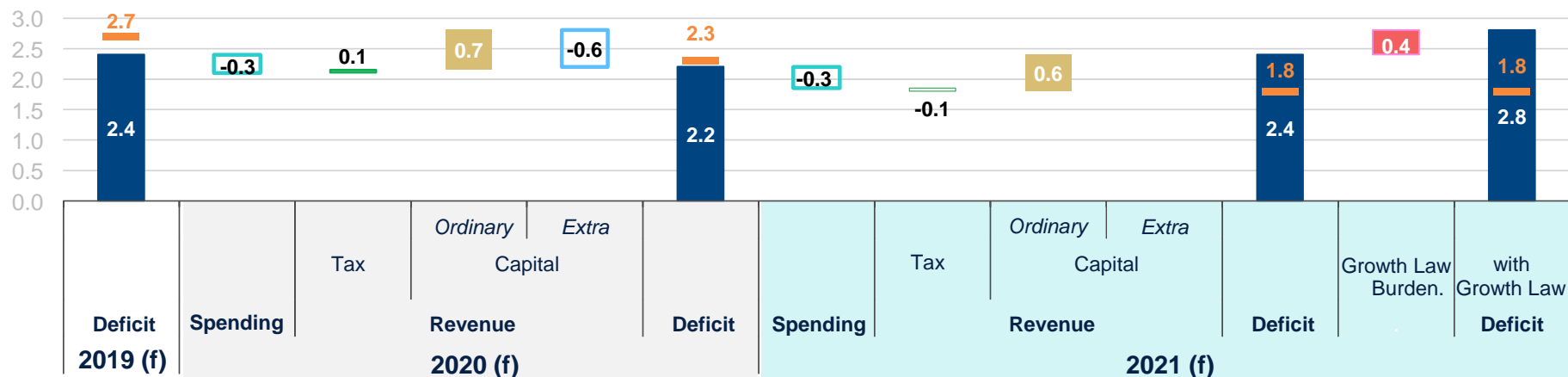
- 2014
- 2015
- 2016
- 2017
- 2018
- 2019
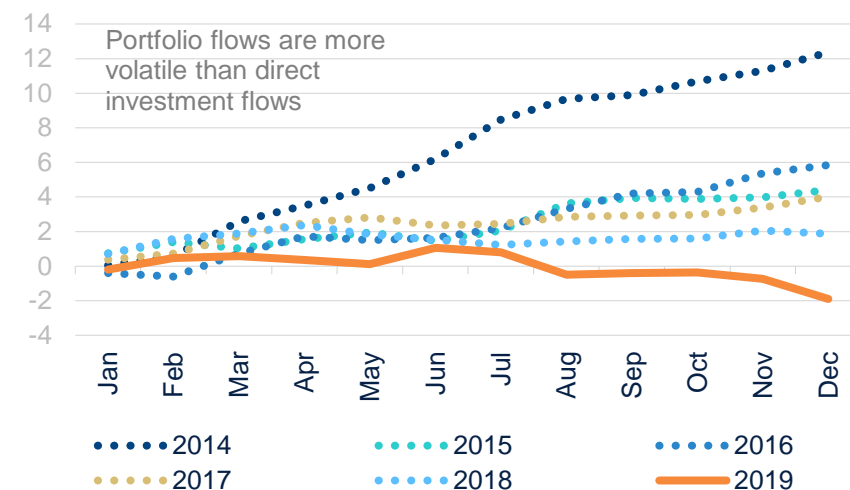
There where portfolio outflows in 2019, specially in the second half.
We don't expect them to continue in 2020

The fiscal rule will be met in 2020 thanks to extraordinary capital resources. For 2021 on fiscal consolidation faces greater challenges

EVOLUTION OF THE FISCAL DEFICIT
(% OF GDP, %)

– Fiscal deficit allowed by the Fiscal Rule

(f) Forecast.
Source: BBVA Research with Minhacienda, Law 1943 of 2018 and 2010 of 2019 data

Despite optimistic government assumptions (relative to the average of analysts), the lower fiscal rule objective, the reduction in some tax tariffs and the compromises from the Growth Law impose a fiscal challenge for 2021

Principal macroeconomic variables

TABLE A1. MACROECONOMIC FORECAST

	2017	2018	2019f	2020f	2021f
GDP (% y/y)	1.4	2.6	3.2	3.2	3.5
Private consumption (% y/y)	2.1	3.6	4.8	4.3	4.0
Public expenditure (% y/y)	3.8	5.6	3.8	3.8	3.3
Fixed investment (% y/y)	1.9	1.5	4.1	5.0	4.7
Inflation (% y/y, eop)	4.1	3.2	3.8	3.4	3.2
Inflation (% y/y, average)	4.3	3.2	3.5	3.5	3.3
Exchange rate (eop)	2,984	3,250	3,277	3,340	3,220
Devaluation (%, eop)	-0.6	8.9	0.8	1.9	-3.6
Exchange rate (average)	2,951	2,956	3,281	3,271	3,231
Devaluation (%, eop)	-3.4	0.2	11.0	-0.3	-1.2
Policy interest rate (%,eop)	4.75	4.25	4.25	4.25	4,75
DTF rate (%, eop)	5.3	4.5	4.4	4.5	4.9
Fiscal balance Central National Government (% GDP)	-3.6	-3.1	-2.4	-2.3	-1.8
Current account (% GDP)	-3.3	-3.8	-4.6	-4.2	-3.9
Urban unemployment rate (%, eop)	9.8	10.7	10.8	10.7	10.5

(*) Contribution to GDP growth. (f) Forecast.
Source: BBVA Research

Principal macroeconomic variables

TABLE A2. MACROECONOMIC FORECAST

	GDP (% y/y)	Inflation (% y/y, eop)	Exchange rate (vs. USD, eop)	Policy interest rate (%, eop)
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	3.3	3.8	3,462	4.25
Q4 19	3.5	3.8	3,277	4.25
Q1 20	3.6	4.0	3,200	4.25
Q2 20	2.9	3.4	3,240	4.25
Q3 20	2.9	3.3	3,320	4.25
Q4 20	3.4	3.4	3,340	4.25
Q1 21	3.8	3.4	3,210	4.50
Q2 21	2.6	3.2	3,215	4.50
Q3 21	4.1	3.2	3,240	4.50
Q4 21	3.6	3.2	3,220	4.75

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