RESEARCH

Economic Watch

Colombia

Bogota, December 27, 2011
Economic Analysis

Colombia
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Continued growth of the Colombian economy expected in 2012

Strength of domestic demand is confirmed in 3Q11

- **Annual GDP growth of 7.7% in the third quarter of 2011 (3Q11) confirms the dynamism of domestic demand**

  Domestic demand grew 9.4% annually, boosted by the sustained dynamism of private consumption and investment and the 20.9% year-on-year increase in civil works investment

- **Leading indicators point to a moderation of private demand**

  Private consumption and investment will moderate as a result of the slowdown of durable goods consumption toward more sustainable long-term growth rates and of the temporary upturn in spending on transport equipment during 2011,

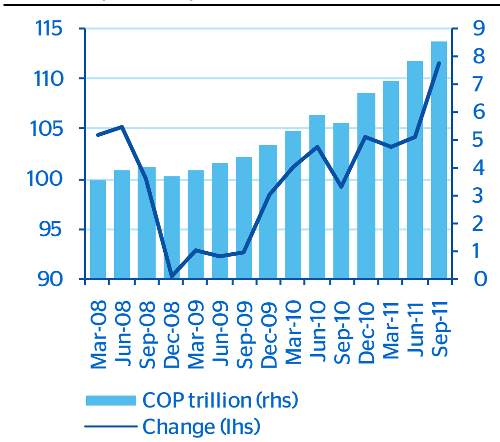
- **Investment in civil works will return to sustainable growth in 2012**

  Rapid growth in civil works is expected, linked to spending to repair the damage caused by the heavy rains and the start of large infrastructure projects, among which the "corredores para la competitividad" ("road works for competitiveness") and the construction of the Ruta del Sol.

- **GDP growth forecasts are conditioned by the external outlook**

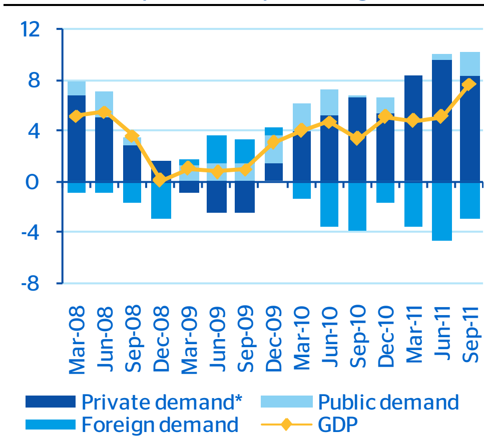
  Observed data as of November show a marginal impact on domestic confidence of the greater instability seen worldwide, suggesting a limited effect on domestic demand. However, a lesser foreign demand as a consequence of a marked slowdown in Europe would have important effects on the manufacturing and other tradable sectors.

Chart 1
Gross Domestic Product
COP and year-on-year variations (%)



Source: DANE and BBVA Research

Chart 2
Contributions to GDP by demand components. In percentage



Source: DANE and BBVA Research

Evaluation and growth prospects

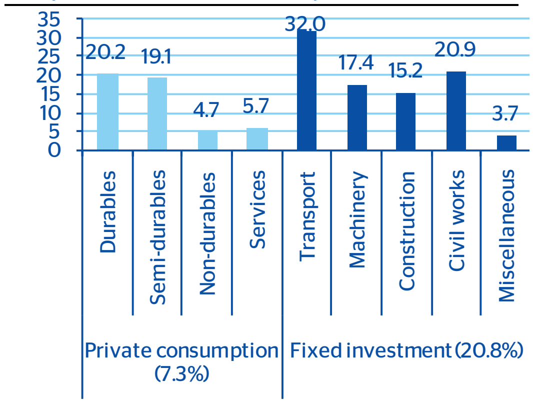
Good pace of activity during the third quarter of 2011

During the third quarter of 2011, the economy grew at an annual rate of 7.7%, maintaining a rate of expansion, in quarterly terms, similar to that seen during the first quarter of the year. In addition, overall performance of the quarter reflected in part the low base of comparison of public consumption and investment seen over the same period in 2010.

By spending sectors, the greatest boost continued to come from private demand (consumption and investment) which, in the midst of a strong recovery of local confidence indicators, accelerated its growth to 10% annually, a level not seen since 2007. Also, civil works provided a considerable boost, especially in the area of mining and the road network. Thus, the good health of domestic demand combined with the positive contribution of public investment, meant diversified growth from several demand sources.

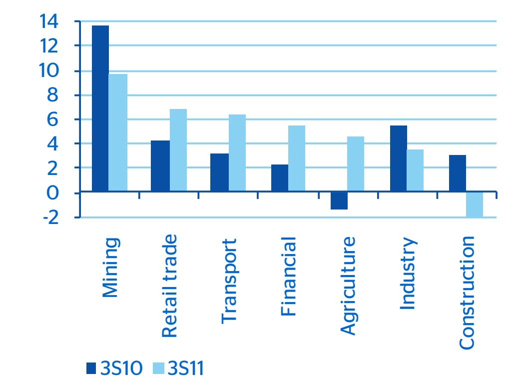
This balanced growth was also seen in the GDP supply components where, as of September, all of the production sectors had been growing throughout the year. Furthermore, the trade and non-tradable sectors grew at a similar pace in the third semester, at 8.4% and 7.5% annually, respectively.

Chart 3
Growth of consumption and investment by components in 3Q11. Year-on-year variations (%)



Source: DANE and BBVA Research

Chart 4
Growth by sectors, 3Q11. Annual variations (%)



Source: DANE and BBVA Research

Leading indicators point to a moderate slowdown of activity

From the fourth semester of 2011 and during the first semester of 2012, we expect private demand to slow down and approach more sustainable rates, after seven consecutive quarters with growth above GDP. On the one hand, early consumption indicators confirm the change of composition of household spending that started at the end of 2010. In particular, spending on durable goods such as vehicles and home appliances has been slowing down from very high rates that implied a strong contribution to the total of household spending in spite of only representing 6% of consumption. Meanwhile, the consumption of semi-durable goods, non-durable goods, and services is undergoing a recovery that is still incipient and does not compensate the lesser contribution of the more dynamic sector.

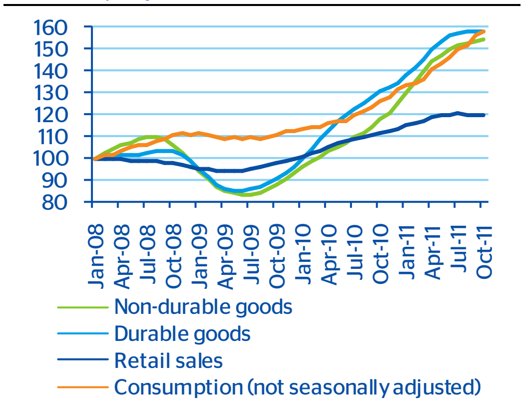
This is reflected in recent retail sales and imports statistics, whose variation during the first half of 2011 was mainly driven by spending on durable goods. In particular, sales of foods and non-alcoholic beverages (30% of the total in sales) have slightly diminished in annual terms due to the scarce supply and increase in prices that resulted from the strong rainy season. Furthermore, hotel occupancy rates, an indicator used to estimate household spending on services, remained stable with respect to the preceding months (seasonally adjusted), all of which anticipates reduced consumption dynamics when compared to that seen throughout this year.

Other explanations for the slowdown in domestic demand are to be found in investment and exports. Investment in transport equipment, which grew in 2011 at a rate approaching 50% year-on-year, will decelerate in 2012 in keeping with recent trends in imports. Finally, manufacturing exports will be subject to decreased foreign demand, mainly as a result of reduced activity in Europe.

The labor market finished the year on a positive trend despite existing rigidities

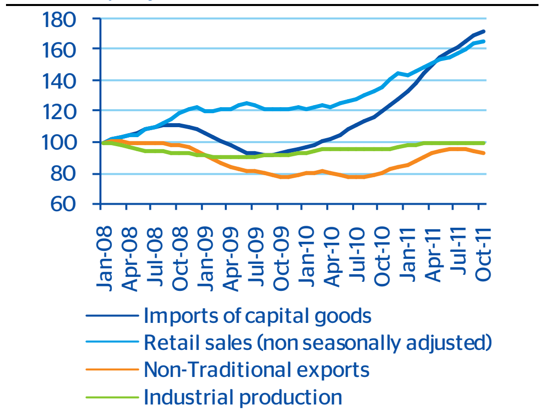
In addition to high confidence levels, the good health of consumption has been supported in large part by a significant improvement in the labor market. As of November this year, the unemployment rate dropped to under 10% and salaried employment grew 4.3% year-on-year, in particular due to increased activity in the commerce, manufacturing, and construction sectors. In 2012, the job creation rate, although positive, could be affected by the high increase in the minimum wage. According to our analysis, the minimum wage increase of 5.8% in 2012, above inflation and the improvement in productivity, contributes to the current inefficiency of the labor market, increasing informality and limiting the positive trend in job creation.

Chart 5
Leading private consumption indicators
Seasonally adjusted index (2008=100)



Source: DANE, Bank of the Republic and BBVA Research

Chart 6
Leading private investment indicators
Seasonally adjusted index, 2008=100



Source: DANE, Bank of the Republic and BBVA Research

The Colombian economy will grow close to its potential in 2012, with a positive contribution from civil works

In 2012 we expect reduced growth in private demand to be largely compensated by the increase in civil works projects. The increase in public investment, which will take place in spite of the launch of new local authorities in January, will be the result of the compromise reached by the national government in the structuring and bidding processes of infrastructure projects, combined with the finalization of large urban public transport works now underway.

Against this background, BBVA Research expects that GDP growth in 2011 will be slightly higher than our previous forecast of 5%, and that this trend will continue into 2012, when the economy will expand near potential (around 5%). This forecast for GDP takes into account the strong boost expected from the construction sector, both public and private.

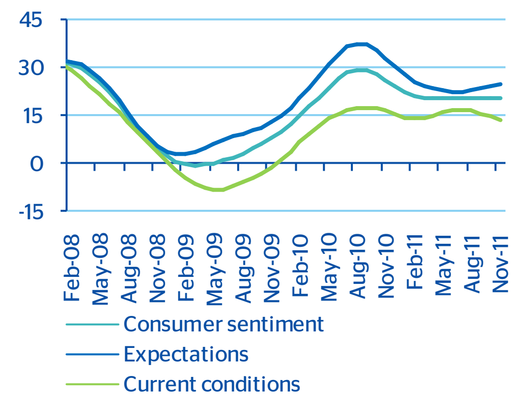
The domestic demand boost will limit the effects of external instability

The performance of the economy next year will be conditioned by the impact of global turmoil on internal development. On this respect, recent data points to a marginal effect of the external environment on consumer and business confidence, compared to the Lehman Brothers episode, which demonstrates that the Colombian economy is better prepared to confront global turbulences and has the necessary tools to carry out counter-cyclical economic policies.

In this sense, the positive tax collection result seen in 2011, which exceeded the official objective in almost 2% of GDP, leaves room for maneuvering toward fiscal stimulus should the European crisis deepen. In addition, in this scenario, the central bank would possess margin to reduce interest rates and stimulate private spending.

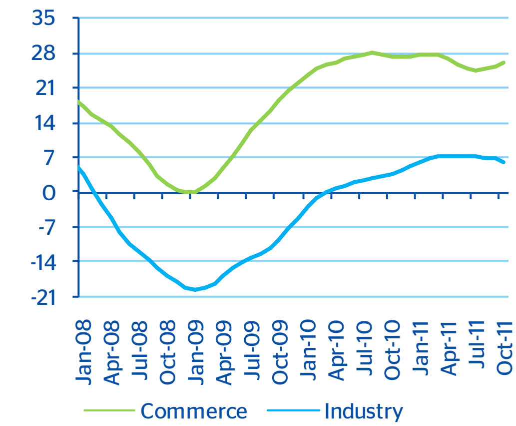
Therefore, with a lesser impact of the external environment on local confidence as well as margin for the enactment of a counter-cyclical policy, solid economic growth can be expected even in the event of a recession in the US and Europe during 2012. Indeed, BBVA Research forecasts indicate that economic growth in 2012 under this more adverse scenario would be above 3%, based on a controlled slowdown of private spending and growth in public demand, which would partially compensate for reduced exports.

Chart 7
Consumer confidence indicators
Seasonally adjusted index



Source: Fedesarrollo and BBVA Research

Chart 8
Business confidence indicators
Seasonally adjusted index



Source: Fedesarrollo and BBVA Research

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