

# Colombia Business Forecast Report Q2 2014

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## Abstracts

### Core Views

We believe that Colombia's economy will expand at robust growth rates in the coming years, characterised by improved macroeconomic conditions and an increasingly friendly business environment. Stronger private consumption will drive the majority of growth, although gross fixed capital formation (GFCF) will play an increasingly important role over the coming quarters.

The infrastructure, mining and hydrocarbons sectors are particularly well positioned for growth.

We expect President Juan Manuel Santos to win re-election in May, and anticipate broad policy continuity throughout the next administration.

### Major Forecast Changes

We have revised our real 2014 real GDP growth forecast from 4.4% to 4.3%, following a downward adjustment to our 2013 growth estimate, from 4.3% to 4.1%, due to weaker-than-expected economic activity in Q413.

The Colombian peso weakened more than we expected this year, prompting us to revise our 2014 average exchange rate forecast from COP1,880/US\$ to COP1,980/US\$, implying a 5.9% depreciation from last year's average exchange rate of COP1,869/US\$.

### Key Risks To Outlook

Upside Risks: Elevated foreign investment inflows into the country following Colombia's

upgrade to 'investment grade' by all three major ratings agencies could drive growth even faster than expected. In addition, a successful agreement during the ongoing peace negotiations between the government and the country's main left-wing insurgent group, the Fuerzas Armadas Revolucionarias de Colombia (Farc), would likely result in even greater foreign investment as risk perception improves.

**Downside Risks:** Another wave of labour strikes would pose significant downside risks to our export and real GDP growth outlook. Indeed, workers demanding higher wages and greater government support disrupted key exports such as coal throughout 2013, and another episode of industrial activity cannot be ruled out at this moment.

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### **CHAPTER 1: POLITICAL OUTLOOK**

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Santos To Win Re-Election But Security Concerns To Remain High

We believe that Colombian President Juan Manuel Santos will win re-election on May 25, though a first-round victory is highly unlikely. We expect that achieving a peace agreement with the Farc will be at the top of Santos's second term agenda, but do not see a longlasting peace agreement being reached this year and believe that rising smaller criminal organisations will be an increasing concern for the government and firms operating in the country.

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Long-Term Political Outlook

Many Structural Challenges Ahead

While Colombia's long-term political outlook is set to remain relatively stable compared with its neighbours, we identify several massive political challenges for the government over the next decade and highlight three scenarios for change.

### **CHAPTER 2: ECONOMIC OUTLOOK**

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Growth To Re-Accelerate In 2014 And 2015 As Consumption And Exports Pick Up

We continue to expect the Colombian economy to accelerate in the coming years, driven by stronger export growth and household consumption. Indeed, we forecast real GDP growth of 4.3% in 2014 and 4.5% in 2015 respectively, up from our estimate of 4.1% in Table: GDP BY EXPENDITURE, REAL GROWTH %

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We forecast Colombia's current account deficit to narrow in 2014 and 2015, driven by a

recovery in exports, after strike activity last year disrupted production in key-export oriented sectors, such as coal. In addition, we expect foreign direct investment to remain robust, especially into the infrastructure and oil and gas sectors, which will continue to result in strong financial account surpluses in the coming years.

Table: CURRENT ACCOUNT, % of GDP

#### Monetary Policy

##### Rate Hiking Cycle To Begin This Year As Inflation Heads Higher

We believe Colombia's Banco Central de la República (BanRep) will begin hiking rates this year, as domestic demand growth accelerates and consumer price inflation ticks up. We forecast BanRep to increase its policy rate by 50 basis points (bps) from 3.25% to 3.75% by end-2014 and then by another 75bps to 4.50% by end-2015.

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After Colombia's government budget deficit widened slightly in 2013, we expect fiscal consolidation to regain traction in 2014 and 2015. Rising revenue growth, in large part due to greater income tax intake, will be a main driver of a stronger fiscal position. In addition, we expect the next administration to maintain fiscal prudence in terms of spending, given the composition of the newly-elected congress, which is dominated by fiscally conservative parties.

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