

Colombia Business Forecast Report Q3 2014

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Abstracts

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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

The Colombian peso strengthened more than we expected in Q214, prompting us to revise our 2014 average exchange rate forecast from COP1,980/USD to COP1,955/USD. We revised our end-2014 policy rate forecast from 3.75% to 4.25%, amid an early than-expected monetary policy tightening cycle by Colombia's Banco Central de la República.

Contents

CHAPTER 1: POLITICAL OUTLOOK

SWOT Analysis

BMI Political Risk Ratings

Domestic Politics

Economic Policies To Remain Investor-Friendly Despite Tight Presidential Race

We expect economic policy to remain investor-friendly in Colombia regardless of the result of the tight presidential race. The election,

which we believe is too close to call, will be decided June 15 in a second -round run-off between centre-right Óscar Iván Zuluaga and

incumbent President Juan Manuel Santos. A victory by Zuluaga would have the most negative implications for the security environment,

as it would increase the risk of attacks by left-wing insurgent groups.

Table: POLITICAL OVERVIEW

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

SWOT Analysis

BMI Economic Risk Ratings

Economic Activity

Growth To Accelerate As Consumption Picks Up And Exports Recover

Real GDP growth in Colombia will accelerate in 2014 and 2015, driven by stronger private consumption growth and a recovery in goods

exports. Indeed, record-low unemployment levels, combined with rising access to consumer credit, will support stronger household

spending, while robust external demand for thermal coal, and improvements in oil production growth, will bolster exports.

Table: GDP By Expenditure

Fiscal Policy

Fiscal Consolidation To Resume In 2015 As Spending Moderates

Colombia's government budget deficit will widen to 2.5% of GDP in 2014 from 2.2% in

2013, due to an uptick in spending in H114 in the run up to the presidential election. However, we expect fiscal consolidation to resume in 2015, driven by a moderation in spending and greater revenue growth, especially from income tax.

Table: Fiscal Policy

Balance Of Payments

External Accounts To Benefit From Trade Diversification

We forecast Colombia's current account deficit to narrow in the coming years on the back of robust export growth, particularly in the oil and coal sectors. While Colombia is highly exposed to declining US demand for oil amid the ongoing shale boom, growing diversification into Asian markets will ensure oil exports continue to grow at a strong pace. In addition, Colombia's external accounts will also benefit from steady demand for thermal coal, both out of Asia and Europe.

Table: Current Account

Monetary Policy

Additional Rate Hikes This Year As The Economy Picks Up Steam

We expect Colombia's Banco Central de la República (BanRep) to pursue additional rate hikes this year, following a 25 basis points (bps) hike to 3.50% in April, and 25bps to 3.75% in May. We forecast 50bps worth of hikes to 4.25% by end-2014, as economic activity continues to improve and inflation expectations head higher.

Table: Monetary Policy

Currency Forecast

COP: Capital Inflows To Sustain Strength

The strength that the Colombian peso has experienced in recent months will prevail through the rest of the year, driven by capital inflows into domestic debt, and robust foreign investment into the hydrocarbons sector. However, ongoing intervention by Colombia's central bank will prevent the unit from appreciating significantly below support at COP1,875/USD for a sustained period.

Table: BMI Colombia Currency Forecast

Table: Exchange Rate

Regional Sovereign Outlook

A Divergent Outlook For Regional Credit Risk

Most major Latin American sovereigns will see credit risk remain relatively stable in the coming quarters given a reduced prospect of sharp capital outflows and still-robust macroeconomic fundamentals. However, poor fiscal dynamics will weigh on investor perceptions

of credit risk in Brazil, and credit default swap markets will continue to price in an elevated risk of default in Argentina and Venezuela.

CHAPTER 3: 10-YEAR FORECAST

The Colombian Economy To 2023

Sustainable And Sturdy Growth

Business-friendly policies and an improving security situation will help Colombia achieve sustainable levels of strong real GDP growth, which we forecast will average 4.6% in 2014-23. A surge in fixed investment will catalyse such growth over the coming years and we expect consumption to follow suit and remain the main driver of the Colombian growth story.

Table: Long-Term Macroeconomic Forecasts

CHAPTER 4: BUSINESS ENVIRONMENT

SWOT Analysis

BMI Business Environment Risk Ratings

Business Environment Outlook

Table: BMI Business And Operation Risk Ratings

Institutions

Table: BMI Legal Framework Rating

Table: Labour Force Quality

Infrastructure

Table: LATIN AMERICA - ANNUAL FDI INFLOWS

Market Orientation

Table: Trade And Investment Ratings

Operational Risk

CHAPTER 5: KEY SECTORS

Defence

Table: Defence Expenditure

Shipping

Table: Major Port Data, 2011-2018

Other Key Sectors

Table: Oil and Gas Sector Key Indicators

Table: Pharma Sector Key Indicators

Table: Infrastructure Sector Key Indicators

Table: Telecoms Sector Key Indicators

Table: Food and Drink Sector Key Indicators

Table: Freight Key Indicators

CHAPTER 6: BMI GLOBAL ASSUMPTIONS

Global Outlook

Emerging Market Deceleration

Table: Global Assumptions

Table: Developed States , Real GDP Growth H, %

Table: BMI VERSUS BLOOMBERG CONSENSUS REAL GDP GROWTH
FORECASTS, %

Table: Emerging Markets , Real GDP Growth , %

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