BBVA Research

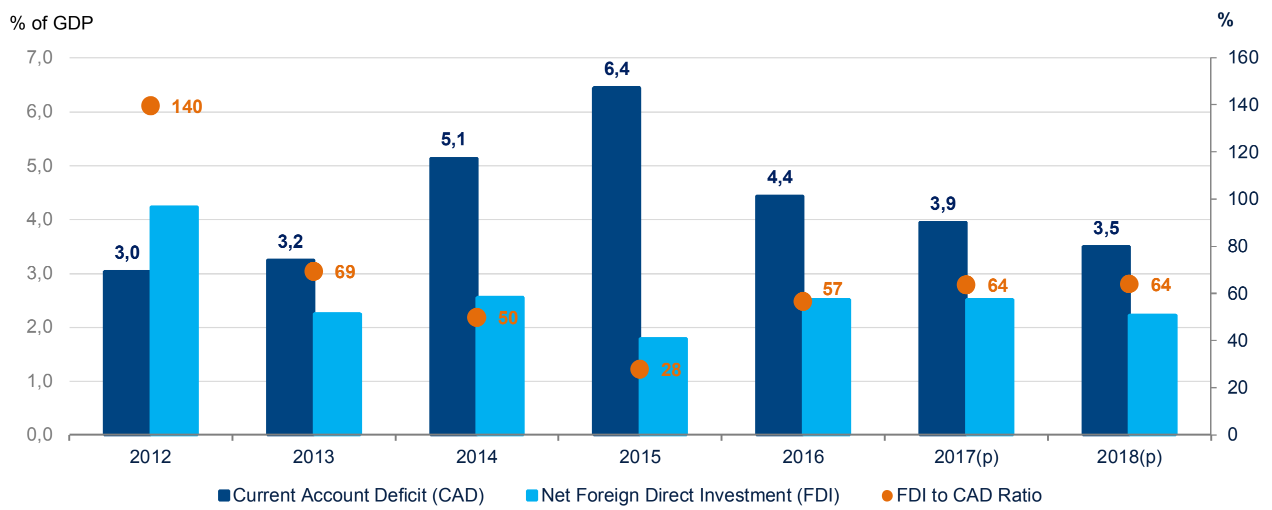
6. The path of improvements in the structural balance must continue over the medium term

Work on adjusting the external balance must continue, although it is likely that the pace will slow

Some of the low growth expected in 2017 and 2018 is explained by a weak outlook for exports. The real devaluation of the exchange increased optimism about the outlook for sales of products other than commodities (and industrial products). However, the value of non-traditional products exported in 2016 (USD 13,600 million) was lower than in 2014 (USD 15,400 million), when the depreciation of the exchange rate began. So far in 2017, there has only been a significant increase in May. Some of this poor performance is explained by low growth in some of the country's trading partners in the region, although the competitiveness issues affecting the country's industry should not be overlooked.

Moreover, expected oil production is down on previous years. This will continue falling, reaching 790 thousand barrels per day in 2020, offsetting some of the gains from the higher oil price we expect to prevail in future. We expect exports to rebound, although more slowly this time, as GDP accelerates in our regional trading partners and because of higher oil prices. These adjustments will slow the external adjustment of Colombia's economy slightly. The current account deficit will stand at 3.9% of GDP in 2017, and 3.5% of GDP in 2018. A large percentage of this will continue to be funded by direct foreign investment (Figure 6.1).

Figure 6.1 Current account deficit and net direct foreign investment (%)



Source: Central Bank of Colombia and BBVA Research

A larger negative effect on the labour market and a cycle of pessimism on the part of consumers are the main risks facing the economy in the coming quarters

The main risks to the economy continue to be domestic. A sharper than anticipated deterioration in the labour market could keep consumer confidence in negative territory for longer, impacting consumption growth in the country. Likewise, a persistent deterioration in business confidence could further delay investment decisions by businesses. Furthermore, while we have been quite conservative in our projections for roll out of the 4G infrastructure programme, there could also be additional delays that would set progress back.

On the international front, one of the main risks - which, while remote, should be assessed now - is the high share of domestic public debt held by foreign investors. There may be a number of explanations for their decision to invest in a country such as Colombia, including that its domestic debt is a more attractive alternative than that of other emerging economies, and even some developed economies. This relative value for long-term holders of debt is maintained through the higher interest on such purchases than they could receive from other investments. However, some investors are motivated by relative value through the extent to which their investment might have revaluation potential in the local market, if there are forces driving the value of the debt upwards. In current circumstances, the drop in inflation and reductions in the Central Bank's rates have driven such a revaluation of the debt. However, we are reaching the limits of this revaluation, and this could potentially lead to investors selling their holdings. This issue has become more relevant, among other factors, because of the Fed's recent announcement that it will start to gradually run down its balance sheet from October. This will involve it making fewer purchases in capital markets, reducing perceptions of liquidity in the market over the medium term, and causing debt to depreciate, motivating the second type of investor to move out of economies such as Colombia. This could lead to some temporary exchange rate risk and a depreciation of domestic debt, whilst making government funding more expensive.