1. Editorial

Our outlook for global growth remains 3.3% in 2017 and 3.4% in 2018. We expect slower growth in the USA, due to weak figures in the first quarter and difficulties in getting expansionary policies through, while economic policies in China have enabled stronger growth, leading us to revise our projections upwards, as is also the case for Europe.

There are few historical precedents for the shock to the terms of trade experienced by Colombia in 2015 and 2016, making it a unique event. On this occasion, confidence in Colombian institutions enabled the country to attract foreign funding, smoothing out the spending cycle, particularly for consumption, stopping the shock developing into a recession. But unlike past cycles, there are no clear exogenous factors supporting recovery, meaning the cycle is likely to show an extended **L** shape, with a very slow recovery.

The economic slowdown has continued into 2017, with YoY growth of 1.1% in the first quarter, and signs of similar, but slower, growth in the second quarter. The conditions for low growth are in place for the recovery phase. We see a number of fiscal and monetary policy restrictions on injection of a robust stimulus to the economy. On the fiscal side, this is due to the drop in revenues and the limits imposed by the fiscal rule, with a deficit that should fall from 4.0% in 2016 to 3.1% in 2018. On the monetary side, this is due to risks of persistent inflation and foreign trade balances which remain high. These will enable interest rates to be reduced to 5.25% in 2017 and 4.50% in 2018, falling in territory between slightly expansionary and neutral. Inflation will stand at 4.3% at year-end 2017 and 3.2%, in 2018, largely due to reversal of the 2016 supply-side shocks.

Lower interest rates and inflation will boost the purchasing power of consumers, whose confidence and spending could gradually return to normal, once they get used to the new tax conditions, with growth in household consumption of 1.6% in 2017 and 2.3% in 2018. Turning to companies, investment will start to adjust to positive territory after two years of contraction. However, expansion will be moderate - at just 1.9% in 2017 and 3.1% in 2018 - due to continuing weakness in demand. This being the case, we expect the economy to grow by 1.5% in 2017, an additional slowdown following the 2.0% recorded in 2016. We expect a slight recovery in activity in 2018, with growth returning to 2.0%, continuing a prolonged cycle of low growth similar to that from 2000 to 2003.

The main risk to the economy is the longer than expected duration of the current cycle. Against this backdrop, the labour market could deteriorate by more than expected, amplifying the negative cycle of business and consumer confidence, and postponing the expected increases in activity. On the external front, the main risk may come from an unexpected adjustment to capital flows, whether resulting from a faster adjustment of US monetary policy or from yields on the financial instruments of countries that are about to embark upon downward rate cycles. However, it should be noted that the vulnerability of the Colombian economy has decreased significantly, with a reduction in the current account deficit of around 2 pp between 2015 and 2016, and expectations of additional improvements in 2017 and 2018.