1. Editorial

The emerging economies' recovery cycle has consolidated, accompanying the developed economies' strong performance in the past few quarters. This dynamic has been underpinned by an improvement in commodity prices resulting from growth in China driven by domestic policies, improved consumer confidence, and increased consumer spending in the US and Europe. This improved outlook for activity, within a context of still-contained inflation, has opened the door to the normalisation of monetary policy in the US, which raised its base rates three times in 2017, with similar adjustments expected for 2018 together with the Federal Reserve's balance sheet reduction programme which started last October. The reaction of the capital markets has been favourable, incorporating this panorama of orderly and gradual adjustments into its asset valuation, which has led to a flattening of the yield curve for US Treasuries and limited gains on the equities front following the strong boost at the end of 2016.

For the region, strong demand from developed economies and China has translated into a significant improvement in the terms of trade, enabling it to cope with the adjustments to monetary policy without too many upsets in their currency or asset prices, while as the same time providing a new boost to regional activity. In the case of Colombia, this boost allows additional narrowing of the current account deficit to levels consistent with the current cycle, with crude at over US$60 a barrel. At the same time, we anticipate improved performance from the mining and energy sector in 2018, with increased investment and output even though in the medium term, risks persist as to reserves. Meanwhile sectors such as civil engineering, exports and trade will post more positive performances, allowing manufacturing to also see positive growth figures in 2018 and 2019. This being so, we expect the economy to grow by 2% in 2018, more than the 1.5% forecast for 2017. Activity will gradually continue to regain dynamism, as it has done since the second half of 2017. We consequently anticipate a better performance in the second half of 2018 than in the first, with growth consolidating at around 3% for 2019, closer to the Colombian economy's potential growth.

Inflation should remain under control, moving closer to the target in 2018, ending the year at around 3.1% and slightly lower in 2019 (2.8%). This dynamic in prices as a whole with less vulnerability in the current account should allow the central bank to cut its base rate in the first half of 2018 to 4% and hold it at that level for a couple of years. On the currency front, we do not see any obvious tensions in the short term to replicate the events of 2014-2016, although in the first half of the year, as a result of the normalisation of US monetary policy and the Colombian electoral cycle, there could be upward pressure on the exchange rate, although not beyond 3,100 pesos to the dollar. In the second half of the year the currency could appreciate thanks to better oil prices, improved production and the impact this will have on the current account. This being so, we expect an exchange rate of around 3,000 pesos to the dollar, ending the year slightly below this figure.

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This report has been produced by the Colombia Unit

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