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Colombia Economic outlook

2Q22

April 6, 2022

Creating Opportunities

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Contents

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01

Global growth is resilient despite higher uncertainty

Global inflation will remain high and Europe will be the most affected zone with the Ukraine-Russia conflict

Main messages

Ukraine-Russia conflict

The military conflict between Ukraine and Russia and the severe sanctions recently implemented represent a significant supply shock, with negative effects on both growth and inflation through the commodities, financial volatility, confidence and supply chains channels. In the current context, uncertainty is exceptionally high.

Activity

The global economy will slow down more than expected. After expanding 6.1% in 2021, global GDP is expected to grow 4.0% this year and 3.6% in the next (-0.4pp and -0.2pp, respectively, compared to previous forecasts). The downward revision of growth is significant in Europe and moderate in the rest of the geographies.

Inflation and central banks

Inflationary pressures continue to increase, most of all due to commodity prices and supply bottlenecks. Central banks are expected to keep their focus on inflation and move forward with the withdrawal of monetary stimulus. The Fed will be more aggressive: it is expected to take interest rates to at least 2% this year and 3% in the next. The ECB, after ending the PEPP and accelerating the reduction of the APP, will begin to raise rates towards the end of the year. Thus, in the Eurozone, the task of cushioning the impact of the conflict would fall on other policies (such as fiscal policy).

Risks

A deterioration of the conflict and a further escalation of sanctions could cause a scenario of stagflation, at least in Europe. The withdrawal of monetary stimulus by the Fed, which could cause an economic recession or financial disruptions, and a hard-landing of growth in China, due to the severe Covid restrictions, are also among the main risks.

Economic uncertainty, at unusually high levels, once again

BBVA RESEARCH INDEX DE ECONOMIC POLICY UNCERTAINTY

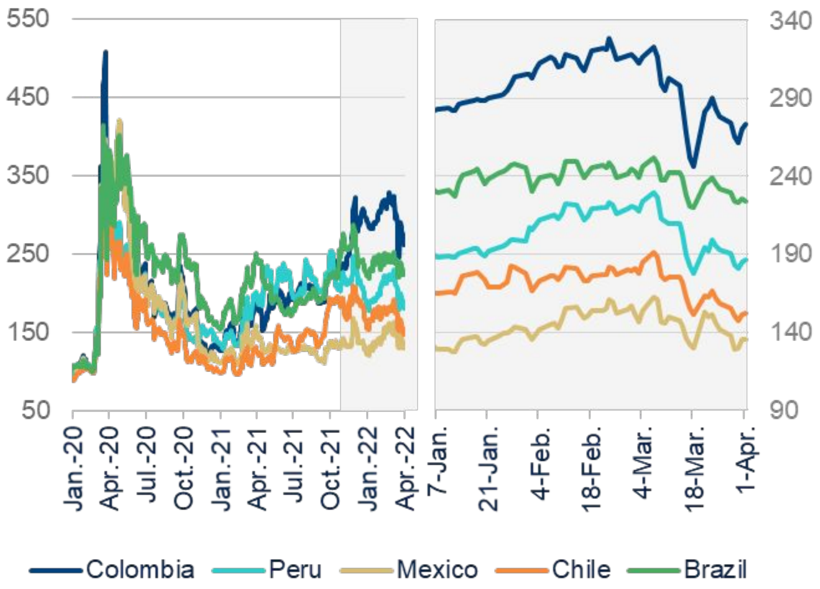
(INDEX FROM 0 TO 100)

Source: BBVA Research based on data by GDELT.

Uncertainty from the conflict and its economic impacts are mixed across the world

5Y CDS FOR NEIGHBORING COUNTRIES

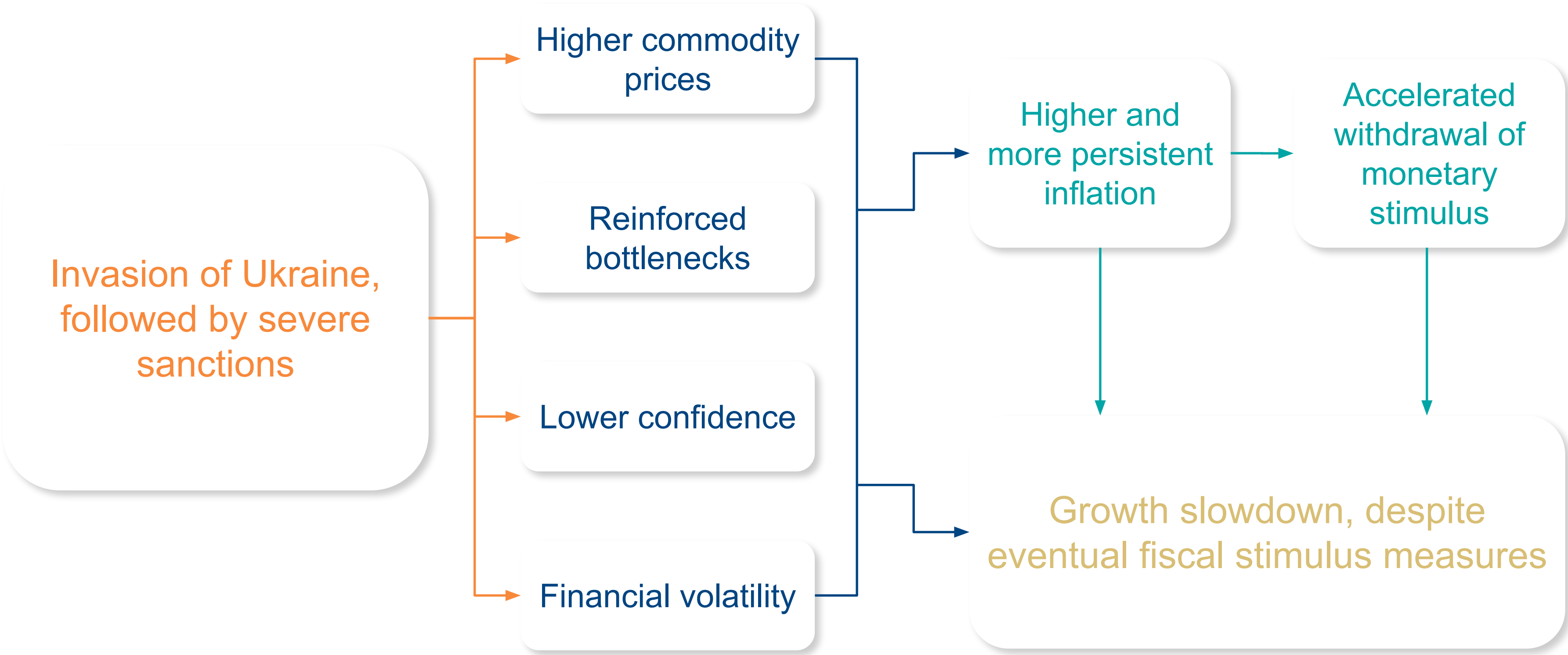
(INDEX, FEB 18, 2020 = 100)



- Risk premiums in Latin America's largest countries have narrowed despite the situation.
- The makeup of the region's economies and foreign trade balances leave them relatively protected from a new shock.

Source: BBVA Research based on data by Bloomberg.

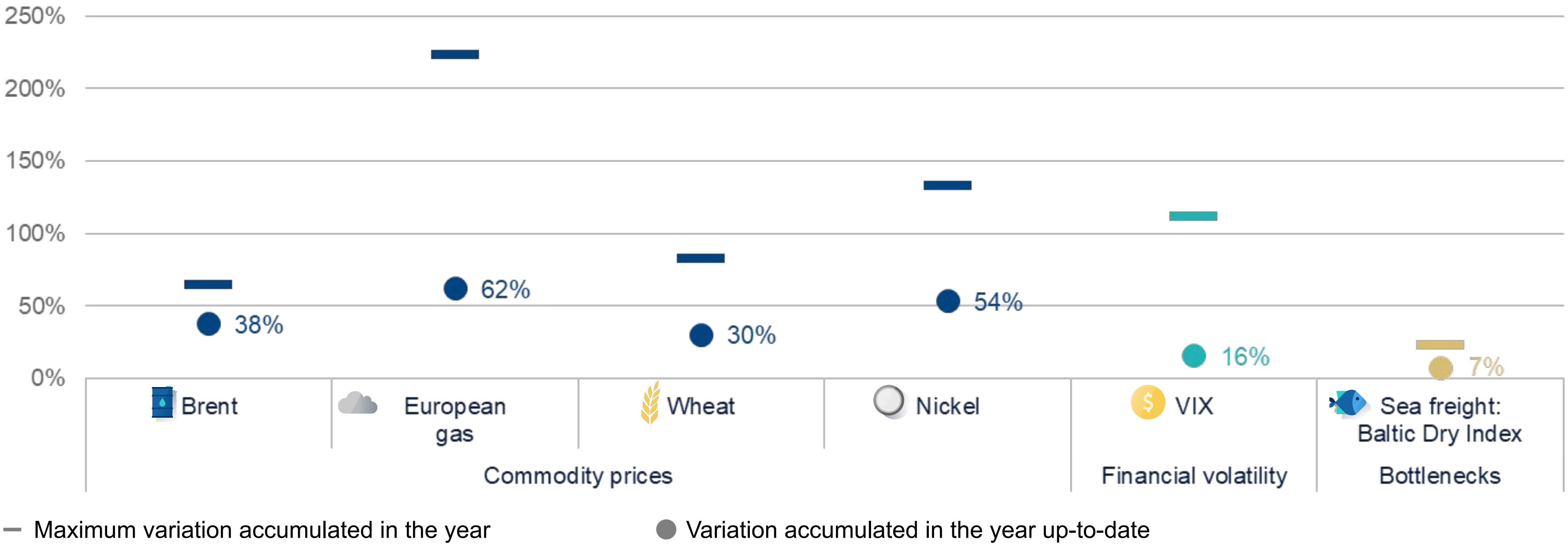
The Ukraine-Russia conflict reinforces both inflationary pressures and the moderation trend in activity growth, mainly in Europe



Sharp rise in commodity prices, financial volatility and signs of further deterioration of supply bottlenecks

SELECTED INDICATORS OF COMMODITY PRICES, FINANCIAL MARKETS AND SUPPLY BOTTLENECKS

(PERCENTAGE CHANGE ACCUMULATED IN THE YEAR UP TO MARCH 31ST, 2022)

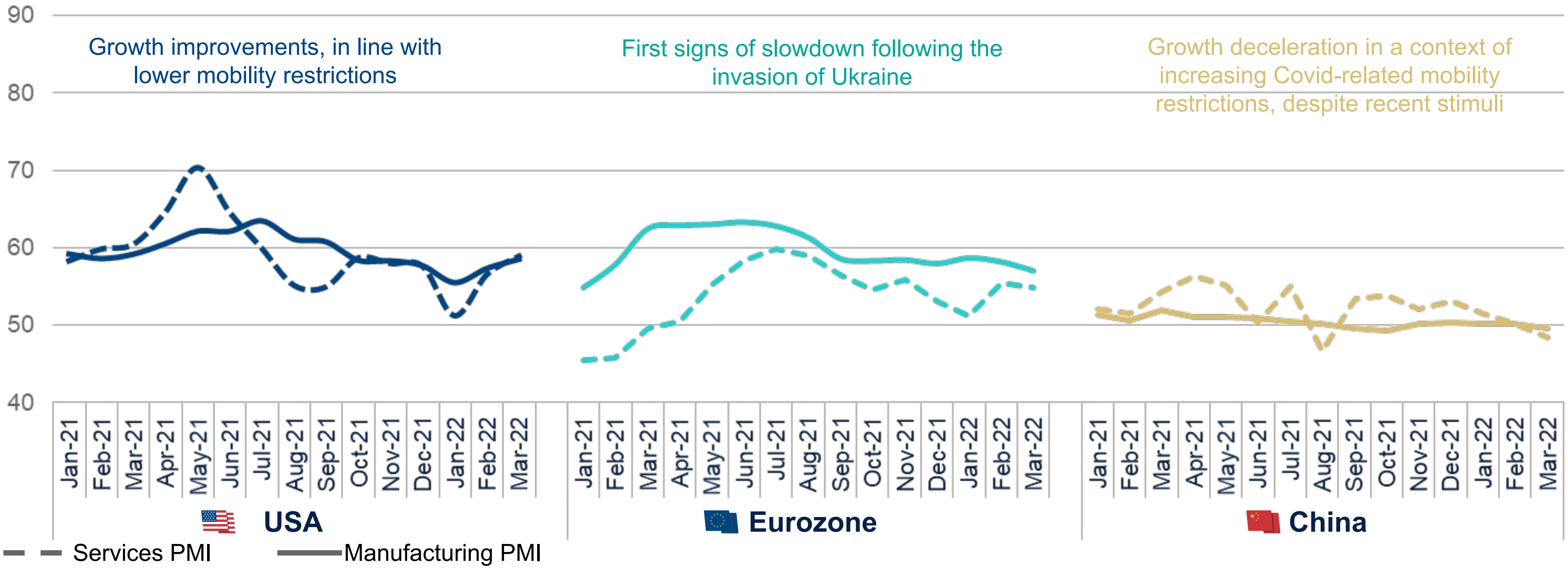


Source: BBVA Research based on data by Haver.

Activity moderates in Europe and exhibits resilience in the US, following the invasion of Ukraine, while it slows in China amid increasing Covid restrictions

PMI INDICATORS

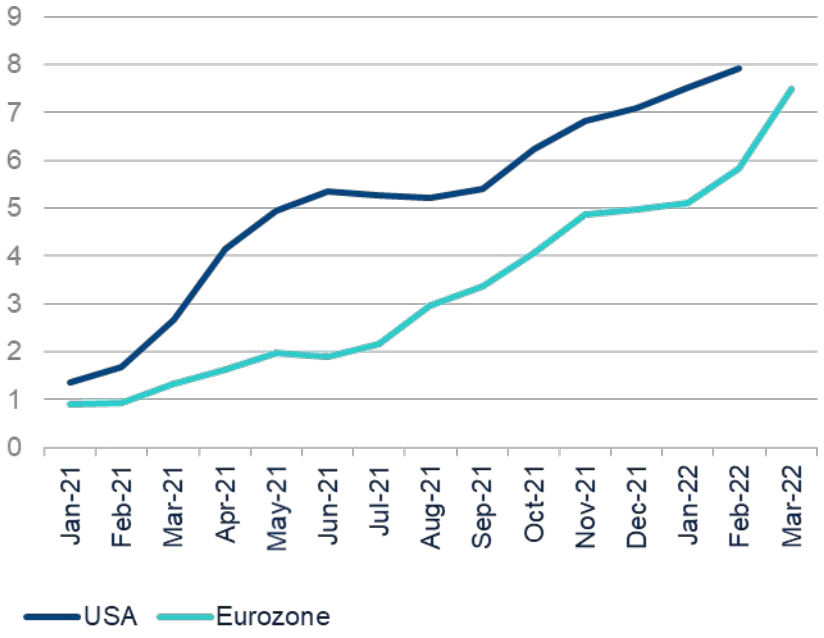
(HIGHER THAN 50: EXPANSION; LOWER THAN 50: CONTRACTION)



Source: BBVA Research based on data by Haver.

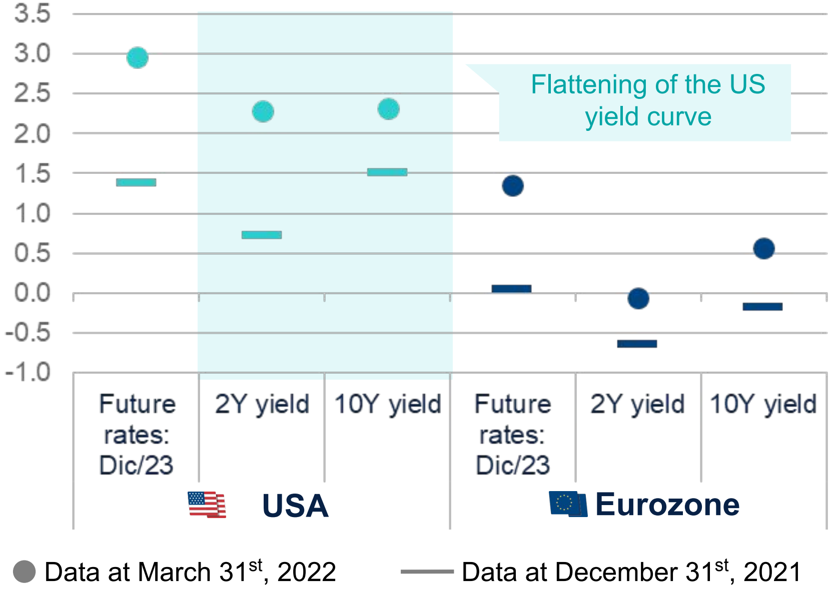
Given the increase in inflationary pressures, expectations of monetary tightening ahead have been reinforced

INFLATION: CPI
(Y/Y %)



Source: BBVA Research based on local statistics.

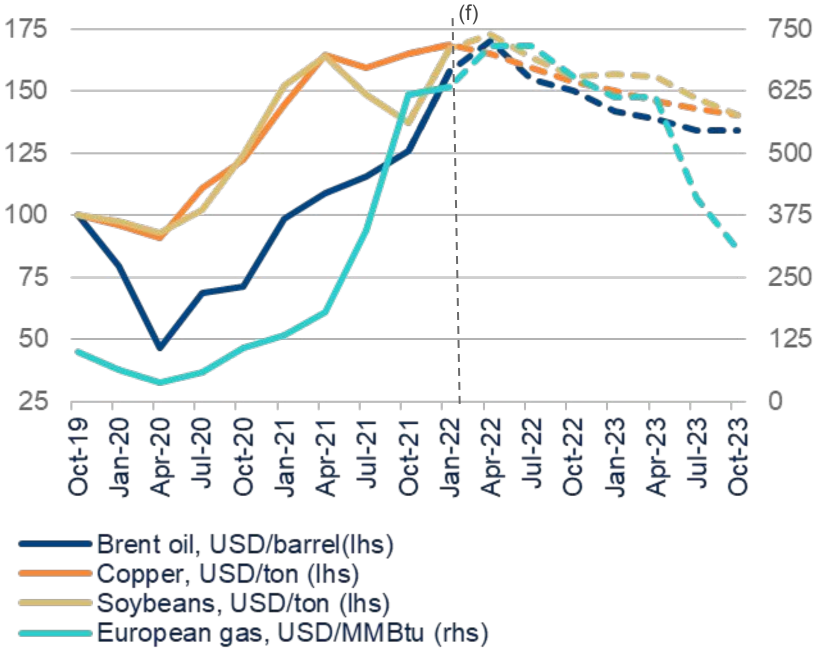
POLICY RATES: MARKET EXPECTATIONS; SOVEREIGN BOND YIELDS *
(%)



*: Market expectations for policy rates in Dec/23 implicit in future contracts. Eurozone yields: German bond yields. .
Source: BBVA Research based on data by Bloomberg.

The war represents a significant supply shock, with negative economic effects mainly through higher commodity prices

COMMODITY PRICES: FORECASTS
(4Q19 AVERAGE= 100, QUARTERLY AVERAGE)



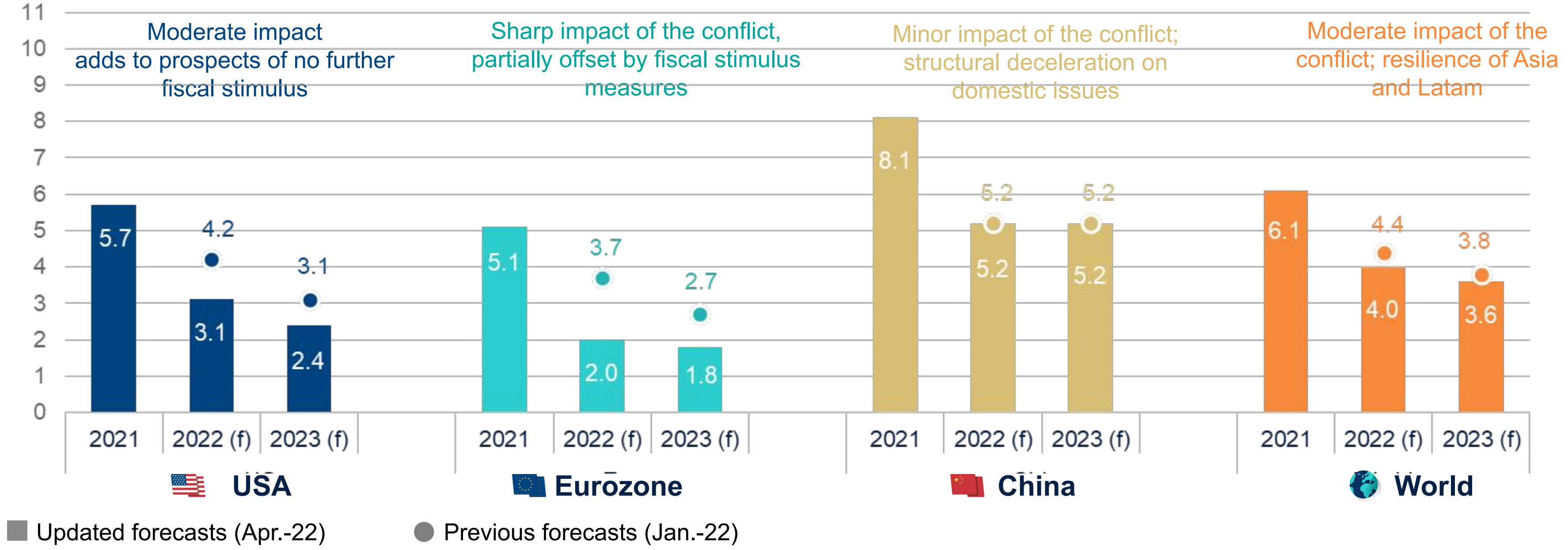
Source: BBVA Research.

- The economic scenario in an environment of high uncertainty: moderation in growth and higher inflation, mainly in Europe; a scenario of global stagflation is avoided.
- Main assumptions:
  - the sanctions are potentially permanent and have a higher economic cost in 2022
  - significant further escalation of sanctions (including an imposed reduction of gas/oil flows between RUS and EUR) is avoided
  - commodity prices: strong price increase, especially in the short term
  - confidence: high volatility in 1H22
  - bottlenecks: higher and more persistent
  - financial systems: no significant disruptions.

Growth forecasts are revised significantly to the downside in Europe, despite the expected (but uncertain) fiscal measures, and moderately in other regions

GDP: ANNUAL GROWTH IN REAL TERMS

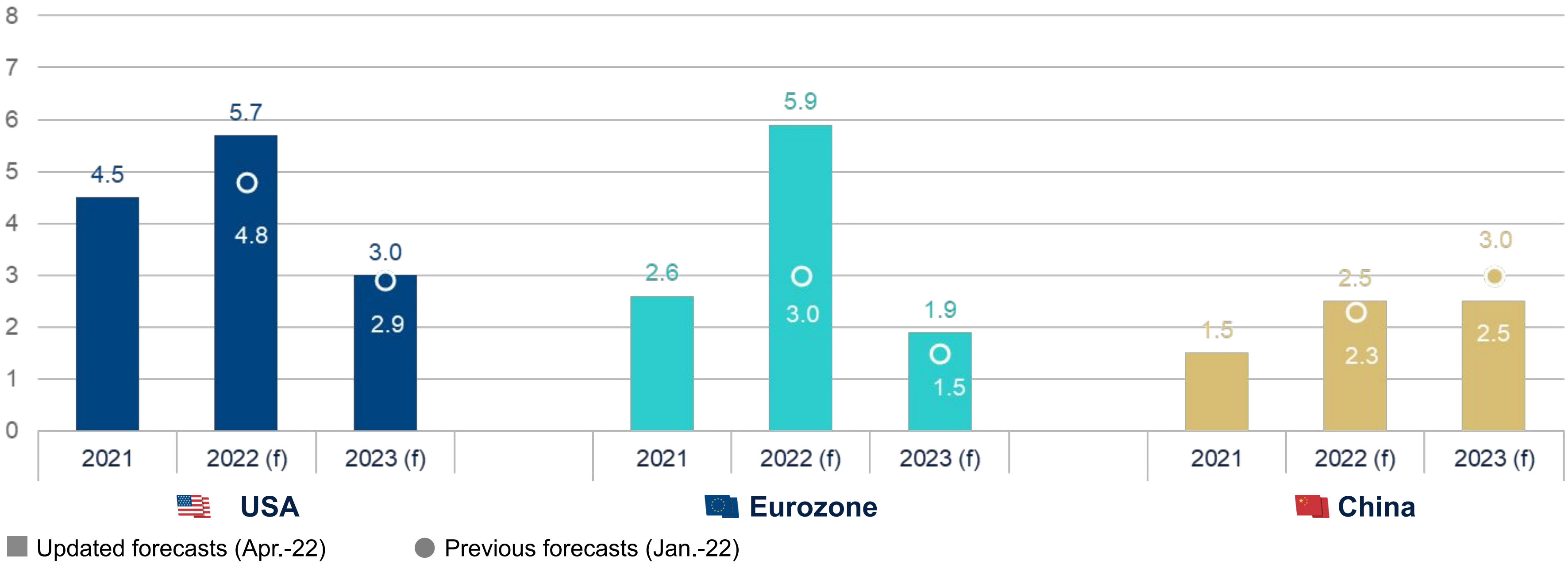
(%)



Source: BBVA Research.

Commodity prices and additional bottlenecks will add to previous pressures and keep inflation very high, at least this year

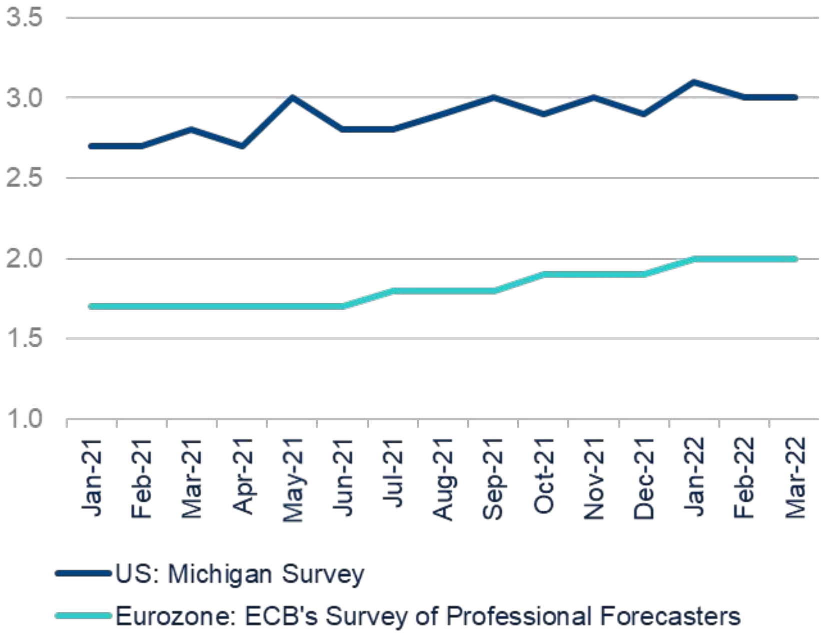
INFLATION: CPI
(Y/Y %, PERIOD AVERAGE)



Source: BBVA Research.

The second-round effects of high inflation are of particular concern in the US, and also, although to a lesser extent, in Europe

5-YEAR INFLATION EXPECTATIONS, BASED ON ANALYSTS SURVEYS(%)



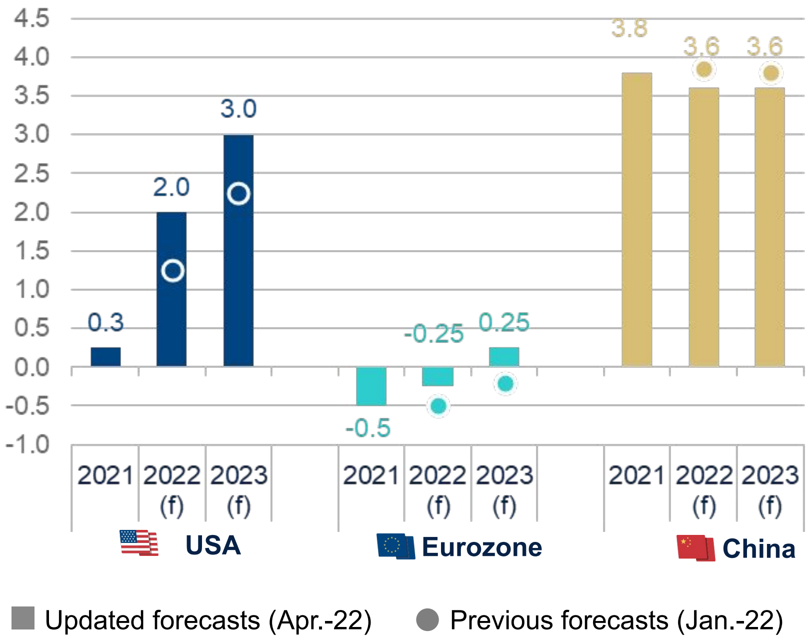
Source: BBVA Research based on data by Haver.

- Persistence of current shocks: high uncertainty, but the pandemic, the war, the energy transition... could have a more lasting impact on inflation.
- Labor markets: dynamism in the US (not so much in the Eurozone) favors second-round effects, but tightness could be temporary.
- Economic policy: central bank credibility is key, but the current environment increases the risk of mismanagements.
- Inflation expectations: above the 2% target in the US and rising, but still anchored, in the Eurozone.

Interest rate hikes by the Fed (more aggressive) and by the ECB (despite the dilemma) from 2022; new fiscal stimulus in the Eurozone, but not in the US

MONETARY POLICY INTEREST RATES*

(%)



* In the case of the ECB, deposit facility rates.
Source: BBVA Research.

Controlling inflation is the main objective

- Fed: more aggressive rate hikes and a reduction in the balance sheet from Jun/22 given high inflation and the labor market strength.
- Fiscal policy: the approval of further fiscal stimulus packages is no longer expected.

Monetary normalization, fiscal support

- ECB: accelerated reduction of the asset purchase program (APP) until its end in 3Q22; gradual rate hikes starting in 4Q22.
- Fiscal policy: additional stimuli at national and European level, in defense, energy, refugees...

Focus on avoiding a sharp slowdown

- PBoC: one/two more rates cuts, credit expansion
- Fiscal policy: local government bond issuance, tax cuts...

Risks are significant and tilted to the downside, not only because of the conflict in Europe, but also because of the Fed’s exit and the deceleration in China

Europe
Stagflation and other extreme economic/geopolitical scenarios due to a worsening of the Ukraine-Russia conflict and further escalation of sanctions limiting the flow of commodity products between Russia and Europe.

USA
Economic recession and financial disruptions due to the withdrawal of stimulus by the Fed

China
A hard-landing of growth and financial stress due to increased restrictions due to Covid or other factors.

Other
Impact on emerging markets of inflation and high rates in developed countries, new waves of Covid, social tensions, new geopolitical conflicts...

Possible long-term effects of the conflict

−

Higher military spending and higher taxes

Deglobalization

Higher cost of security (cybernetics, energetic...)

Geopolitics emerge as a salient global risk

New geopolitics map

+

More incentives to accelerate energy transition

Further EU integration

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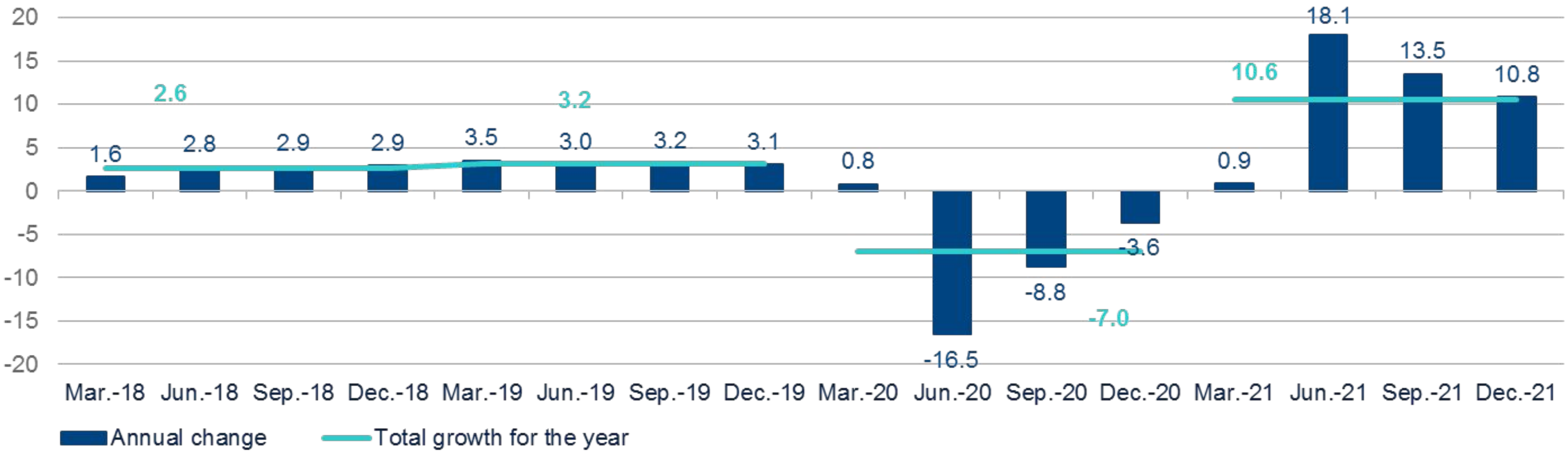
02

Colombia continues on a challenging recovery process, taking advantage of tailwinds

Colombia's economy amid new global uncertainty caused by the Ukraine - Russia conflict

Colombia is entering a new phase of global uncertainty with its economy facing tailwinds

GDP
(ANNUAL CHANGE, %)

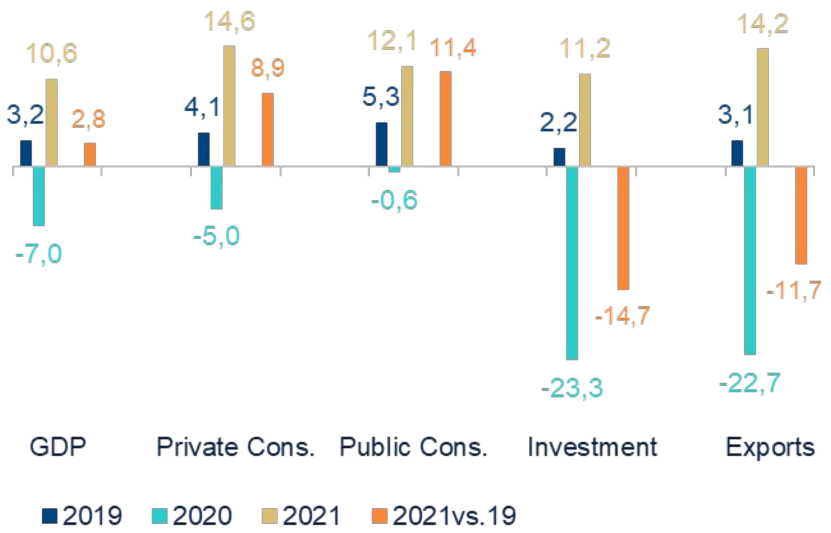


Source: BBVA Research based on data by DANE.

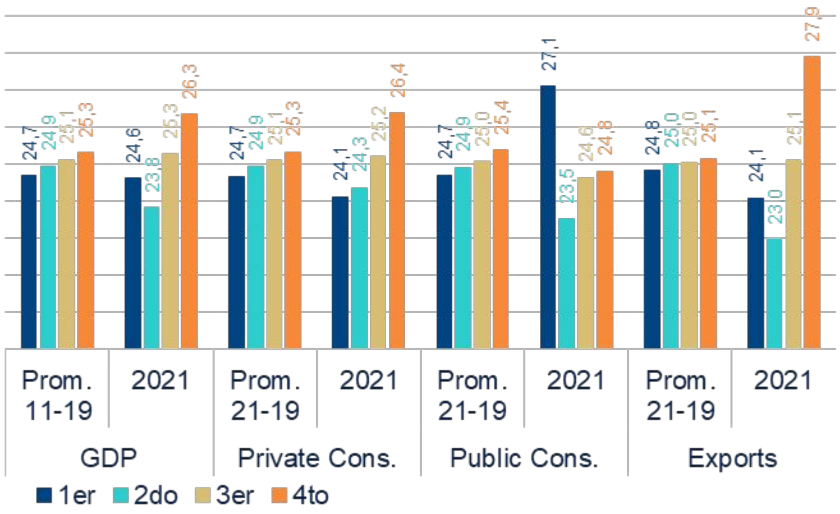
The Colombian economy rebounded strongly in 2021, growing 10.6%...

Economic growth was 2.8% higher in 2021 than in 2019. The bulk of activity was concentrated in the year's second half…

GDP AND DEMAND COMPONENTS
(ANNUAL AND BIENNIAL CHANGE, %)



GDP PRODUCED BY QUARTER
(% OF ANNUAL GDP)



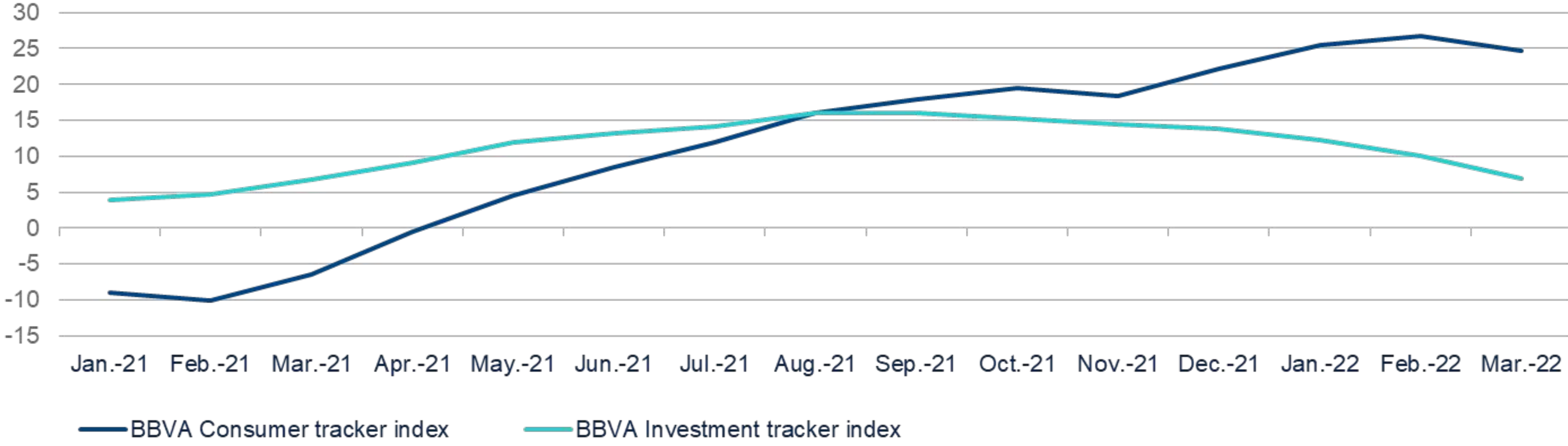
Source: BBVA Research based on data by DANE.

…and leaving positive momentum in the first quarter of 2022.

BBVA indicators confirm the upward trend in the first months of this year, but with growth slowing

BBVA BIG DATA INDICATORS: CONSUMPTION AND INVESTMENT (*)

(MOVING ANNUAL AVERAGE, REAL ANNUAL GROWTH, %)

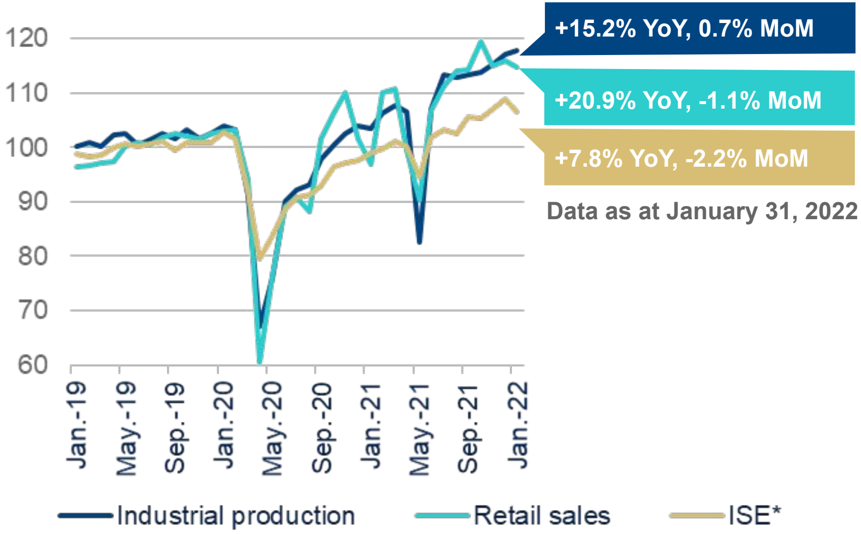


(*) Data until March 31st 2022
Source: BBVA Research based on BBVA transactional data.

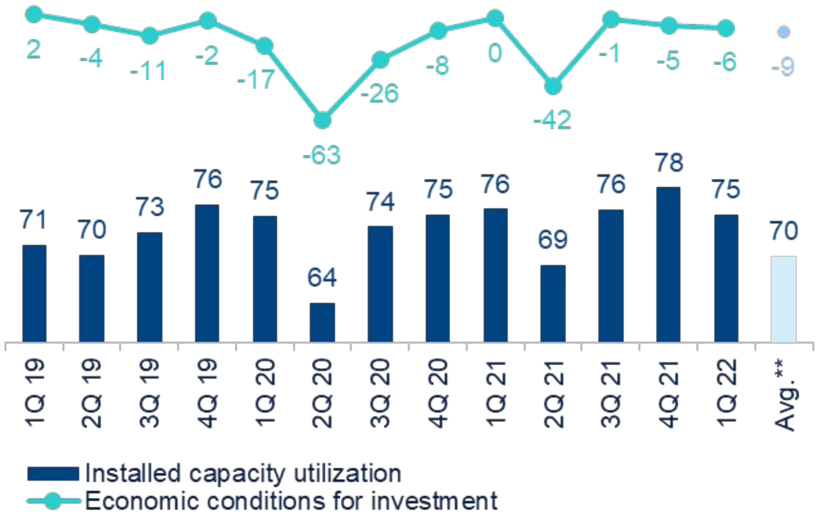
Investment remains robust, but is lagging consumption.

Available indicators for industry and commerce also support this positive trend

ECONOMIC ACTIVITY INDICATORS
(INDEX, 2019 = 100)



CAPACITY UTILIZATION AND INVESTMENT CONDITIONS (% OF TOTAL AND BALANCE OF RESPONSES)

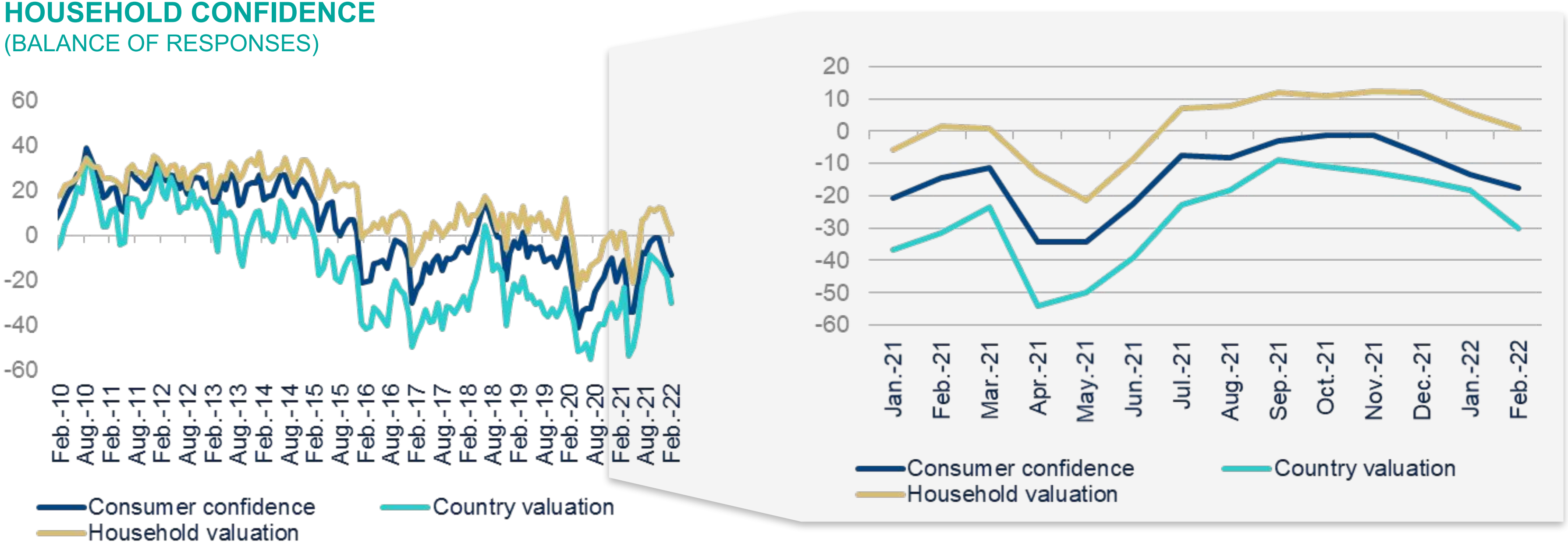


(*) Monthly activity indicator (ISE in Spanish); (**) Average for the first quarter since 1990
Source: BBVA Research based on data by DANE and Fedesarrollo.

However, we expect them to show a slowdown in growth soon.

This is despite disappointing household confidence indicators since the end of last year

HOUSEHOLD CONFIDENCE
(BALANCE OF RESPONSES)



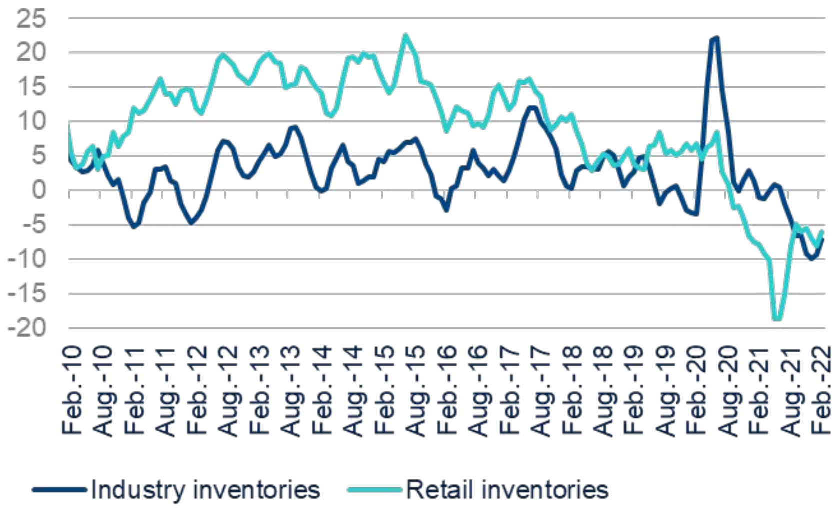
Source: BBVA Research based on data by Fedesarrollo.

Both country and household confidence have eroded lately…

And confidence among businessmen and merchants remains high…

INDUSTRY AND RETAIL DEMAND
(BALANCE OF RESPONSES)

INDUSTRY AND RETAIL INVENTORIES
(BALANCE OF RESPONSES)

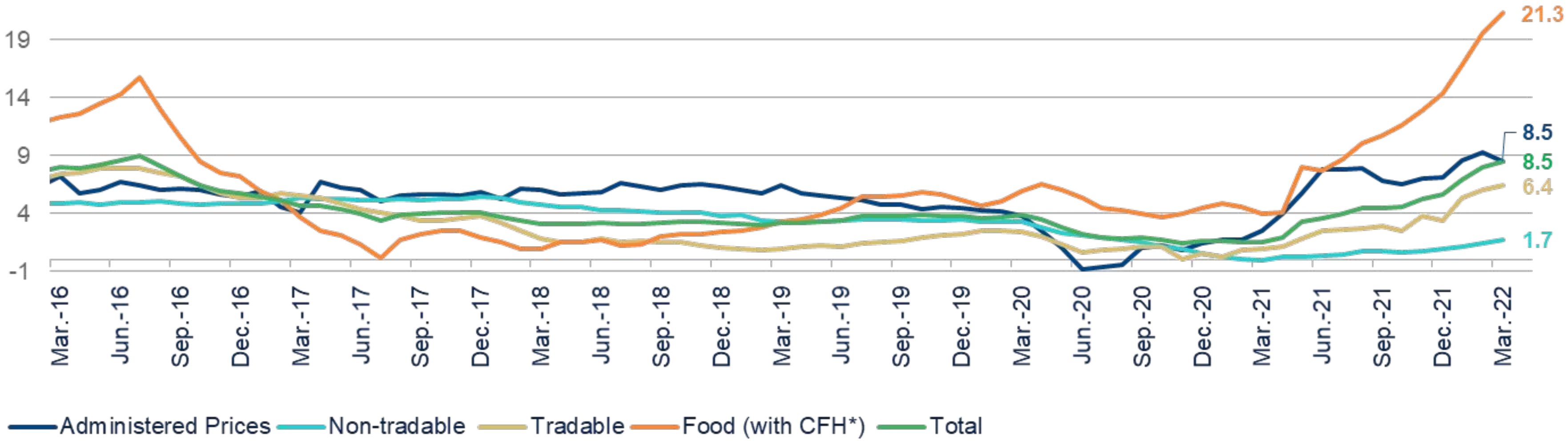


Source: BBVA Research based on data by Fedesarrollo.

...but confidence is underpinned by increasing orders received by businesses and high inventory turnover.

Rising inflation is one factor undermining confidence

INFLATION BY ECONOMIC BASKET
(ANNUAL CHANGE, %)

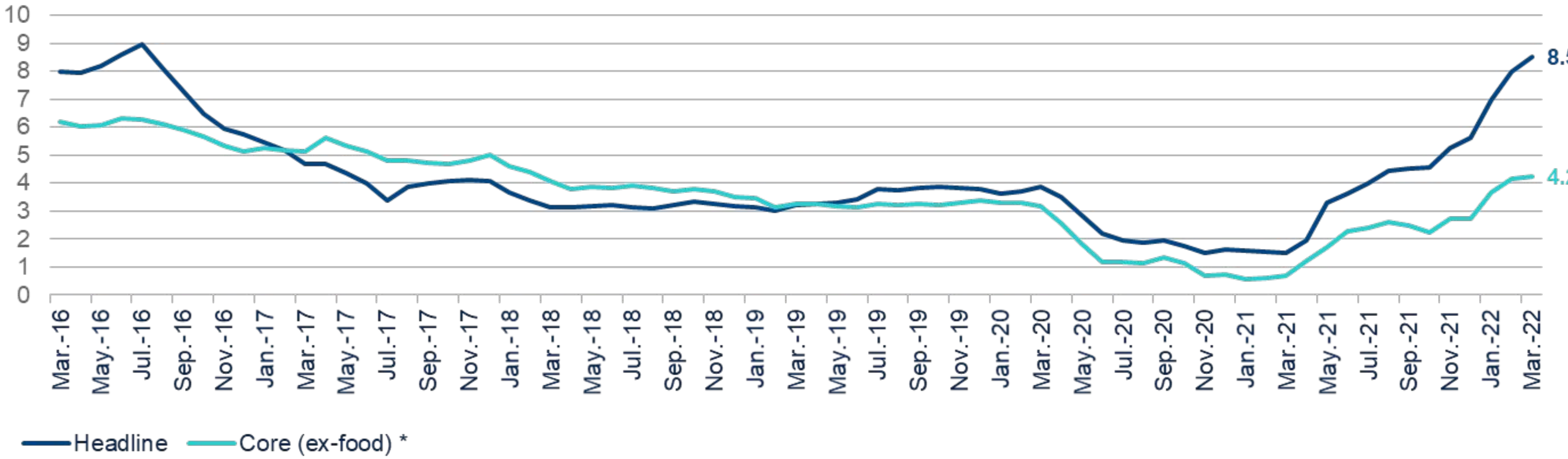


(*) Food away from home
Source: BBVA Research based on data by DANE.

Headline inflation was running at above 8% year-on-year in the first few months of 2021, after ending the year at 5.6%

The uptick in inflation has mostly shifted from a supply-side to a more demand-related issue

HEADLINE AND CORE INFLATION
(ANNUAL CHANGE, %)

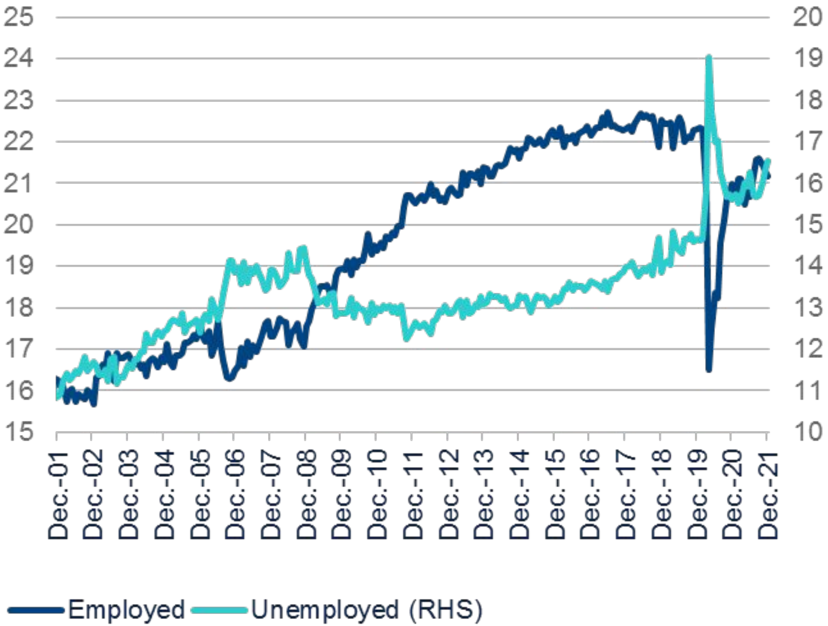


(*) Without food away from home
Source: BBVA Research based on data by DANE.

Core inflation is rising, and while inflation expectations are anchored, they are still above the central bank's target.

The slow job recovery could also be affecting confidence

NATIONAL EMPLOYED AND UNEMPLOYED
(MILLION PEOPLE, SEASONALLY-ADJUSTED SERIES)



Source: BBVA Research based on data by DANE.

Formal employment has fallen more than informal employment

- Many jobs lost during the pandemic have been recovered, but there are close to a million jobs to be recovered.
- There are nearly 2 million more people out of work now than before the outbreak of the pandemic.

In addition to tailwinds and major country-specific challenges, Colombia now has to deal with the uncertainty caused by the Ukraine - Russia conflict

Transmission channels

COMMERCIAL

- Energy (oil, gas)
- Raw materials (commodities and other)
- Consumer goods and Machinery and equipment
- Exports with differential effects by trade partner (developed countries, commodity exporters)

FINANCIAL

- Lower risk appetite and capital flows to emerging economies
- Colombia vs. other emerging economies: possible differentiation

CONFIDENCE

- Impact is, at the moment, marginal

The oil industry has a large footprint in the Colombian economy

Figures at year-end 2021
including refinancing

- **7.1%** OF GDP
- **33%** OF EXPORTS
- **9%** OF FDI
- **2.5%** OF GOVERNMENT REVENUE
- **2.5%** OF GOVERNMENT TAXES
- **17.3bn** IN ROYALTIES (2021-22 PERIOD)

Source: BBVA Research based on data by national sources.

Sensitivity of macro variables to USD10 increase in Brent barril prices/year

- **Growth +0.2pp:** through growth in national revenue and investment.
- **Current account balance +0.4pp:** through increase in value of exports, offset partly by growth in remittances.
- **Central government fiscal balance +0.3pp**%: through higher tax revenue and dividend payments (33% of the impact in the current year and 67% of the next year).

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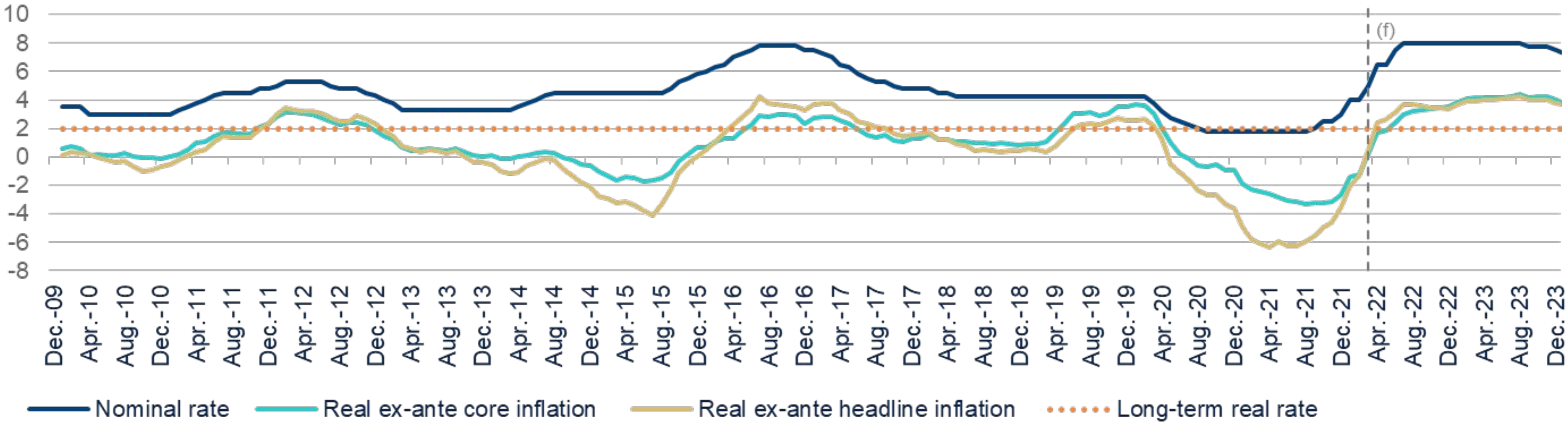
03

Dilemmas regarding economic policy and growth

Colombia’s economy is set to grow 4.5% in 2022 and 2.5% in 2023. The central bank should continue on its rate-tightening campaign until it adopts a contractionary policy

BanRep is expected to continue hiking its key intervention rate until it adopts a contractionary policy

REAL AND NOMINAL MONETARY POLICY RATE
(%, REAL: WITH 12-MONTH FORWARD BBVA RESEARCH INFLATION FORECAST)

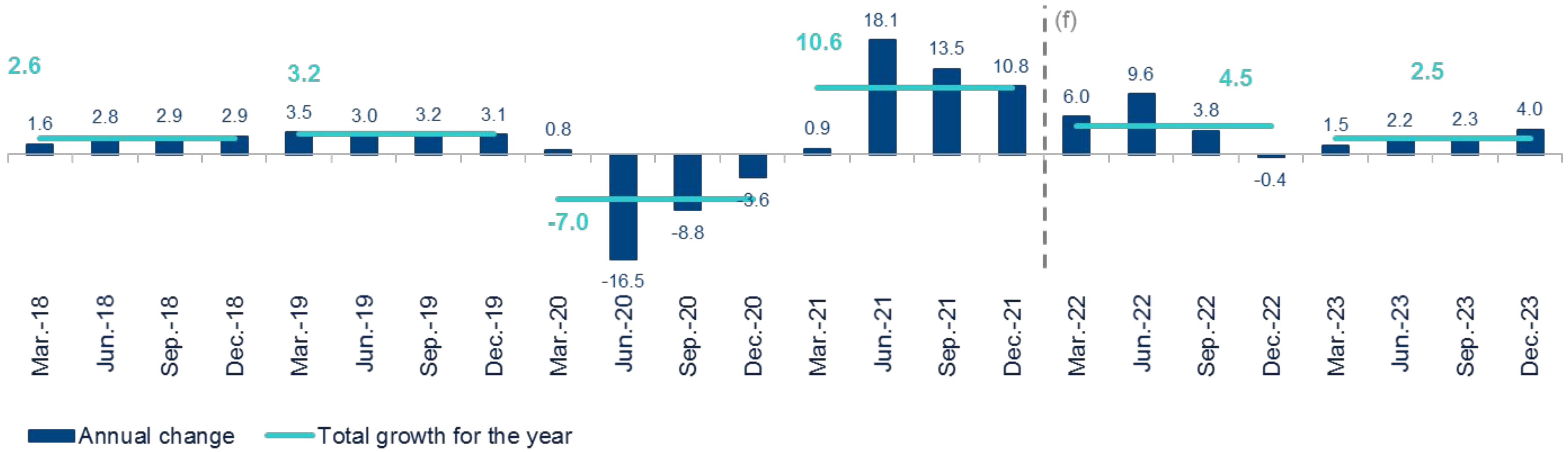


(F): BBVA Research forecasts.
Source: BBVA Research based on data by BanRep and DANE.

Interest-rate hikes will be fast to keep inflation expectations anchored and contain surplus demand against a backdrop of global uncertainty regarding prices and the supply of goods.

In this setting, the economy looks set to grow by 4.5% this year and 2.5% in 2023

GDP
(ANNUAL CHANGE, %)

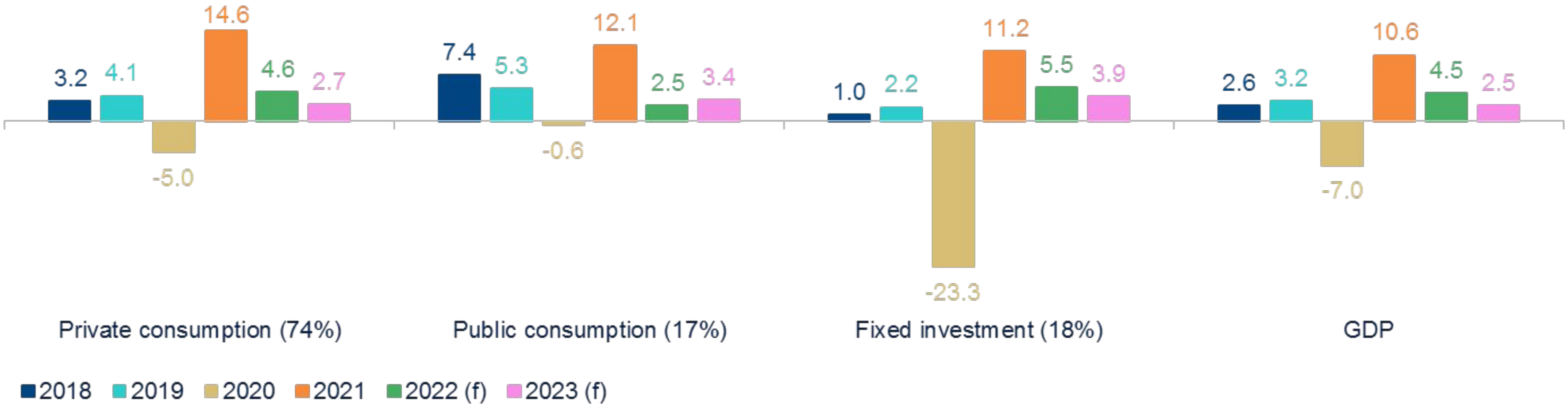


(F): BBVA Research forecasts.
Source: BBVA Research based on data by DANE.

We expect growth to slow in the second half of 2022 and gather momentum again in the second half of 2023.

Consumption should continue to be a key growth driver, while investment should again outstrip GDP growth

GDP BY DEMAND COMPONENT
(ANNUAL CHANGE AND % OF GDP IN 2021 IN PARENTHESES)

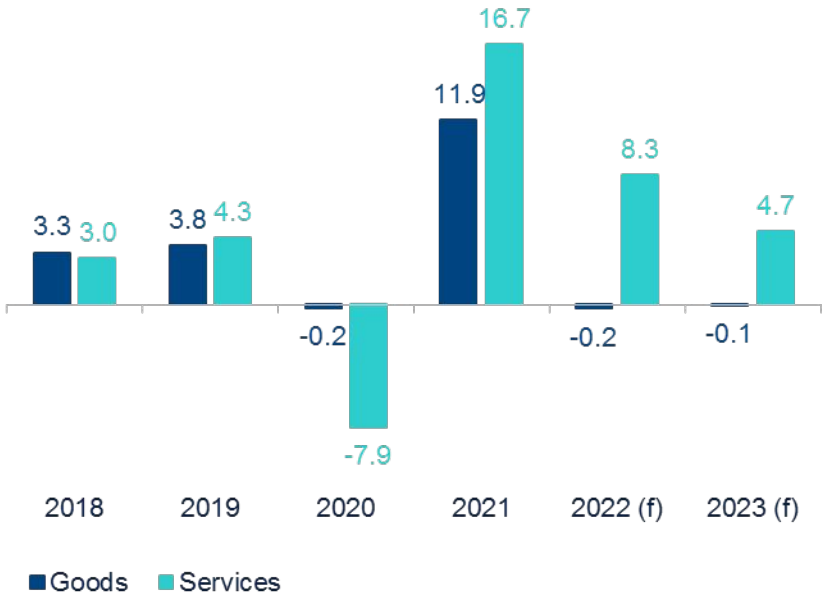


(F): BBVA Research forecasts.
Source: BBVA Research based on data by DANE.

Private consumption is forecast to grow by 4.6% in 2022 and 2.7% in 2023 and investment by 5.5% and 3.9%, respectively.

Consumption of services should continue to recover

PRIVATE CONSUMPTION BY TYPE
(ANNUAL CHANGE, %)



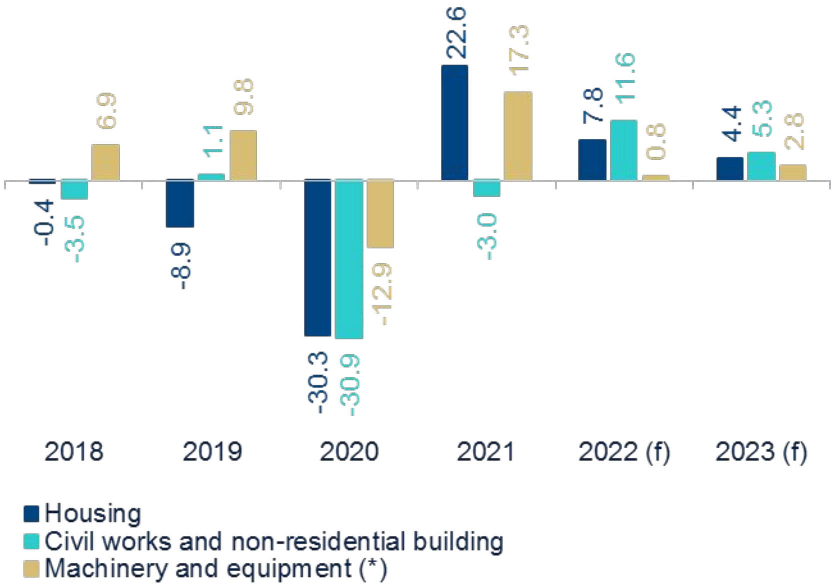
(F): BBVA Research forecasts.
Source: BBVA Research based on data by DANE.

Services based on social interaction should drive consumption in 2022 and 2023

- In 2020 and 2021, households will place priority on obtaining goods to increase home comfort thanks to savings from spending less on services.
- In 2022, a more widespread opening up of services and a stronger rebound by tourism should encourage household expenditure, which will again take over from goods.
- Moreover, high inflation and higher interest rates should cause the pace of consumption of goods financed with credit (durables and semi-durables) to ease.

We expect public civil works and mining project execution to accelerate

FIXED INVESTMENT BY TYPE
(ANNUAL CHANGE, %)



(F): BBVA Research forecasts;.(*) Includes machinery and equipment, biological resources and intellectual property
Source: BBVA Research based on data by DANE.

How construction performs will be crucial for investment

- Housing investment should accelerate as the record-high level of pre-sold construction projects of 2021 are completed.
- Investment in civil works projects should be driven by increased execution from mayors and governors and from mining and oil investments.
- Expenditure on machinery and equipment should slow gradually as interest rates rise and the consumption of goods trends downward, but the mining and oil sector should remain a driver.

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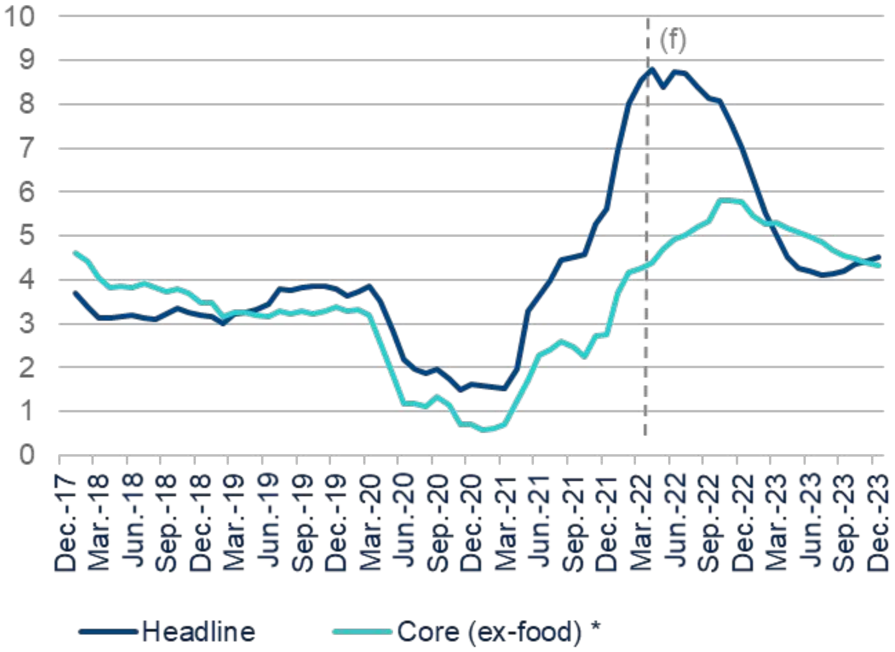
04

Inflation, external accounts and budget deficit

Inflation should begin easing by the end of 2022, as macroeconomic imbalances correct

Inflation should begin easing by the end of 2022, but still remain high in 2023

HEADLINE AND CORE INFLATION
(ANNUAL CHANGE, %)

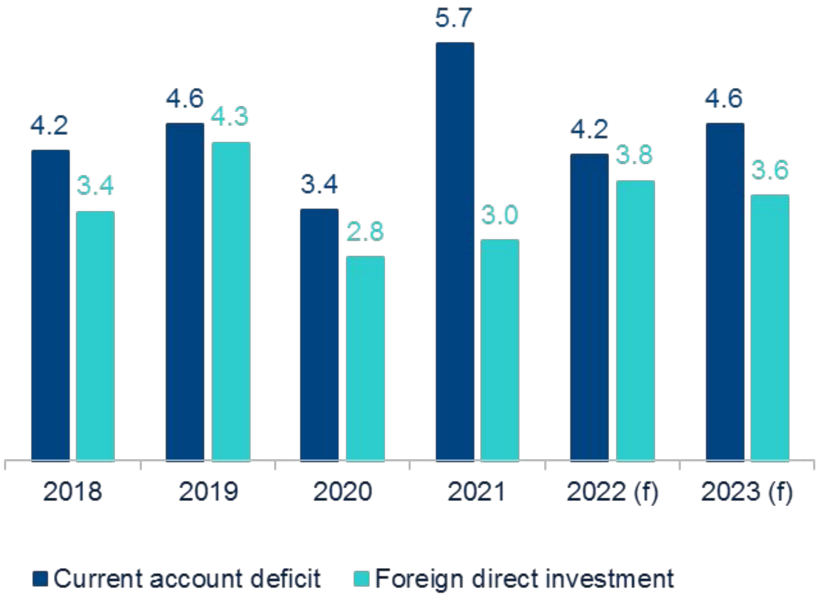


(F): BBVA Research forecast.; (*): Without food away from home
Source: BBVA Research based on data by DANE.

- Inflation should end this year at around 7% and 2023 at 4.5%.
- Core inflation should rise further, ending 2022 close to headline inflation.
- The Ukraine-Russia conflict, China's zero-COVID-19 policy and country-specific factors leave Colombia's inflation with an upward bias.

Better oil prices should help the external deficit fall faster

CURRENT ACCOUNT DEFICIT AND FOREIGN DIRECT INVESTMENT (% OF GDP)

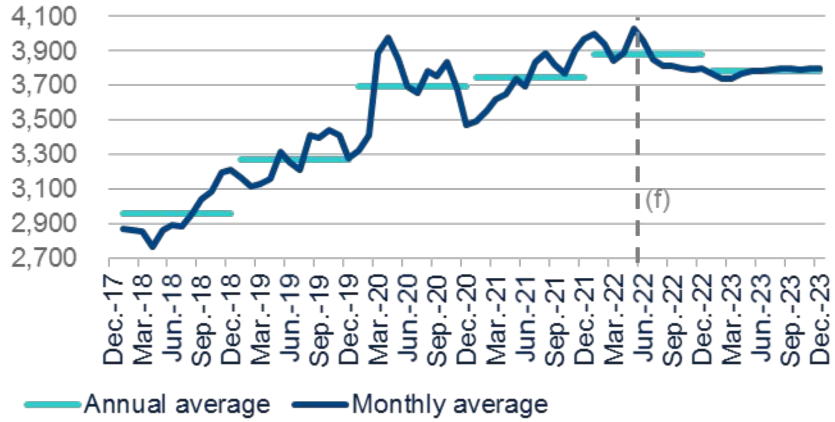


(F): BBVA Research forecasts.
Source: BBVA Research based on data by Banco de la República.

- Oil exports in US dollars, which will account for 37% of the total in 2022, should help lower the trade deficit from 4.4% of GDP in 2021 to 2.5% in 2022 and 3.3% in 2023.
- Roughly 91% of the deficit will be funded with foreign direct investment in 2022 and 79% in 2023, up from 53% in 2021.
- Therefore, the economy will have lower needs for financing by portfolio debt and external loans.

This scenario includes marginal depreciation by the Colombian peso in 2022 and appreciation in 2023

EXCHANGE RATE
(PESOS PER DOLLAR)



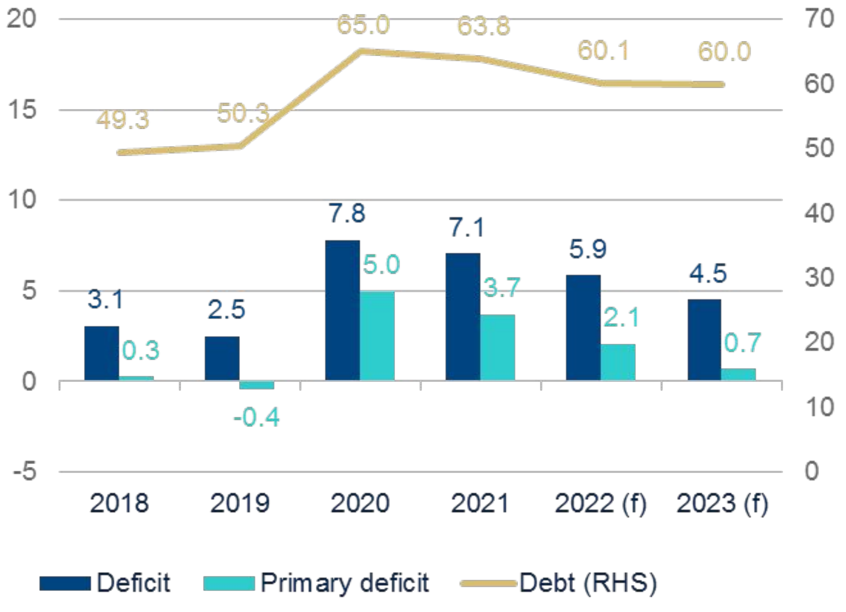
	2018	2019	2020	2021	2022 (f)	2023 (f)
End of period	3,213	3,277	3,469	3,968	3,800	3,800
Annual average	2,956	3,273	3,693	3,744	3,877	3,780
Annual avg. deviation	0.2	10.7	12.9	1.4	3.6	-2.5

(F): BBVA Research forecasts.
Source: BBVA Research based on data by BanRep

- The COP will remain under pressure in the rest of 2022 and 2023 from the external deficit, the economy's and the government's financing requirements, the political cycle and the normalization of US monetary policy. This is despite the positive impact in recent months of rising oil prices and the inflow of funds to pay taxes and carry out M&A.

Meanwhile, better oil prices and higher revenue from increased activity in 2021 drove an improvement in the year-end fiscal balance

CENTRAL NATIONAL GOVERNMENT DEFICIT AND DEBT (% OF GDP)



(F) BBVA Research forecast.
Source: BBVA Research based on data from the Ministry of Finance.

- Tax revenue from oil is expected to account for 10% of GDP in 2022 and 11% in 2023.
- Public debt should remain high in both 2022 and 2023.
- The new institutionalization of the tax rule should help the revenue generated by higher oil prices to be accounted for appropriately.

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05

Final thoughts

More sustainable growth in a challenging context

Challenges bestowed upon Colombia by the world

Globally

- The worst consequences of the crisis caused by the Ukraine-Russia conflict were felt in trade due to higher prices and global supply bottlenecks, as well as energy supply and prices.
- The conflict has also fanned inflation, which was already a global concern.
- All in a context of higher global uncertainty with effects on global confidence may distort consumption and investment decisions
- The higher prices for Colombian energy exports softens the macro imbalances, but just transitorily

Long lasting and new challenges are not minor

Locally

- The transition, both at the legislative and presidential levels, will generate uncertainty. Strong institutions guaranty an ordered transition that will continue to promote investment and consumption
- The new government government will have to invest its energy in closing the wounds that the pandemic left on household wellbeing (poverty, employment, education, health, among others)
- At the same time, it should undertake the structural challenges that allow the country to grow more and more sustainable
- A more sustainable growth should be built on an increasing productive investment that favors the closing of the aggregate imbalances and enables to undertake the expenditure and reforms that allow to increase the wellbeing of all colombians.

BBVA Research

06

Forecasts

Macroeconomic forecast

	2017	2018	2019	2020	2021	2022 (f)	2023 (f)
GDP (% y/y)	1.4	2.6	3.2	–7.0	10.6	4.5	2.5
Private consumption (% y/y)	2.1	3.2	4.1	-5.0	14.6	4.6	2.7
Public consumption (% y/y)	3.6	7.4	5.3	-0.6	12.1	2.5	3.4
Fixed investment (% y/y)	1.9	1.0	2.2	-23.3	11.2	5.5	3.9
Inflation (% y/y. eop)	4.1	3.2	3.8	1.6	5.6	6.8	4.5
Inflation (% y/y. avg)	4.3	3.2	3.5	2.5	3.5	8.0	4.6
Exchange rate (eop)	2,991.4	3,212.5	3,277.0	3,468.5	3,967.8	3,800.0	3,800.0
Devaluation (%. eop)	-0.6	7.4	2.0	5.8	14.4	-4.2	0.0
Exchange rate (avg)	2,951.3	2,956.4	3,272.6	3,693.3	3,744.3	3,877.6	3,780.1
Devaluation (%. eop)	-3.4	0.2	10.7	12.9	1.4	3.6	-2.5
Interest policy rate (%. eop)	4.8	4.3	4.3	1.8	3.0	8.0	7.5
Current Account (% GDP)	-3.2	-4.2	-4.6	-3.4	-5.7	-4.2	-4.6
Urban unemployment rate (%, eop)	9.8	10.7	10.5	15.6	11.6	11.6	11.3

(f): BBVA Research forecast.
Source: BBVA Research with DANE and Banco de la República data.

Main macroeconomic variables

	GDP (% y/y)	Inflation (% y/y. eop)	Exchange rate (vs. USD. eop)	Interest Policy Rate (%. eop)
Q1 19	3.5	3.2	3,125	4.25
Q2 19	3.0	3.4	3,256	4.25
Q3 19	3.2	3.8	3,400	4.25
Q4 19	3.1	3.8	3,277	4.25
Q1 20	0.8	3.8	3,888	3.75
Q2 20	-16.5	2.2	3,691	2.50
Q3 20	-8.8	2.0	3,750	1.75
Q4 20	-3.6	1.6	3,469	1.75
Q1 21	0.9	1.5	3,617	1.75
Q2 21	18.1	3.6	3,693	1.75
Q3 21	13.5	4.5	3,820	2.00
Q4 21	10.8	5.6	3,968	3.00
Q1 22	6.0	8.5	3,806	5.00
Q2 22	9.6	8.6	3,965	7.50
Q3 22	3.8	8.0	3,810	8.00
Q4 22	-0.4	6.8	3,800	8.00
Q1 23	1.5	5.2	3,740	8.00
Q2 23	2.2	4.2	3,785	8.00
Q3 23	2.3	4.2	3,795	7.75
Q4 23	4.0	4.5	3,800	7.50

Source: BBVA Research with DANE and Banco de la República data.

Disclaimer

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