BBVA Research

Colombia Economic Outlook

December, 2022

Creating Opportunities

Research

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BBVA Research

01

Global environment

Signs of global slowdown amid inflationary pressures and a more aggressive central bank response.

Main messages

Economic activity

Economic activity is expected to lose steam over 2023. Global growth is forecast to reach 2.3% in 2023 -an unusually low level- after having grown 6.3% in 2021 and around 3.3% in 2022. Aggressive monetary tightening coupled with still significant price pressures, amid a war in Ukraine and increasing hurdles to free-trade, will likely weaken labor markets and private consumption, which have been holding up relatively well so far. Uncertainty is high and risks are tilted to the downside: a sharper-than-expected activity deceleration could pave the way for a global recession.

Inflation

The ongoing easing of commodity prices and bottlenecks reinforces the prospects that inflation will slow down ahead, favored by positive base effects. In the US, actually, inflation is already falling. Although, in the Eurozone, price pressures continue to build, inflation is still expected to soon peak, assuming that expectations and second-round effects remain under control. Still, inflation will remain well above targets, at least throughout 2023. Risks of more persistent price increases remain alive.

Monetary policy

The interest-rate hiking cycle is likely to come to an end in early 2023, both in the US and the EZ. Policy rates are forecast to converge to around 5% in the former and 2.75% in the latter. However, there will be scarce room for monetary easing till the end of 2023. Moreover, a quantitative tightening is set to remain in place in the US and to be launched next year in the EZ.

Financial volatility

Declining global liquidity, high interest rates and dollar strength could continue spurring volatility and significant corrections in financial markets. Stress episodes, such as those recently observed in the UK and in crypto markets, and even a financial crisis could emerge ahead, specially if inflation and interest rates end up being higher than expected.

Economic activity has weakened throughout 2022, amid high inflation, sharp monetary tightening and financial volatility, while still exhibiting resilience

RECENT DEVELOPMENTS IN THE WORLD ECONOMY

EASING BUT STILL RESILIENT GROWTH

Easing growth on monetary tightening, price pressures, effects of the war and covid in China.

But activity has shown resilience: robust labor markets, (declining) reopening effects.

SHARP MONETARY TIGHTENING

Fed: has started a quantitative tightening and sharply hiked interest rates, but monetary tightening has still some way to go.

ECB: rates are moving up, bank lending conditions have been tightened and a quantitative tightening is being prepared.

China: moderately expansionary policies.

HIGH INFLATION

US inflation is trending down as commodity prices and bottlenecks ease and interest rates move up.

In Europe, pressures continue to build up amid more widespread and frequent price rises.

Expectations remain broadly under control, also in China, where inflation remains relatively low.

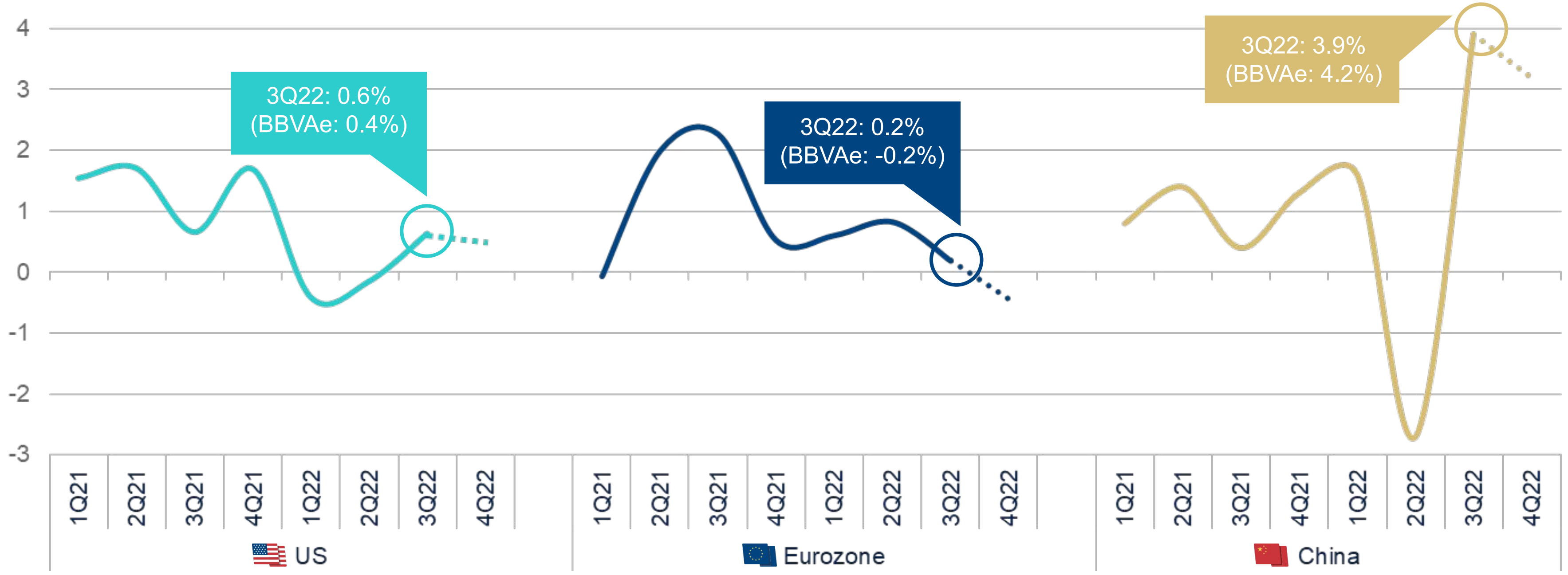
FINANCIAL VOLATILITY

Declining liquidity, higher rates and dollar strength have sparked volatility and corrections across financial markets and countries.

Financial turmoil has emerged in some specific cases, such as in the UK and in crypto markets.

Growth has lately surprised upwards in the US and the EZ, despite the negative trend, and downwards in China, mostly due to covid and real estate tensions

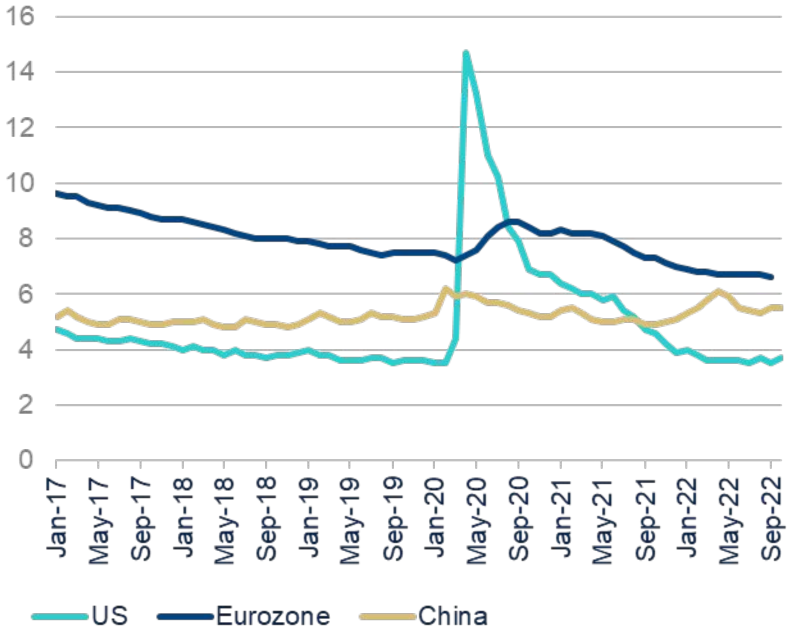
GDP GROWTH (*)
(QOQ %, SEASONALLY ADJUSTED)



(*): BBVA Research estimates for the 4Q22
Source: BBVA Research based on data from Haver.

The labor market strength and the (fading) effects of the post-covid reopening continue to support private consumption in the US and in the Eurozone

UNEMPLOYMENT RATE
(%)

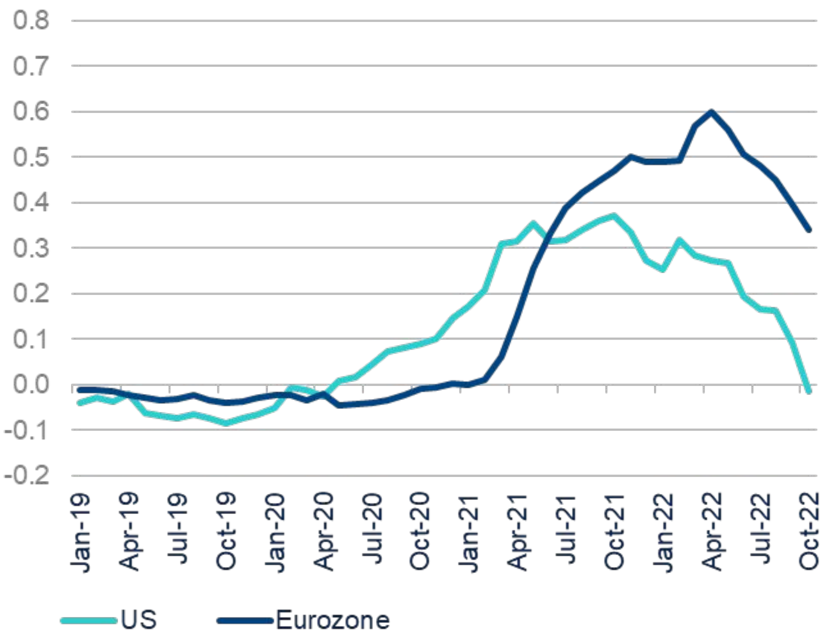


Source: BBVA Research based on data from Haver.

- Tight labor markets, mainly the US: unemployment is at record-low levels, job vacancies remain very high and wages are growing at a faster pace (but below inflation).
- Accumulated savings and pent-up demand seem to be still supporting demand, although at a declining pace.
- Private consumption has been holding up well, better than investment, despite easing signs: it grew 0.5% QoQ in 2Q22, 0.3% QoQ in 3Q22 in the US; 1.0% QoQ in 2Q22 in the Eurozone.
- In China, domestic demand shows a relatively downbeat tone given covid concerns and property markets tensions.

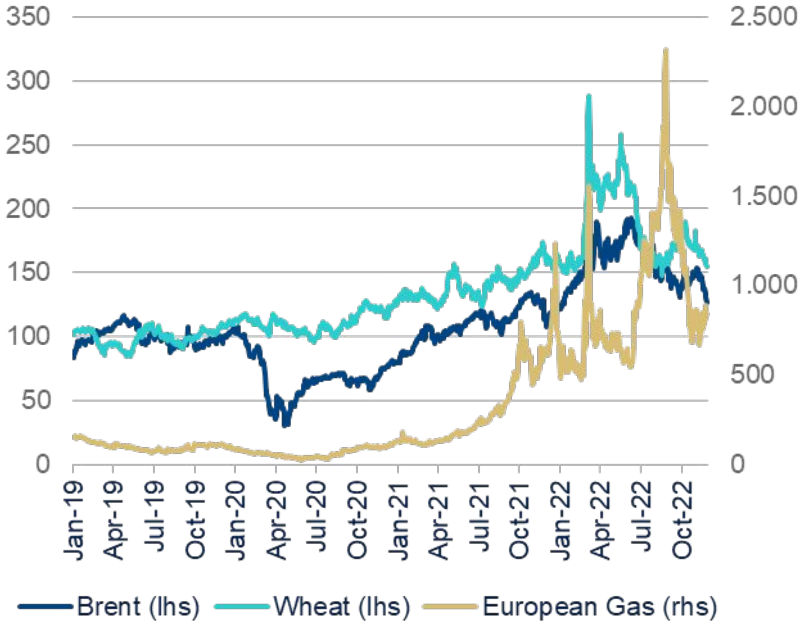
Growth slowing has contributed to easing bottlenecks and commodity prices; gas prices have fallen on high reserves and saving measures in the EU

BBVA RESEARCH BOTTLENECK INDEX
(INDEX: AVERAGE SINCE 2003 = 0)



Source: BBVA Research

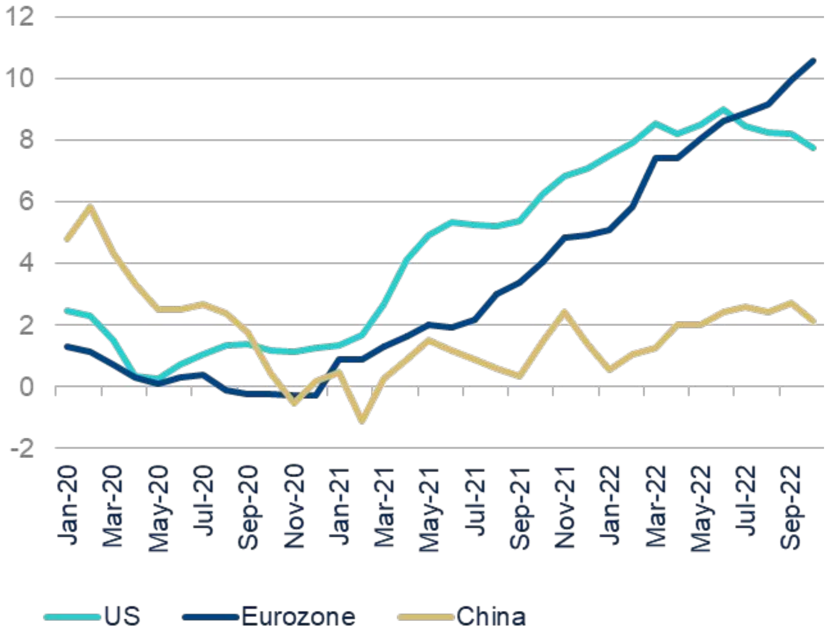
COMMODITY PRICES
(INDEX: 2019 AVERAGE = 100)



Source: BBVA Research based on data from Bloomberg

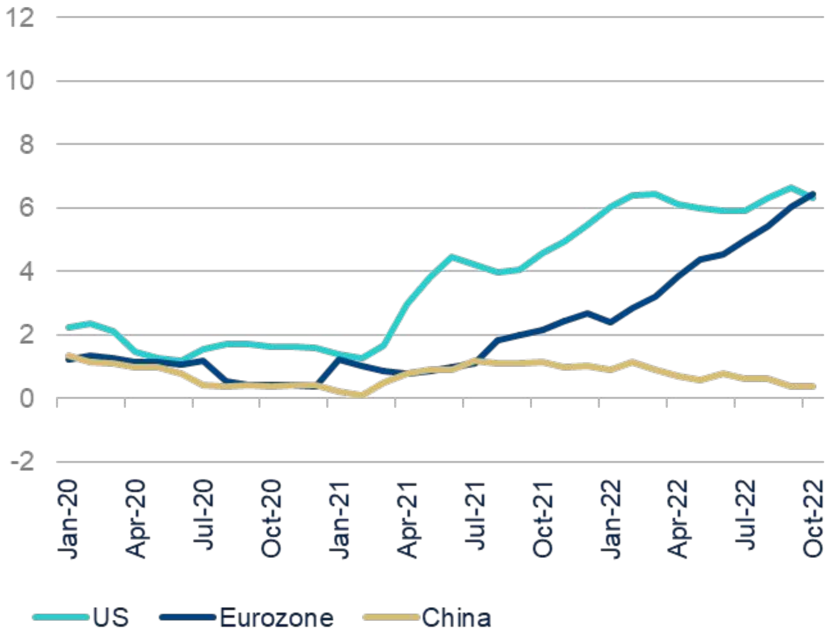
Inflationary pressures have continued to build in the Eurozone, started to recede in the US and remained under control in China

INFLATION: CPI
(Y/Y %)



Source: BBVA Research based on data from Haver.

CORE INFLATION: CPI
(Y/Y %)

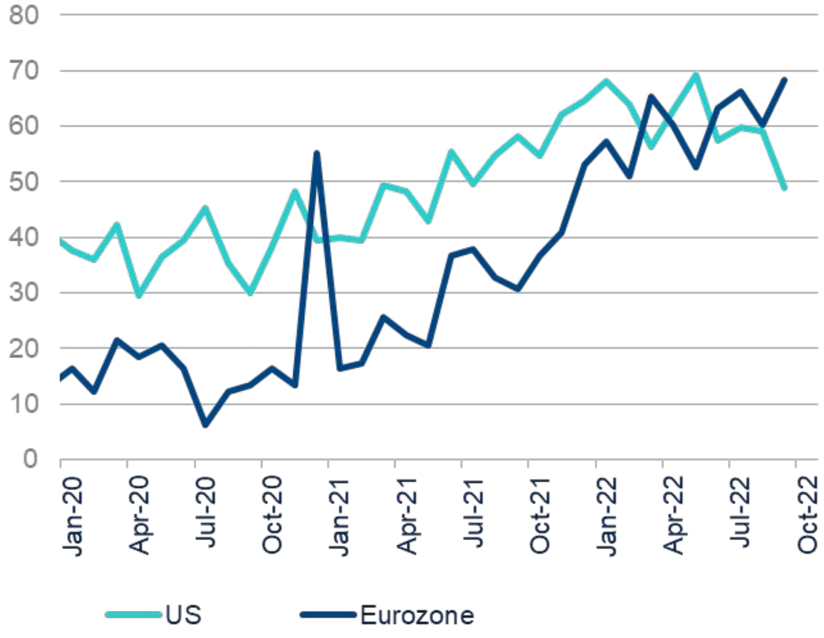


Source: BBVA Research based on data from Haver.

Price adjustments are still becoming more widespread and more frequent in the Eurozone, while the situation continues to improve in the US

ITEMS OF THE CPI BASKET WITH ANNUALIZED MONTHLY INFLATION HIGHER THAN 4%

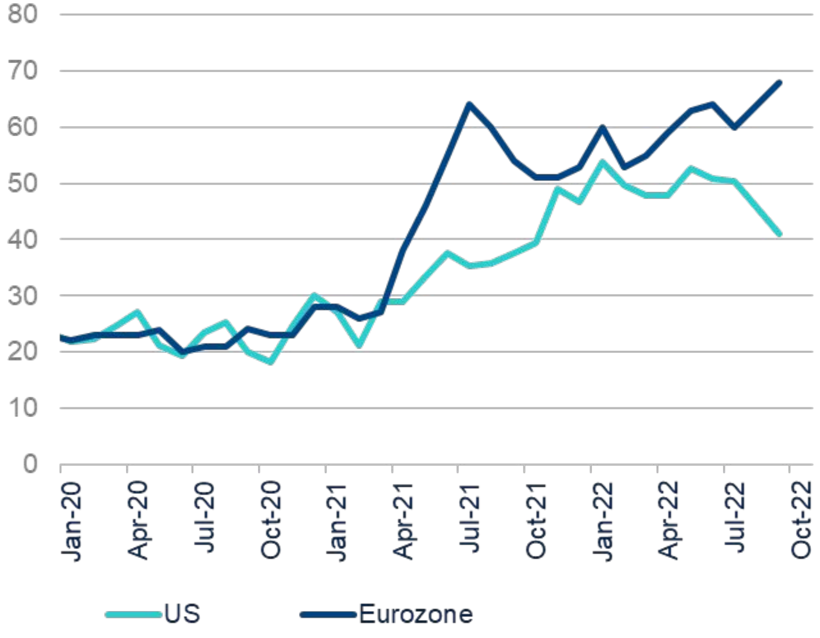
(SHARE OF TOTAL 2-DIGIT CPI ITEMS)



Source: BBVA Research based on local statistics.

ITEMS OF THE CPI BASKET WITH THREE CONSECUTIVE MONTHLY PRICE RISES

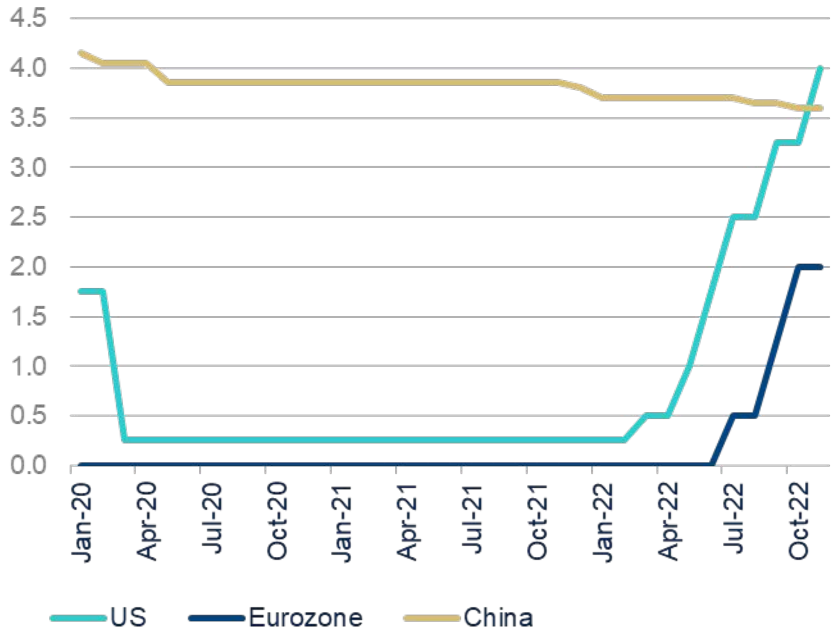
(SHARE OF TOTAL 2-DIGIT CPI ITEMS)



Source: BBVA Research based on local statistics.

Policy rates are high and still rising; market rates have stabilized recently on prospects of a less hawkish Fed following lower inflation in the US

POLICY INTEREST RATES
(%, END OF PERIOD)



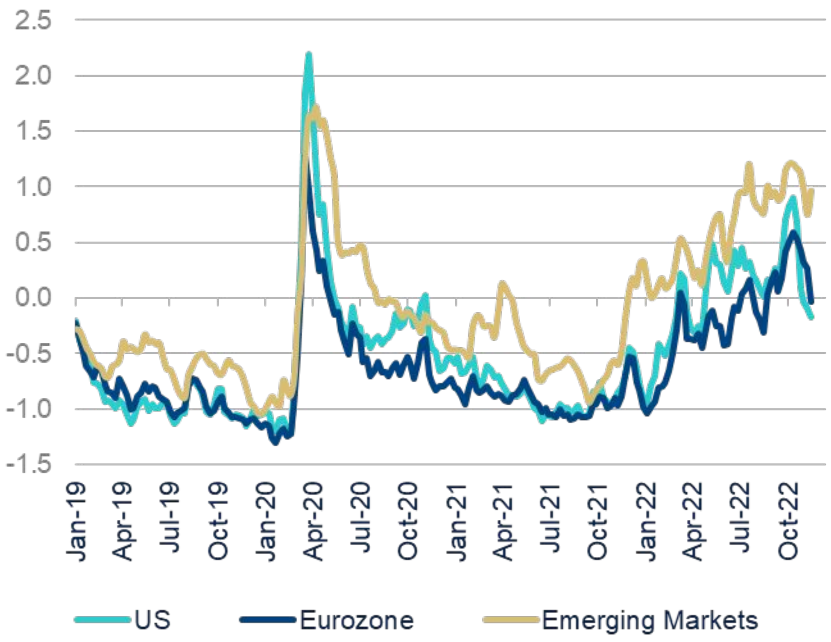
Source: BBVA Research based on data from Haver.

MARKET INTEREST RATES: US AND GERMANY 10-YEAR BOND YIELDS
(%)

Source: BBVA Research based on data from Haver.

Declining liquidity, higher rates and dollar strength have sparked volatility and corrections in financial markets, but a more upbeat tone has prevailed lately

BBVA RESEARCH FINANCIAL TENSIONS INDEX
(INDEX: AVERAGE SINCE 2006 = 0)



Source: BBVA Research.

- Financial volatility has increased across markets over the last months, despite some recent improvement.
- Low liquidity in sovereign bond markets is also a source of volatility and concerns.
- Most currencies have weakened against the USD, which is 10% up since Dec/21, although it has lost 5% in the last month.
- Leveraged loans, high-yield bonds and tech stocks, among others, have gone through large corrections.
- Emerging countries have faced capital outflows, while the EZ peripheral risk remains under control despite some increases.
- Stress has emerged in some specific cases, such as in the UK and in crypto markets.

A sharp growth deceleration, with (mild) recessions in the US and the EZ, is likely over 2023 as interest rates and inflation will remain at high levels

BBVA RESEARCH CENTRAL SCENARIO: MAIN ASSUMPTIONS AND IMPACTS

GROWTH TO SLOW DOWN SIGNIFICANTLY

Global growth to ease from 6.3% in 2021 to 3.3% (+0.1pp) in 2022, 2.3% (-0.1pp) in 2023, and to bounce back to 3.3% in 2024.

Energy prices to soon push the EZ into a recession, but gas shortages are not expected.

A mild recession by the mid-23 is likely in the US.

Growth to remain relatively weak, despite a likely recovery in China.

MONETARY TIGHTENING: STILL NOT OVER

Policy rates will continue to raise, but likely at a more gradual pace as inflation/growth lose steam.

Once they peak in 1Q23, rates are likely to remain unchanged at least till the end of 2023.

Rate increases will be complemented by quantitative tightening

Pro-growth measures to remain in place in China.

INFLATION TO EASE WHILE REMAINING HIGH

Inflation expected to slow as commodities prices and bottlenecks continue easing.

Wages are likely to grow more than in the past, but less than inflation.

Large second-round effects to be prevented.

Monetary tightening to reign in on expectations.

FINANCIAL VOLATILITY TO REMAIN IN PLACE

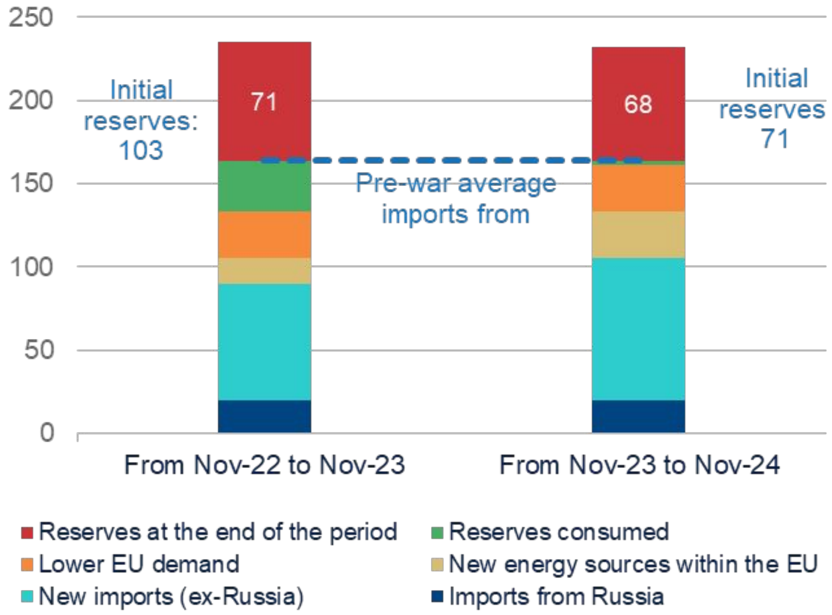
Inflation easing to take some pressure off central banks.

But lower global liquidity and high interest rates to continue supporting the USD and bond yields.

Volatility is set to remain relatively high and stress episodes should not be ruled out.

Gas markets: high reserves, saving measures and flows from alternative sources will prevent shortages in 2023, and, possibly, also in 2024

EUROPEAN GAS: BASE SCENARIO FOR SUBSTITUTION OF RUSSIAN IMPORTS (*)
(BCM: BILLION CUBIC METERS)

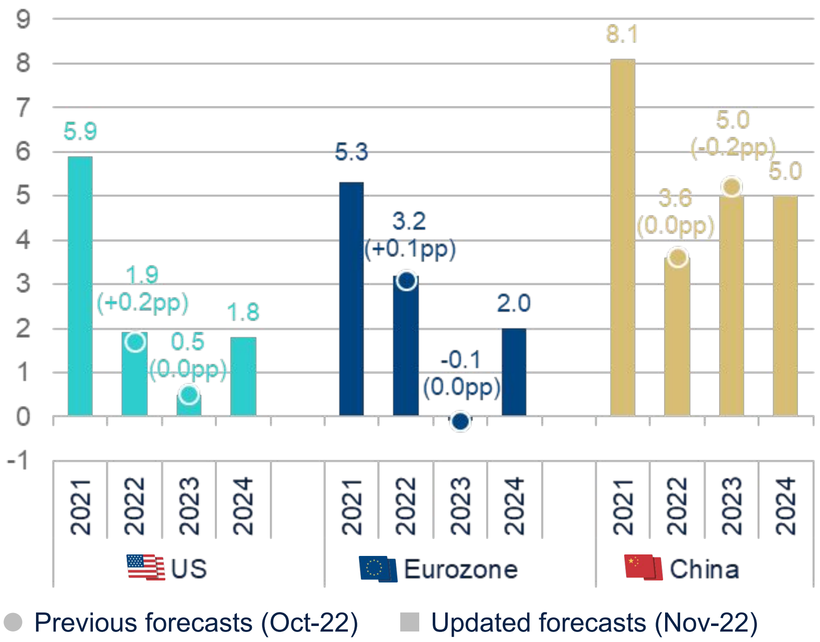


(*) Current reserves: 103 BCM. Imports from Russia ahead: 20 BCM/year. Assumed demand reduction: 7% lower than the pre-war (2017-21) average.
Source: BBVA Research.

- Base scenario: gas prices settle below record highs, but above current levels, with no shortages over 2023-24 even if Russia halves current provision (40 bcm/year) from now on.
- The main risk is that Russia cuts gas exports to zero: reserves could fall below 50 bcm in Nov/23, potentially insufficient to match the needs for the winter of 2024.
- This risk scenario implies that Russian liquified gas would likely be available to other buyers, meaning that Europe could find new supplies elsewhere.
- Scenarios ahead will depend on weather conditions and global demand for gas, on top of flows from alternative sources and saving measures in Europe.

Growth to stagnate before going back to potential levels in 2024 in the US and EZ in 2023, and to converge to 5%, with downside risks, in China

GDP: ANNUAL GROWTH IN REAL TERMS (*)
(%)

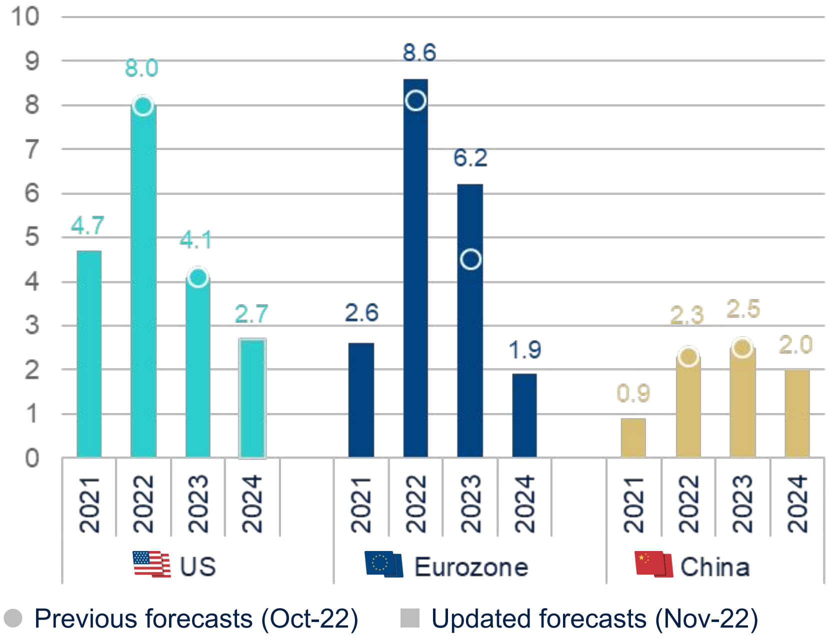


* Forecast change in parentheses.
Source: BBVA Research.

- 2022 GDP forecasts revised slightly up in US and EZ, in line with upward 3Q22 surprises.
- Deceleration prospects remain broadly unchanged: monetary tightening and price pressures will eventually hit harder labor markets and private consumption.
- A mild recession is likely over the next few quarters in the EZ, although gas shortages are not anticipated, and by mid-2023 in the US.
- In China, growth is still expected to recover, supported by infrastructure investment, but 2023 GDP forecast has been revised down.
- The recent measures to ease covid policies and support to the real estate sector are insufficient to significantly reduce concerns about weak growth.

Inflation will decline more quickly in the US than in the EZ, at least in 2023, as the shock imposed by the war will continue affecting mainly the latter

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



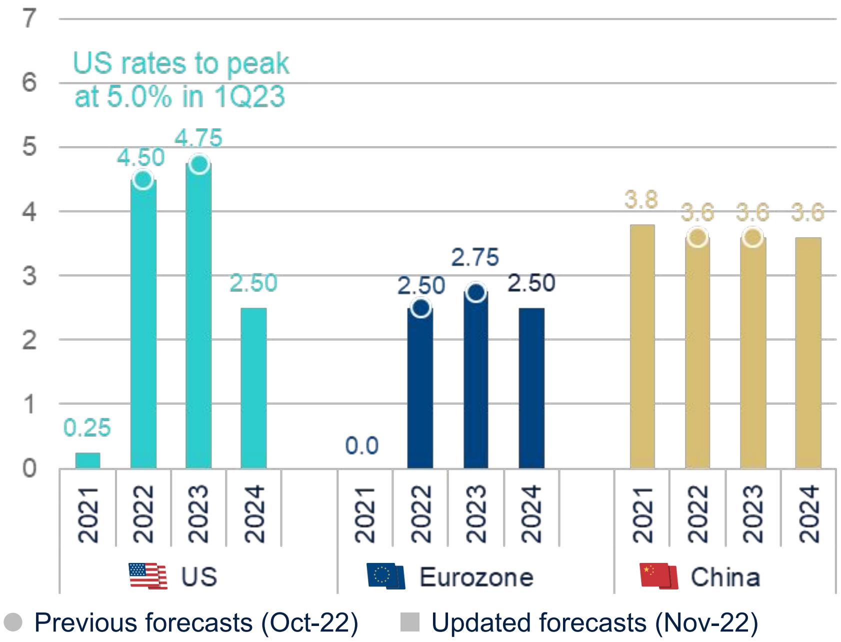
Source: BBVA Research.

- Inflation is set to continue slowing in the US as ongoing shocks wane and demand weakens, but it will be above the 2% target for some time.
- In the EZ, inflation is likely to soon peak, but forecasts have been revised up as the effects of more widespread price revisions, higher wage growth (to be around 4% ahead) and a weaker euro offset lower than expected energy prices.
- Inflation expectations are expected to remain broadly anchored both in the US and in the EZ.
- In China, inflation will continue at low levels largely on declining commodity prices, increasing imports from Russia and subdued demand.
- Inflation forecasts still have an upward bias.

The interest-rate hiking cycle is likely to come to an end in early 2023 in the US and the EZ, but there will be scarce room for monetary easing before 2024

MONETARY POLICY INTEREST RATES (*)

(%, END OF PERIOD)



* In the case of the Eurozone, interest rates on refinancing operations.
Source: BBVA Research based on Bloomberg data.

- The Fed and the ECB will continue raising rates , but probably at a softer pace than in the last few months: policy rates to reach 5.0% in the US and 2.75% (with an upside bias) in the EZ in 1Q23.
- A long pause is likely afterwards: inflation above targets should prevent rate cuts before Dec/23.
- Although rate hiking cycles should be soon over, a quantitative tightening is set to remain in place in the US and to soon start in the EZ.
- A non-expansionary fiscal policy is likely in the US, but not necessarily in the EZ.
- In China, controlled inflation will allow policy rates to remain low, but significant monetary stimulus are not anticipated.

Risks: multiple factors, such as long-lasting inflation or new war-related shocks, could trigger a global recession or a financial crisis

MAIN SHORT-TERM RISKS TO THE WORLD ECONOMY

PERSISTENT INFLATION AND HIGHER RATES →

UKRAINE WAR AND GEOPOLITICS →

HARD-LANDING IN CHINA →

SOCIAL TENSIONS AND POPULISM →

GLOBAL RECESSION

Growth in G3 economies could weaken more than expected, pushing emerging markets and the global economy into a recession. In particular, if inflation refrains from easing significantly (due to new supply shocks or monetary policy mismanagement, for example), a stagflation scenario could also emerge.

FINANCIAL CRISIS

Declining global liquidity, higher Fed rates, financial volatility and a strong USD could trigger sharp corrections and financial turmoil. Risks are higher in some segments: leveraged loans, high yield debt markets, shadow banking, dollar indebted agents and EM countries, real estate in some DMs, etc.

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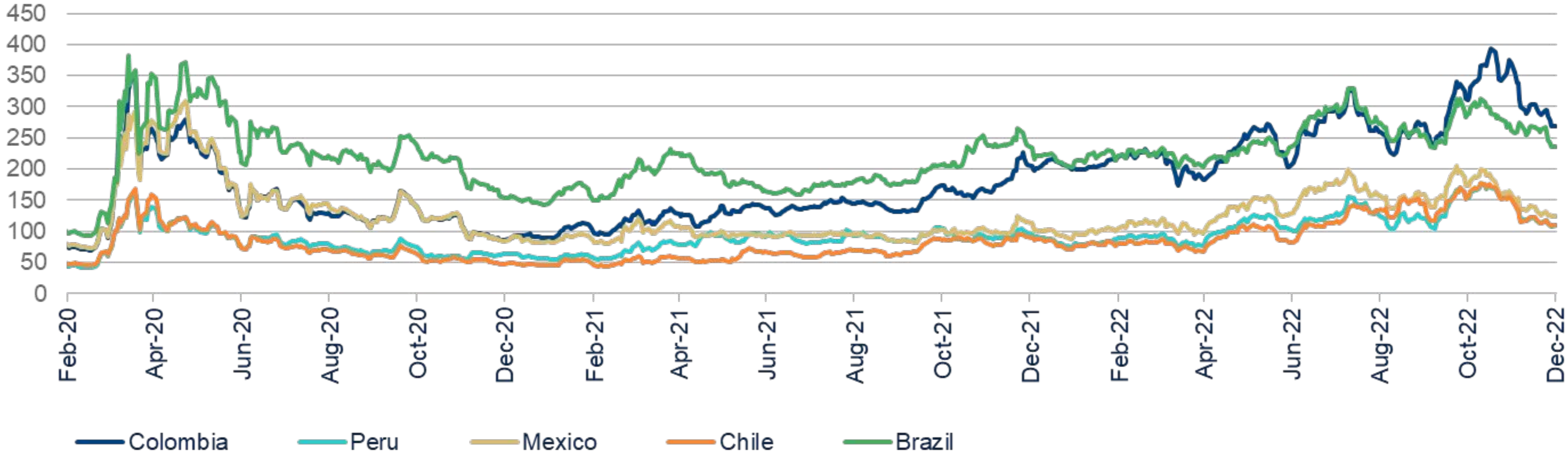
02

Local activity & local markets

Domestic demand remains strong, with some signs of a slowdown in private consumption and fixed investment.

In 2022, risk premiums increased in the region, especially between May and September, but the change was stronger in the case of Colombia.

CDS(*) IN SELECTED COUNTRIES
(BASIS POINTS)

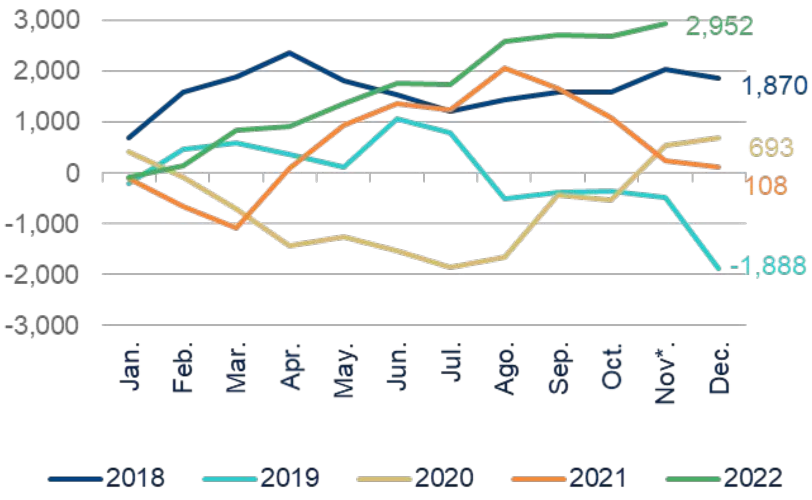


(*): The CDS (Credit Default Swap) is the cost in basis points charged to anyone who wants to insure payments on the sovereign debt of a given country.
Source: BBVA Research with data from Bloomberg

The increase in CDS began in 2021, when Colombia lost its investment grade rating, and was accentuated by the beginning of the global restrictive monetary policy, the electoral season and greater uncertainty.

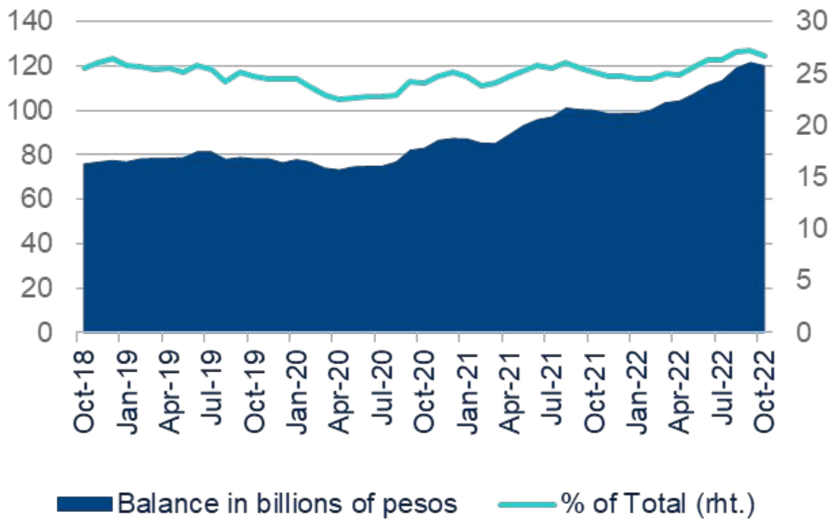
During this period of heightened risk aversion, portfolio capital flows remained stable, although they slowed down recently

EXTERNAL PORTFOLIO INVESTMENT INFLOWS
(MILLIONS OF DOLLARS, CUMULATIVE)



(*): On November 18, 2022
Source: BBVA Research with data BanRep and Ministry of Finance

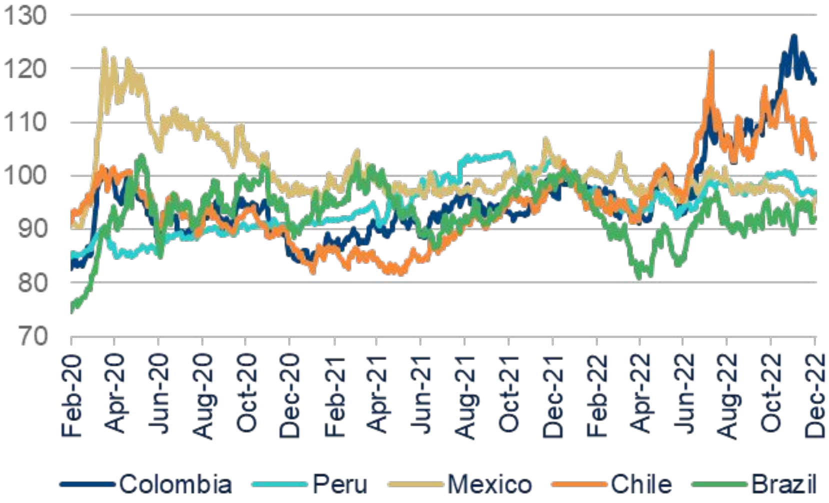
HOLDINGS OF TES BONDS BY FOREIGN FUNDS
(BILLIONS OF PESOS AND % OF TOTAL)



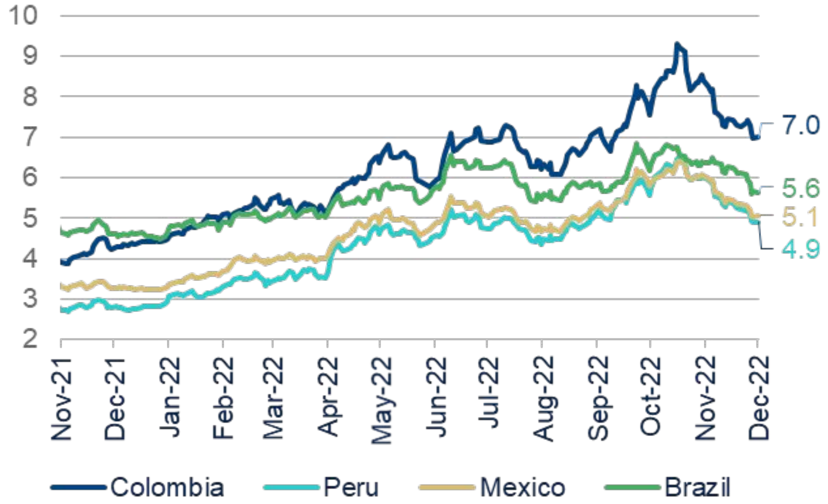
Foreigners have kept their share of domestic public debt relatively stable.

The exchange rate responded to higher external and domestic volatility and depreciated more than other regional peers so far this year

EXCHANGE RATE IN SELECT COUNTRIES
(INDEX, JAN.-3, 2022 = 100)



YIELDS ON 10Y-DOLLAR GOVERNMENT DEBT IN SELECT COUNTRIES (%)

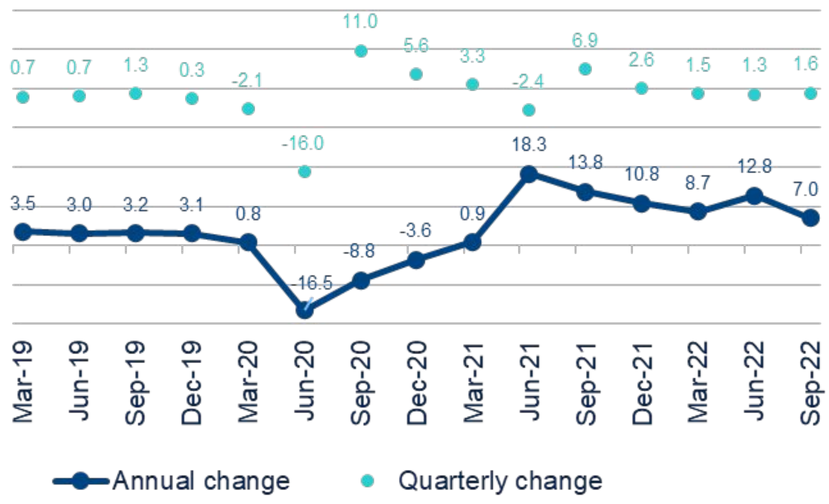


Source: BBVA Research with data from Bloomberg

The 2022 public debt financing interest rates were, on average, higher than those reported in 2021 and more volatile.

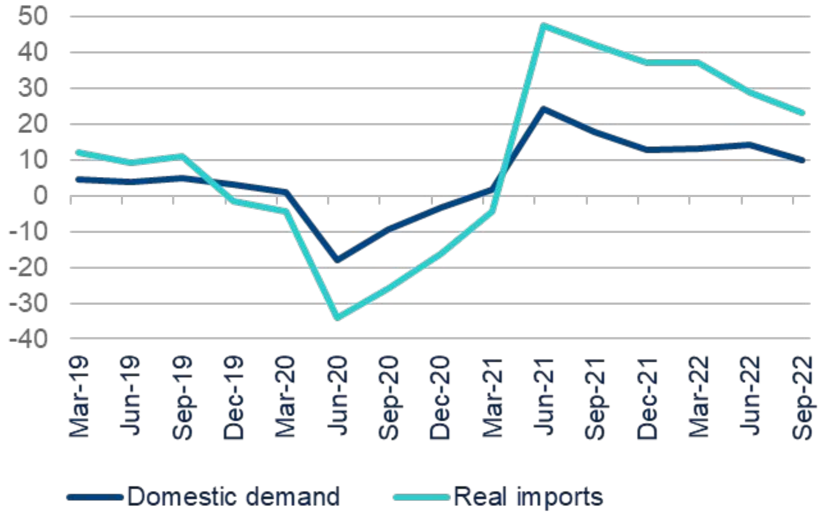
The economy continued to grow strongly in the third quarter, even with a high level of comparison in 2021

GDP
(REAL ANNUAL AND QUARTERLY CHANGE, %)



Source: BBVA Research with data from DANE.

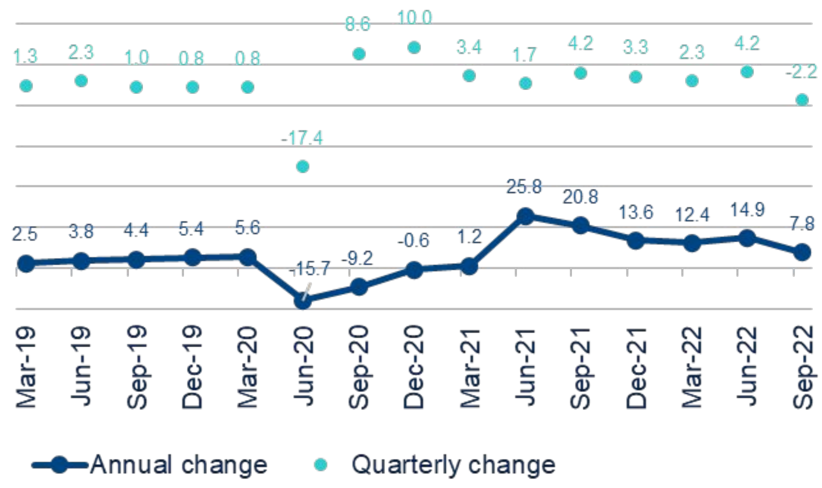
DOMESTIC DEMAND AND REAL IMPORTS
(REAL ANNUAL CHANGE, %)



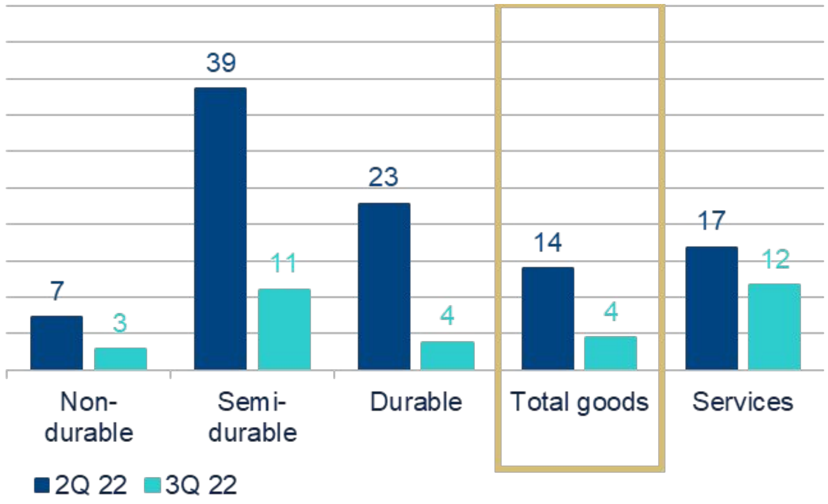
Growth continues to be driven by domestic demand, which has led to strong growth in imports. This phenomenon maintains pressure on the external balance.

Private consumption showed signs of slowdown, especially in the case of expenditure on goods, with a better performance in services

PRIVATE CONSUMPTION
(REAL ANNUAL AND QUARTERLY CHANGE, %)



PRIVATE CONSUMPTION BY COMPONENT
(REAL ANNUAL CHANGE, %)

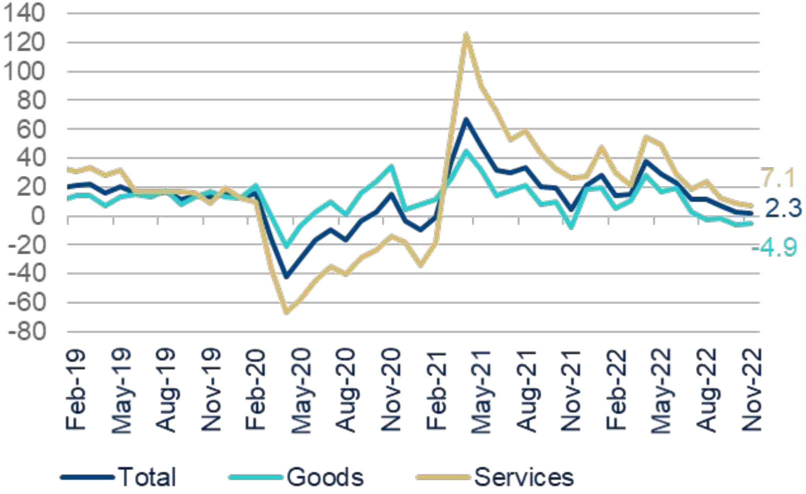


Source: BBVA Research with data from DANE.

Expenditure on services started to recover later than on goods, due to the mobility restrictions that remained when the economy reactivated following COVID-19. Now, it seems to show greater resilience in the midst of the slowdown.

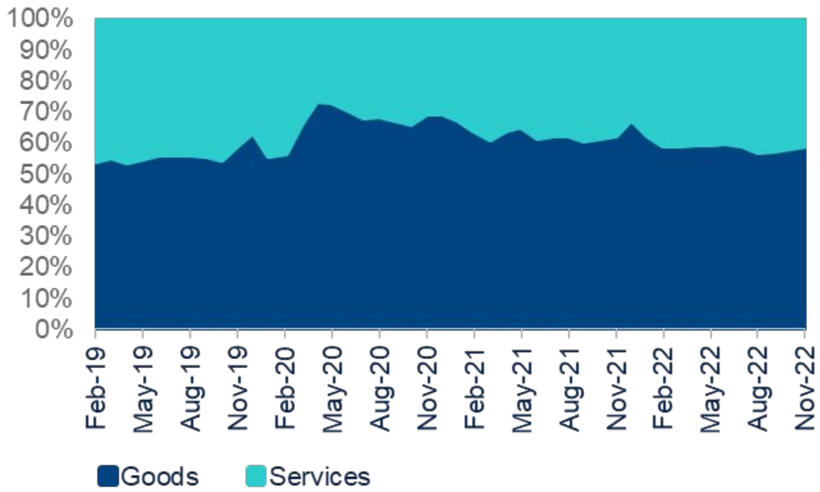
Our real-time indicator of household consumption shows that the slowdown continued into the fourth quarter of this year

BBVA *CONSUMER TRACKER* (*)
(REAL ANNUAL CHANGE, %)



(*): Data from November 30, 2022
Source: BBVA Research with data from BBVA transactions

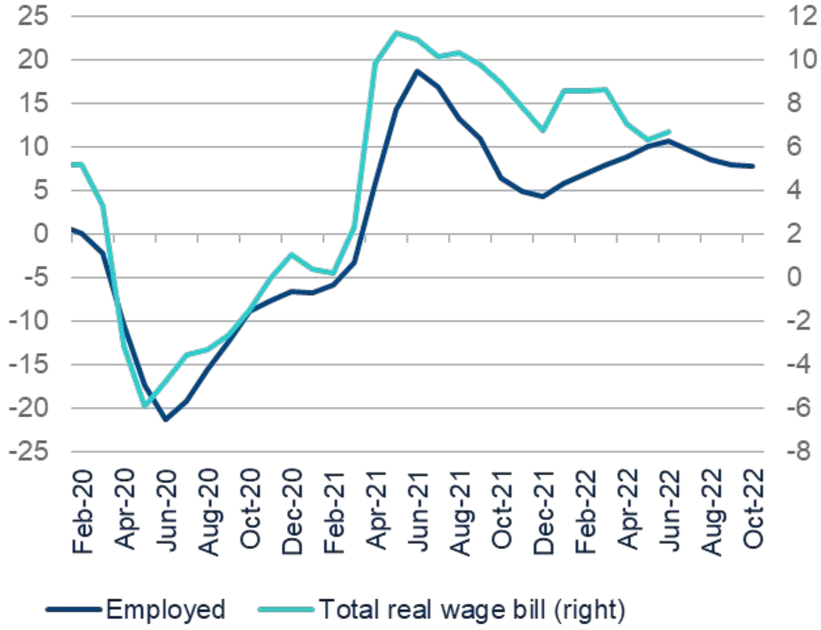
BBVA *GDP TRACKER*: COMPOSITION OF EXPENDITURE (% OF TOTAL)



In addition, services are close to regaining the share of household expenditure allocated to them prior to the COVID-19 pandemic. Though goods have gained some momentum in november due to the promotions held in the second half of the month.

Private consumption slows down due to the moderation of the labor market and other financing flows as well as higher interest and inflation rates

NATIONAL EMPLOYED AND REAL TOTAL WAGE BILL OF FORMAL EMPLOYMENT (ANNUAL CHANGE)(*)



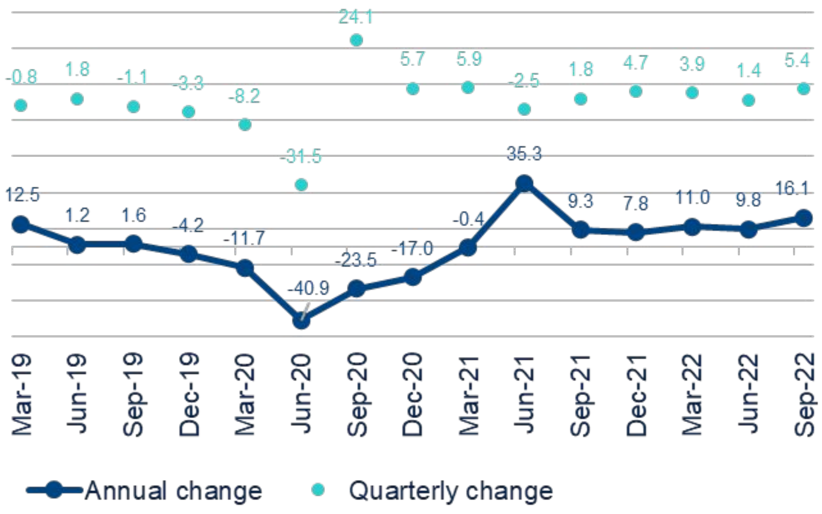
(*): In the case of national employees, this is the annual change in the quarterly data.
Source: BBVA Research with data from DANE and PILA.

Factors behind the slowdown in consumption (which will continue in the following quarters):

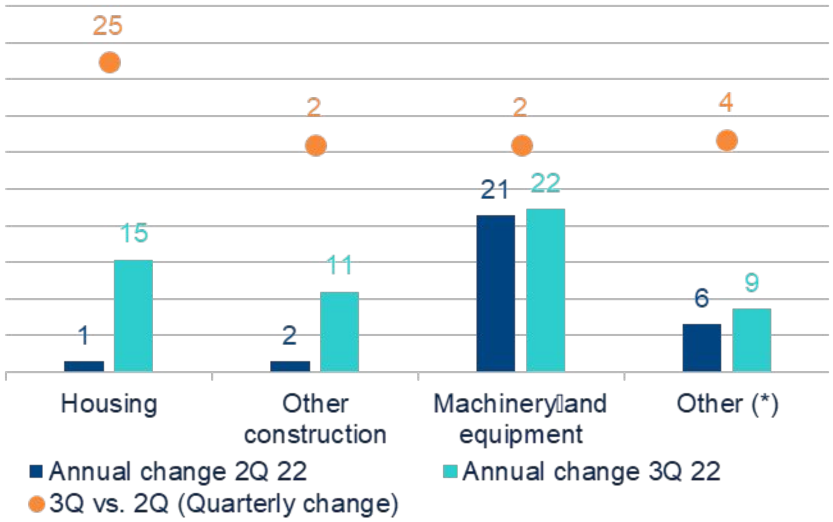
- Labor market slowing down (see graph).
- Lower consumer credit dynamics. Each month between Jan.-Jun., this balance grew by COP 3.4 billion. Between Jul.-Oct., it grew by COP 2.5 billion (COP 1.7 billion in Oct.).
- Lesser increase in other sources of financing: resources (summed) from coffee and remittances grew each month by COP 0.8 billion until June(*). Then, COP 0.6 billion in August and COP 0.5 billion in September.
- Higher inflation and interest rates reduce purchasing power, especially for longer-lasting goods. In addition, private savings have been depleted, which used to offset these negative effects.

Investment rebounded in the third quarter on the back of improved construction performance and continued high expenditure on machinery

FIXED INVESTMENT
(REAL ANNUAL CHANGE, %)



FIXED INVESTMENT BY COMPONENT
(REAL ANNUAL AND QUARTERLY CHANGE, %)

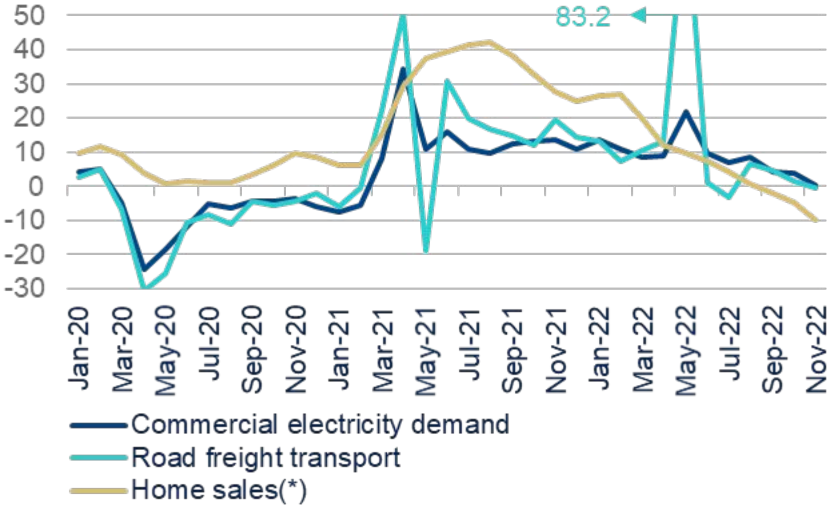


Source: BBVA Research with data from DANE.

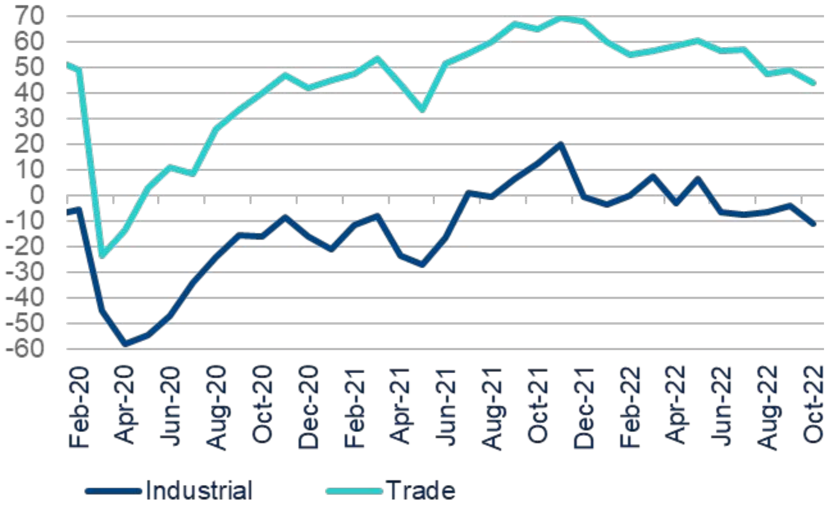
Housing investment accelerated due to increased completion of work already underway and lower construction cost pressures. Civil works were driven by higher investment in roads and other engineering projects associated with the regions.

Leading indicators related to investment show signs of slowdown

ENERGY AND TRANSPORT DEMAND
(ANNUAL CHANGE, %)



BUSINESSES PERCEPTION OF DEMAND
(BALANCE OF RESPONSES, %)

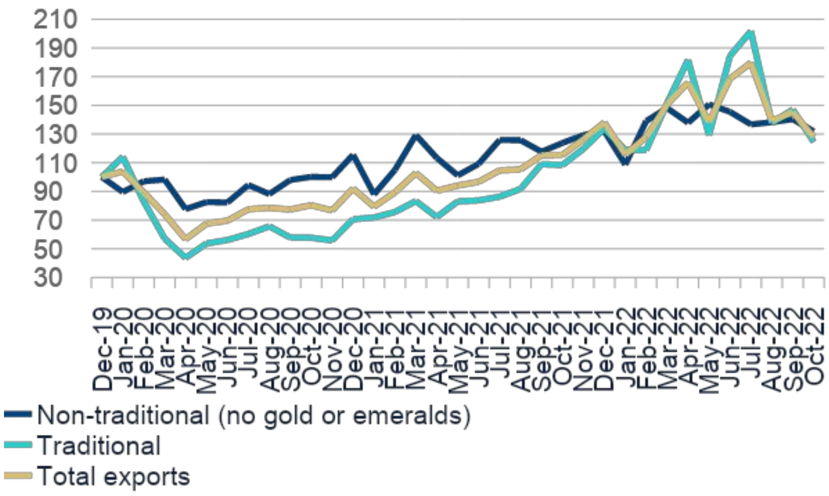


(*): For home sales, a rolling year was used to avoid the volatility of the series.
Source: BBVA Research with data from XM, Ministry of Transport and DANE.

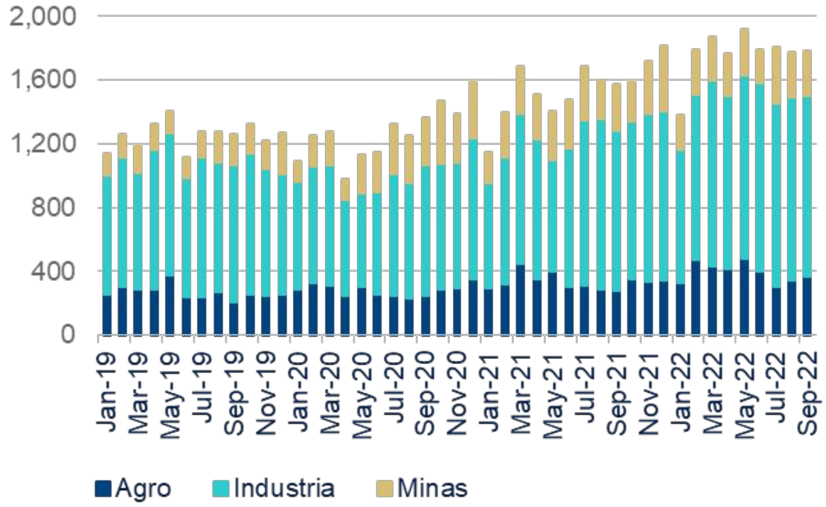
In addition, businesses perception of demand is decreasing for trade and remains negative for industry.

Non-traditional exports stabilized at high levels, while traditional exports remain highly volatile at high levels

EXPORTS
(INDEX, 2019 AVERAGE = 100)



NON-TRADITIONAL EXPORTS
(MILLIONS OF DOLLARS, MONTHLY)

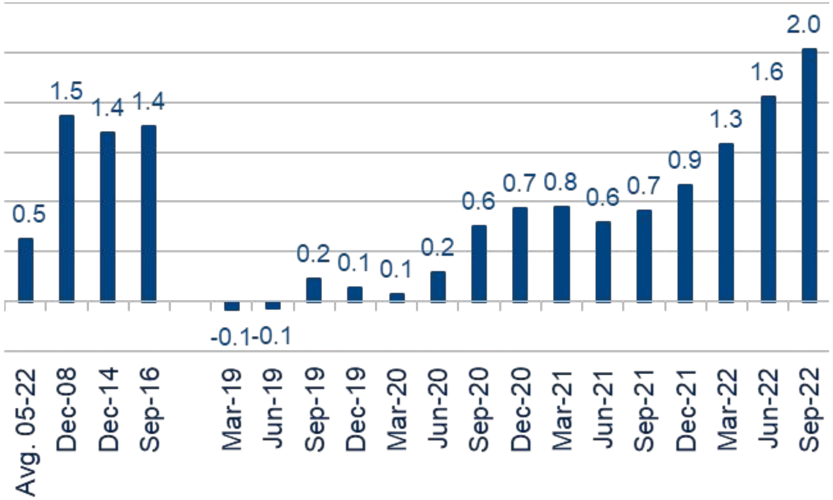


Source: BBVA Research with data from DANE and BanRep.

Foreign trade has supported positive investment dynamics by providing an additional boost to tradable sectors. However, expected slower global growth could limit the positive impact of exports on investment.

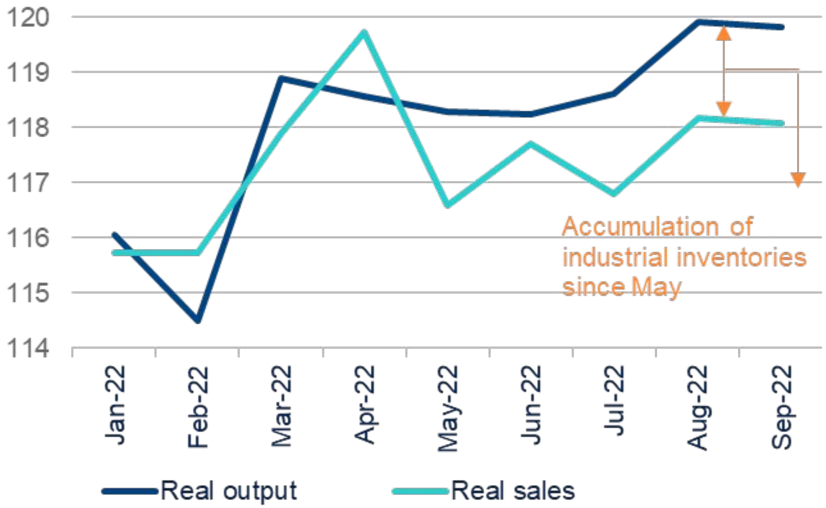
All in all, inventory accumulation is a sign that demand is losing traction and output will subsequently moderate

INVENTORIES(*) OF THE ECONOMY
(% OF REAL GDP, ROLLING YEAR)



(*): It is the difference between gross investment and fixed investment
Source: BBVA Research with data from DANE.

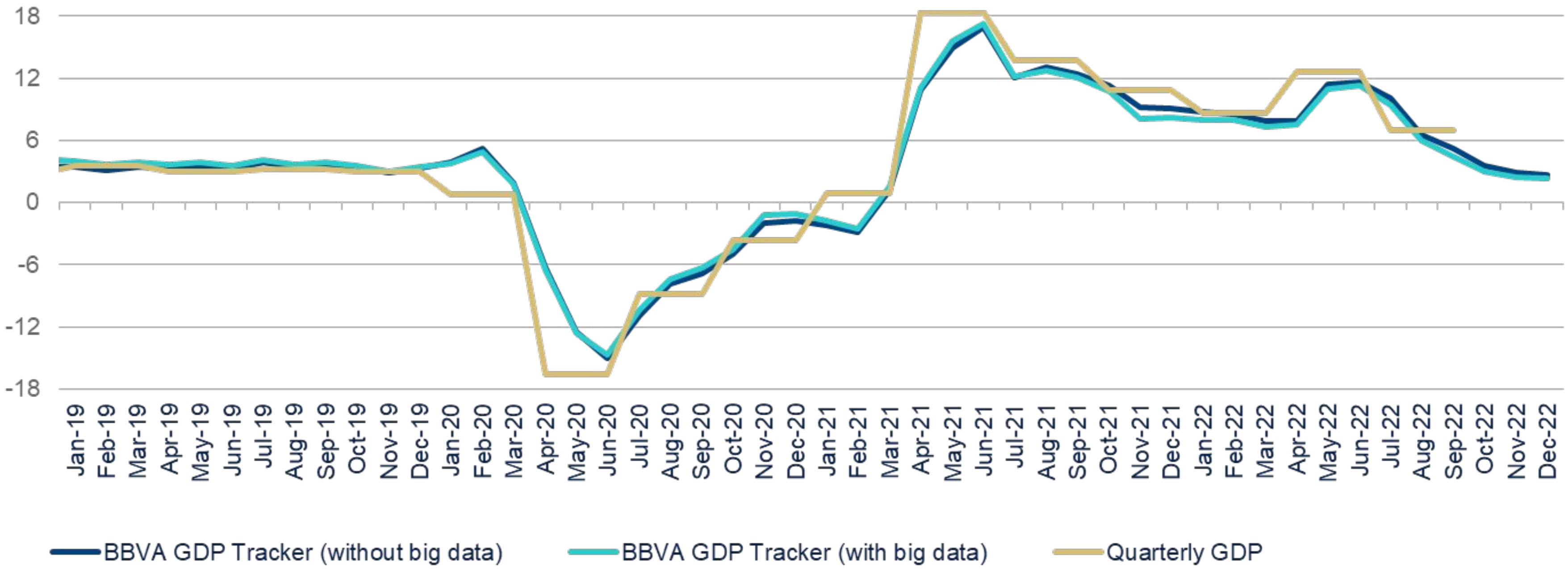
2022 ZOOMING IN: THE MANUFACTURING INDUSTRY (INDEX 2019 = 100)



In other periods of slowdown, inventories also increased (on a rolling year basis): in 2008, they went from 0.1% at the beginning of the year to 1.5% at the end of the year. In 2014, from 1.0% to 1.4%. In 2016, from 0.9% to 1.4%. This time, the inventory accumulation cycle has been more pronounced since 2Q22.

Our forecasting indicator for GDP performance(*) confirms the slowdown trend reported by some leading indicators

BBVA *GDP TRACKER*
(REAL ANNUAL CHANGE, %)



(*): It is a methodology that combines the analysis of multiple economic variables. See this indicator *(BBVA GDP Tracker*) here.
Source: BBVA Research.

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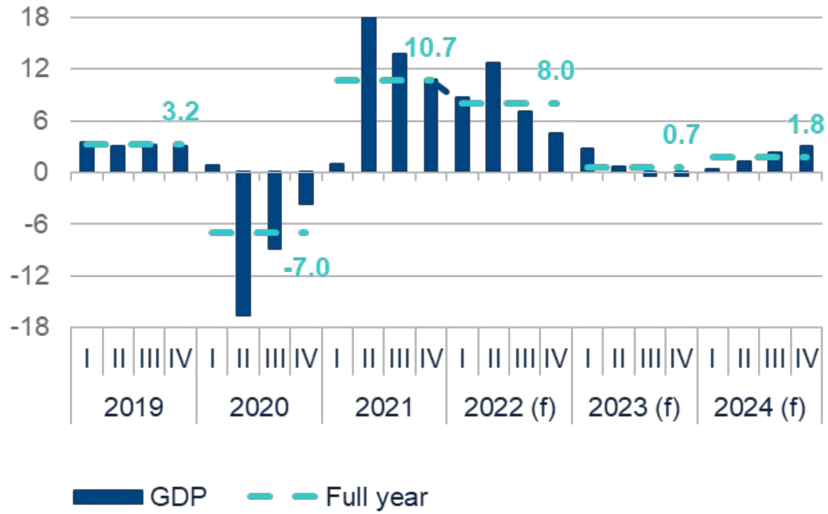
03

Growth forecasts

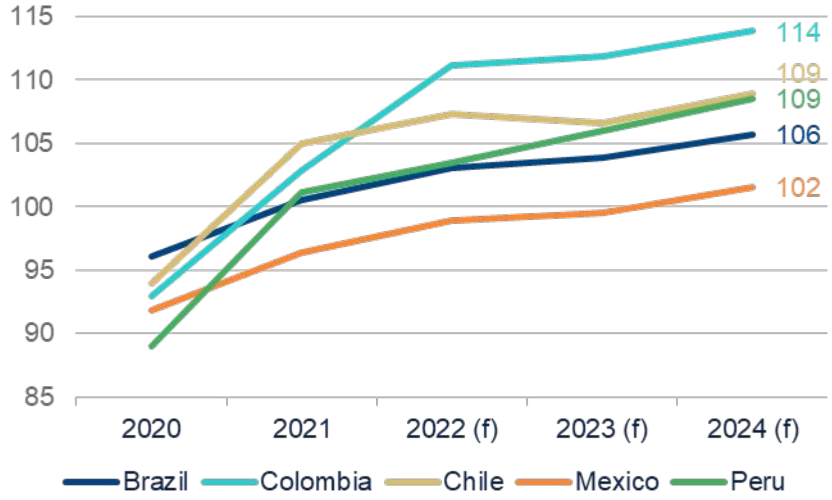
On average, domestic demand, especially private consumption and machinery investment, will grow below GDP over the next two years. Investment in civil works will remain strong.

We expect the economy to grow 0.7% in 2023 and 1.8% in 2024 after high dynamics in 2022 (8.0%) and 2021 (10.7%)

GDP
(REAL ANNUAL CHANGE, %)



REAL GDP IN SELECT COUNTRIES
(INDEX, GDP 2019 = 100)

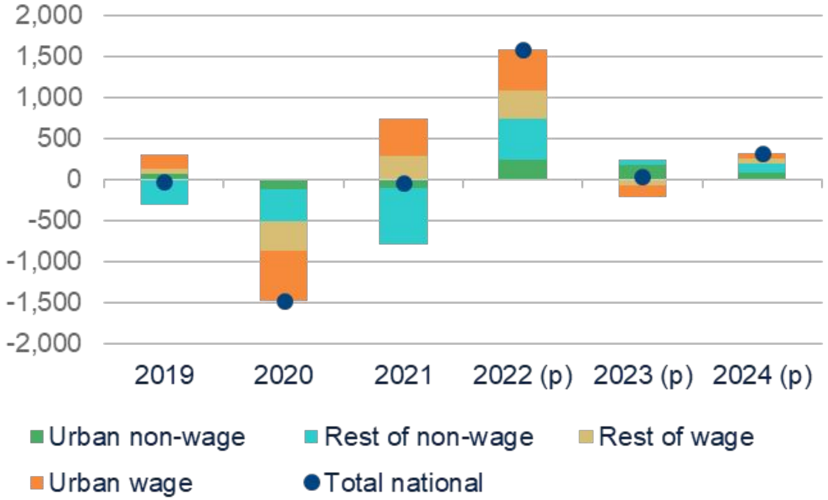


(f): BBVA Research forecasts for Colombia, Mexico and Peru. From Latinfocus consensus for Chile and Brazil.
Source: BBVA Research with data from DANE.

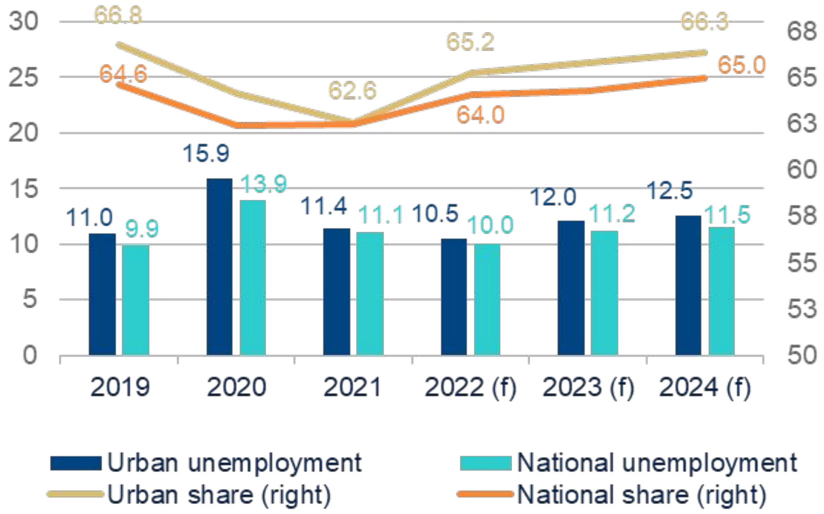
Colombia will maintain high levels of output and income in the coming years, even when compared to other countries in the region and compared to the pre-pandemic period.

The economy will reduce its capacity to create new jobs, and those new jobs will be informal, thus affecting private consumption

ANNUAL NATIONAL JOB CREATION(*) (ANNUAL, THOUSANDS OF PEOPLE)



UNEMPLOYMENT RATES(**) AND LABOR PARTICIPATION RATES(***) (%)

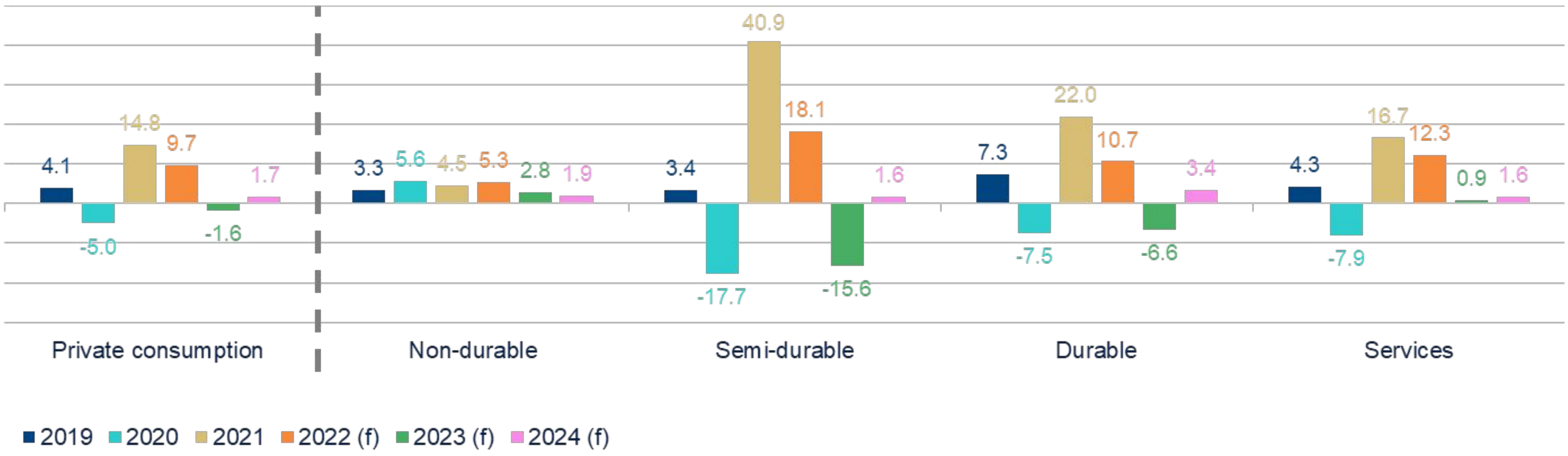


(f): BBVA Research forecasts (*): Is the change between the fourth quarters of two consecutive years. (**): Unemployment as a % of the active population. (***): Active population as a % of the working-age population. Source: BBVA Research with data from DANE.

The reduction in household income will lead more household members to seek employment, which will increase labor participation, a proxy for labor supply, and the unemployment rate, since not all of them will find work.

Private consumption will lead the downward correction in growth, and we expect this to help gradually increase savings levels

PRIVATE CONSUMPTION
(REAL ANNUAL CHANGE, %)

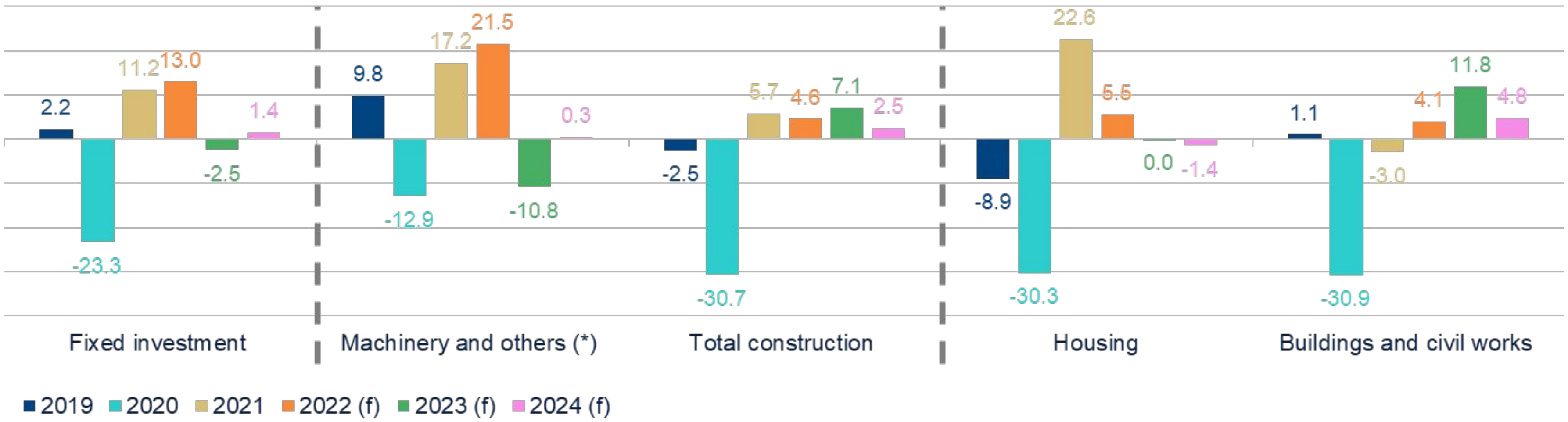


(f): BBVA Research forecasts
Source: BBVA Research with data from DANE.

The fall in consumption will be stronger in durable goods, while it will continue to grow in non-durable goods (food) and services. The latter still have room to grow because their cycle is lagging.

Investment will be driven by civil works, while machinery and buildings are expected to slow down

FIXED INVESTMENT
(REAL ANNUAL CHANGE, %)

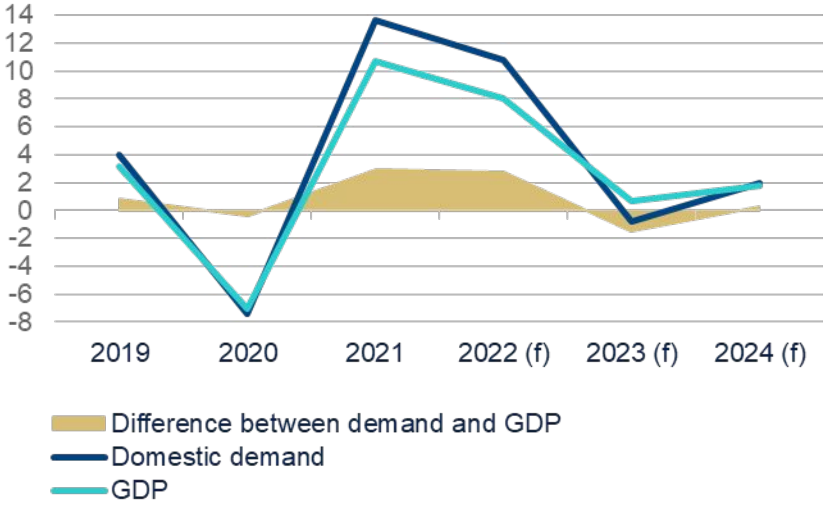


(f): Forecasts by BBVA Research. (*): Includes machinery and equipment, intellectual property and biological resources.
Source: BBVA Research with data from DANE.

Infrastructure expenditure in regional and local governments and national government plans will largely determine the future performance of investment and will compensate for diminished private investment decisions.

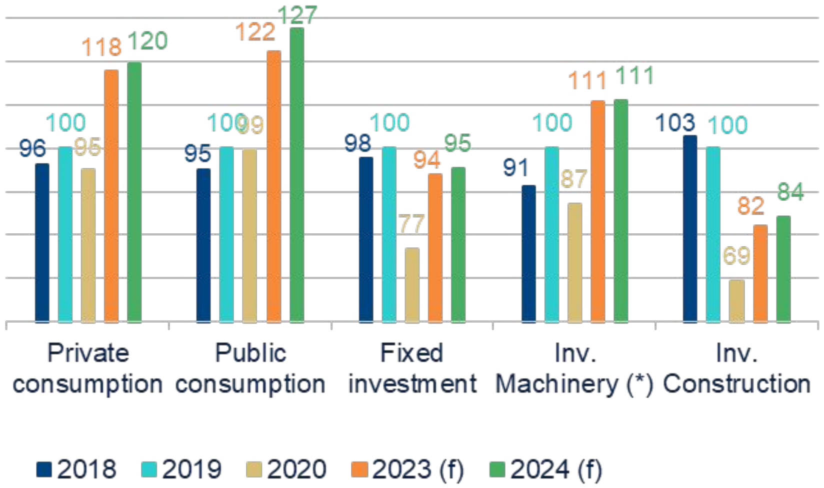
After a period of high domestic demand momentum, domestic demand will grow below GDP in 2023 and match it in 2024

DOMESTIC DEMAND AND GDP
(REAL ANNUAL CHANGE AND GAP, %)



(f): BBVA Research forecasts
Source: BBVA Research with data from DANE.

LEVEL OF REAL GDP COMPONENTS IN 2023-24
(2019 = 100)



The moderation of domestic demand will help the external balance of the economy, through a slight reduction in real imports and an increase in savings. Exports, in turn, will be relatively stable in the coming years: with a slight fall in exports to developed countries and an increase in exports from LatAm countries.

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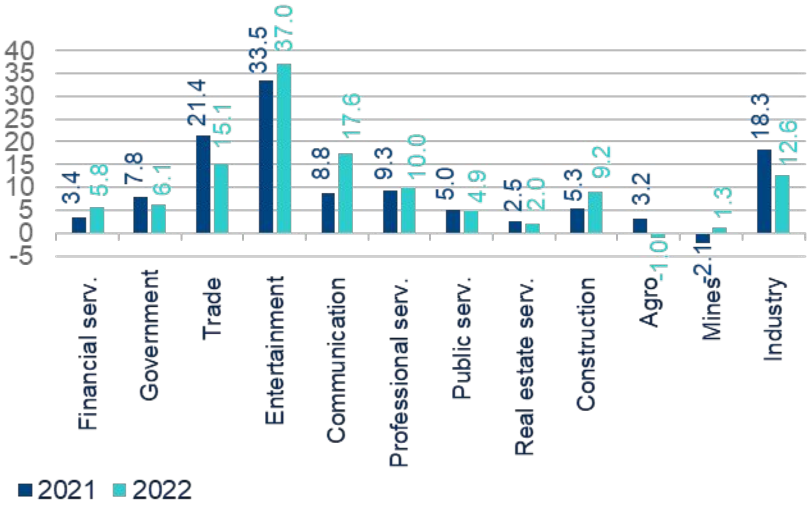
04

Economic sectors

The services and industry sectors led the growth of the economy in 2022. In the coming years, the government will participate more in the economy, partly due to the slowdown in the tradable sectors and trade.

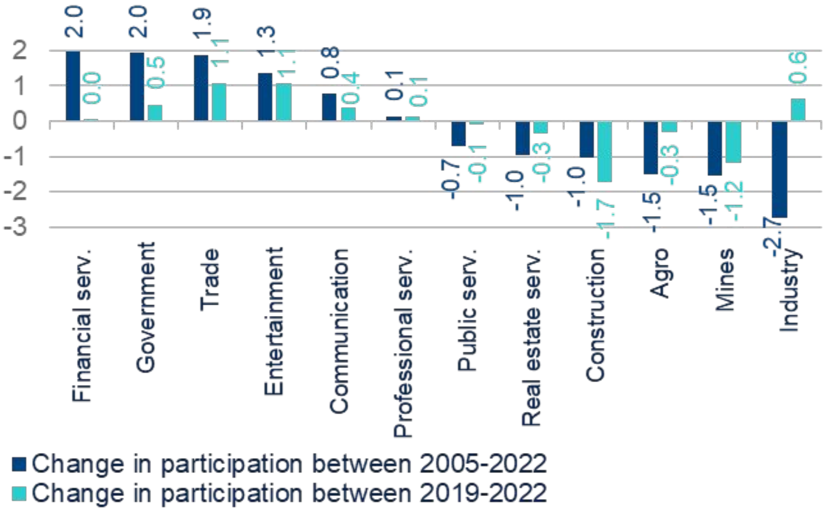
The service sectors are leading this year's growth, associated with a stronger upturn in demand in 2022

SECTORAL GROWTH IN 2021 AND 2022
(YEAR-TO-DATE REAL CHANGE, %)



Source: BBVA Research with data from DANE.

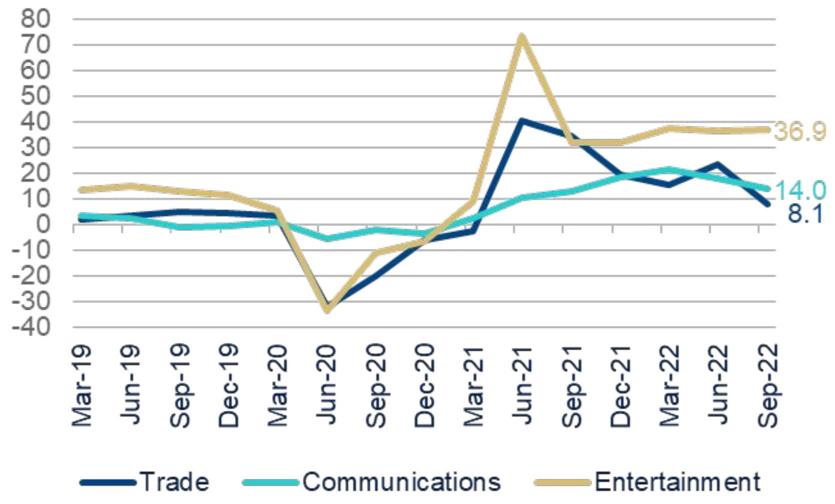
SECTORAL BALANCE OF THE ECONOMY
(CHANGE IN PERCENTAGE POINTS, % OF GDP)



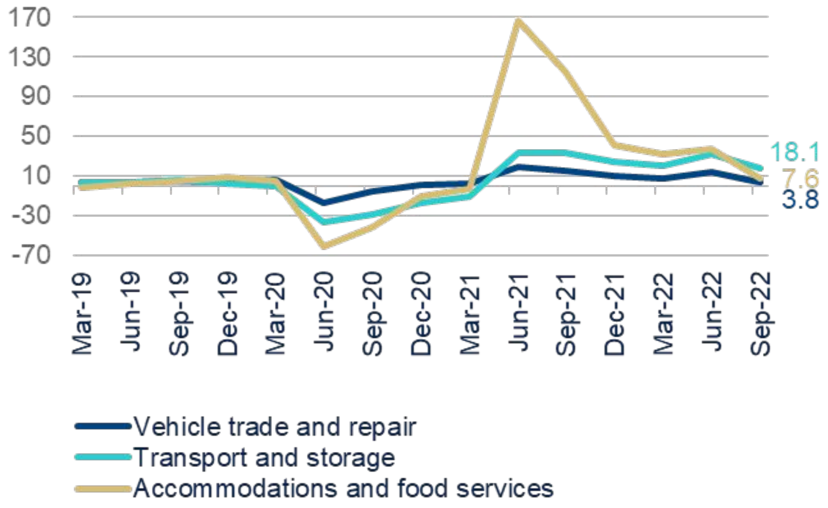
Since 2005, the sectors that have gained the largest share of GDP were financial services, entertainment and trade. Similarly, since the pandemic, entertainment and trade again gained the most share.

The shift in consumption toward services consumption is evidenced by the high and sustained growth rates in recent quarters

SECTORS ASSOCIATED WITH SERVICES
(REAL ANNUAL CHANGE, %)



MAIN TRADING DIVISIONS
(REAL ANNUAL CHANGE, %)



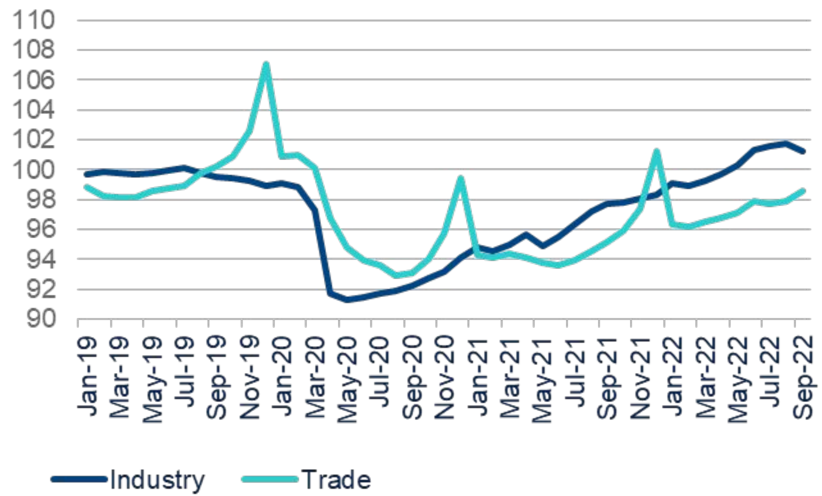
Source: BBVA Research with data from DANE.

Although moderations in trade are seen, they correspond to a slowdown in accommodations and restaurant services.

Industry also has a prominent place: increased foreign trade, together with strong domestic demand, is driving industry growth

OUTPUT(*) AND GROWTH MANUFACTURING IND. (BILLIONS OF REAL PESOS AND ANNUAL CHANGE, %)

EMPLOYMENT INDICES IN RETAIL TRADE AND INDUSTRIAL OUTPUT (ANNUAL CHANGE, %)

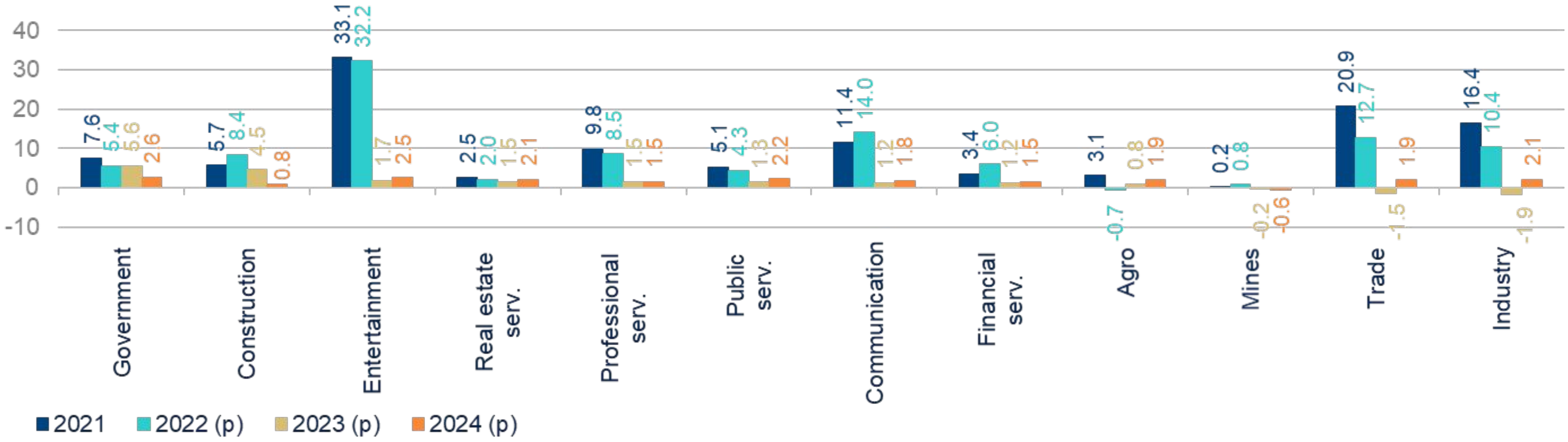


(*): Seasonally adjusted series
Source: BBVA Research with data from DANE.

In addition, industry is one of the sectors that has contributed the most employment so far (along with trade and services).

The sectors that will grow the most in 2023 and 2024 are government, construction and entertainment

GDP BY SUPPLY
(REAL ANNUAL CHANGE, %)

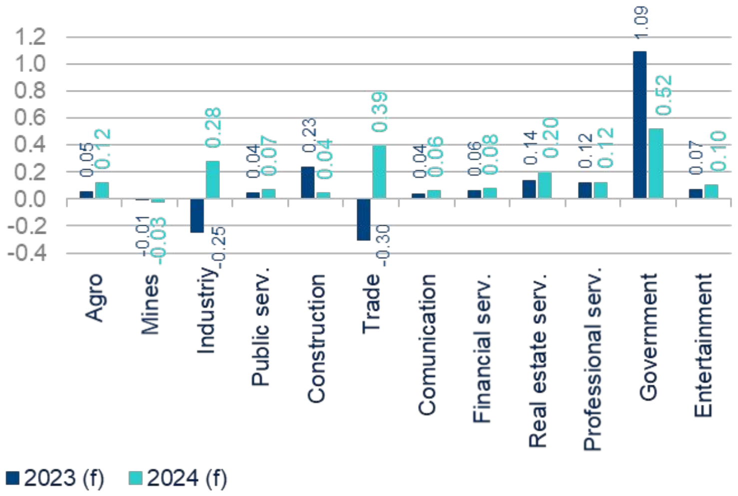


(f): BBVA Research forecasts.
Source: BBVA Research with data from DANE.

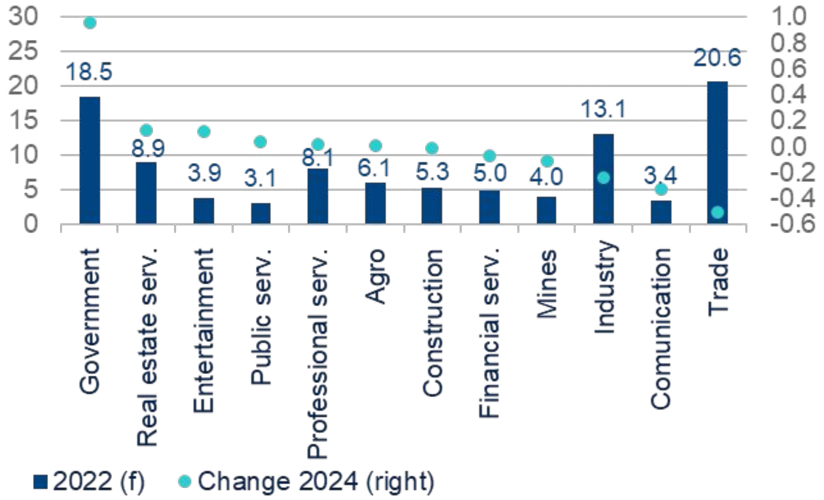
The government sector will be associated with higher expenditure to be implemented by the Central Government. In construction, civil works will stand out. Entertainment will be driven by the better overall performance of the services sector.

Between 2023 and 2024, the government, real estate and construction sectors will contribute the most to the growth of the economy

SECTORAL CONTRIBUTION TO GDP GROWTH
(% OF TOTAL GDP GROWTH)



COMPOSITION OF GDP 2022 AND CHANGE 2022-2024
(PERCENTAGE POINTS, %)



(f): BBVA Research forecasts.
Source: BBVA Research with data from DANE.

Thus, these sectors will increase their share the most between 2022 and 2024, while those that will reduce their share of GDP will be trade, communications and industry.

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05

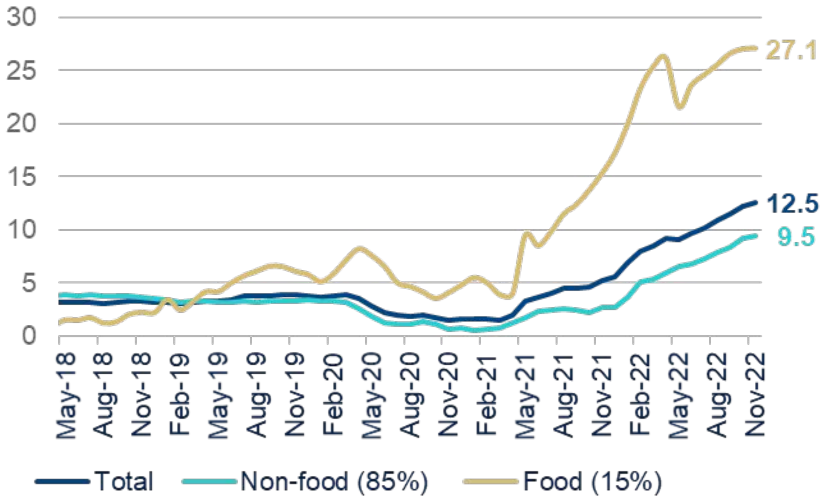
Inflation and interest rates

The inflation rate will be reduced starting in 2023, but at a more gradual pace than in previous cycles, which will influence the BanRep's reductions to be progressive from the end of next year as well.

In 2022, inflation has been driven mainly by food prices. Non-food inflation still shows signs of accelerating

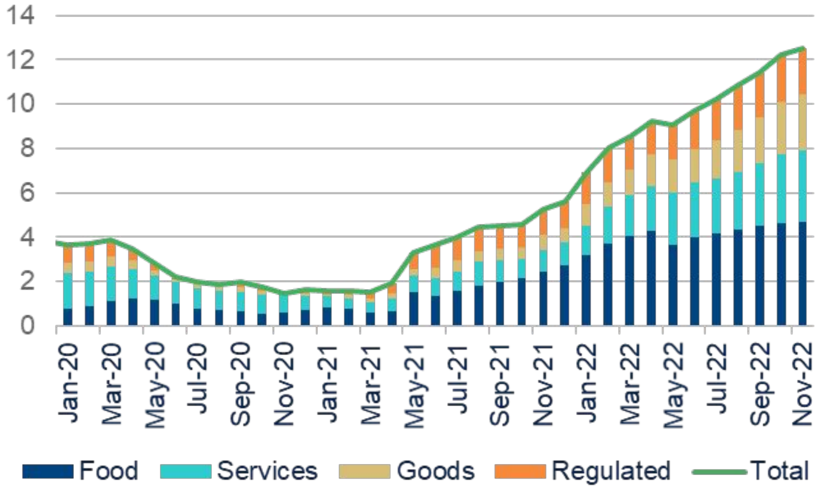
INFLATION OF THE MAIN BASKETS(*)

(ANNUAL CHANGE, %)



CONTRIBUTION OF THE MAIN SUB-BASKETS

(ANNUAL CONTRIBUTION, %)

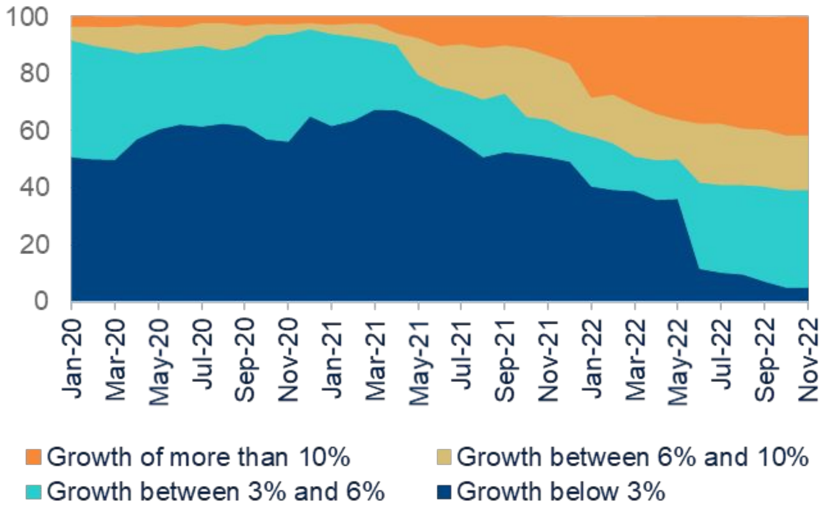


(*) Weight of the basket in parentheses
Source: BBVA Research with data from DANE.

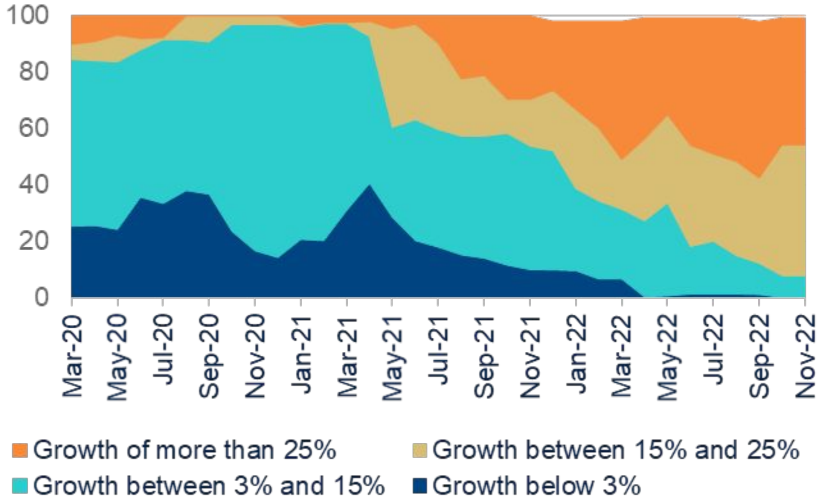
The sub-baskets that have contributed the most to the increase in inflation in 2022 have been food and services. However, generalized increases are perceived in the remaining sub-baskets.

Inflation still shows upward pressures that only show signs of a slowdown in specific food items

ITEMS GROWING ABOVE CERTAIN THRESHOLDS (% OF TOTAL WEIGHT)



FOOD ITEMS GROWING ABOVE CERTAIN THRESHOLDS (% OF TOTAL WEIGHT)

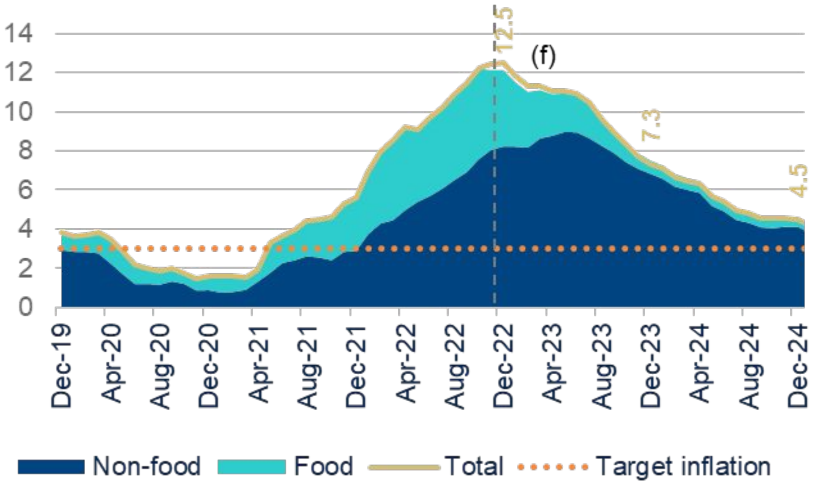


Source: BBVA Research with data from DANE.

The slowdowns are beginning to occur in the basket that generated the greatest pressures during the year (food) and it is expected that when this eases, it will mark the beginning of the slowdown in total inflation, although it will continue to be pressured by core inflation.

Inflation will be on a gradual slowdown path from 2023 onwards, but will still face some challenges in moderation

TOTAL INFLATION AND CONTRIBUTION OF FOOD AND NON-FOOD (ANNUAL CHANGE, %)



(f): BBVA Research forecasts.
Source: BBVA Research with data from DANE.

DETERMINING FACTORS OF INFLATION

Devaluation that makes imported goods more expensive.

Second round effect of high costs in production and service chains.

High indexation to be transmitted more easily in the first half of 2023.

Lower growth in domestic demand that will reduce inflationary pressures, especially in the second half of 2023.

Moderation in agricultural inputs, although they remain at high levels.

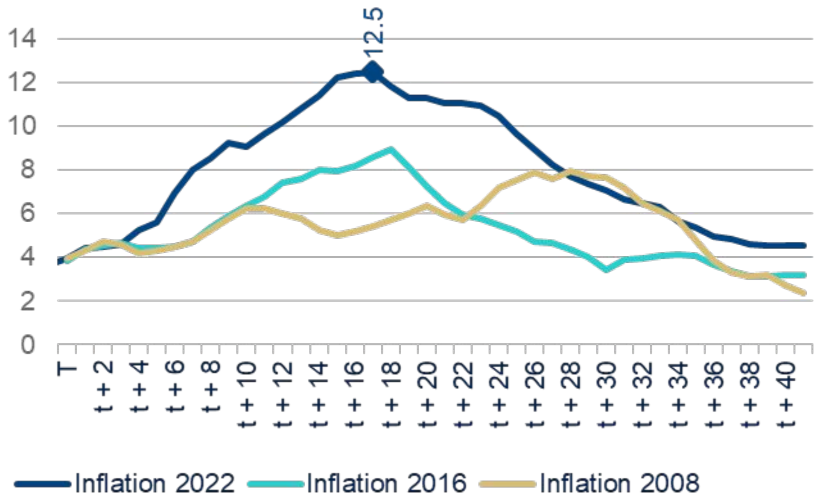
Climate factors dissipate from the second quarter of 2023.

Bottlenecks continue to be reduced.

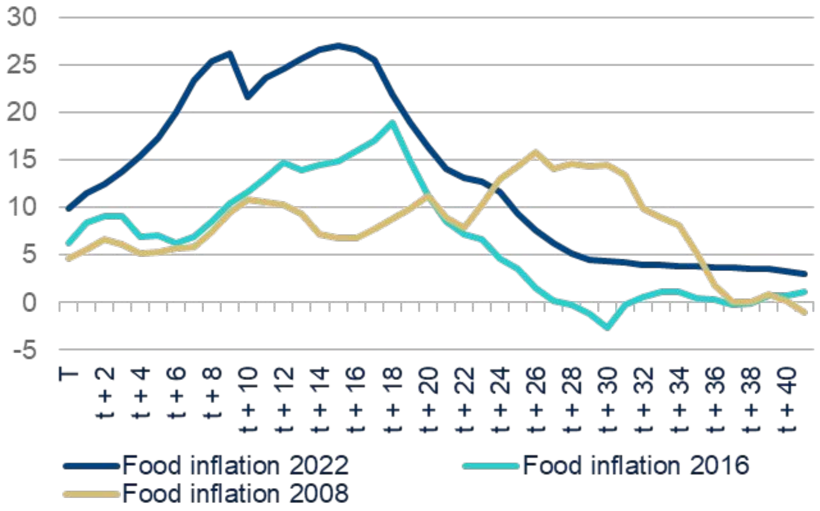
Food inflation will peak in the transition to 2023, while core inflation will peak in the first half of 2023. After that, total inflation will ease more broadly and more strongly.

Total inflation accelerates faster in this inflation scenario and takes longer to return to the inflation target

COMPARISON OF HIGH INFLATION PERIODS: 2008, 2016 AND 2022 (ANNUAL CHANGE, %)



COMPARISON OF HIGH FOOD INFLATION PERIODS: 2016 AND 2022 (ANNUAL CHANGE, %)



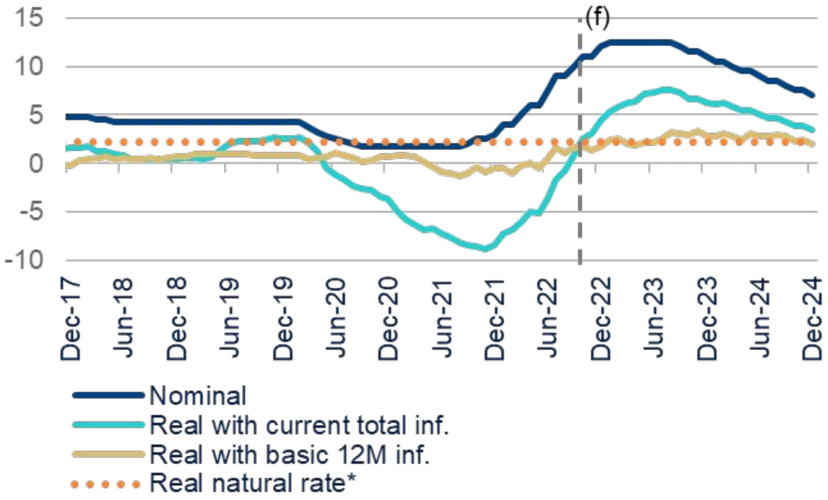
Source: BBVA Research with data from DANE.

The food basket is rising faster but slowing down at the same rate as in other inflation periods.

The Central Bank is nearing the end of its rate hike cycle, with a terminal value at 12.5%, the highest in more than 20 years

POLICY INTEREST RATE

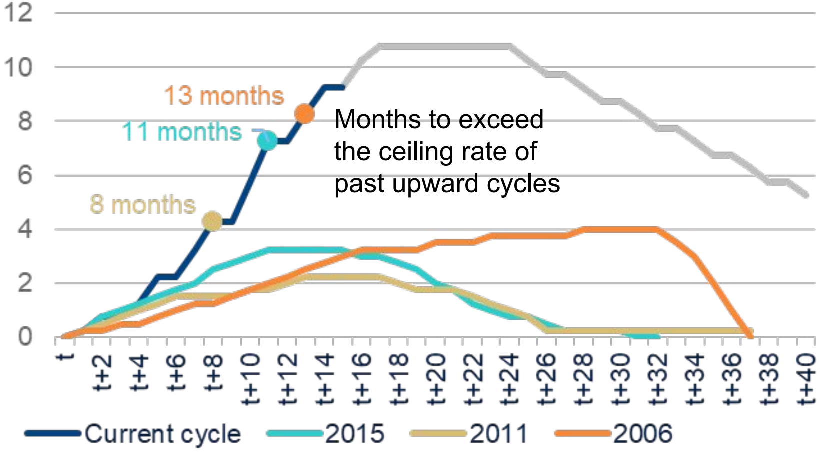
(NOMINAL AND REAL RATE, %)



(f): BBVA Research forecasts
Source: BBVA Research with data from BanRep and DANE.

COMPARISON OF MAIN UPWARD CYCLES

(EFFECTIVE ANNUAL RATE, %. T = TIME AT WHICH THE UPWARD CYCLE BEGINS)



The current upward cycle has been the steepest in this century, surpassing the increases of the previous one in just 8 months

The rate will remain at high levels in the first part of 2023 and will begin a gradual rate reduction cycle starting in September 2023. Its speed will depend on the level of economic weakening and the decline in inflation.

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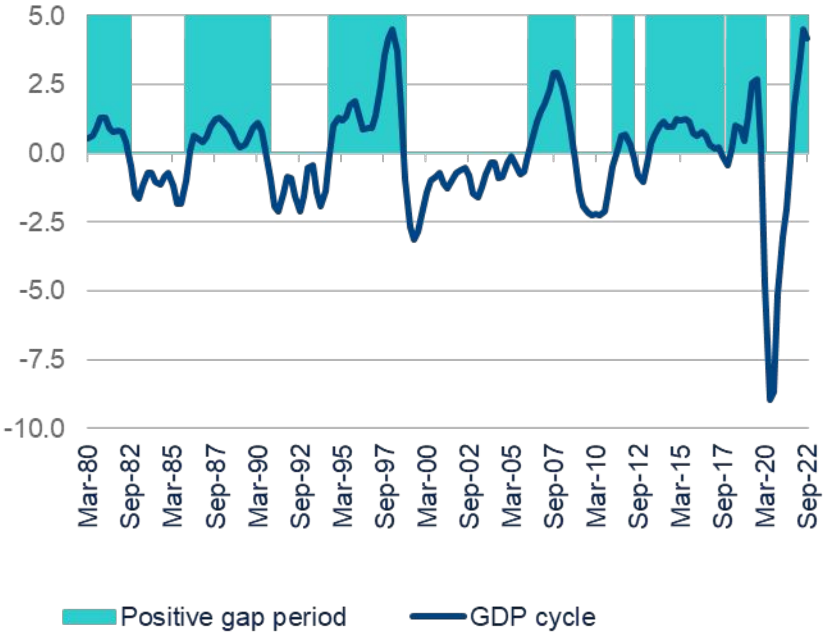
06

Structural balances

The post-pandemic economic cycle upswing was high and rapid and was accompanied by external and fiscal imbalances. The slowdown in domestic demand will help to increase domestic savings and reduce these deficits.

The expansionary cycle that is coming to an end featured one of the biggest upswings in history and was short-lived

GDP CYCLE(*)
(DEVIATION FROM TREND LEVEL, %)

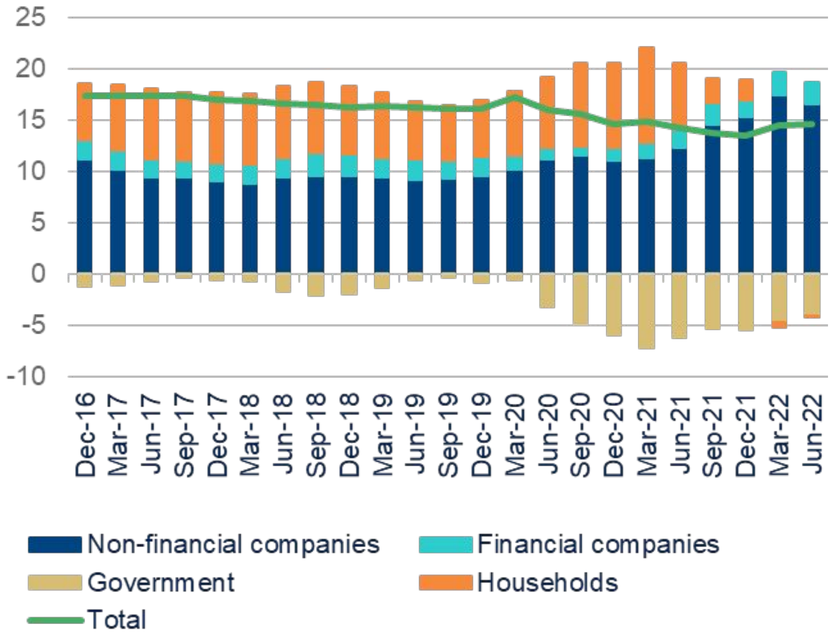


(*): Hodrick-Prescott filter
Source: BBVA Research.

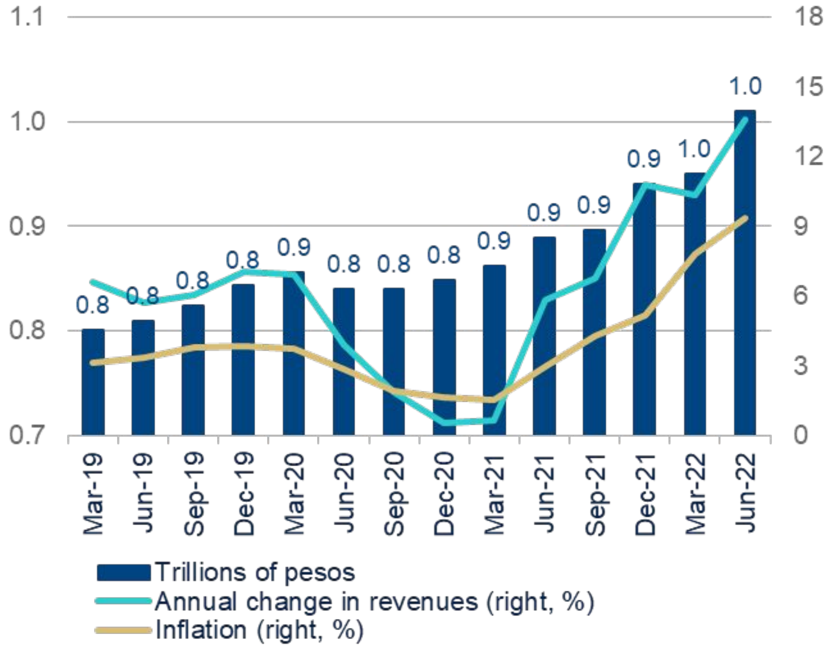
- The most recent expansionary cycle peaked in June 2022.
- The upswing was the largest since March 1998.

The cycle was accompanied by a sharp drop in savings. For households, savings even fell while income improved rapidly

GROSS DOMESTIC SAVINGS
(ROLLING YEAR, % OF GDP)



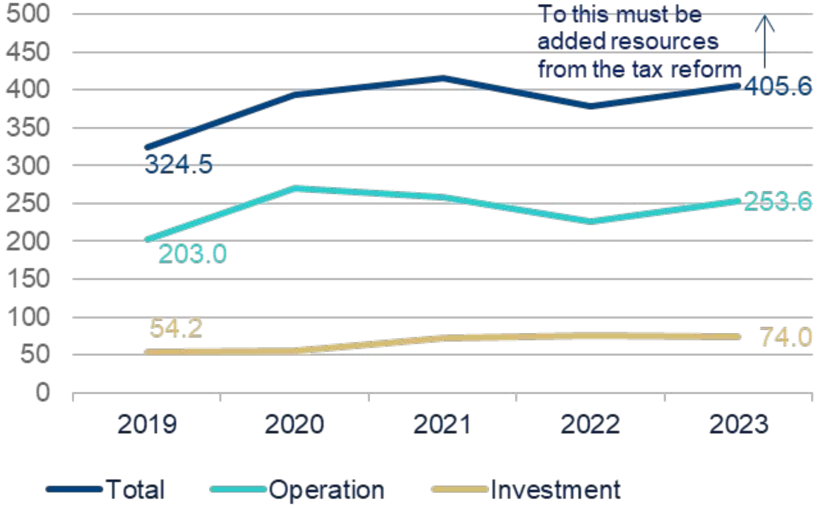
HOUSEHOLD DISPOSABLE INCOME
(ROLLING YEAR, NOMINAL, ANNUAL CHANGE IN %)



Source: BBVA Research.

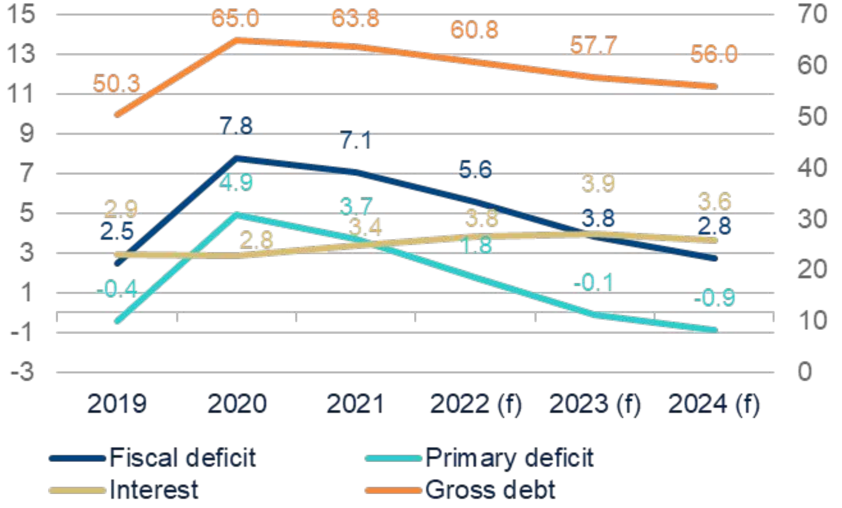
Government expenditure was high and still high in 2023: the budget, not yet including tax reform and discounting inflation, is 25% higher than that of 2019

CENTRAL NATIONAL GOVERNMENT BUDGET AS OF DECEMBER, EACH YEAR(*) (BILLIONS OF PESOS AS OF DEC.-23)



(*): For 2022 this is the budget for the year, as of June, and for 2023 the approved budget. (f) BBVA Research.
Source: BBVA Research with data from the Ministry of Finance and DANE.

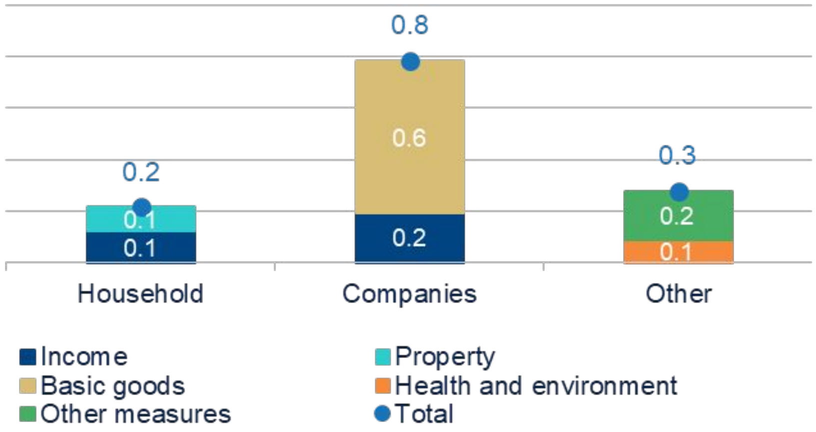
CENTRAL NATIONAL GOVERNMENT GROSS DEFICIT AND DEBT (% OF GDP)



Starting in 2024, complying with the tax rule will require reducing expenditure as a percentage of GDP, in addition to revenues from tax reform. The interest burden will be high so the deficits allowed by the tax rule will widen, thus slowly reducing the debt.

The approved tax reform will raise about $20 billion (1.3% of GDP), mainly from oil and coal companies

REVENUE FROM THE REFORM, ACCORDING TO THE GOVERNMENT
(% OF GDP AND BILLIONS OF PESOS — BELOW)



	COP billion		COP billion
Natural persons	3.4	Income legal entities	3.0
Income	1.9	Basic goods	9.3
Property	1.5	Health and environment	1.4
		Other measures	3.0
Total	**20.0**		

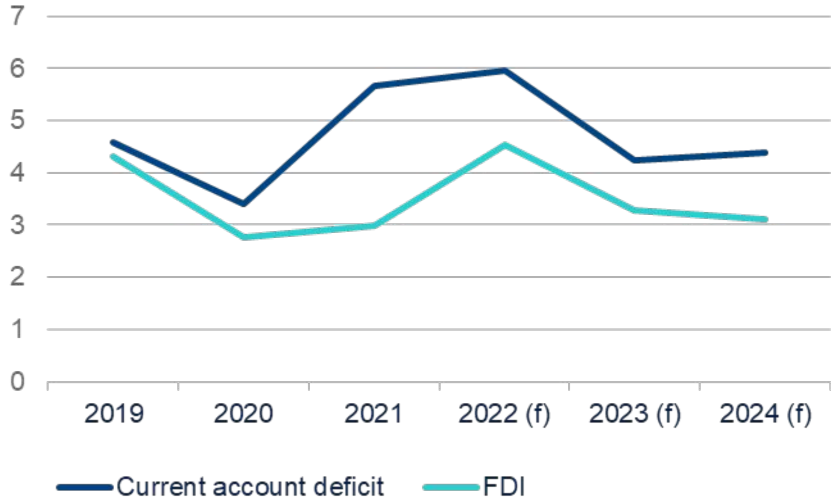
Source: BBVA Research with data from the Ministry of Finance.

- In companies, the reform maintains the corporate rate (at 35%) and reduces exemptions, thus increasing the effective tax rate, and imposes surcharges on the corporate rate in coal, oil and hydroelectric companies and increases and extends that of the financial sector.
- For individuals, it reduces exemptions and creates a wealth tax. In terms of the increase in collection, individuals contribute relatively little, which limits the progressive impact of the reform and increases the imbalance in the tax burden between individuals and companies.
- Effects, in terms of lower confidence of both household and business, and of lower savings and investment.

The external deficit in 2023 will be corrected by continued strong export performance and expectations of lower domestic demand

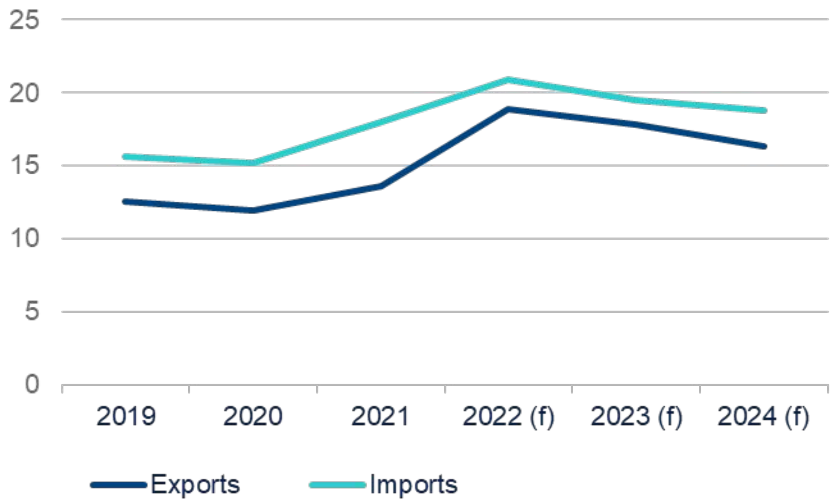
EXTERNAL DEFICIT AND FINANCING

(% GDP)



TRADE BALANCE

(% GDP)

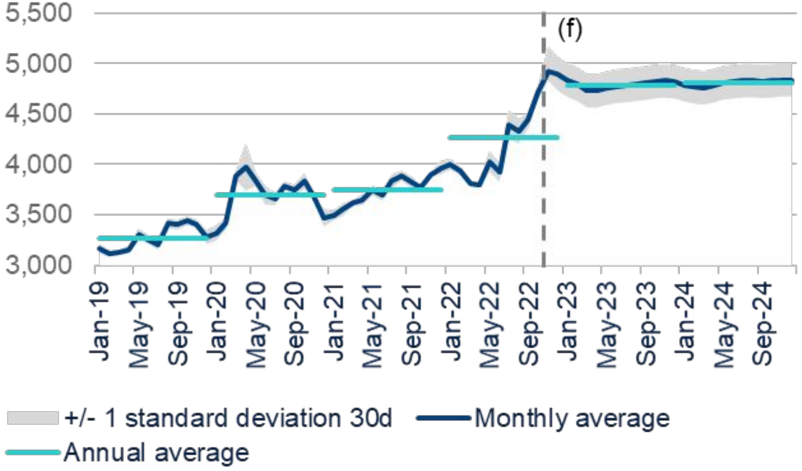


(f): BBVA Research forecasts.
Source: BBVA Research with data from DANE and BanRep.

In 2024, non-traditional exports will gain momentum, although the decrease in mining prices and quantities exported will put upward pressure on the trade deficit, together with imports. FDI will decrease in key sectors such as oil and mining (due to domestic trends and global slowdown)

The exchange rate would remain weak in 2023 and 2024, averaging around 4,800 pesos per dollar

EXCHANGE RATE
(PESOS PER DOLLAR)



	End of period		Period average	
	Rate	Annual chg.	Rate	Annual chg.
2022 (f)	4,900	23.5	4,266	13.9
2023 (f)	4,820	-1.6	4,790	12.3
2024 (f)	4,840	0.4	4,810	0.4

Source: BBVA Research with data from BanRep

External factors underpinning the dollar's strength

- The accelerated pace of monetary policy tightening in developed economies
- Geopolitical tensions
- Weakening global activity

Internal factors underpinning the peso's weakness

- Colombia's large current account deficit and the financing needs of the Colombian economy
- Lower growth prospects for the mining sector.
- The increase in inflation and the low real interest rates it implies.

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07

Closing remarks

Colombia will face some major challenges in the coming years: it has structural strengths that it must preserve and that will help it to face the new slowdown cycle.

Colombia will face the challenges of the global and domestic slowdown: it must take advantage of its economic strengths and reduce its vulnerabilities

Vulnerabilities in the current growth cycle

- High domestic expenditure, with a high share in consumption
- Low savings
- External and fiscal imbalances
- Global growth deceleration

Structural strengths for facing the economic slowdown

- Greater labor formality
- Less leveraged mortgage market
- Implementation of Basel III
- Independent and credible monetary policy
- Flexible exchange rate
- Access to external financing
- Tax Rule
- Sound local finances

CHALLENGES

Increase long-term growth and improve Colombians' standard of living

Find new sources of growth

Take advantage of changes in the world: become part of the new global chain structure

WHAT ELSE TO DO?

Households: increase savings and take care of the financial health

Companies: increase productivity and formalization. Integrate to global value chains. Improve energy efficiency

Economic institutions: reduce the fiscal deficit, reduce spending, expand productivity-enhancing investment and maintain macroeconomic stability.

The slowdown cycle can be shorter and shallower the better the economy's strengths are leveraged and preserved and macroeconomic stability is preserved.

Macroeconomic forecast

	2018	2019	2020	2021	2022 (f)	2023 (f)	2024 (f)
GDP (% y/y)	2.6	3.2	–7.0	10.7	8.0	0.7	1.8
Private consumption (% y/y)	3.2	4.1	-5.0	14.8	9.7	-1.6	1.7
Public consumption (% y/y)	7.4	5.3	-0.6	10.3	5.2	5.9	4.3
Fixed investment (% y/y)	1.0	2.2	-23.3	11.2	13.0	-2.5	1.4
Inflation (% y/y. eop)	3.2	3.8	1.6	5.6	12.5	7.3	4.5
Inflation (% y/y. avg)	3.2	3.5	2.5	3.5	10.1	10.0	5.4
Exchange rate (eop)	3,212.5	3,277.0	3,469.0	3,968.0	4,900.0	4,820.0	4,840.0
Devaluation (%. eop)	7.4	2.0	5.9	14.4	23.5	-1.6	0.4
Exchange rate (avg)	2,956.4	3,272.6	3,693.3	3,744.3	4,266.0	4,789.8	4,810.4
Devaluation (%. eop)	0.2	10.7	12.9	1.4	13.9	12.3	0.4
Interest policy rate (%. eop)	4.25	4.25	1.75	3.00	12.00	11.00	7.00
Current Account (% GDP)	-4.2	-4.6	-3.4	-5.7	-6.0	-4.2	-4.4
Urban unemploimet rate (%. eop)(*)	11.1	11.0	15.9	11.4	10.5	12.0	12.5

(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 20	0.8	3.8	3,888	3.75
Q2 20	-16.6	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	18.3	3.6	3,693	1.75
Q3 21	13.7	4.5	3,820	2.00
Q4 21	10.8	5.6	3,968	3.00
Q1 22	8.6	8.5	3,806	5.00
Q2 22	12.8	9.7	3,922	7.50
Q3 22	7.0	11.4	4,437	10.00
Q4 22	4.5	12.5	4,900	12.00
Q1 23	2.9	11.4	4,731	12.50
Q2 23	0.8	10.9	4,776	12.50
Q3 23	-0.2	9.0	4,806	12.00
Q4 23	-0.3	7.3	4,820	11.00
Q1 24	0.4	6.5	4,760	10.00
Q2 24	1.3	5.4	4,820	9.00
Q3 24	2.3	4.6	4,825	8.00
Q4 24	3.1	4.5	4,840	7.00

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

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Colombia Economic Outlook

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Creating Opportunities