

Growth strengthens during second half of 2013

Colombia Outlook

BBVA Research Colombia

August 2013

Main messages

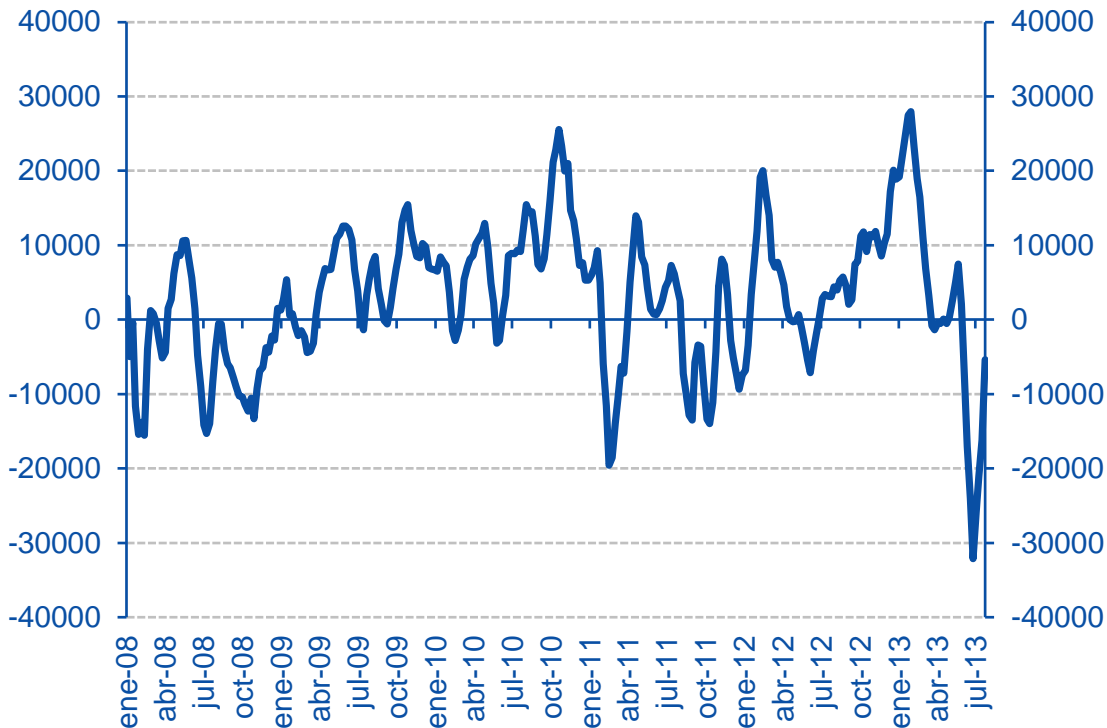
- Growth decelerated in emerging economies, but a gradual recovery of developed economies consolidates
- **Colombia's economy slowed during the first quarter, however it did not compromise our year end growth forecast of 4.1% of GDP. For 2014 we expect a more robust growth rate of 4.7%**
- Inflation will be slightly below the mid point of the target range in 2013 (2.7%) and slightly above in 2014 (3.2%). We do not anticipate a change in the monetary stance until the second quarter of 2014
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Lower growth in emerging markets and uncertainty regarding withdrawal of quantitative easing in the U.S.

Lower liquidity will have greater impact on emerging markets

Net flows to EM bond and equity funds (Mln dollars, four-week average)

Source: EPFR and BBVA Research



Market reaction to Fed's announcement of QE withdrawal was greater than expected

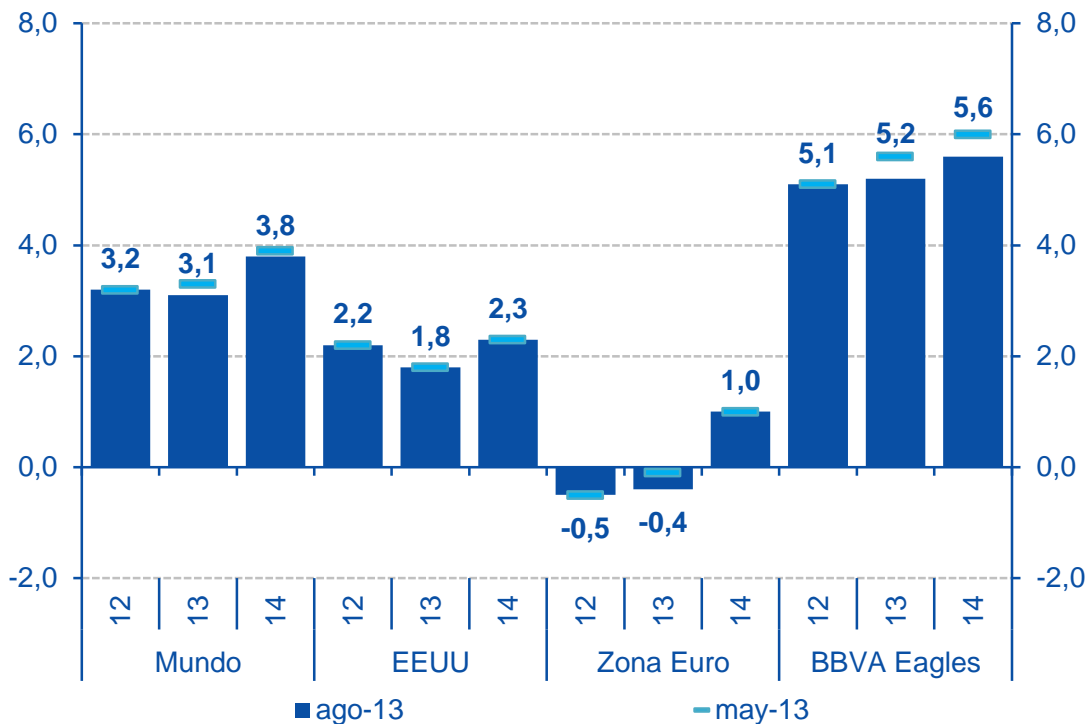
Normalization of global financial conditions, with higher interest rates and lower demand for emerging markets

Global economy with cyclical weakness, above all in EM

- We have reduced our world GDP growth forecast due to a less favorable global economic scenario.

GDP Growth (Percentage)

Source: BBVA Research



EM have experienced a more intense deceleration of growth

Global financial tightening due to US slow recovery

In 2014 we expect a 3.8% world GDP growth

* BBVA Eagles: Emerging and Growth-Leading Economies. China, India, Brazil, Indonesia, Korea, Russia, Turkey, Mexico, Taiwan.

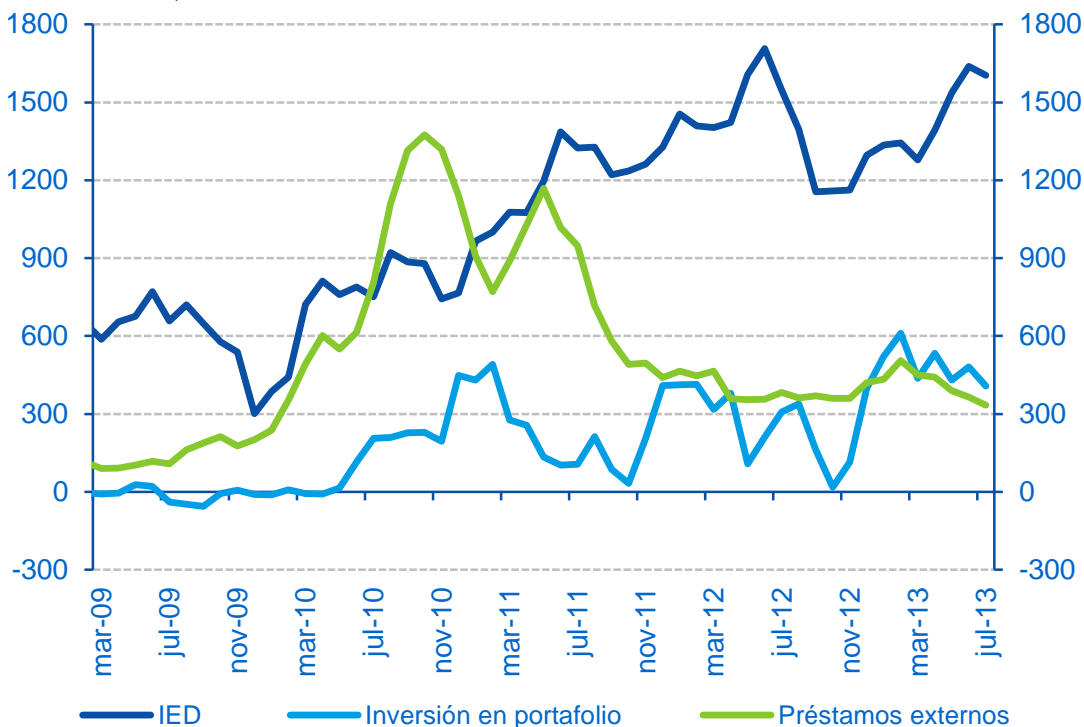
Colombia: economy will strengthen for the remainder of 2013 and 2014 even though demand remains weak

Net flows towards Colombia remained robust

- Domestic financial markets reacted to the anticipated change in US monetary stance. Expectations of lower global liquidity weakened COP and increased risk premia.

Net capital flows (annual change, %)

Source: BanRep and BBVA Research



Financial volatility due to global uncertainty, with limited impact on fundamentals

Period was faced with slackness even though heightened sovereign debt cost

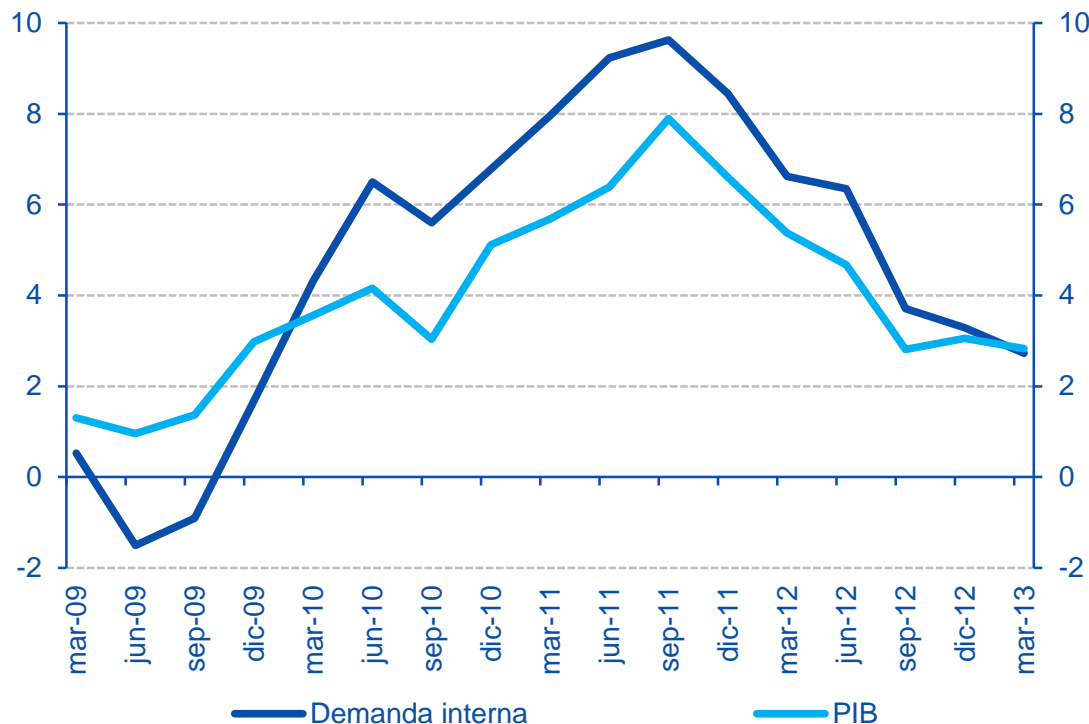
Weakening of COP in line with the region regardless of pension funds regulatory noise

Heightened construction growth (17,5% annual) held back deceleration

- Domestic demand was weaker than expected due to a stronger deceleration of private consumption and a fall in non-residential investment. A corresponding adjustment in imports was observed.

GDP and domestic demand (annual change, %)

Source: DANE and BBVA Research

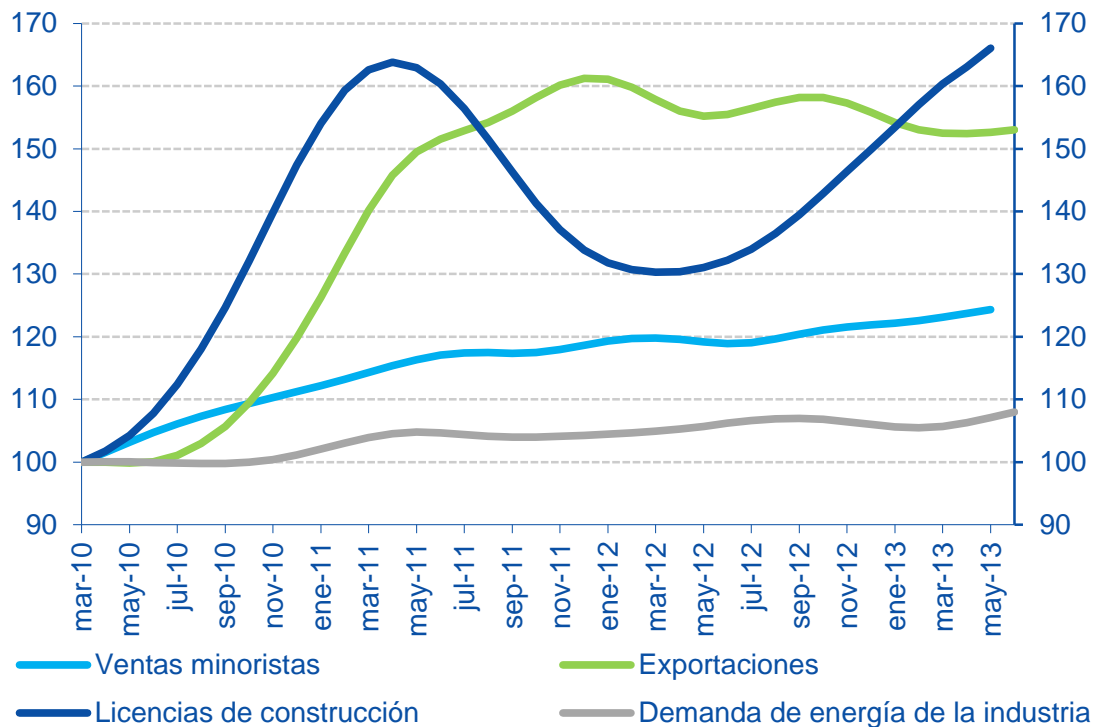


Annual variation	4Q12	1Q13	Expected?
Private consumption	4,6	3,2	✗
Private investment	5,6	3,8	✓
Public investment	4,1	8,4	✓
Exports	1,4	-1,2	✓

Stronger leading indicators during second quarter of 2013

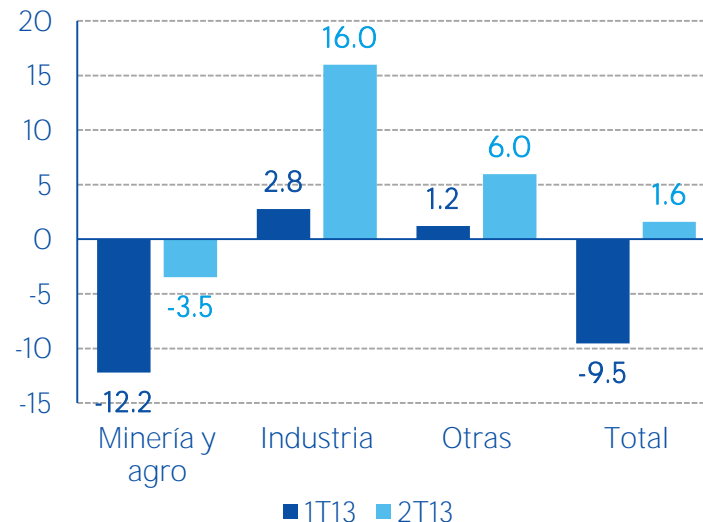
- Gradual recovery of private consumption and slow growth of non-residential investment.
- Industry supported by foreign and domestic demand.

Available leading indicators (Seasonally adjusted, Mar10=100) Source: DANE and BBVA Research



Exports by product type

Annual variation, %

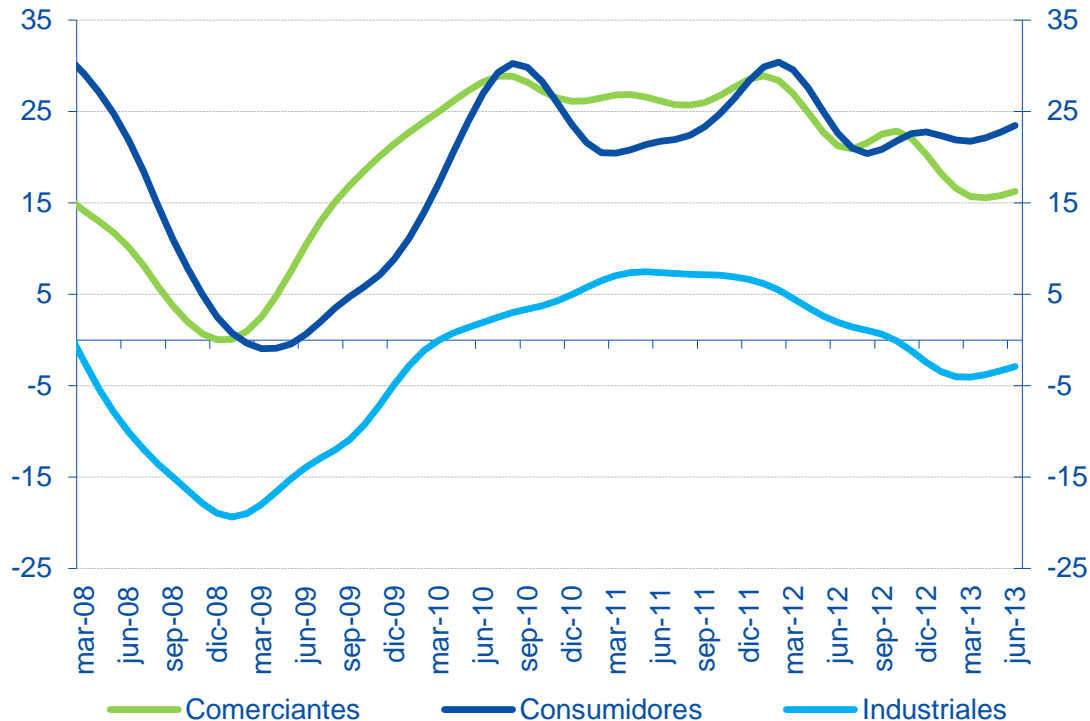


Confidence recovery anticipates a better second half of the year

- Households and businesses regained optimism about economic activity for the upcoming six months.

Household and business confidence (Seasonally adjusted)

Source: Fedesarrollo and BBVA Research



In June, households revealed a high disposition to purchase durable goods and housing

Consumer confidence reached its minimum in March, anticipating a recovery.

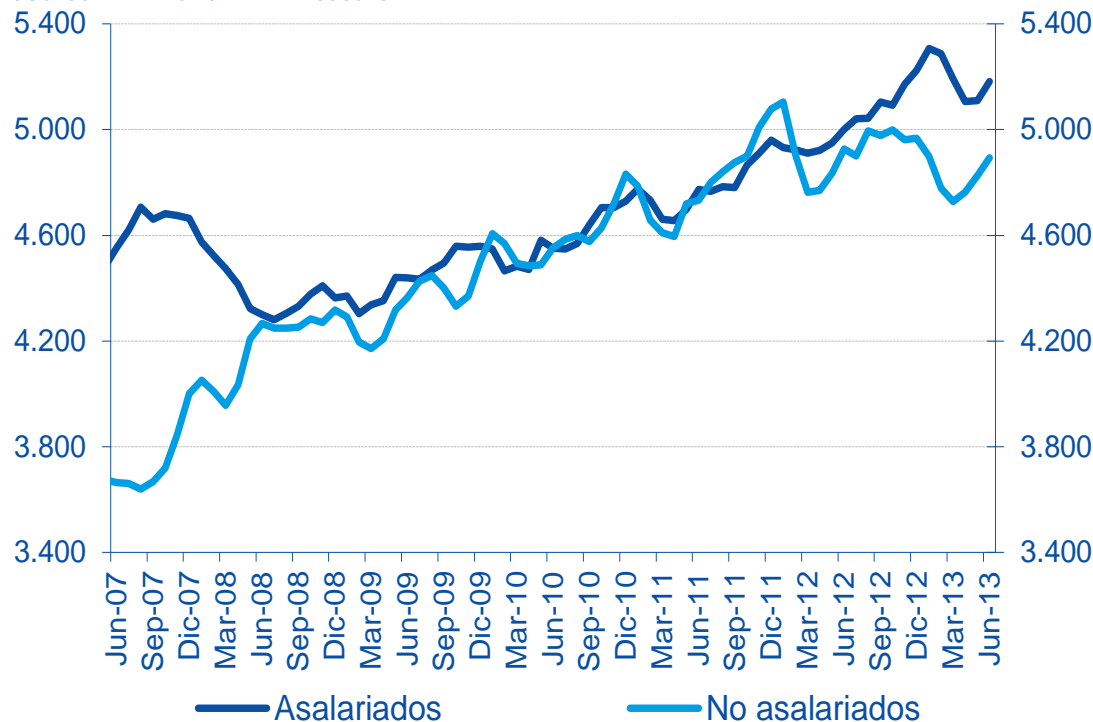
Industry has gradually reduced inventory since February

Further consolidation of employment will sustain recovery in private consumption

- Employment increased during 2Q13, but at a lower pace than in 2012.
- Construction dynamism and industry recovery in 2H13 will allow employment to improve

Formal and informal employment (Number of people, in thousands)

Source: DANE and BBVA Research

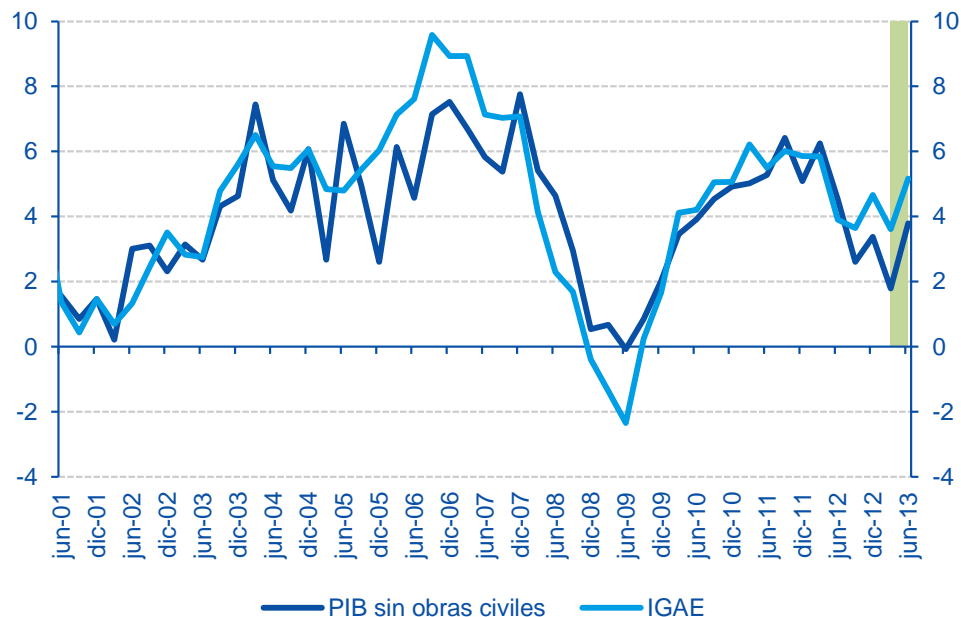


Heightened growth during second half of 2013

- Favorable statistical base and improved economic dynamics will be determining factors: construction, private consumption and exports.
- Economic activity index -IGAE- suggests a recovery for 2Q13, consistent with a year end 3.3% annual GDP growth.

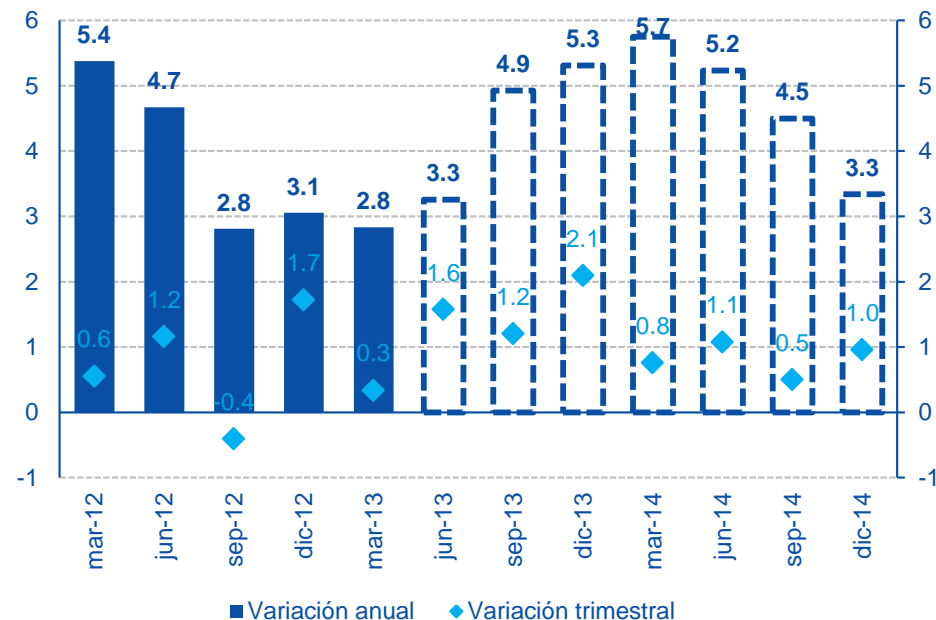
IGAE (principal component of leading indicators)

Source: BBVA Research



GDP growth forecast (annual and quarterly variation)

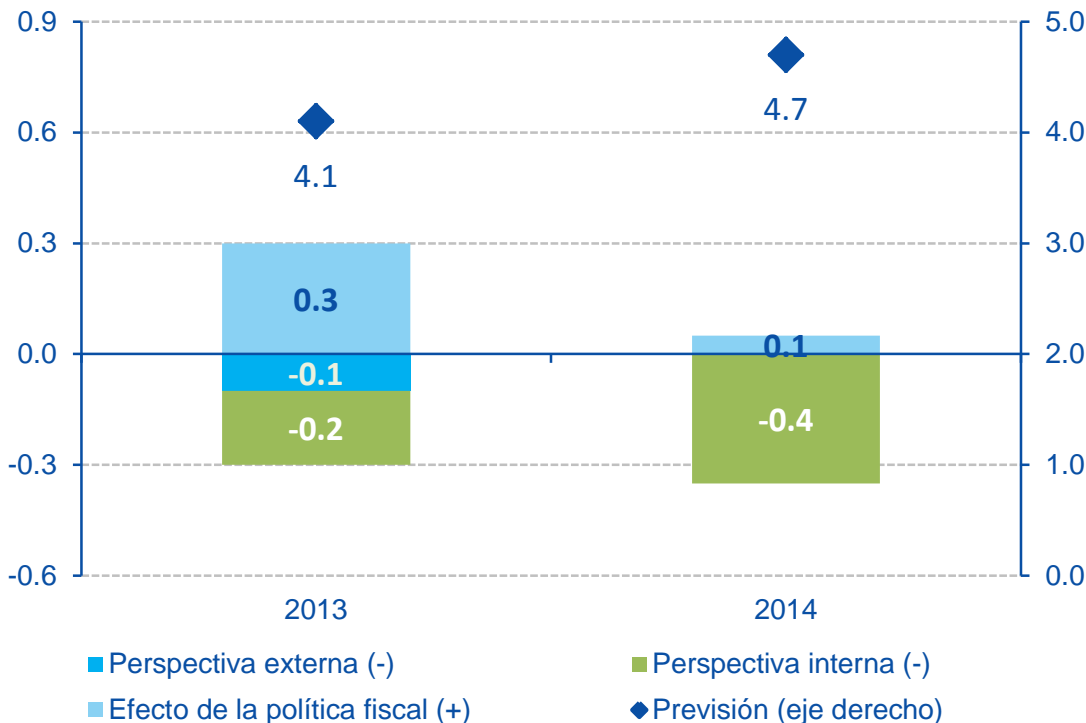
Source: DANE and BBVA Research



Growth for 2013 remains at 4.1% and we revised our 2014 forecast to 4.7%

- Economic growth in 2013 will be less sustained by domestic demand.
- Domestic demand will grow by 3.8% in 2013, below GDP growth rate for the first time since 2009.

GDP growth forecast and adjustments (annual variation and basis points change) Source: DANE and BBVA Research



Construction, housing and civil works will support 1.2 pp of GDP growth rate in 2013

We have revised downwards private consumption growth, but maintain its recovery trend since 2Q13

Imports will adjust due to lower domestic demand

Exports will have positive dynamics, above that of GDP growth from 2H13 onwards

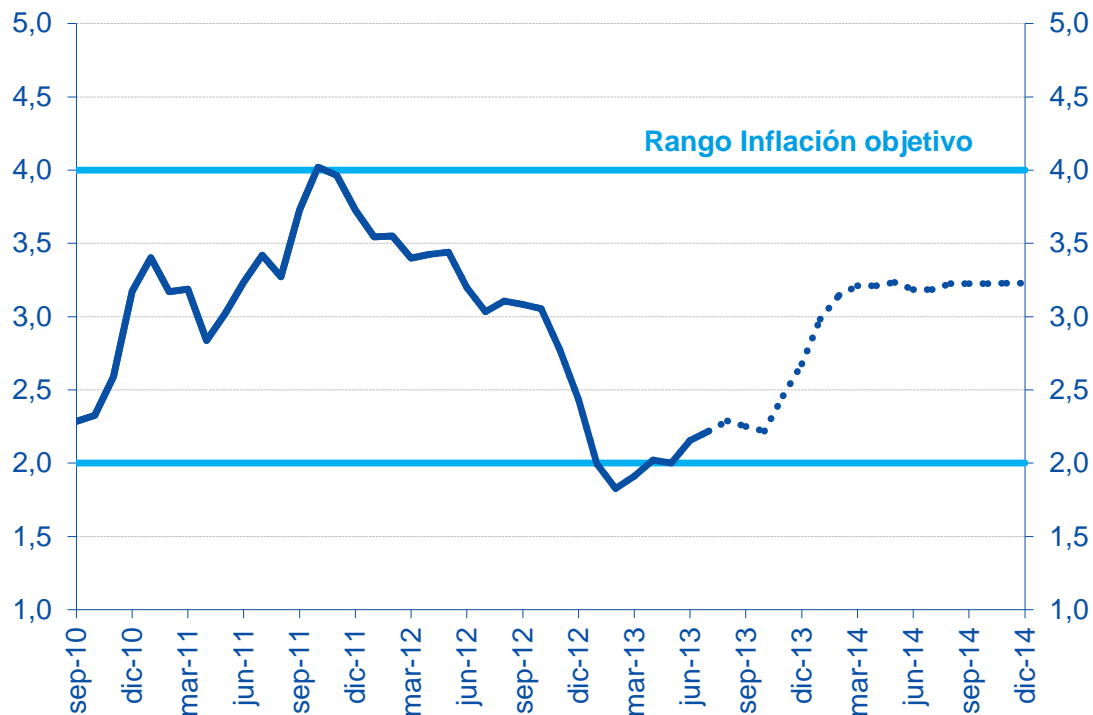
We do not anticipate any change in
monetary conditions until 2Q14

Inflation remains well within the target range

- Inflation will increase gradually during the second half of the year, but well within the target range for 2013 and 2014.
- Low base effect and expected private consumption recovery will rise inflation in 2014. Constrained domestic demand has allowed for limited COP depreciation passthrough.

Consumer price inflation (percentage change, %)

Source: DANE and BBVA Research



Inflation will end 2013 in 2.7%

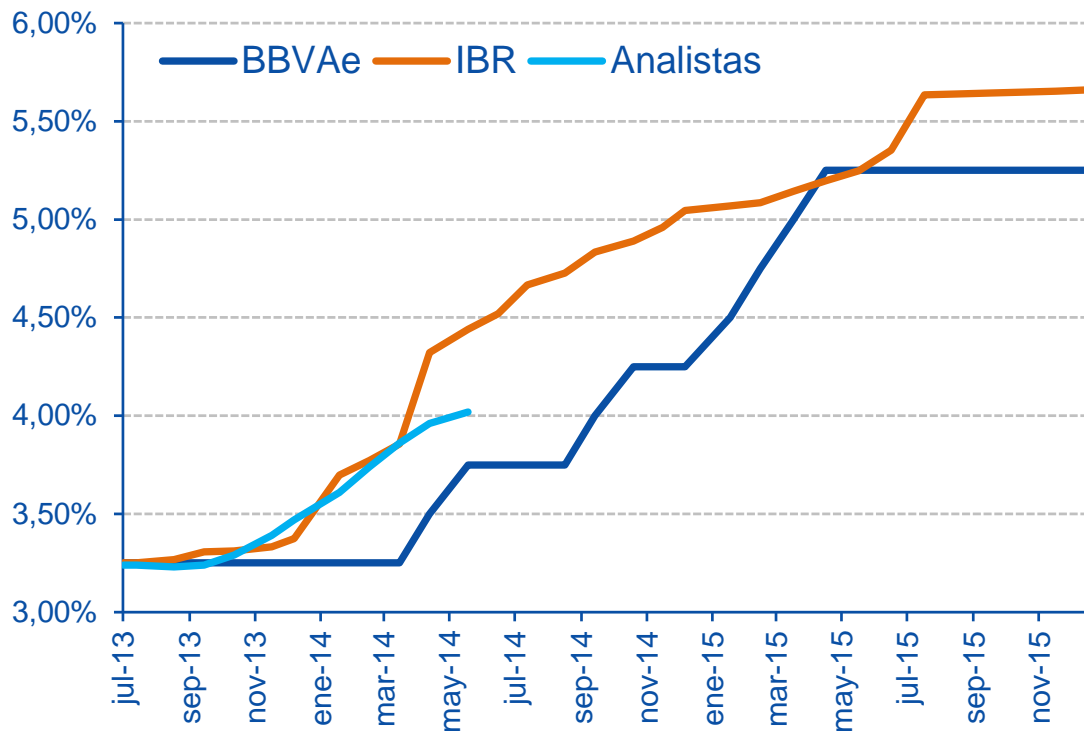
In 2014 inflation will reach slightly above the 3% mid-range target, ending in 3.2%

Expansive monetary stance will remain during the end of the year

- We expect a first interest rate hike by the central bank in April of 2014, under limited inflation pressure.
- Expansive monetary stance will remain until 2015, before the gradual closure of the product gap.

Nominal intervention rate (%)

Source: BanRep, DANE and BBVA Research



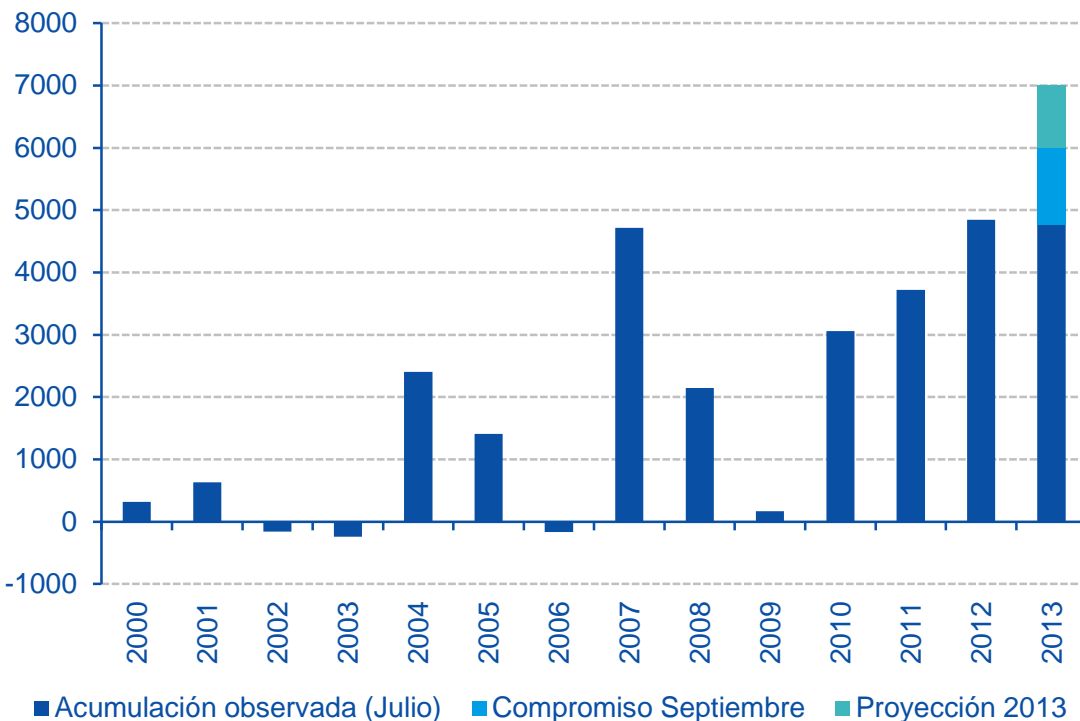
Reference interest rate remains expansive (3,25% vs. 5,25% neutral).

Central bank remains moderately optimistic about growth prospects

Central Bank will extend foreign exchange purchase program

- We anticipate USD 7bn of international reserves accumulation in 2013, thereby remaining USD 1bn for the 4th quarter
- FX intervention will extend into 2014, with an estimated space of USD 6.4bn

BanRep foreign exchange market intervention and expected reserve accumulation (annual variation, %) Source: BanRep and BBVA Research



International reserves remain below **Government's announced optimal level (11% vs. 15% optimum)**

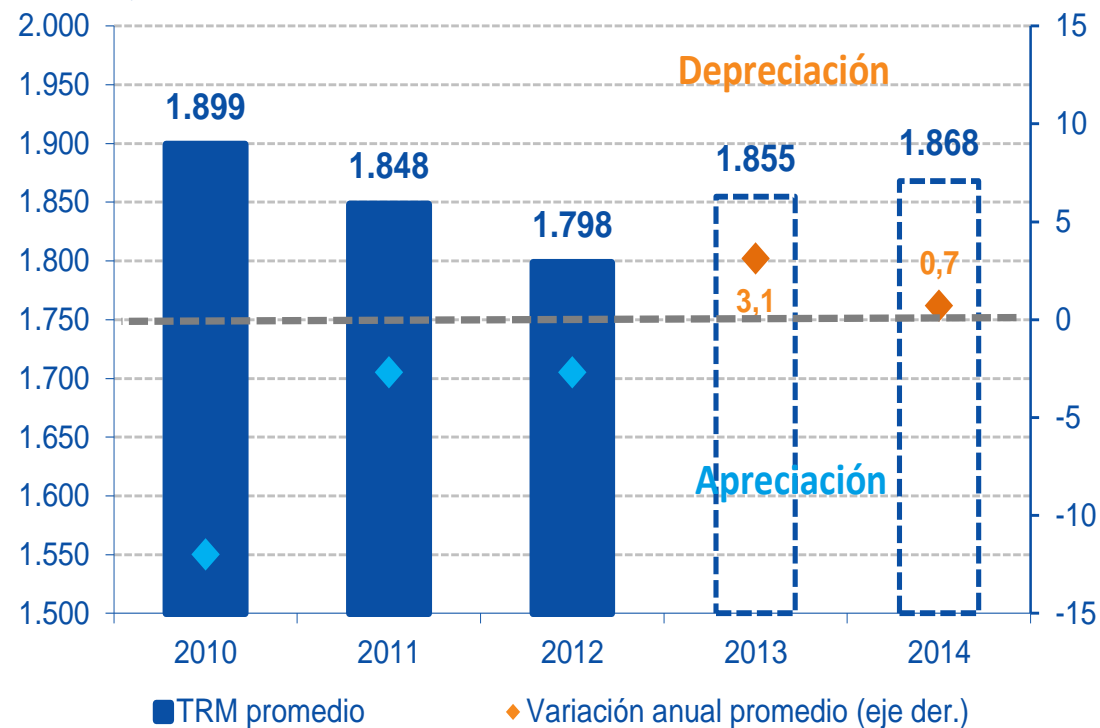
Balance of payment equilibrium level anticipates international reserves accumulation during 2014

Continued uncertainty regarding Fed QE withdrawal will increase COP volatility

- COP forecast is contingent upon external monetary conditions.
- COP appreciation is expected in 2014 due to economic recovery and interest rate hikes.
- Normalization of external monetary conditions will depreciate COP.

Average exchange rate and annual variation (pesos per dollar, %)

Source: BanRep and BBVA Research



Main messages

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Forecasts

Colombia

	2011	2012	2013	2014	2015	2016
GDP (% y/y)	6,7	4,0	4,1	4,7	5,1	5,4
Private Consumption (% y/y)	6,0	4,7	3,5	4,1	4,8	5,1
Public Consumption (% y/y)	3,6	5,1	4,6	4,8	3,5	3,9
Private Investment (% y/y)	17,1	8,0	4,7	7,7	6,9	6,7
Residential Investment (% y/y)	3,7	5,6	8,5	7,1	5,5	5,6
Public Investment (% y/y)	22,8	1,5	9,3	10,3	9,1	7,0
Inflation (% y/y, eop)	3,7	2,4	2,7	3,2	3,0	3,0
Exchange Rate (vs. USD, eop)	1934	1794	1885	1869	1890	1952
Policy Interest Rate (% eop)	4,75	4,25	3,25	4,25	5,25	5,25
Policy Interest Rate (% average)	4,25	4,88	3,25	3,81	5,19	5,25
DTF (% eop)	5,12	5,22	3,74	4,58	5,73	5,86
DTF(% average)	4,21	5,34	4,15	4,05	5,40	5,80
Fiscal Balance (% GDP)	-2,9	-2,3	-2,6	-2,6	-2,0	-1,9
Current Account Balance (% GDP)	-2,9	-3,2	-3,1	-2,7	-2,7	-2,9

Source: DANE, Superfinanciera, Banco de la República, Ministerio de Hacienda and BBVA Research

Thanks

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