Latam Daily: Colombia's Recovery Advances

- **Colombia: Near-term inflation expectations fall; Q3 GDP in line with expectations**

I. Inflation expectations for December decreased after October surprise; but medium-term remains anchored

According to BanRep's November survey of macroeconomic expectations, released on Tuesday, November 17, analysts see inflation hitting 1.73% y/y in December 2020, -19 bps lower than in last month's survey (table 1). Consensus inflation expectations for longer tenors did not change much: at the 1Y tenor they stood at 2.80% y/y, the same as last month, and for the 2Y tenor they were 3.10% y/y (chart 1). For December 2021, inflation is expected to be below 3.00% y/y as weaker demand is projected to offset new price pressures from the withdrawal of government subsidies that kept some costs down, additional biosecurity costs, and FX pass-through effects. Looking at the survey's details:

- **On average, November's monthly inflation is expected at 0.08% m/m, in line with our projections, which would leave annual inflation at 1.73% y/y.** In November, Colombia has another VAT holiday and Black Friday sales that normally lasts for three days. These two events should lower some tradable-goods prices; however, foodstuff prices appear to be increasing, which would partially offset other price gains;

- **USDCOP forecasts for end-2020 stood at 3,671, down -57 pesos from the previous monthly survey.** For December 2021, respondents think, on average, that the USDCOP exchange rate will end up at 3,600. We believe FX volatility will continue, although with US elections behind us and positive news on possible COVID-19 vaccines, the COP is now moving closer to levels implied by our FX models; and

- **BanRep's repo rate is expected to close 2020 at its current level of 1.75%, according to the median of survey respondents; market consensus is not expecting further rate cuts.** The first hike of 25 bps is anticipated by September-2021, earlier than in the previous month's survey. The monetary policy rate is expected to reach 2.00% by the end of 2021 (chart 2). For November's meeting, analysts' consensus points to a hold.

BanRep's survey showed that the recent downside inflation surprise in October led to revised expectations for end-2020, but they remained anchored near the 3% target for the longer term. November's headline inflation reading is expected to show offsetting effects from lower tradable-goods prices and a rebound in food prices. The balance of risks points to a moderate recovery in economic growth with small upside pressures on inflation. **Along with the consensus, we expect the BanRep Board to keep the monetary-policy rate on hold at the November 27 meeting.**

II. Colombian economy rebounded in Q3 in line with expectations as lockdown measures eased

On Tuesday, November 17, DANE released Q3-2020 GDP growth data that showed the recovery from Q2 proceeded in line with expectations. Real GDP

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Table 1
Colombia: Headline Inflation Expectations

	Average	Change vs previous survey, bps
Nov-2020, m/m % change	0.08	…
Dec-2020, y/y % change	1.73	-19
Nov-2021, y/y % change	2.80	…
Dec-2021, y/y % change	2.83	-3
Nov-2022, y/y % change	3.10	…

Sources: Scotiabank Economics, BanRep.

fell by -9.0% y/y in Q3, pointing to a rebound from the second quarter when the economy contracted by -15.8% y/y. On a sequential basis, the economy grew by 8.7% q/q sa. It is worth noting that during the third quarter, the government gradually eased lockdown restrictions, and then consolidated the re-opening under its "new normal" scheme in September. However, there is a long way to go to achieve a full recovery: Q3 production levels were still well below those in 2019 and are equivalent to those we last saw in 2015 (chart 3).

Growth in real GDP in Q3 matched the Bloomberg survey consensus of -9% y/y and was close to our expected rate of -9.3% y/y. Commerce, transport, and hotels (-20.1% y/y), construction (-26.2% y/y), and mining (-19.1% y/y) accounted for three quarters of the total year-on-year contraction. On the positive side, agriculture (1.5% y/y), financial activities (1.5% y/y), and real estate activities (1.8% y/y) dominated (charts 4 and 5). It is worth noting that Q1 and Q2 growth were revised down to 1.2% y/y and -15.8% y/y from their previous estimates of 1.4% y/y and -15.7% y/y, respectively, on the back of weaker agricultural and mining activities. For the nine months to end-September, the economy contracted by -8.1% y/y.

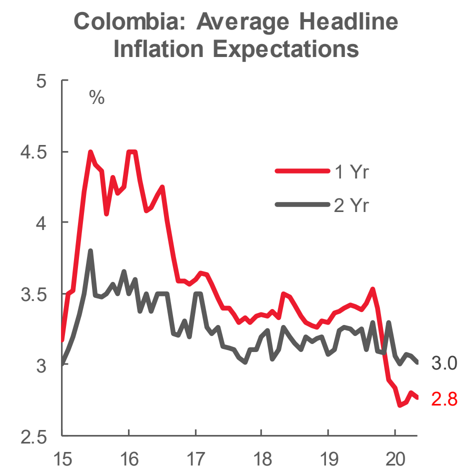
During the third quarter, the Colombian economy consolidated the re-opening process: during July and August, restrictions varied between regions, while in September, the re-opening was broadly-based and implemented nationwide. In fact, by July 78% of the economy had been allowed to re-open and by September around 95% of the economy was working again. The monthly GDP proxy, the ISE, showed that the national recovery gained steam in September with 3.4% m/m sa growth (chart 6).

From the supply-side point of view, nine out of 12 sectors contracted in Q3-2020. Still, on a seasonally-adjusted basis, all 12 sectors rebounded, which puts the economy on a solid recovery path. It is worth noting that the quarterly recovery was led by manufacturing (23.4% q/q sa) and commerce (22.3% q/q sa). Still, some sectors remained weak; that was the case for mining, which, although it rebounded in the quarter (2.4% q/q sa), it faced structural challenges in the coal sector. In the construction sector, the -26.2% y/y overall contraction was concentrated in public works (-24.7% y/y and -0.6% q/q sa), especially those related to oil pipelines; on the positive side, building contracted by -27.2% y/y, but expanded by 18.3% q/q sa. Nevertheless, there's no question that the re-opening led to improvements in economic activity and we expect that in Q4 commerce and other services-related sectors will continue to notch up gains.

On the demand side, domestic demand fell by -9.5% y/y (up 10.7% q/q sa) in Q3 (chart 7). Private spending grew by 9.4% q/q sa on better durable goods consumption (41.3% q/q sa), but government spending remained nearly flat on a quarterly basis, with an expansion of only 2.6% y/y in annual terms. Investment contracted at a similar pace than Q2 (-20% y/y); however, it expanded by 21.3% q/q sa on a rebound in machinery spending (48.4% q/q sa) and housing (6.8% q/q sa). We anticipate that the recovery in demand will continue to be led by private consumption through end-2020 since government policies are providing incentives to increase household purchases.

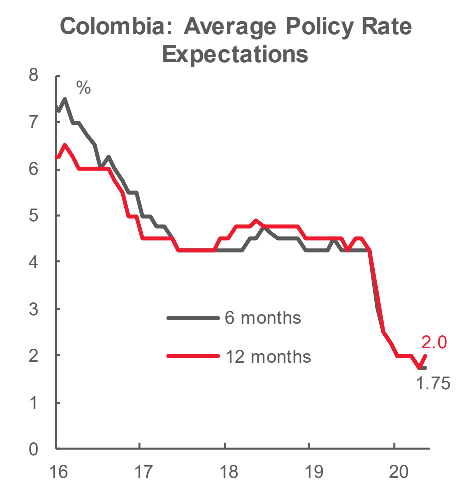
Net exports contributed negatively to Q3-2020 growth (chart 8) because imports expanded (13.5% q/q sa) by more than exports (1.9% q/q sa). Global demand for mining production weighed on exports, while recoveries in domestic consumption and investment activities drove import demand up. Having said this, we continue to project a current account deficit of -3.2% of GDP in 2020: adjustment is taking place in the income account, but not in the commercial balance.

Chart 1



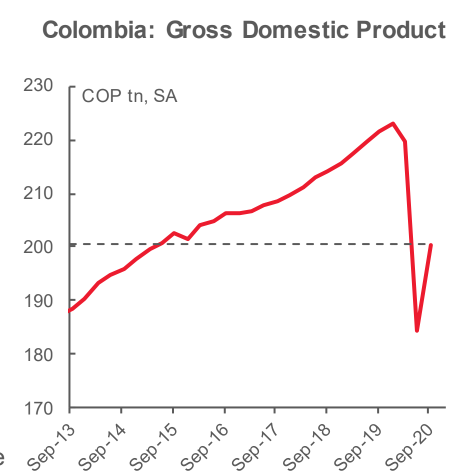
Sources: Scotiabank Economics, BanRep.

Chart 2



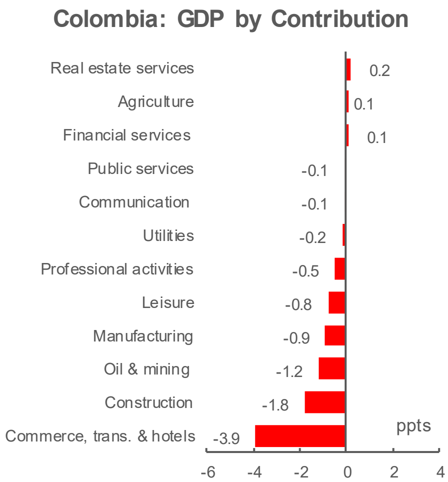
Sources: Scotiabank Economics, BanRep.

Chart 3



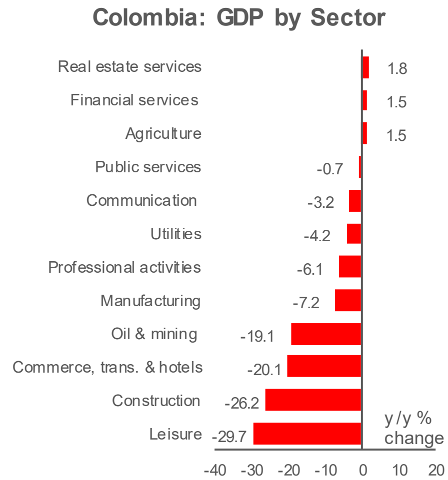
Sources: Scotiabank Economics, DANE.

Chart 4



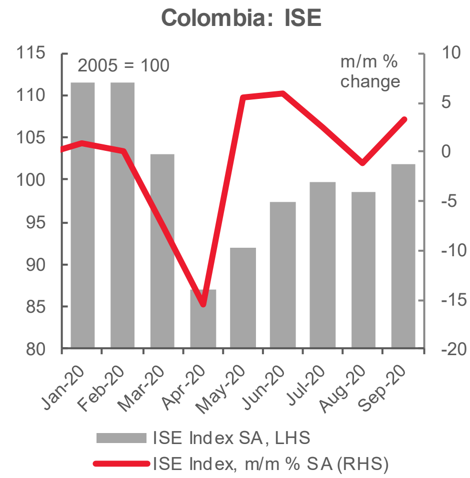
Sources: Scotiabank Economics, DANE.

Chart 5



Sources: Scotiabank Economics, DANE.

Chart 6



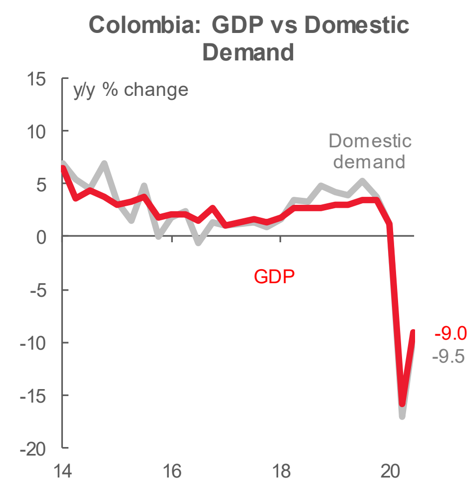
Sources: Scotiabank Economics, DANE.

All in all, Q3-2020 real GDP data confirmed that Colombia has overcome the worst of the current crisis and the recovery is proceeding broadly in line with expectations. Some green shoots have consolidated as the incidence of new COVID-19 cases has moderated and re-opening efforts gained traction. For 2020 as a whole, we forecast a GDP contraction of around -7.5% y/y (see the November 14 edition of the *Latam Weekly*): gains in Q4 are expected to slow as re-opening produces decreasing marginal effects.

Under existing data and our current forecasts, we continue to expect the central bank to keep its monetary policy rate at 1.75% in the coming months.

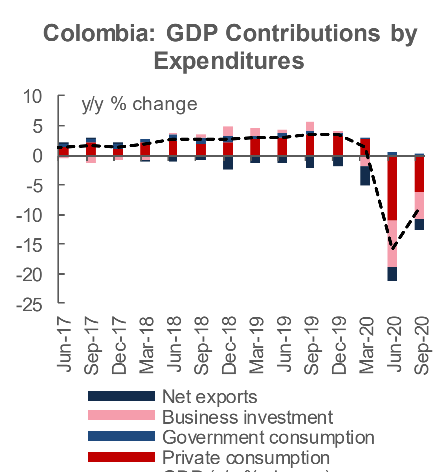
—Sergio Olarte & Jackeline Piraján

Chart 7



Sources: Scotiabank Economics, DANE.

Chart 8



Sources: Scotiabank Economics, DANE.