Economics Colombia
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Colombia Macro Insight: Assessing the explained and unexplained components of COP appreciation

The USDCOP has reached its strongest level since mid-2019, showing remarkable resilience amid a highly challenging international environment. This suggests that a significant part of the movement has been explained by idiosyncratic fundamentals, especially those associated with a contractionary monetary policy stance and the transition toward a government that is demonstrating a commitment to fiscal sustainability. We acknowledge that both fundamentals could be temporary; however, in this piece we will dig deeper into the macroeconomic scenario and the key signals we need to monitor to determine whether the recent trend can be sustained, and for how long.

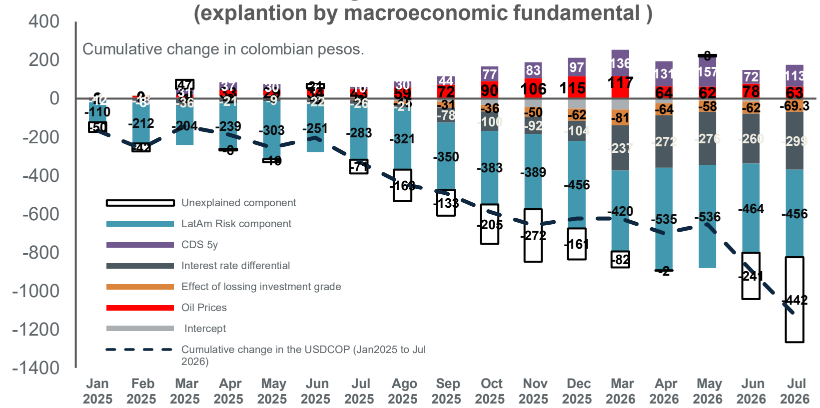
What we found in our analysis is that there are currently around 450 pesos of FX appreciation that cannot be explained by traditional fundamentals and could instead be strongly associated with an overshooting driven by expectations that effective economic policies will reduce risk across different fronts, particularly on the fiscal side.

In our view, this overshooting, reflected in an FX premium, represents a vote of confidence in the commitment to restore public finances. However, it will take time to determine whether these policies will be as effective as anticipated. That said, although our estimate of the fundamental USDCOP level is closer to 3,500 pesos, we do not expect the currency to converge to this level in the short term. Instead, we expect it to continue trading around current levels in the coming months, as the market's vote of confidence also reflects a willingness to be patient while assessing the implementation of the announced policies. Additionally, we expect the central bank to maintain a contractionary stance, which should continue to support a strong COP scenario.

About drivers of the FX appreciation

Since the beginning of 2025, the exchange rate in Colombia has appreciated by approximately 1,200 pesos. This FX movement reflects a combination of international factors and domestic fundamentals **(Chart 1)**. Based on our macro-fundamental exercise, which measures the relationship between USDCOP movements and regional trends, domestic risk, short-term interest rate differentials versus the US, and oil prices, we can conclude:

Chart 1. Cumulative change in the USDCOP Jul 2026 vs Jan 2025. (explantion by macroeconomic fundamental)

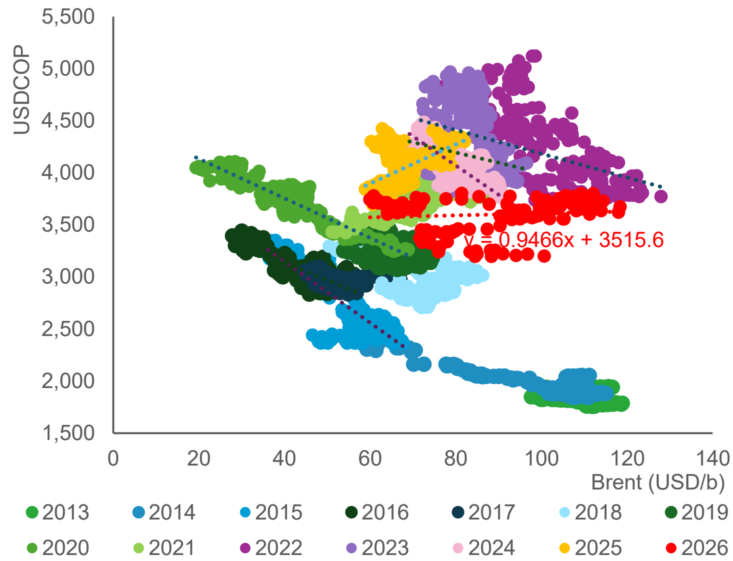


Source: DAVIbank Economics.

- **International drivers explain approximately 450 pesos of COP appreciation over the last year and a half.** We measure this global impact through the regional risk component. This component implicitly reflects the effect of a weaker global dollar across the region, in a context where increased political uncertainty has also generated a different dynamic in emerging markets compared to developed markets.

- **Short-term shocks to the external sector.** It is worth noting that, in recent years, Colombia's current account deficit has remained particularly low. In fact, in Q1-2026, the current account deficit was equivalent to 1.2% of GDP, its narrowest level since 2005, demonstrating that, from a real-sector perspective, pressures for a stronger dollar are virtually nonexistent. In this context, short-term external sector signals are mainly reflected in oil prices, which, compared with levels observed at the beginning of 2025 (around USD 80/bbl Brent), are not generating significant pressures which is also compatible with the fact that explanatory power of this variable over the currency has weakened **(Chart 2).**

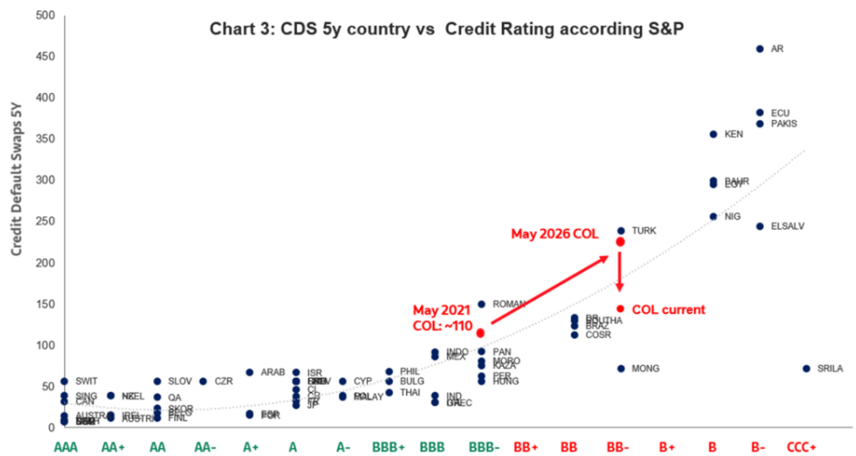
Chart 2. Relación USDCOP vs Precios del petróleo Brent



Source: Bloomber, DAVIbank Economics.

- **Domestic risk.** The 5-year CDS has declined significantly since the elections. In fact, Colombia's current sovereign risk premium is consistent with a level approximately one notch above its current S&P credit rating (Chart 3), reflecting a more constructive market assessment of the country's medium-term outlook. This improvement has supported the COP in recent months.

Chart 3: CDS 5y country vs Credit Rating according S&P



Source: Bloomberg, DAVIbank Economics.

However, when the current CDS effect is compared with that observed at the beginning of 2025, the picture is less favorable. The credit rating downgrades recorded during the past several quarters have increased the sensitivity of FX markets to sovereign risk indicators. As a result, our model estimates that domestic risk has not been a contributor to the recent appreciation trend. On the contrary, relative to the beginning of 2025, the CDS effect has exerted depreciation pressures of around 110 pesos on the exchange rate.

- **Interest rate differential.** Measured as the differential between 3-month rates in Colombia and the US, the explanatory power of this variable increased significantly starting in the last quarter of 2025. Together with a widening short-term interest rate differential, this explains a fundamental appreciation of around 300 pesos.

- **The unexplained component of COP strengthening.** After aggregating all identified macroeconomic effects, we estimate that approximately 450 pesos of appreciation cannot be explained by the traditional model framework. We interpret this differential as a confidence premium associated with the announced plans to improve Colombia's fiscal position. In this regard, investors appear to view these promises within the context of successful fiscal adjustment experiences in other countries. Argentina is perhaps the most prominent example, but cases such as Panama and Costa Rica are also present in investors' minds. This perception leads us to believe that markets are willing to give Colombia the benefit of the doubt, reducing the likelihood of a sudden FX correction that would eliminate this premium.

The macroeconomic drivers behind the FX premium.

- **Fiscal scenario:** Moving Colombia toward a path of fiscal sustainability represents a significant challenge. For now, the strategy is focused on identifying opportunities to improve spending efficiency. However, experience suggests that this measure alone is insufficient to achieve a successful fiscal adjustment. The Autonomous Committee for the Fiscal Rule has also argued that Colombia requires a fiscal adjustment of at least 5% of GDP to return to compliance with the fiscal rule. Even under such a scenario, the best outcome would likely be a debt-to-GDP ratio converging toward 63.5%, compared with the current 58.6%. What we do recognize is a strong willingness from the incoming administration to begin correcting the fiscal trajectory, and this will probably sustain the market's vote of confidence for some time.

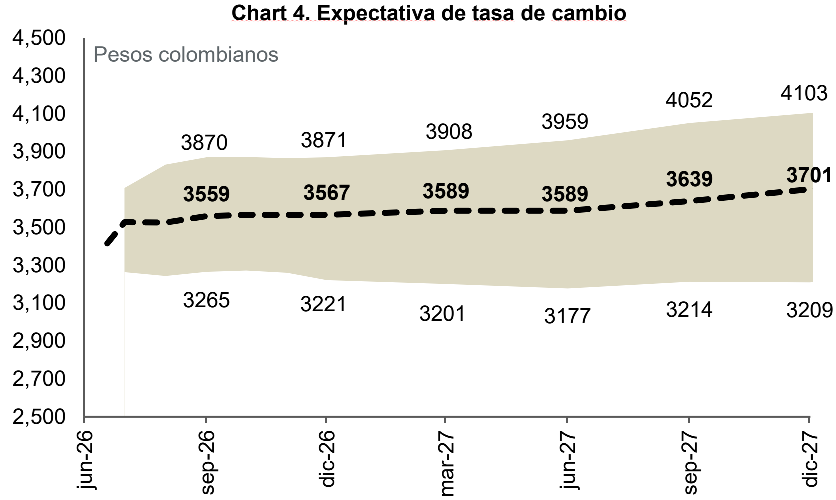
- **Monetary policy:** BanRep has emphasized the need to maintain a contractionary stance, as inflation is expected to take longer than previously anticipated to converge to target. The ex-ante real monetary policy rate is currently around 6.5%. However, we do not expect this situation to ease until inflation provides strong evidence of a sustainable convergence path toward the target. As a result, the interest rate differential is likely to remain a key fundamental supporting a strong peso for at least another year. By the end of 2027, we expect the policy rate to reach 10%, which would begin narrowing interest rate differentials relative to lower-rate economies, gradually reducing the contribution of carry trades to currency strength. Nevertheless, we do not anticipate a sudden reversal. Instead, the transition toward lower rates is expected to occur gradually and cautiously.

- **Economic reactivation and pressures from the real sector:** Another factor to consider is how the real economy could eventually limit further appreciation pressures. In particular, the economic strategy of the new administration aims to reactivate investment, which in Colombia is typically associated with a wider current account deficit. In this regard, although we expect any increase in the current account deficit to be financed by higher FDI inflows, it will be important to assess whether this process could generate forces that either place a floor under the appreciation trend or partially reverse the current confidence premium.

Projections:

Our macroeconomic fundamentals framework points to a medium-term equilibrium exchange rate in the COP 3,550-3,700 range (Chart 4). However, given the overshooting dynamics identified by the model, we expect the exchange rate to converge only gradually toward its fundamental value. As a result, the peso could continue to trade near the lower bound of the estimated range for an extended period. Going forward, evidence regarding the effectiveness of the fiscal adjustment process and the maintenance of a restrictive monetary policy stance will be critical determinants of the pace of convergence.

Chart 4. Expectativa de tasa de cambio



Source: DAVIbank Economics.

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Macroeconomic forecast DAVIbank Economics Colombia

Forecast	2019	2020	2021	2022	2023	2024	2025pr	2026pr	2027 pr
National Accounts									
Real GDP growth (yearly %)	3.2	-7.2	11.1	7.6	0.9	1.5	2.6	2.4	2.7
Domestic demand (y/y. %)	4.0	-7.5	13.8	10.5	-2.3	1.6	3.9	2.9	3.2
Consumption (y/y. %)	4.3	-4.3	14.1	9.5	0.7	1.4	4.4	3.4	3.1
Private (y/y. %)	4.0	-5.0	15.3	11.1	0.6	1.6	3.5	3.2	3.6
Goverment (y/y. %)	5.5	-0.9	10.3	2.2	1.1	0.0	8.3	4.4	0.8
Gross capital formation (y/y. %)	3.2	-7.2	11.1	7.6	0.9	1.5	2.6	2.4	2.7
Exports (y/y. %)	3.3	-22.3	15.7	13.6	3.1	0.3	1.8	1.9	1.7
Imports (y/y. %)	7.7	-19.8	28.5	25.0	-9.8	1.3	8.8	3.0	4.2
Laboral Market									
Unemployment (%. Average)	10.9	16.7	13.8	11.2	10.2	10.2	8.9	9	9.4
Balance of Payments									
Trade Balance (USD$. B)	-14.15	-13.10	-20.00	-16.10	-7.81	-9.77	-14.89	-16.61	-19.91
Exports (USD$. B)	51.3	38.2	50.9	73.5	68.7	69.1	71.5	79.22	82.1
Imports (USD$. B)	65.5	51.3	70.9	89.6	76.5	78.9	86.3	97.05	103.10
Current account (USD$ Balance. B)	-14.81	-9.27	-17.95	-20.88	-8.32	-7.10	-11.02	-13.4	-16.18
Current account (% of GDP)	-4.6	-3.4	-5.6	-6.0	-2.3	-1.7	-2.4	-2.3	2.7
Prices. Rates & Exchange Rates									
CPI (y/y. %. End period)	3.80	1.61	5.62	13.12	9.28	5.20	5.10	6.87	4.87
CPI (y/y. %. Average)	3.52	2.53	3.49	10.15	11.77	6.63	5.14	6.01	5.67
CPI without food (y/y. %. End period)	3.45	1.03	3.44	9.99	10.33	5.60	5.11	6.50	4.77
COP ($. End period)	3297	3422	4077	4850	3902	4405	3780	3567	3701
COP ($. Average)	3281	3694	3766	4254	4322	4153	4052	3643	3629
BanRep's rate (%. End period)	4.25	1.75	3.00	12	13.0	9.50	9.25	12.75	10
Fiscal projections*									
Net Debt of CNG (% of GDP)	48.4	60.7	60.1	57.6	53.4	59.3	58.5	61	62.9
Primary Balance of CNG (% del PIB)	0.4	-5.0	-3.6	-1.0	-0.3	-2.4	-3.5	-4.1	0.5
Deficit of CNG (% of GDP)	-2.5	-7.8	-7.1	-5.3	-4.3	-6.8	-6.4	-7.4	-5.1

*Source: CARF Report June 2026 about MTFF. For 2027 the projection assumes a 3.7% of GDP adjustment

Source: DAVIbank Economics Colombia.

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