Colombia's Macroeconomic Performance: 4Q 2016 GDP and Current Monthly Indicators

MUFG UNION BANK, N.A.
ECONOMIC RESEARCH (NEW YORK)
KAREN MARTINEZ
Latin America Economist
+1(212)782-5708
KMartinez@us.mufg.jp

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The Bank of Tokyo-Mitsubishi UFJ, Ltd.
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Overview

Colombia's GDP grew 1.6% YoY in Q4 2016 (1.0% QoQ), an acceleration from Q3 2016 (1.2% YoY). This acceleration was the result of a modest expansion in household consumption during this period.

It is expected that Colombia will continue to have weak economic activity in 2017. The positive economic signs (improving commodity prices, Colombia's new investment program, and the peace deal between Colombia and FARC), could be overshadowed by the still present headwinds. The tax reform will likely further deteriorate the already lackluster household consumption.

Congress approved a structural tax reform late in 2016 with the objective of increasing tax revenues to close the gap that decreased oil revenues left in 2016. While the tax reform will likely help to improve fiscal stability, it could further exacerbate the weak household consumption and lead to a spike in inflation.

The inflation rate in February stood at 5.2%, the seventh consecutive month where the inflation rate declined. The Central Bank, in its last meeting in March, decided to decrease its policy rate by 0.25 percentage points to 7.0%. The Central Bank expects that the shocks that affected inflation in 2015 and 2016, such as El Niño phenomenon and the depreciation of the Colombian peso, will dissipate in 2017. The Central Bank may look to further cut rates during 2017 as it seeks to improve sluggish domestic demand.

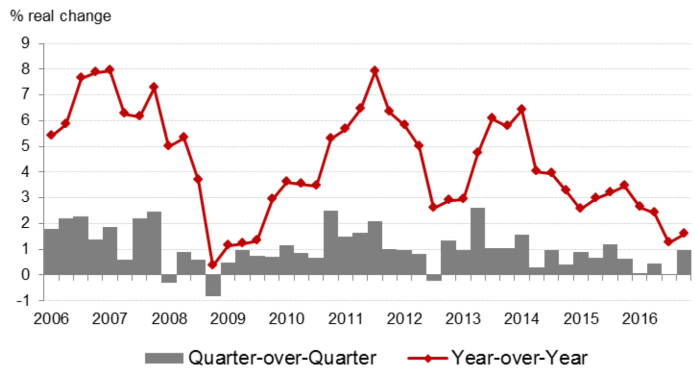
1. GDP, Economic activity

Colombia's GDP grew 1.6% YoY in Q4 2016 (1.0% QoQ), an acceleration from Q3 2016 (1.2% YoY) (Figure 1). This acceleration was the result of a modest expansion in household consumption during this period.

GDP by Sector

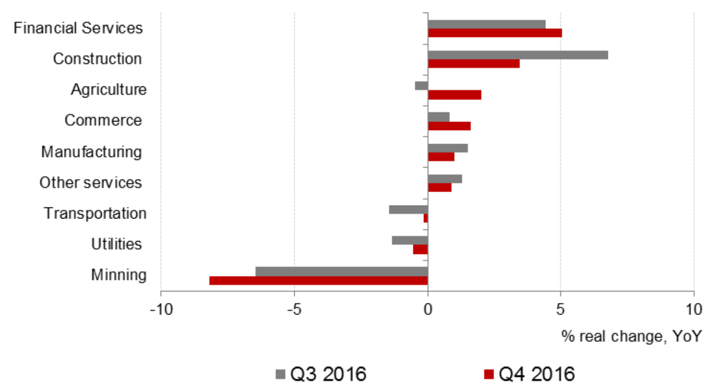
On the production side, the mining sector suffered a large contraction in Q4 2016 (8.2% YoY) (Figure 2). This reduction was mainly driven by the decrease in production of oil and natural gas that resulted from issues with the operation of the plants and terrorist attacks[1]. On the other hand, two important sectors – agriculture and commerce – registered an expansion during the last quarter 2016 (2.0% YoY in comparison to -0.5% YoY in Q3 2016 and 1.6% YoY in comparison to 0.8% YoY in Q3 2016, respectively). The expansion in agriculture is explained by an expansion in the permanent crops[2] sub-sector (3.0% YoY) and coffee production (4.2% YoY). Growth in the commerce sector was mainly the result of an expansion in maintenance and repair of vehicles (4.1% YoY).

Figure 1: GDP Growth



Source: Departamento Administrativo Nacional de Estadistica (DANE), MUFG

Figure 2: GDP by Sector



Source: DANE, MUFG

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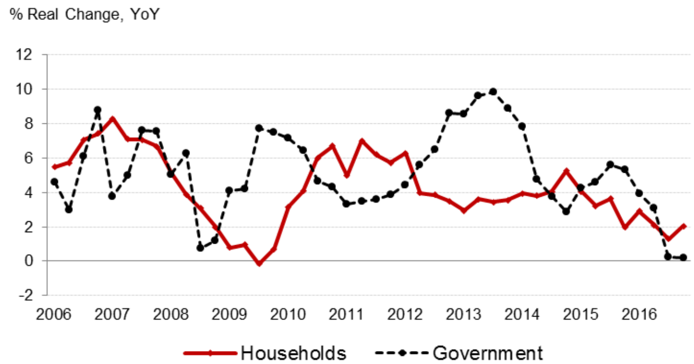
[1] The pipeline Cano Limon-Covenas, operated by Occidental Petroleum Corp, stopped its operations on November 17 2016 due to a series of bombs by the Ejercito de Liberacion Nacional (ELN), the second biggest group of rebels in Colombia. Attacks by the group throughout 2016 have led to the spill of 22,000 barrels of oil.

[2] Permanent crops include, fruits and nuts, flowers, seeds and oleaginous fruits, and sugar cane.

Consumption

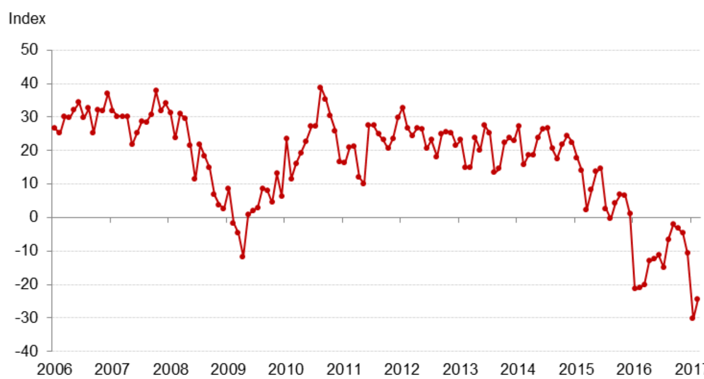
Figure 3: Consumption



Source: DANE, MUFG

There was an uptick in household consumption in Q4 (2.0% YoY) when compared to Q3 (1.3% YoY) (Figure 3). This is explained by an increase in alcoholic beverages and tobacco consumption of 7.1% YoY and transportation (5.8% YoY).

Figure 4: Consumer Confidence



Source: Fedesarrollo, MUFG

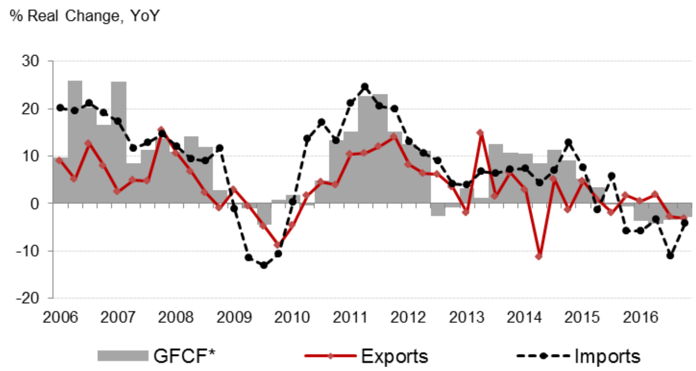
The consumer confidence indicator showed since 2016 that consumers have a negative overall expectation. In January 2017, the consumer confidence index suffered a significant contraction, registering its lowest level (-30.2) (Figure 4) since November 2001. Weak employment conditions (the unemployment rate stood at 11.7% in January 2017) and the expectation that the tax reform that came into force in January 2017 will reduce the purchasing power of consumers via an increase in the sales tax rate are some of the factors that contributed to this drop in consumer confidence. While the index showed a slight improvement in February it is still close to its historical low. The movement of this index could foreshadow a fall in household consumption in the short term. Since household consumption comprises about 60% of GDP, this could negatively affect GDP growth in 2017.

Government consumption only grew by 0.2% YoY in Q4 2016, the same rate as in Q3 2016 but marking a slowdown from Q4 2015 (5.3% YoY). This is due to the government making adjustments to the 2016 budget, such as reducing current expenses and also public investment to compensate for the decreased revenues coming from lower oil production.

Investment, Exports and Imports

Gross Fixed Capital Formation (GFCF) declined 2.9% YoY in Q4 2016 (Figure 5) and a total of 3.6% YoY in 2016. GFCF has been affected by weak domestic demand, mainly in the purchase of machinery (-14.0% YoY Q4 2016). The government reduced its budget expenditures for 2016 and this had a negative impact on government investment.

Figure 5: Investment, Exports and Imports



*Gross Fixed Capital Formation
Source: DANE, MUFG

For 2017, it is expected that GFCF will increase. The government recently approved a program called “Colombia Repunta” that is intended to increase investment in construction, agriculture and social programs linked with the peace deal and targeted at post-conflict areas.

Exports contracted in Q4 2016 (-3.2% YoY), due mainly to a decrease in oil, natural gas and other minerals (-27.3% YoY). While imports sharply contracted during Q3 2016 (-11.1% YoY), they moderated somewhat during Q4 2016 (-4.2% YoY), due to an increase in imports of transportation equipment (23.8% YoY). It is expected that terms of trade will improve in 2017 as oil and other commodity prices increase; however, this improvement is expected to be slow.

Outlook

It is expected that Colombia will continue to have weak economic activity in 2017. The positive economic signs (improving commodity prices, Colombia’s new investment program, and the peace deal[3] between Colombia and FARC), could be overshadowed by the still present headwinds. The tax reform will likely further deteriorate the already lackluster household consumption.

The recent corruption scandal linking the government with Odebretch[4] could expand in scope. This scandal has already affected two large projects[5] and could delay a large highway concessions project. If this scandal intensifies, it will affect other investments, further deteriorate the labor market, and hurt consumer and business confidence.

[3] The Peace deal signed between FARC and the Government is an important step towards stabilizing the country further. However, this positive impact will not be perceived immediately and could come with some negative hiccups, such as a potential strengthening of the second biggest terrorist group, ELN, and the drug cartels. It has been reported that these drug cartels are offering twice the amount of money that the government is paying the rebels in exchange for their arms. The government will need to address these outstanding issues.

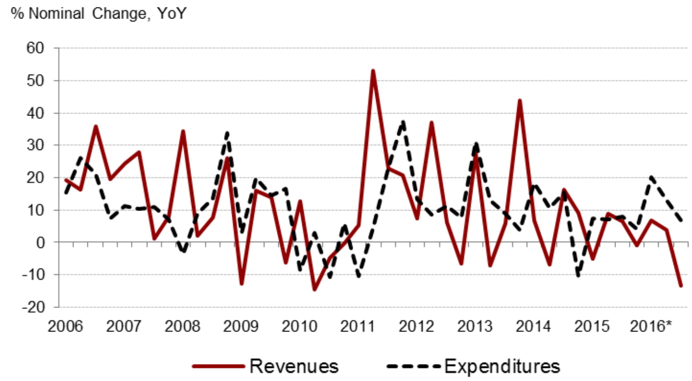
[4] Oderbrecht, is a Brazilian company that was at the center of the political turmoil that took place In Brazil in 2016 as a result of several different corruption scandals.

[5] Ruta del Sol 2 and Navegabilidad del rio Magdalena.

2. Fiscal Policy

Central government revenues in Colombia were hit in 2016 by lower oil revenues and the higher cost of debt due to the depreciation of the Colombian peso. Revenues fell by 13.0% in Q3 2016 (Figure 6), and the Ministry of the Treasury estimates that the central government deficit will increase to 4.0% of GDP in 2016, up from 3.0% of GDP in 2015.

Figure 6: Central Government Revenues and Expenditures



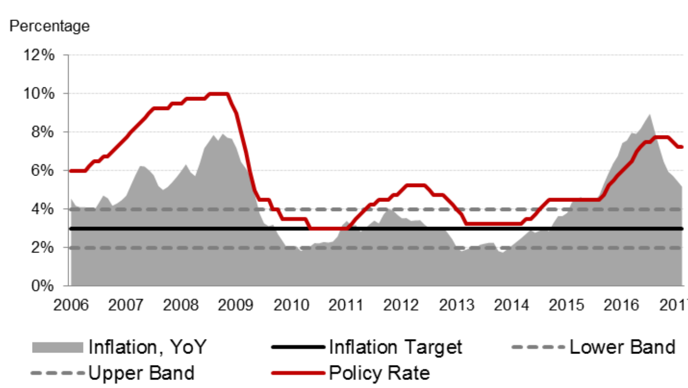
*Q3 is the latest official data available
Source: Central Reserve Bank of Colombia, MUFG

For 2017, the central government is expected to have a central government deficit of 3.3% of GDP due to the tax measures passed in 2016. This tax reform has two main objectives: first, to increase revenues in order to close the gap that formed due to a shortfall in oil revenues during 2016. Second, to convince credit rating agencies that Colombia is on sound financial footing. Without this reform, the government was expecting the credit rating for Colombia to fall from BBB to BBB-. This would increase the cost of borrowing and possibly reduce foreign investment. Now, as a result of this tax reform, in March 2017, Fitch ratings decided to maintain the credit rating for Colombia at BBB and revise upward their outlook from negative to stable. In the short term, however, the tax reform could cause household consumption to slide, which would negatively affect overall economic activity in Colombia. The tax reform could cause inflation to increase, as it increases the rate of the VAT.

3. Monetary Policy and Financial Markets

Colombia experienced one of the highest periods of inflation of the last 10 years when inflation peaked at 8.9% YoY in July 2016 (Figure 7). Inflation started to decline back towards the historical average after this peak and in February 2017 inflation was 5.2% YoY (still above the target rate of 3.0%). February was the seventh consecutive month of decreasing inflation and this fall was driven by a reduction in the prices of food and housing.

Figure 7: Inflation and Policy Rate



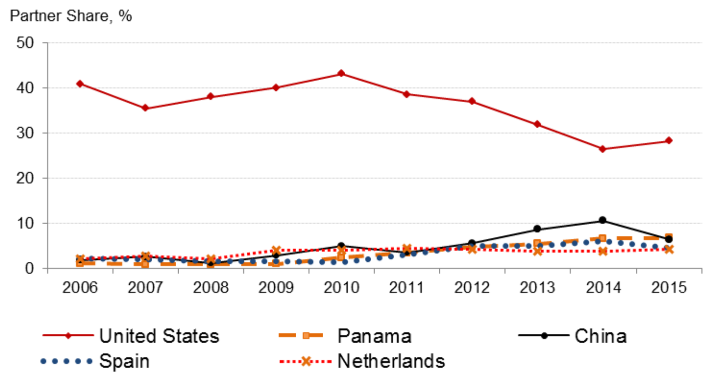
Source: Central Reserve Bank of Colombia, MUFG

The Central Bank, at its last meeting in March, decided to cut its policy rate by 0.25 percentage points to 7.0%. These cuts are due to decreasing inflationary pressures and a desire by the Central Bank to provide some stimulus to the sluggish domestic demand. The Central Bank expects the shocks that affected inflation in 2016, such as El Niño phenomenon and the depreciation of the Colombian peso to fade in 2017 and that any impact from the tax reform would be temporary.

The Central Bank highlighted that although the world economy is showing signs of recuperation, there are still uncertainties that could affect the Colombian economy. These uncertainties include any decisions by the Federal Reserve to change United States' interest rates and any changes in United States' trade policy, as it is one of the principal trading partners of Colombia (Figure 8).

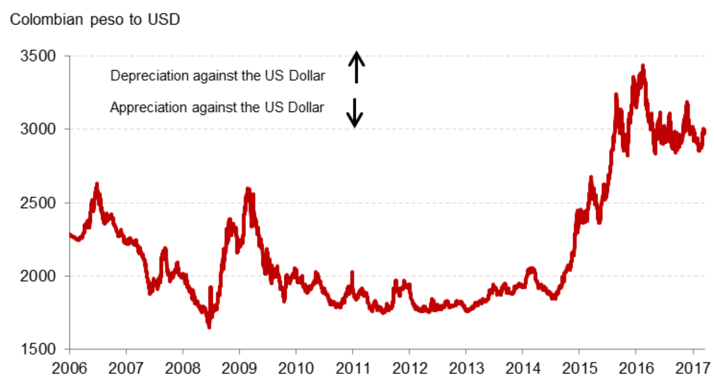
The Colombian peso went through a period of significant depreciation starting in September 2014 that reached its peak in February 2016 (Figure 9). Since then, the Colombian peso has recovered around 12.0% of its value; this appreciation is related with better external economic conditions that have also helped to improve Colombia's terms of trade. The Colombian peso is expected to stabilize during 2017 due to both internal and external economic conditions.

Figure 8: Share of Major Export Partners



Source: World Bank-World Integrated Trade Solutions, MUFG

Figure 9: Exchange Rate (Colombian peso)



Source: Central Reserve Bank of Colombia, MUFG