Colombia's Macroeconomic Performance: 2Q 2017 GDP and Current Monthly Indicators

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Overview

Colombia continues to experience lackluster economic performance. GDP growth was 1.3% YoY in Q2 2017, almost unchanged from Q1 2017 (1.2% YoY). Household consumption expanded by only 1.5% YoY during Q2 2017, similar to the previous quarter (1.4% YoY), while government consumption accelerated more rapidly (4.2% YoY in Q2 compared to 2.6% YoY in Q1).

Inflation started to decline back towards its historical average after peaking during 2016. In July 2017, inflation was 3.4% YoY, the lowest rate since September 2014. The Central Bank, at its last meeting in July, decided to cut its policy rate by 0.25 percentage points to 5.5%.

Colombia is expected to improve its economic activity during the second half of 2017 and throughout 2018. Low inflation will likely lead to stronger household consumption. The rate cuts being implemented by the Central Bank will also likely lead to increased consumption, in addition to providing an impetus for new investment. Infrastructure investment via the government program "Colombia Repunta" will positively impact GDP growth.

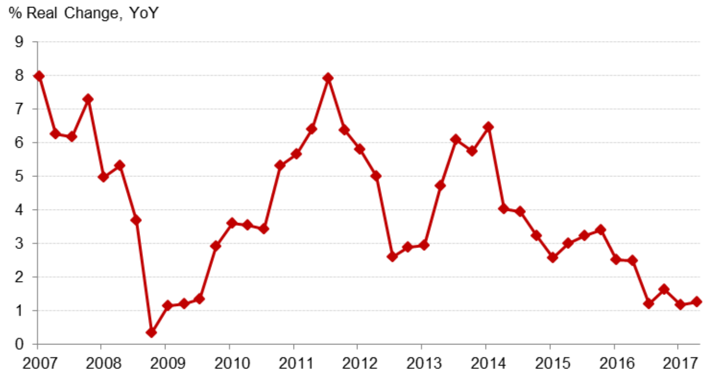
1. GDP

Colombia continues to experience lackluster economic performance. GDP growth was 1.3% YoY in Q2 2017, almost unchanged from Q1 2017 (1.2% YoY) (Figure 1).

GDP by Sector

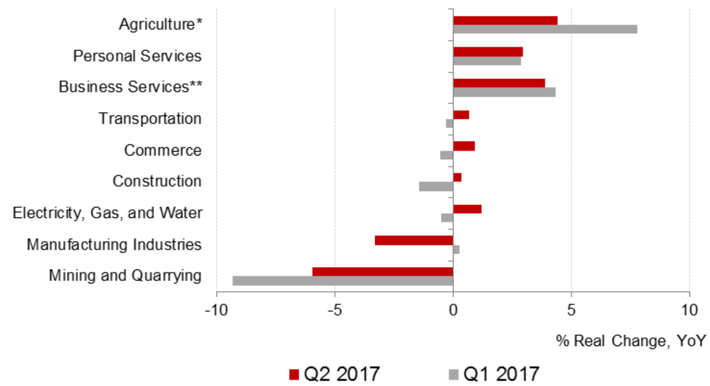
On the production side, GDP growth was limited by contractions in the manufacturing and mining sectors during Q2 2017 (-3.3% YoY and -6.0% YoY) (Figure 2). Both sectors are important parts of Colombia's economy and each contributed -0.4 percentage points to Q2 GDP growth, limiting the overall impact of positive growth in other sectors. Within the manufacturing sector, there were three subsectors that experienced large contractions: metallurgy products (-11.9% YoY), fabric and clothing articles (-11.1% YoY) and non-metallic mineral products (-6.2% YoY). The mining sector contracted for the eighth consecutive quarter and the contraction in Q2 2017 is mainly the result of poor performance in the following three subsectors: graphite (-7.1% YoY), other metallic minerals (-16.3% YoY) and oil production (-5.4% YoY).

Figure 1: GDP Growth



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

Figure 2: GDP by Sector



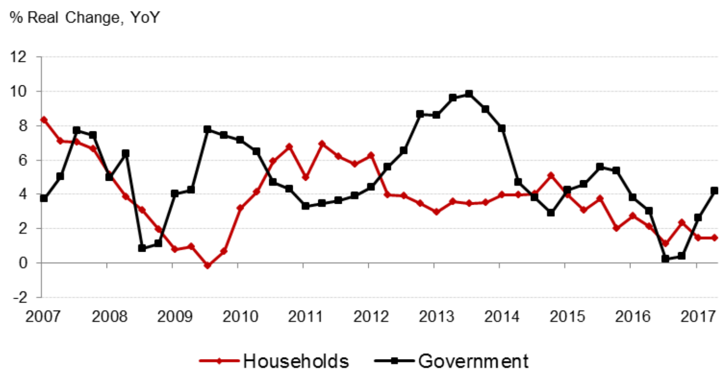
* Includes agriculture, livestock, forestry, and fishing
** Includes financial establishments, insurance, real estate and business services
Source: DANE, MUFG

All other sectors grew during Q2 2017, with business services (3.9% YoY), agriculture (4.4% YoY) and personal services (3.0% YoY) expanding the most, although business services and agriculture decelerated in comparison to the previous quarter.

Consumption

Household consumption expanded by only 1.5% YoY during Q2 2017, almost unchanged from the previous quarter (1.4% YoY), while government consumption accelerated more rapidly (4.2% YoY in Q2 compared to 2.6% YoY in Q1) (Figure 3). The lackluster performance of household consumption is likely the result of the lingering effects of a tax increase at the beginning of the year and the sharp depreciation that the Colombian Peso suffered during the second half of 2014 and throughout 2015 (the Colombian Peso lost around 40% of its value during that period and from Janury 2016 to July 2017 recovered only around 10% of its value). Consumer confidence improved during the months of June and July, but still remains low.

Figure 3: Consumption



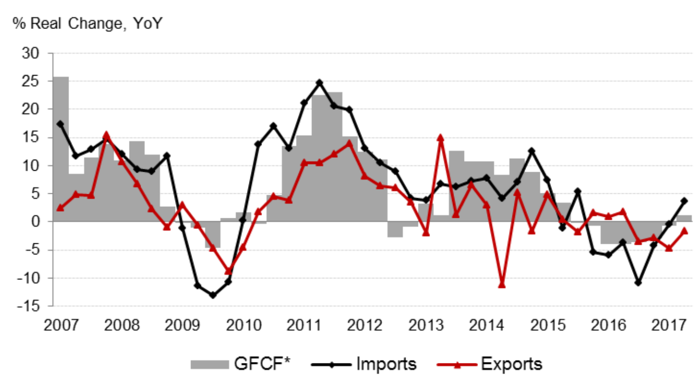
Source: DANE, MUFG

Government consumption expanded at a faster rate than in Q1 2017 due to an increase in both current and capital expenditures; the latter was mainly driven by investment in infrastructure.

Investment, Exports and Imports

Gross Fixed Capital Formation (GFCF) experienced its first expansion (1.1% YoY) after seven consecutive quarters of contraction (Figure 4). This expansion was supported by an increase in investment in machinery and equipment (2.8% YoY) and principally by an increase in investment in infrastructure[1] (6.9% YoY). The expansion in infrastructure is the result of the government program "Colombia Repunta"[2]. The investment in housing construction is the one contributing to the low total expansion in GFCF due to its continued contraction.

Figure 4: Investment, Exports and Imports



*Gross Fixed Capital Formation
Source: DANE, MUFG

Exports contracted for the fourth consecutive quarter in Q2 2017 (-1.7% YoY). This contraction was mainly the result of a decrease in the volume of oil exports. This decrease is the result of a drop in oil production that was mainly caused by domestic terrorist attacks on pipelines.

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[1] Investment in infrastructure represents around 35% of total GFCF. These infrastructure projects include new construction for the mines in Colombia, electricity generation, pipelines to transport oil and gas, and roads.

[2] "Colombia Repunta" program is based on stimulus via lower taxes to private companies and an increase in government investment.

Imports registered an increase of 3.7% YoY during Q2, 2017. This is explained by an increase in imports of capital goods (transportation equipment) and intermediate goods (goods used for agriculture).

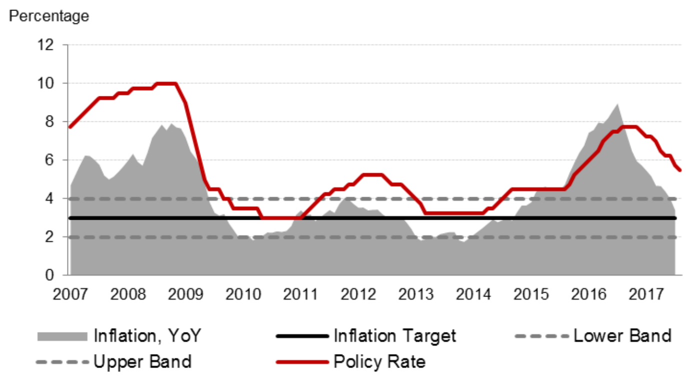
2. Fiscal Policy

Central government revenues increased 7.0% YoY in nominal terms during Q2 2017 mainly due to the tax reform and an improvement in oil prices. It is expected that the tax reform will lead to an increase of total government revenues for 2017 amounting to around 10% YoY. Central government expenses expanded by 4.0% YoY during Q2 2017. It is expected that the fiscal deficit in 2017 will be lower than in 2016.

3. Inflation and Monetary Policy

Inflation started to decline back towards the historical average after peaking during 2016. In July 2017, inflation was 3.4% YoY (still above the target rate of 3.0%), the lowest rate since September 2014 (Figure 5).

Figure 5: Inflation and Policy Rate



Source: Central Bank of Colombia, MUFG

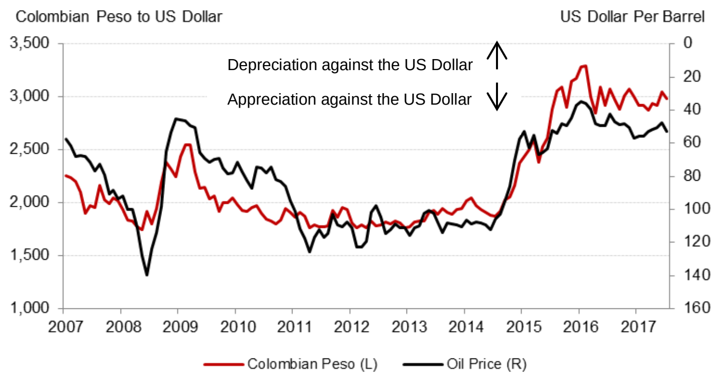
The El Niño phenomenon and the depreciation of the Colombian Peso, were the main factors that impacted inflation in 2016. As the Colombian Peso has stabilized and weather patterns have returned to a more normal state, inflation has decreased during the first half of 2017. The annual inflation rate has fallen for 12 consecutive months, mainly the result of much lower rates of increase (0.2% YoY) in food prices.

The Central Bank, at its last meeting in July, decided to cut its policy rate by 0.25 percentage points to 5.5%. This means that through the first seven months of 2017, the Central Bank has reduced the policy rate by 2.0 percentage points. These cuts are due to decreasing inflationary pressures and a desire by the Central Bank to provide some stimulus to the sluggish domestic demand.

4. Exchange Rate

The Colombian Peso tends to track oil prices (Figure 6). As a result of the sharp decline in oil prices during the second half of 2014 and throughout 2015, the Colombian Peso experienced a period of significant depreciation during the same period. At the beginning of 2016, oil prices slowly started to improve, causing the Colombian Peso to slowly begin to appreciate. Oil prices are expected to continue increasing slowly throughout the rest of the year and this will likely result in the Colombian Peso continuing to gain some value.

Figure 6: Exchange Rate and Oil Prices



Source: Central Bank of Colombia, Bloomberg, MUFG

5. Outlook

Colombia is expected to improve its economic activity during the second half of 2017 and throughout 2018. Low inflation (which is expected to be lower than in 2016 but still finish slightly above the upper band of the inflation target in 2017) will likely stimulate stronger household consumption. The rate cuts being implemented by the Central Bank will also likely lead to increased consumption, in addition to providing an impetus for new investment. Infrastructure investment via the government program “Colombia Repunta” will positively impact GDP growth. As a result, total annual growth for 2017 is expected to exceed that for 2016 (2.5% YoY in comparison with 2.0% YoY) and for 2018, Colombia is expected to further accelerate its GDP growth (3.0% YoY).