Scotiabank

GLOBAL ECONOMICS

LATAM DAILY

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Latam Daily: Colombia Outlook Downgrade, Econ Activity Recap

- **Colombia: S&P lowered Colombia's credit rating outlook from 'stable' to 'negative', highlighting a need for better quality economic growth; Economic activity rebounded in November with growth in y/y and m/m terms**

S&P LOWERED COLOMBIA'S CREDIT RATING OUTLOOK FROM 'STABLE' TO 'NEGATIVE' HIGHLIGHTING A NEED FOR BETTER QUALITY ECONOMIC GROWTH

S&P maintained Colombia's BB+ rating for Foreign Currency Debt; however, it reduced the country's outlook to 'negative' from 'stable'. The main concern for S&P is that the slowdown in economic activity reflects not only a deceleration in household demand but also weak private investment activity which poses a risk for medium-term GDP growth perspectives.

Key points about S&P decision:

- S&P's action was unexpected and, in our opinion, could bring some volatility in domestic markets. However, we don't expect a negative episode comparable to the one observed in 2021 when Colombia lost the investment grade by two credit agencies. In fact, according to our models, the USDCOP already involves a risk premium of around 250 pesos due to the fact that Colombia is no longer an investment-grade country. That said, we don't expect the currency to start a new depreciation path, but it could probably fluctuate around 4000 pesos in the medium-term. On the FI side, we think that the main driver for rates continues to be the expected easing cycle from the central bank.
- S&P mentions that "the negative outlook indicates that (they) could lower the rating over the next two years if economic growth is below expectations, indicating less economic resilience and contribution to fiscal slippage or higher vulnerabilities." In that sense, we think today's action is a warning signal from S&P to the government, signaling that Colombia needs policies that contribute to pursuing higher investment activity, which we call growth quality. Ultimately, a better growth quality will contribute to achieving stable and higher fiscal income.
- It is worth mentioning that up to Q3-2023, investment activity in Colombia was 15% below pre-pandemic levels, and it was especially reflected in construction-related activities. For 2024, a context of lower interest rates, lower inflation, and new regional administrations could contribute to generating a better environment for investments. On the other side, the government must implement the budget in investment programs to contribute to better growth quality.
- On the positive side, S&P continued highlighting Colombia's robust institutions—a stable democracy, political institutions that preserve predictable economic policies, and an independent central bank. In our opinion, those characteristics are valuable assets that confirm the tradition of Colombia of paying its debt.

Current Credit Ratings Profile:

- Moody's foreign issuer rating: Baa2 (investment grade), outlook stable
- Fitch long-term foreign currency debt rating: BB+, one level below investment grade, outlook stable.

Overall, we think today's S&P reduction in the outlook is calling attention to pursue better policies to increase investment in Colombia's economy. At Scotiabank Economics, we think that economic conditions in 2024 will improve, inflation is expected to decelerate, interest rates could go down and despite the economic recovery takes time, we think that improved conditions could permit the start of a healthier economic cycle. Either way, it is critical for the government to implement the investment budget and promote a suitable environment for private investments. At Scotiabank Colpatria, we projected a 1.1% GDP growth in 2023 and a 1.8% expansion in 2024.

—Sergio Olarte, Jackeline Piraján & Santiago Moreno

COLOMBIA: ECONOMIC ACTIVITY REBOUNDED IN NOVEMBER WITH GROWTH IN Y/Y AND M/M TERMS

On Thursday, January 18th, DANE published the latest data for the economic activity indicator (ISE) for November 2023. The indicator showed a rebound of 2.3% y/y (chart 1), interrupting three months in a row of contraction. This result was in line with our expectations (2.4% y/y). The rebound also was observed in the monthly variation, as seasonally adjusted growth was 0.9% m/m, after -1.1% m/m in the previous month.

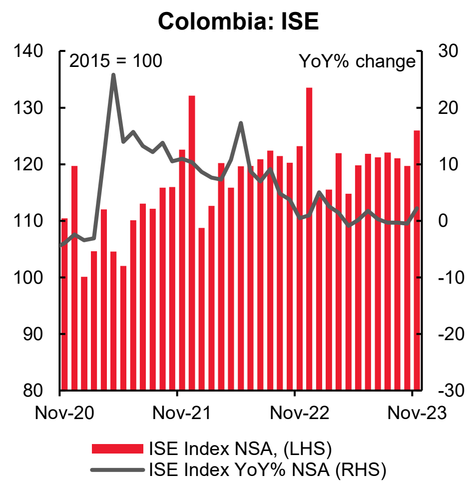
On a yearly basis, November showed a positive balance for primary activities, which grew by 8.4% y/y, followed by tertiary activities (services), which expanded by 2.6% y/y in November. Within the tertiary sector, public administration, arts and entertainment together with financial services, insurance, and public utilities drove growth in this sector. Nevertheless, trade, transport, and accommodation were the sub-sectors that registered a negative variation, although with a slight improvement compared to the record for the last 6 months.

In seasonally adjusted terms, all three sectors registered an improvement versus October's results, with the primary sector registering the highest growth in November at 2.5% m/m, followed by the secondary and tertiary sectors, which posted monthly expansions of 1.6% m/m and 0% m/m, respectively, in the penultimate month of 2023.

The Colombian economy is expected to expand by 1.1% in the whole of 2023. However, November's results are pointing out that the economic cycle is probably bottoming. In Scotiabank Colpatria, we project the economic growth will improve in Q4-2023 and will continue recovering at a moderate pace during H1-2024. Either way, we think domestic demand has adjusted to more sustainable levels, but investment is still a concern. During 2024, it will be relevant to observe if the economy responds to the lower exchange rate, lower inflation, and the expectation of potentially lower interest rates. Construction and manufacturing are sectors to keep an eye on.

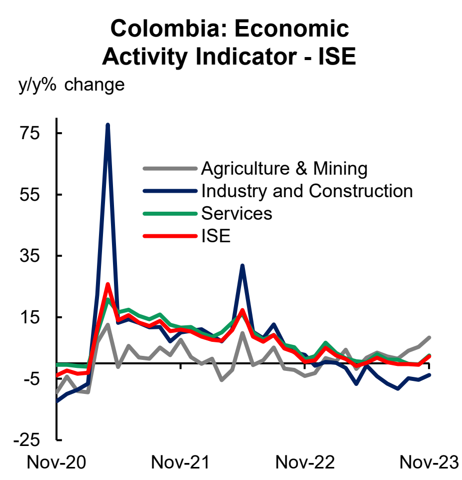
The slowdown in economic activity in 2023 has allowed inflation to decelerate rapidly to 9.28% by the end of 2023. This has allowed BanRep to initiate the easing cycle with a 25 bps cut to 13% in December. With inflation expected to decelerate further to 4.4%, BanRep is also expected to accelerate the easing cycle, reaching 7% in December of this year. Current data also support the discussion of a possible 50 bps rate cut to 12.50% at the January BanRep meeting, which is our baseline scenario.

Chart 1



Sources: Scotiabank Economics, DANE.

Chart 2



Sources: Scotiabank Economics, DANE.

Highlights:

- Primary activities (agriculture and mining) grew at an annual rate of 8.4% y/y (chart 2) and 2.5% m/m seasonally adjusted. In agriculture, the moderation in producer prices continues to increase food production, partly due to the appreciation of the exchange rate and its relationship with the level and statistical base. In the mining sector, oil and coal production has contributed to the improved performance of the sector.
- Secondary activities (manufacturing and construction) ended nine consecutive months in negative territory, registering a contraction of 3.9% y/y; however, this is the smallest decline recorded for this indicator in the last 6 months. In seasonally adjusted terms, there was a slight rebound of 1.6% m/m in November from the -2.4% m/m recorded in October.
- According to data published by DANE on Wednesday, January 17th, real manufacturing production contracted by 6.4% y/y in November 2023, completing nine consecutive months of annual contraction. Nevertheless, there was a slight rebound at the margin

from the previous month, as the manufacturing sector rebounded to -0.2% m/m in November from -0.9% m/m in October. This decline, combined with the low dynamism of the construction sector, has led to a slowdown in secondary activities on an annual basis.

- As for the tertiary sector (which includes activities related to trade and services), an annual growth of 2.6% was recorded in November. This result was due to growth in public administration, arts, and entertainment (+6.9% y/y), financial and insurance services (+4.2% y/y), and public services (+3.5% y/y). On the other hand, trade, transport, and accommodation were the subsector that registered a negative variation in November, contracting by 2.3% y/y, although with a slight improvement compared to the record of the last 6 months. In seasonally adjusted terms, an annual variation of 0% was recorded, with the subsectors of public administration, education and entertainment (-0.5% m/m), professional activities (-0.2% m/m) and financial and insurance services (+0.8% m/m) driving the tertiary sector in comparison with October, offsetting the decline in the subsectors of trade, transport and accommodation (-2.6% m/m) and information and communication (-0.4% m/m).

—Jackeline Piraján & Santiago Moreno