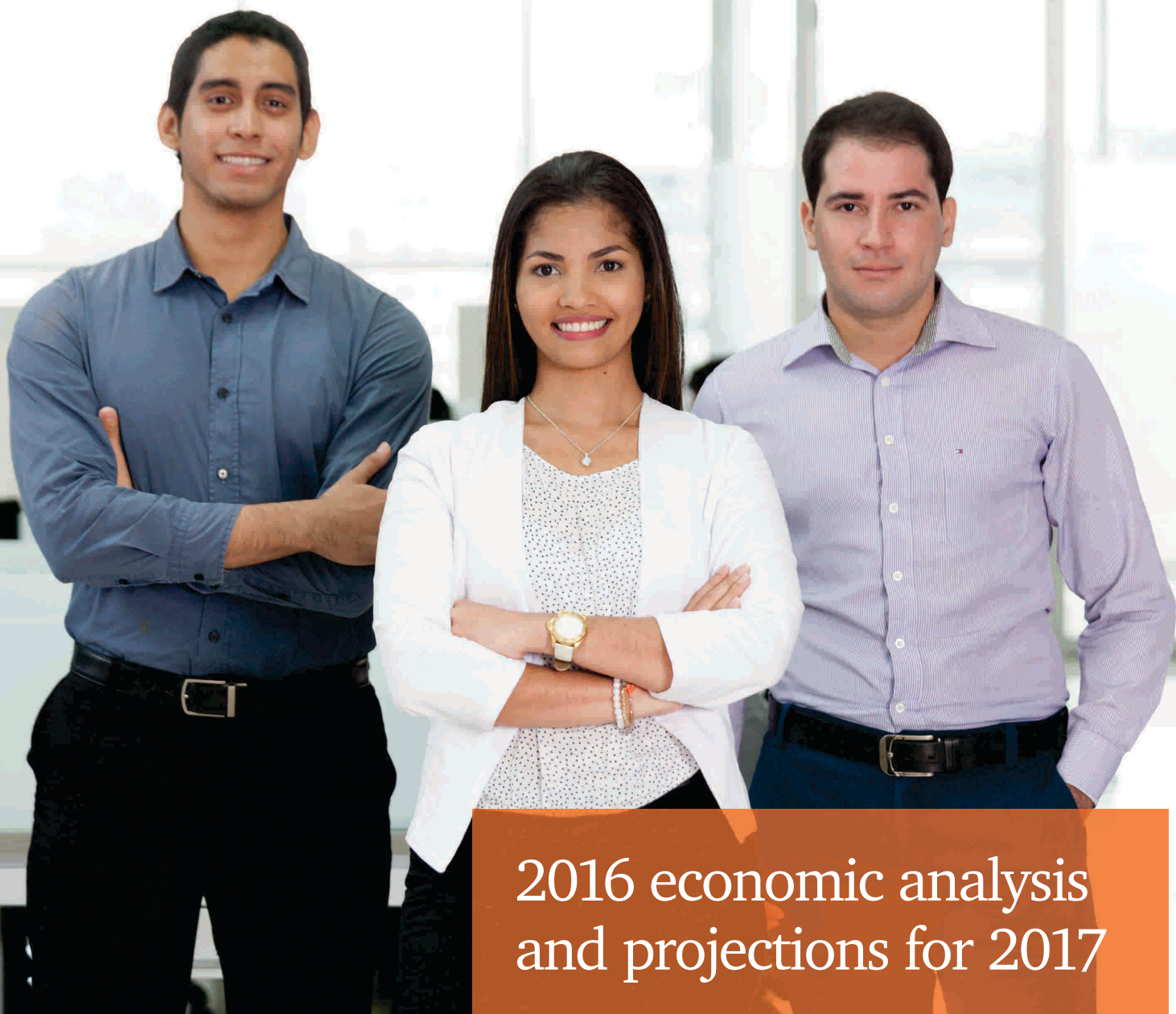


Colombian Highlights



2016 economic analysis
and projections for 2017

Wrap-up 2016

The Colombian economy performed acceptably in 2016, taking into account the international economic environment. The effect of volatile international oil prices, low prices of commodities, the El Niño phenomenon and the domestic truck drivers' strike had an effect on the reduced growth of the Colombian GDP, as do the expectations generated by the tax reform.

Even though the growth rate was less than that of 2015 it was still a positive one, mostly driven by the construction and financial services sectors.

The main characteristic of 2016 was a challenging macroeconomic environment. This was so because of increased inflation rates, high interest rates and high market exchange rates as a result of reduced flows of foreign investment, among other factors. All this added to lower exports which led to less US dollars being injected into the domestic exchange market. Nevertheless, the strong dynamics of domestic demand counter-balanced the negative effects, and minimum historical unemployment rates were observed. The BBB investment grades granted by both Fitch Ratings and Standard & Poor's for foreign debt kept their ground during this year. This highlights the good management of Colombian macroeconomic policy in the midst of difficult external and internal circumstances.

Economic Growth

Colombian economy grew 2% in 2016 (January-December) compared to 2015. Although this is a low number when contemplating the estimates made by several economic agents at the beginning of 2016, it is worth noting that seven out of the nine industries in Colombia showed positive growth. Four of them were above the average economic growth.

The four sectors that grew beyond 2% were the following: financial services (5%); construction (4.1%); the manufacturing industry (3%); and social, community and personal services (2.2%). The sectors with a growth under the average variation were: commerce, repairs, restaurants and hotels (1.8%); agriculture, farming, hunting, forestry and fishery (0.5%); and the supply of power, gas and water (0.1%). The sectors with negative growth rates were: transportation, storage and communications (-0.1%) and mines and quarries exploitation (-6.5%).

Inflation

The inflation rate for 2016 was 5.75%, which is once again above the target range set by the Banco de la República¹ (between 2% and 4%).

We observed a reduction of 1.02% compared to the rate for 2015 (6.77%). The negative effects of the El Niño phenomenon, high oil prices and high prices of imports resulting from the devaluation of the Colombian peso continue to affect our economy.

The sectors with inflation rates over the average were the following: Health (8.14%), other expenses (7.25%), foods (7.22%), and education (6.34%). The groups with inflation rates under the average were: Housing (4.83%), communications (4.72%), transportation (4.47%), entertainment (4.05%) and clothing (3.98%).

Interest Rates

The intervention interest rate was at 5.75% at the beginning of 2016. This year stands out for high increases in interest rates (1.75% throughout the year), which were set in order to counterbalance inflationary pressures resulting from increases in food prices and depreciation.

Effective February, the Central Bank started to increase rates, climbing to 6.5% in the first quarter, 7.5% in the second quarter and 7.75% during the third quarter. At the end of the year rates dropped by 0.25%, closing at 7.5%.

The 90-days fixed term deposit interest rate closed at 6.86%, compared to 5.22% in 2015, while the average placement rate went from 12.24% in December 2015 to 14.4% in December 2016.

¹ The Colombian Central Bank



Foreign exchange rate

After three years in a row with the Colombian peso devaluating, with 8.97% in 2013, 24.17% in 2014 and 31.64% in 2015, in 2016 the Colombian peso appreciated again compared to the US dollar (4.72%).

Despite the above, US dollar purchase rates fluctuated throughout the year. In January 2016, the dollar sold at an average price of COP3,149 . In April it dropped to COP2,900. By mid-May, it went up again, reaching COP3,118. In October, it dropped again, reaching the year minimum of COP2,880. At the year end, the average US dollar purchase rate showed a slight increase and set at COP3,001.

The Colombian peso has become one of the most devalued currencies of the world. High US dollar prices have multiple effects on the country: On one side, this favors revenues from exports and the economy of the foreigners visiting Colombia. On the other hand, it makes imports of raw materials pricier, which has an impact on inflation, and there is also a negative effect for every Colombian who travels abroad.

Finally, the effects of devaluation in Colombia are more negative than positive. Nontraditional exports to all destinations will continue to drop, as well as all sorts of foreign revenue. This is evidenced by the deficit in the current account of Colombian foreign trade balance.

Trade Balance

According to figures published by DANE (the National Statistics Department), the total exports figure for 2016 dropped to USD31.04 billion when compared to USD35.7 billion in 2015, amounting to a 13%. For the most part, said drop can be explained by decreases in various industries, such as the 21.7% in fuels exports and mining products, 10% in the manufacturing sector, 1% in the farming sector, foodstuffs and beverage products, as well as by an increase of 40.2% in other sectors.

The main export locations that affected the general drop of Colombian exports were: Aruba, China, Venezuela, Spain and Panama, among others. In general, exports to Andean community countries dropped by 12%, and exports to the European Union dropped by 17%. Exports to the United States remained stable, growing by 0.2% when compared to 2015.

Regarding the import report, foreign purchases in the country dropped by 17% in 2016 compared to the previous year. They dropped from USD 54.06 billion CIF in 2015 to USD 44.9 billion CIF in 2016. Said reduction can be mostly explained by a decrease in the import of manufactured, falling from USD 41.9 billion CIF in 2015 to USD 33.9 billion CIF in 2016, and the drop in the fuels and mining products sector, which added 24%, falling from USD 5.9 billion CIF in 2015 to USD 4.6 billion CIF in 2016.

At the closing of 2016, the foreign trade balance showed a USD 11,8billion FOB deficit. The deficit mainly appeared in trade with China (USD 7.12 billion FOB), Mexico (USD 2.36 billion FOB), the United States (USD 1.42 billion FOB) and the European Union (USD 1.06 billion FOB).



Foreign debt

According to preliminary figures from the Central Bank, in November 2016 Colombian foreign debt totaled 116.2 billion USD, which is equal to 41.5% of the GDP. An increase in long-term debt is the main factor behind this figure.

Colombian foreign debt is principally made of public debt (60%) and private debt (40%). Out of the total amount, the public sector is responsible for USD 69.9 billion and the private sector for USD 46.3 billion. Regarding the payment terms, USD 14.8 billion correspond to short-term indebtedness, whereas USD 101.4 billion correspond to long-term indebtedness.

Net International Reserves

By the end of 2016, average net international reserves reached USD 46.7 billion, which represents a drop of 0.12% compared to 2015.

Direct Foreign Investment

Between January and September 2016, foreign direct investment grew 6.9% with respect to the same period in 2015, reaching USD 10.2 billion. The investment figure for the third quarter, USD 1.9 billion, is the lowest recorded for the last six years, with the previous lowest being USD 2.3 billion in 2010. The drop is explained mostly by reduced capital investments in the mining and energy industries.

The sectors with the largest participation on foreign investment flows from January to September 2016 were the following: Electric power, water and gas, which went from 2% in 2015 to 34% in 2016, a clear reflection of the sale of Isagen; the mining and energy sector which lost weight due to the low prices of oil and low commodity prices (37% in 2015 vs 14% in 2016); the manufacturing industry, which dropped by 4% in 2016 (from 20% in 2015 to 16% in 2016); and the financial and corporate services sector, which dropped by 2% (from 14% in 2015 to 12% in 2016).

With respect to the countries that invest in Colombia, we found that, differently from 2015, when the main countries investing in Colombia were the United States (19%), Panama (16%), Bermuda (11%) and Switzerland (9%), in 2016 the United States (14%) and Bermuda (14%) continued on the list with some percentile variations, with Canada (21%) and Spain (10%) joining the list.

Employment

According to DANE reports, the unemployment rate for the period January-December 2016 was 9.2%.

Out of 23 surveyed cities, 18 reduced their unemployment rates and 7 showed single-digit rates. The cities with the highest unemployment rate were: Quibdó (17.5%), Cucuta (15.4%) and Armenia (14.8%). Likewise, the cities with the lowest unemployment rates were: Barranquilla (8.2%) and Cartagena (8.9%).

An analysis of the October - December quarter (Q4) of 2016 showed that the business sectors with the highest employment rates were: commerce, restaurants and hotels, 27.8%; community, social and personal services, 19.2%; agriculture, cattle raising, hunting, forestry and fisheries 16.3%; and the manufacturing industry, 12.1%. These four sectors contained 75.4% of the total employed population of the country. In 2017, the minimum monthly salary was set at COP 737,717 (USD 242)², i.e., an increase of 7% compared to that of 2016. The transportation allowance went from COP 77,700 (USD 28)³ to COP 83,140 (USD 27).

Public Finance

The total fiscal deficit projected by the National Government for 2016 was set at 4% of the GDP. For 2017, it is expected that the deficit will drop down to COP 30.3 billion (3.3% of the GDP), as a result of the revenue expected in the amount of COP 137 billion (15.1% of the GDP) and expenses expected in the amount of COP 167 billion (18.5% of the GDP).

The National Government expects that this 0.7% improvement of the GDP in the fiscal deficit for 2017 will occur mainly due to an increase in tax revenues by 0.7% of the GDP, which will finance the expenditure projected by the Government.

² Foreign exchange rate used is COP 3,051, the average 2016 rate.

³ Foreign exchange rate used is COP 2,743, the average 2015 rate.

Politics

In 2016, the political environment was mostly centered on the peace process, with the most important event for Colombia being the end of the armed conflict with the FARC guerrilla, through the signing of the peace agreement. Other milestones that stood out during the year were the approval of same-sex marriage by the Constitutional Court, and changes in leadership positions in several important institutions of the country.

After more than 50 years of civil war in Colombia, on September 26, 2016, Colombian President Juan Manuel Santos signed the peace agreement with the FARC guerrilla commission led by FARC's lead negotiator, Timoleón Jiménez, a.k.a. Timochenko. After they signed the peace agreement, the government subjected it to popular vote, in what became known as the plebiscite for peace. Elections were called for October 2, 2016, and 50.23% of Colombian voters said NO, rejecting the agreements reached within the scope of the peace negotiations.

After the victory of NO in the popular elections, the legislative committee for peace and several political parties, including the strongest in the opposition, Centro Democrático (Democratic Center), got to work and helped in preparing changes to the peace agreement. After renegotiations were completed, the peace agreement was signed again on November 24, 2016, and took immediate effect under the approval of the Congress of the Republic. The Congress also approved a fast track mechanism for the process, which has been crucial to develop and work on the contents of the peace agreement. That mechanism and some others contained in the Special Jurisdiction for Peace granted special powers to President Santos to issue legislative decrees without the need for Congress approval.

In light of the work of President Juan Manuel Santos in matters related to the peace process, he was awarded the Nobel Peace Prize in 2016.

On the other hand, after having approved same-sex couple adoption in 2015, in 2016 the Constitutional Court approved same-sex marriage in Colombia. These events have caused a great stir in Colombian society.

Finally, there were changes in the leadership positions of several country institutions. The appointment of Alejandro Ordoñez as Inspector General was declared null and void by the High Court, having considered that there were vices in the process for his reelection. We also had the election of the new Attorney General, Nestor Humberto Martínez, who replaced Luis Eduardo Montealegre. Finally, the General Ombudsman, Jorge Armando Otálora, was fired from office by the Office of the Inspector General under grounds of harassment in the workplace. He was replaced by Carlos Negret.



Projections for 2017

After a difficult environment in 2016, the economy is expected to grow once again in 2017. The tax reform, the peace process and the so-called fourth-generation highway projects (or 4G projects) are some of the factors that open the way to a clearer national perspective.

Economic analysts expect stronger GDP growth rates for 2017. At the international level, the International Monetary Fund (IMF) expects a growth of 2.6%, while at the local level the government expects growth to set at 2.5% with other economic analysts (such as Fedesarrollo) expecting it to set at 2.4% for the year.

One of the main challenges for 2017 is implementation of the peace agreement and the gradual reincorporation of former members of the armed groups into the Colombian society. The adjustment for the drop in oil revenue will continue and it is expected that demand will drop as well, taking into account the impact of inflation, high interest rates and the increased VAT of 19%, along with other effects of the tax reform.

For this year, the Ministry of Finance expects that net tax revenue collections will reach COP 130.4 billion, which represents a nominal increase of 11% over those of 2015. The government expects to collect as much as 5.1% of the GDP just from the increase in the VAT rate from 16% to 19%.

According to the projections of the government and the IMF, inflation will continue to fall this year, closing at 3.7%. This rate would be within the range set by the Central Bank, which means that the inflation rate would return to “normal” after two consecutive years of remaining above the target rate.

The deficit in the current account will also continue to fall this year. The government expects the deficit to be 3.5%, while other analysts, such as Anif, expect it to be 4% at year closing.

Given the worldwide uncertainty triggered by oil prices with the impact of the measures enacted by the OPEC, Colombia has set its projection for this year based on US\$50 per oil barrel (under the Brent benchmark) on average, with production ranging between 890,000 and 910,000 oil barrels per day, according to the Colombian Petroleum Association.

According to the National Planning Department, the average foreign exchange rate will be COP 3,037 for one US dollar in 2017. The government expects that exports will grow for the first time since 2013, by 9.2% when compared with 2016 export rates. The government also expects imports to grow by 4.5% in 2017 compared to 2016.

Regarding the political environment, in addition to implementing the peace agreement, 2017 will be a year of political campaign for the presidential elections of 2018.

Colombia:

Macroeconomic Indicators

	2015	2016	2017 (projection)
GROSS DOMESTIC PRODUCT			
Actual growth (%)	3,1	2,0	2,5
POPULATION			
Millions (Dec 31)	48,5	49,0	49,6
INFLATION			
Var. Consumer Price Index (CPI) Dec-Dec (%)	6,77	5,75	3,70
INTEREST RATES			
Inter-bank rate	5,75	7,50	6,25
90-day Fixed Term Deposit (Fin de año)	5,22	6,86	6,10
Placement rate ⁴	12,24	14,40	13,80
EXCHANGE RATE (year end)			
December	3.149	3.001	3.037
Devaluation (%)	31,64	- 4,71	1,20
PAYMENT BALANCE			
Exports (USD 000 FOB)	35.691	31.045	33.901
Imports (USD 000 CIF)	54.058	44.889	46.909
Trade balance (USD 000)	- 15.907	- 11.804	- 13.008
Net international reserves (USD 000)	46.731	46.675	46.460
GOVERNMENT FINANCE			
Central domestic government (% GDP)	≈ 3,1	≈ 4	≈ 3,3
External debt (% GDP)	38,1	41,5	41,1
DOMESTIC UNEMPLOYMENT RATE (%) Year end	8,9	9,2	9,6

⁴ Weighted average of consumption, ordinary, preferential and treasury credit rates

Sources: DANE, Ministry of Finance and Public Credit of Colombia, Banco de la República

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