

# Macroeconomic risks and policy challenges for **COLOMBIA** of rising international interest rates



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Background

**Colombia:**  
Recovering from  
the terms of trade shock

# Following a severe shock, the Colombian terms of trade and trading partners' growth are expected to continue recovering. However, downside risks persist.

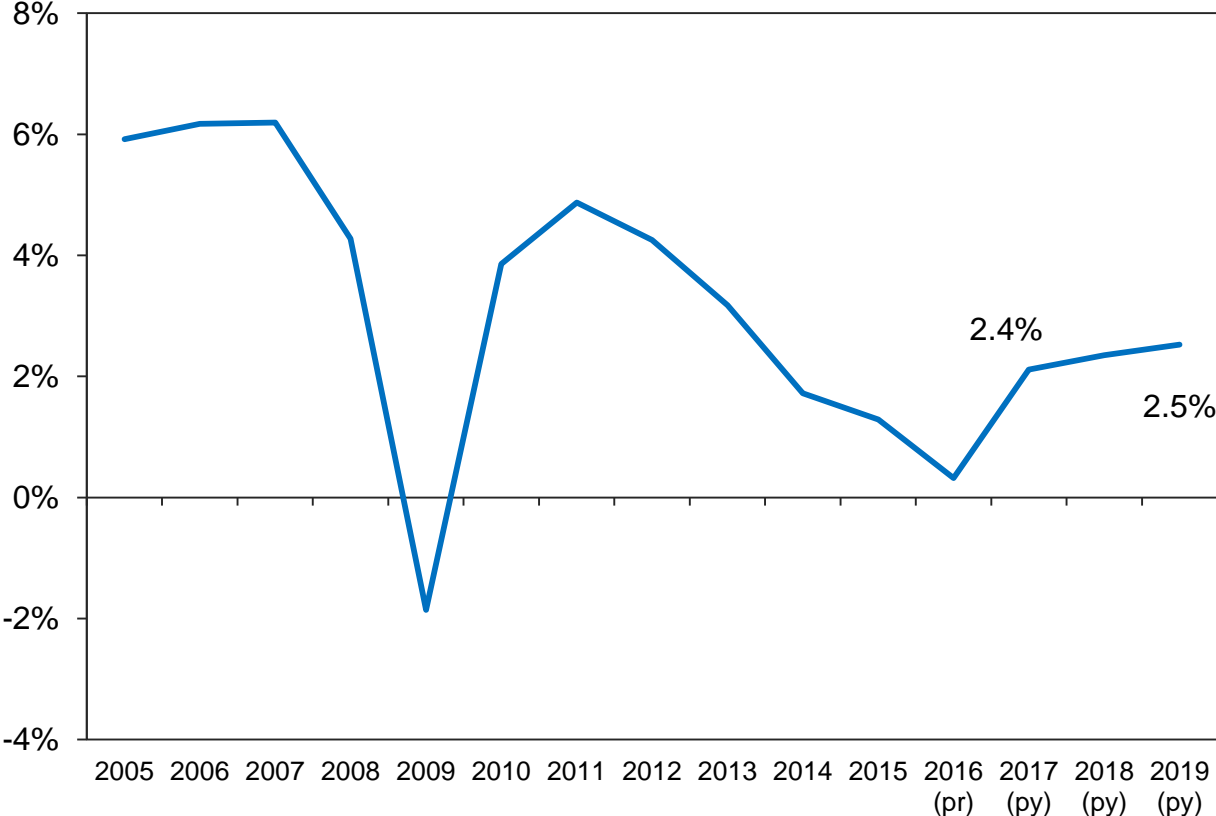
## Terms of Trade

(Index)



## Growth of Colombia's Trading Partners

(Percentage)

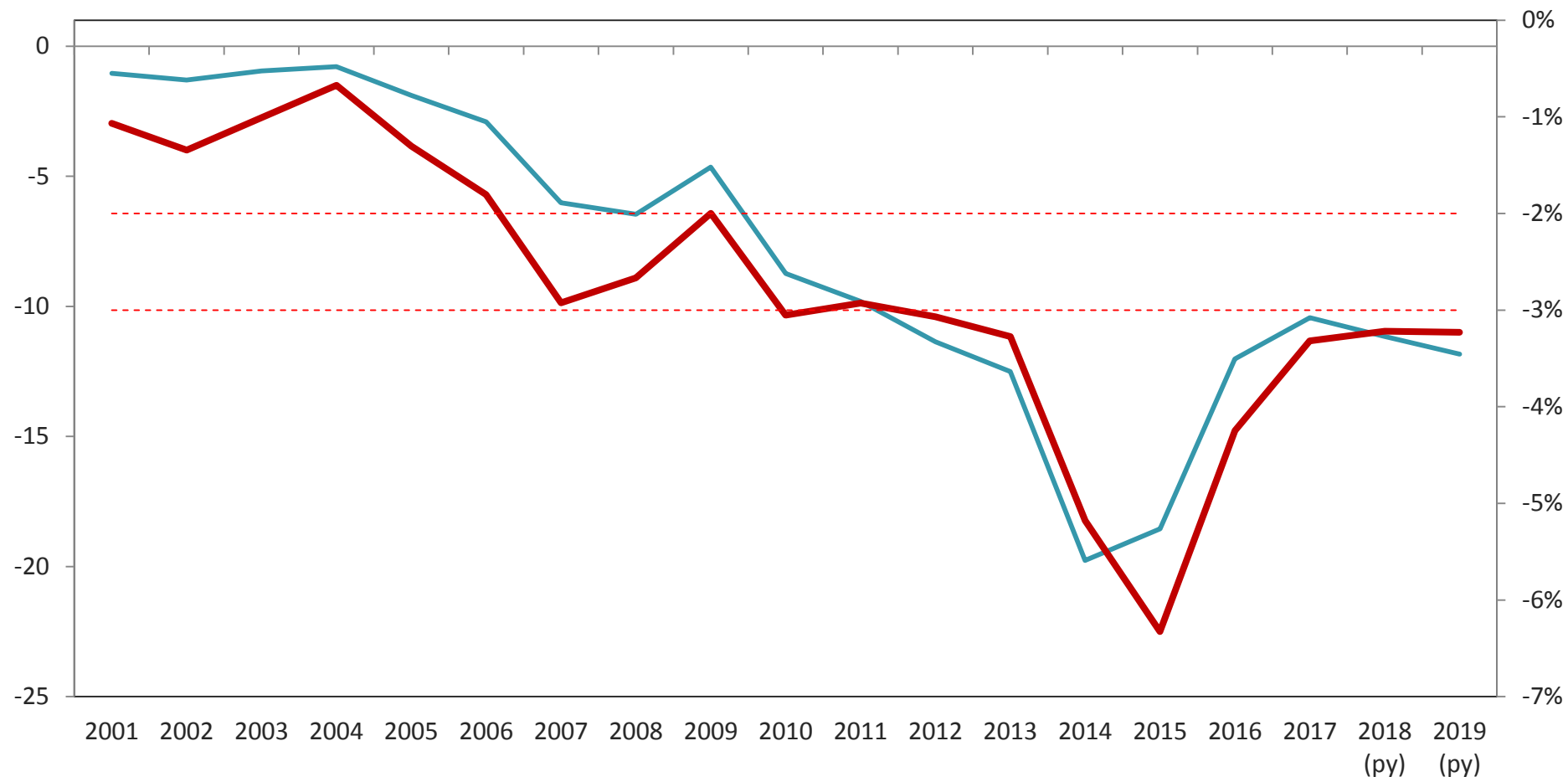


Source: Banco de la República.  
Latest update (july-2018)

Source: Banco de la República.

By 2015, the current account deficit attained 6,4% of GDP. Over the last three years there has been a significant correction, and currently it is close to sustainable levels.

**Current Account**  
(Percentage of GDP and Billions of U.S. dollars)



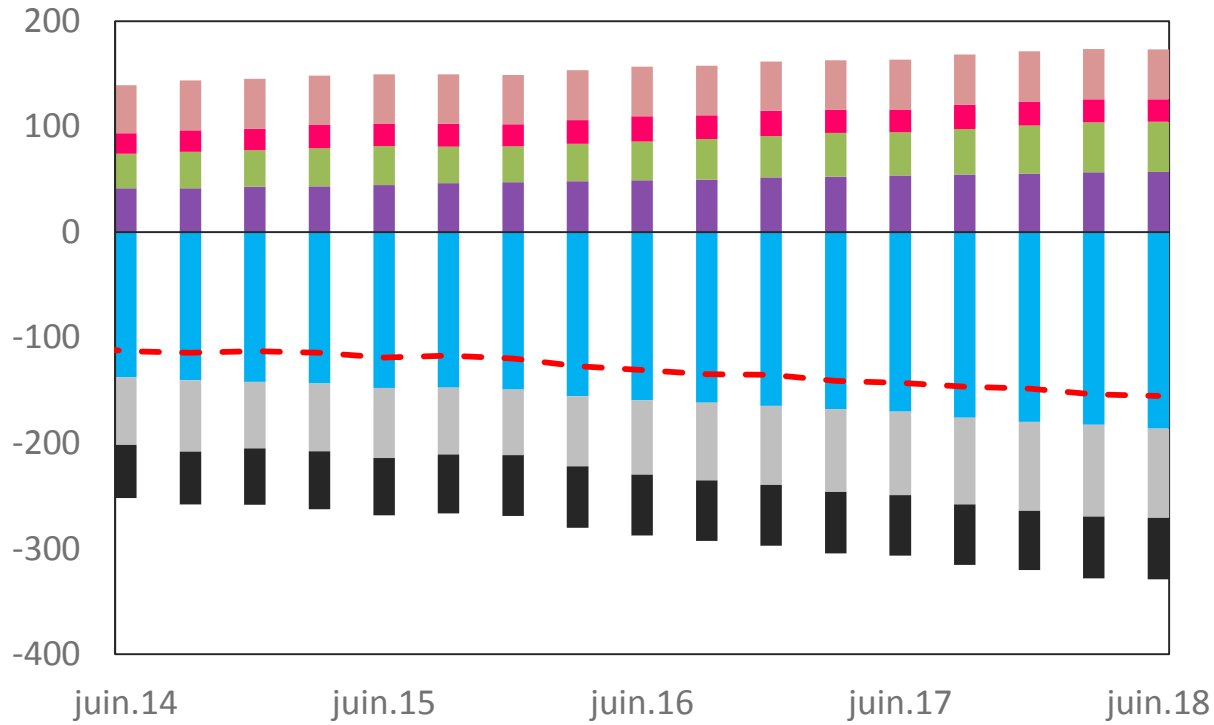
Source: Banco de la República

— Billions of U.S. dollars — Percentage of GDP (Right axis)

# Continued access to external financing and exchange rate flexibility, helped to cushion the effects of negative external shocks.

## International investment position

(Billions of U.S. dollars)

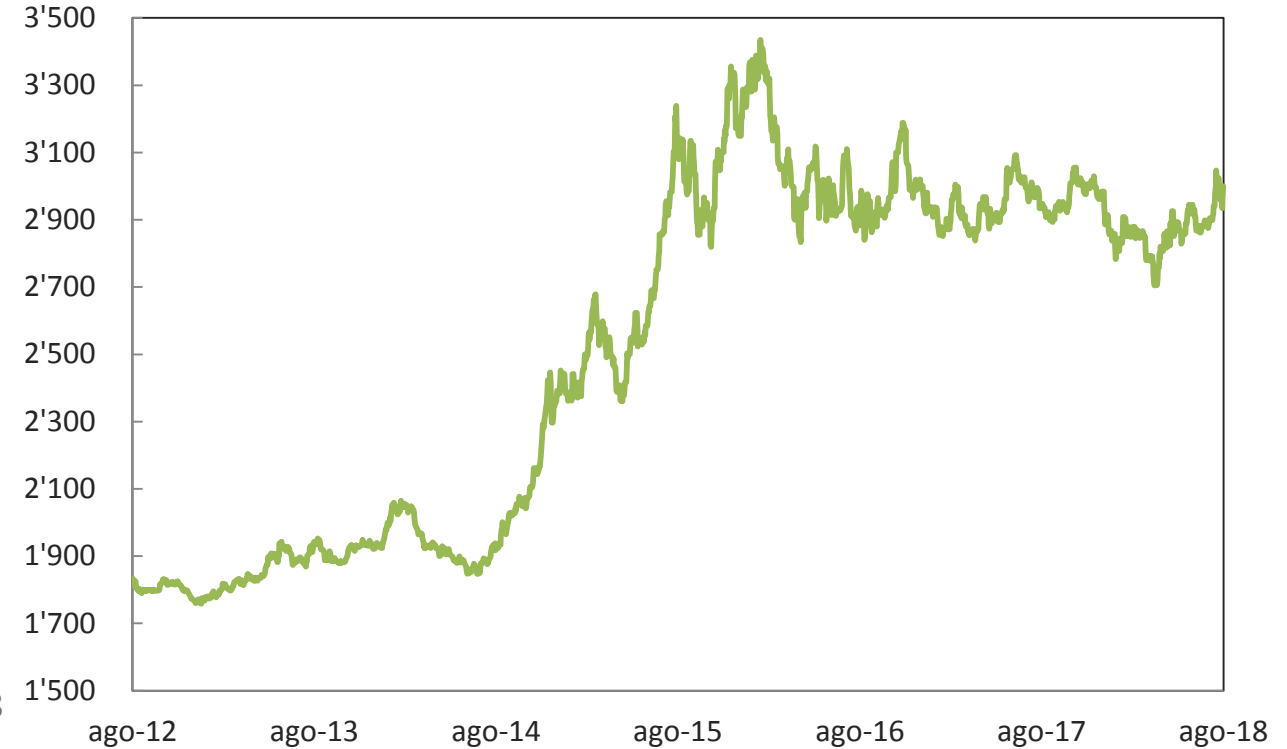


- Direct investment (Assets)
- Other investment (Assets)
- Portfolio (Assets)
- Reserve assets
- Direct investment (liabilities)
- Portfolio investment (liabilities)
- Other investment (liabilities)
- - - Net IIP

Source: Banco de la República

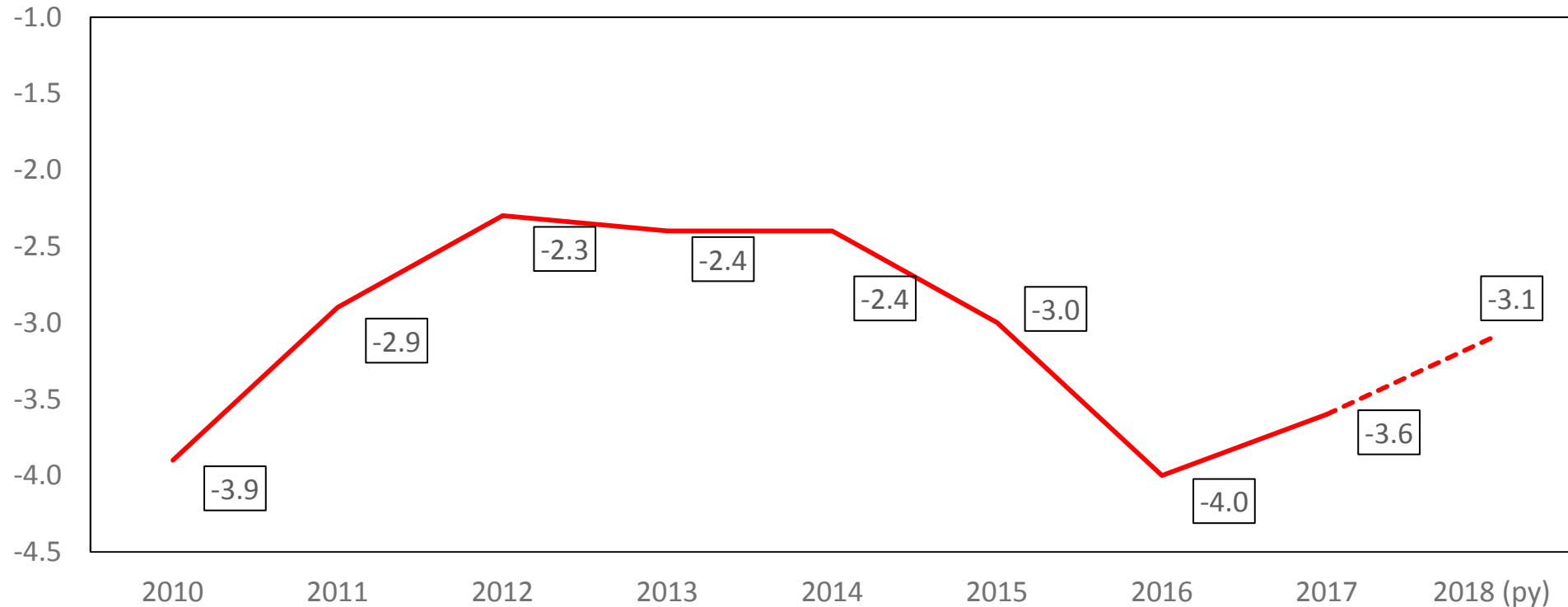
## Nominal Exchange Rate

(COP/USD)



The shrinking of oil revenues deteriorated the government's balance. Two consecutive tax reforms (2014-16) and expenditure austerity allowed the Central Government to reduce its negative balance. The forthcoming tax reform will continue strengthening its fiscal position.

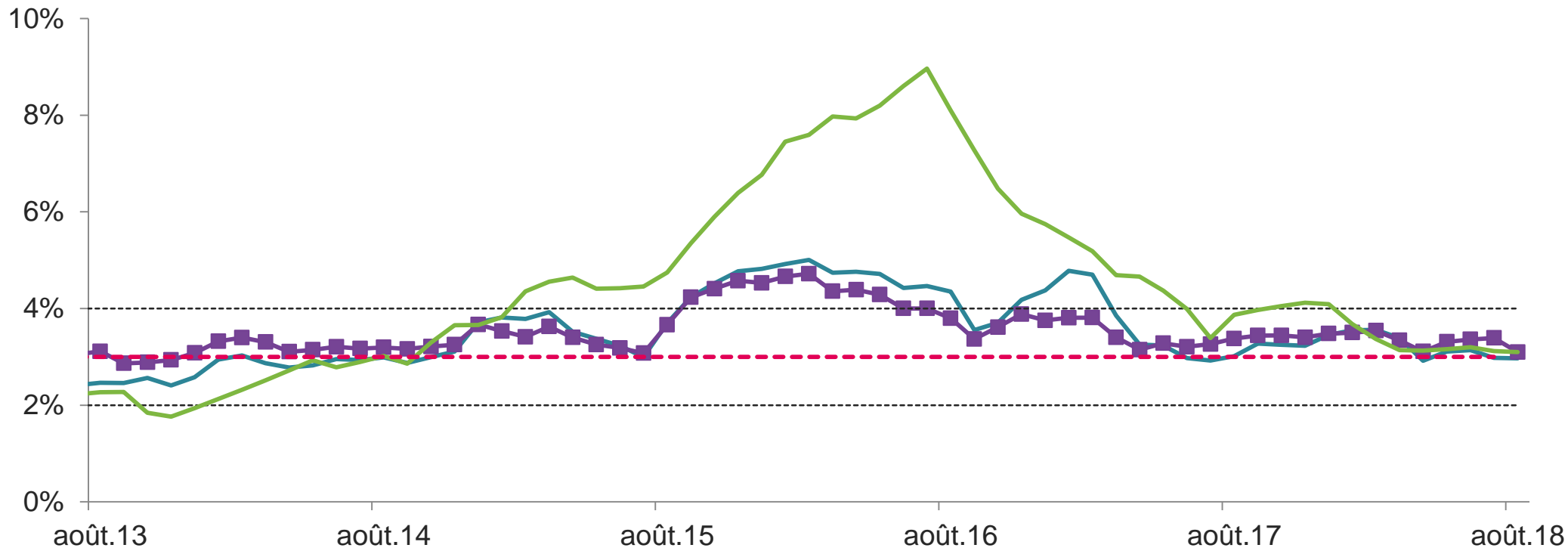
**National Government balance**  
(Percentage of PIB)



Due to exchange rate pass-through and climate factors, consumer's inflation accelerated. However, most recently both inflation and its expectations have been converging to the 3.0% target.

### Inflation Rate and Inflation Expectations Implicit in Government Bonds (TES of 2 and 5 years)

(Percentage)



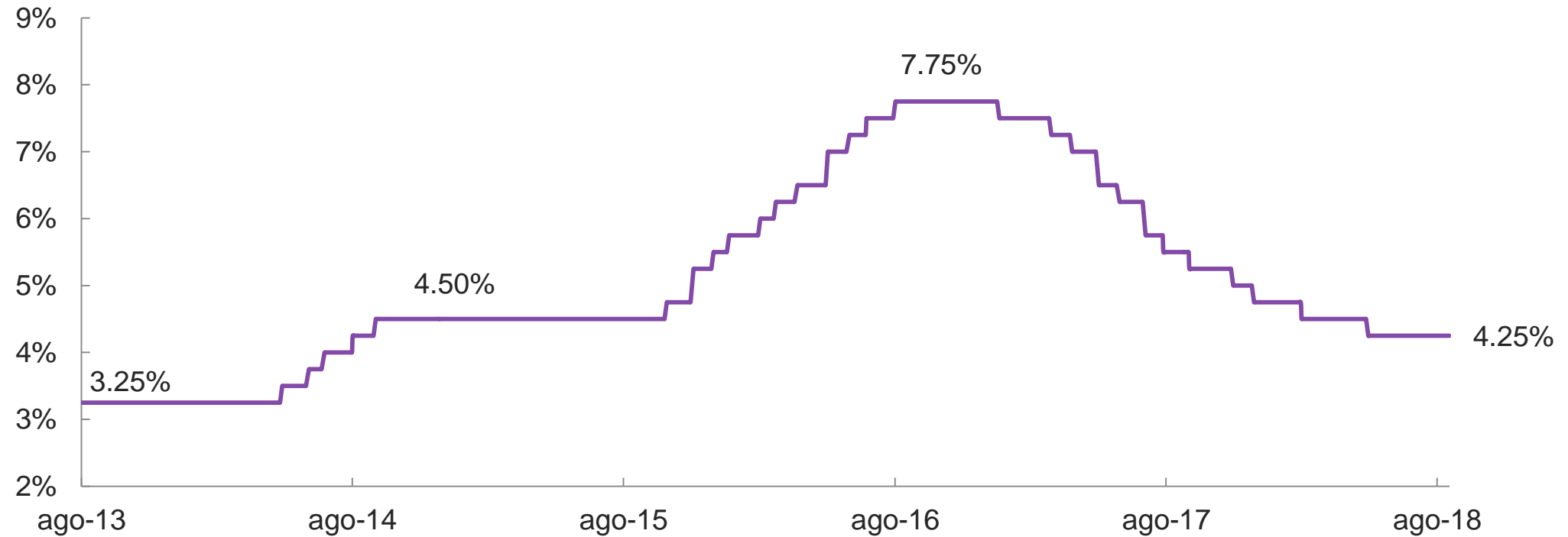
Source Fuente: DANE. ; Calculations by Banco de la República.

— 2 years    —■ 5 years    — Total Inflation    - - - Inflation target

The credibility of the monetary regime allowed a gradual response. First, a delayed tightening, just enough to tame rising inflation expectations. Then a monetary stimulus, to encourage economic recovery.

## Policy Interest Rate

(Percentage)





# The labor market has been resilient to the economic slowdown. Rural labor explains part of these developments.

## Unemployment Rate

(seasonally adjusted quarterly moving average)

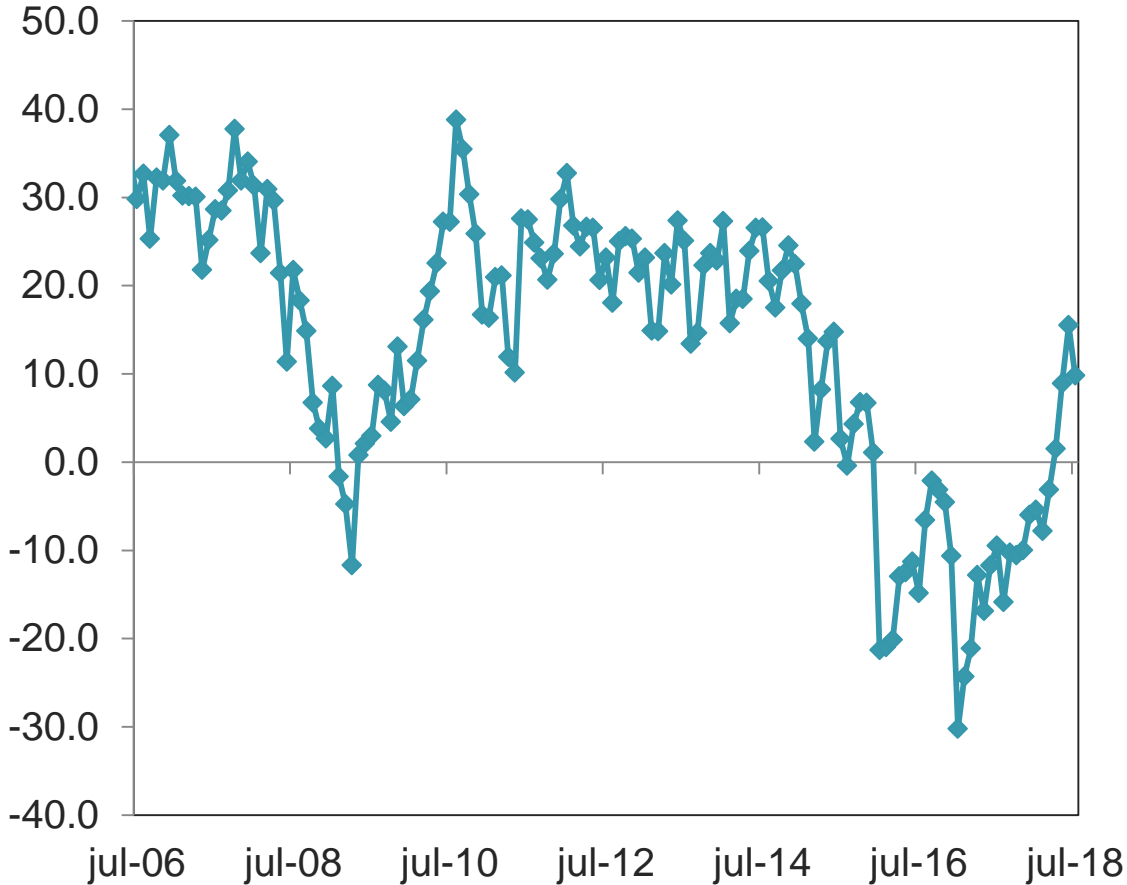


Source: GEIH – DANE.

# Progress in the economic adjustment has contributed to the improvement of consumers and entrepreneurs' confidence.

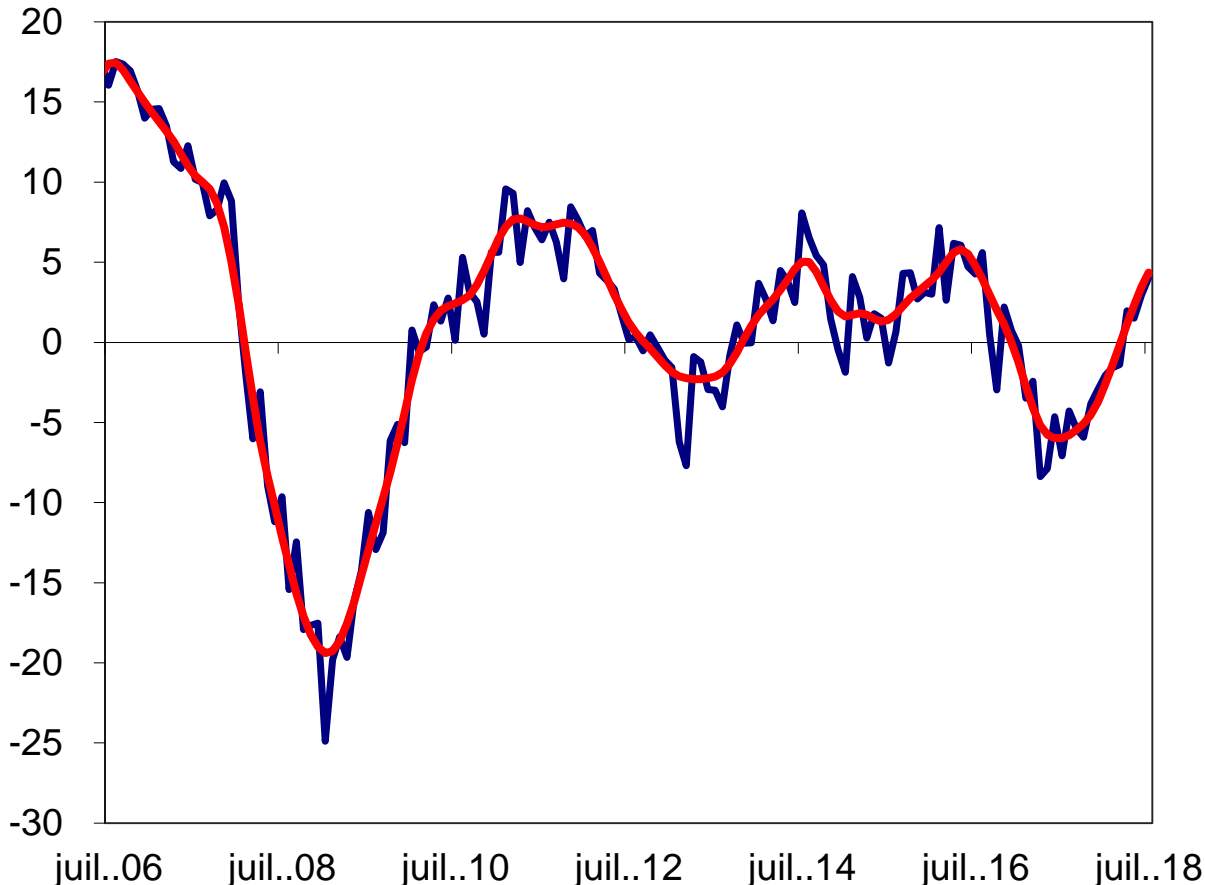
### Consumer Confidence Index

(monthly indicator)



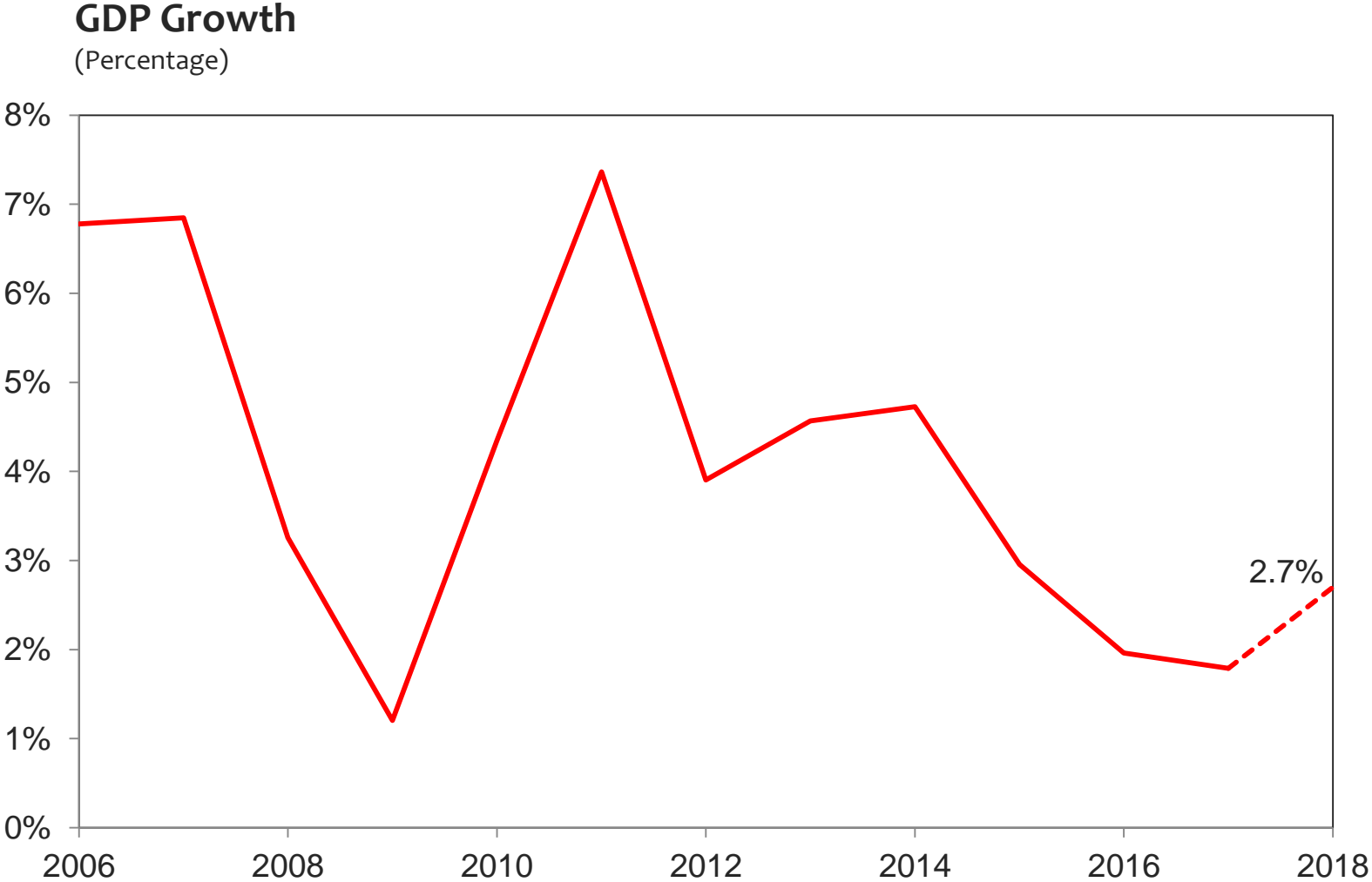
### Manufacturing industries Confidence Index

(Seasonal adjustment)



Source: Fedesarrollo.

# Economic activity is starting to pick up. Nonetheless, current GDP growth continues to be below potential, estimated at an annual rate of 3,5%



Source: DANE and del Banco de la República.

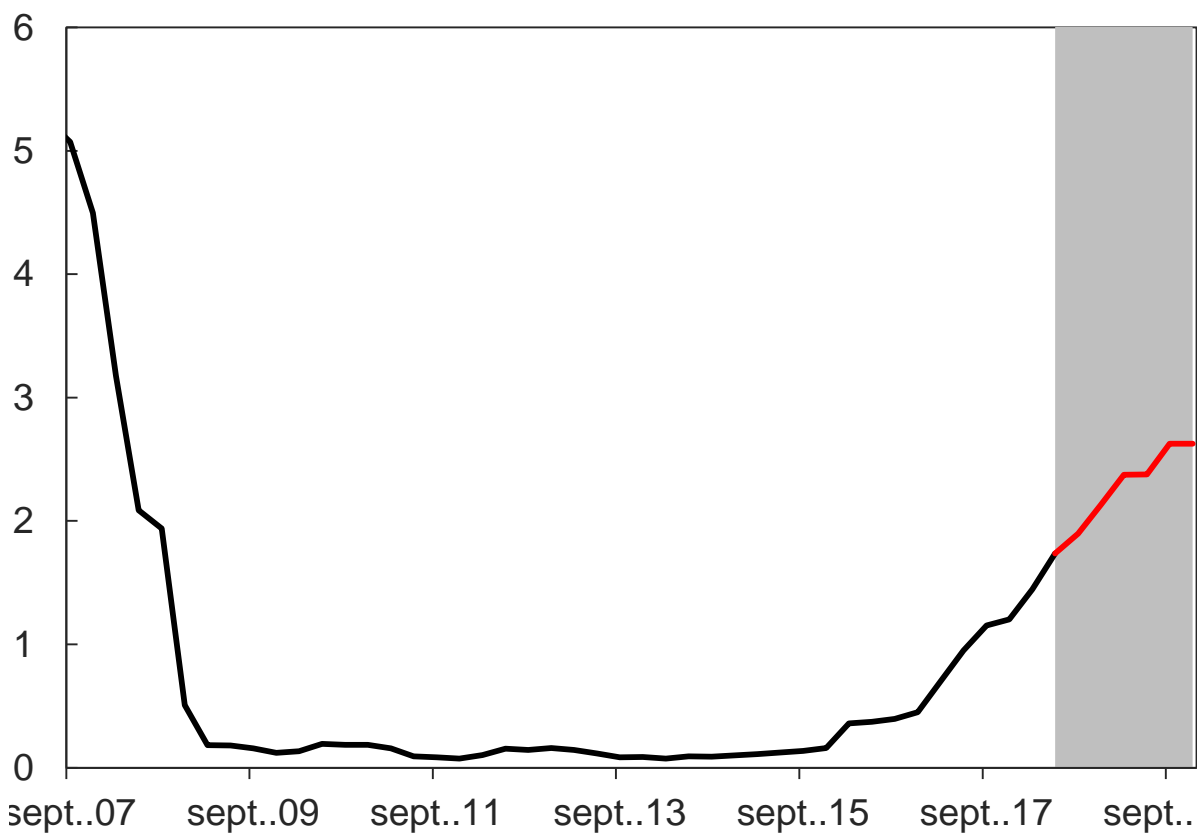
# **Macroeconomic risks and Policy challenges**

# Current macroeconomic risks arise from changes in external conditions

- **Financial**
  - Monetary policy normalization in the US
  - Increases in risk aversion
  - Dollar appreciation
- **Non-financial**
  - Fall in commodity prices
  - The resurgence of protectionism

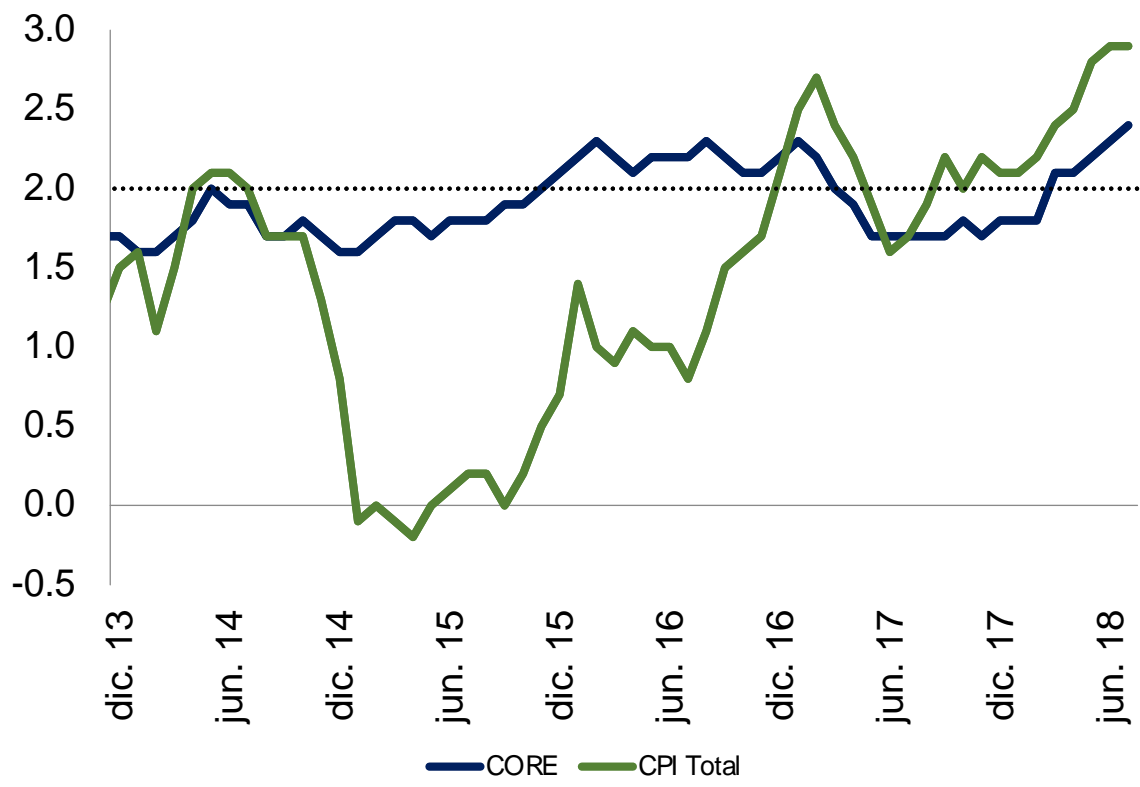
# The Federal Reserve continues tightening its monetary policy, as core and total inflation are rising and unemployment registers historical low levels

**Monetary policy rate (Fed )**  
**Average of quarterly effective rate**  
 (Percentage)



Source: Bloomberg and Banco de la República.

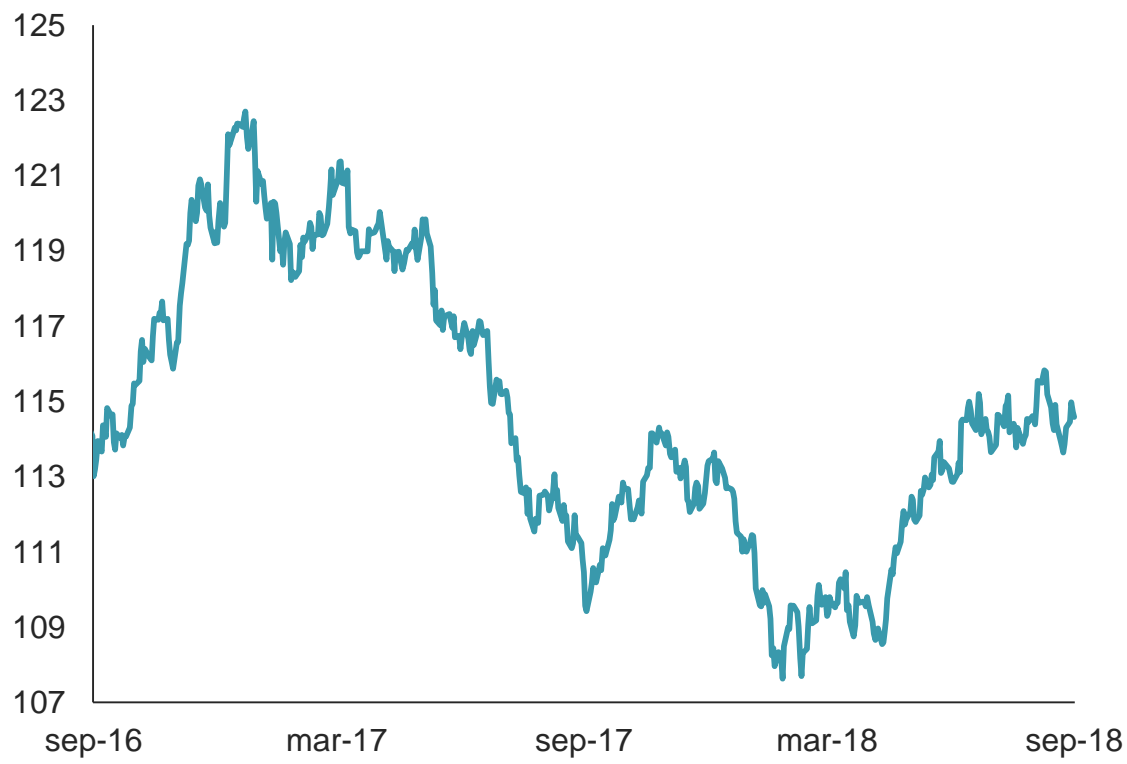
**Annual inflation rate**  
 (Percentage)



Source: Bloomberg

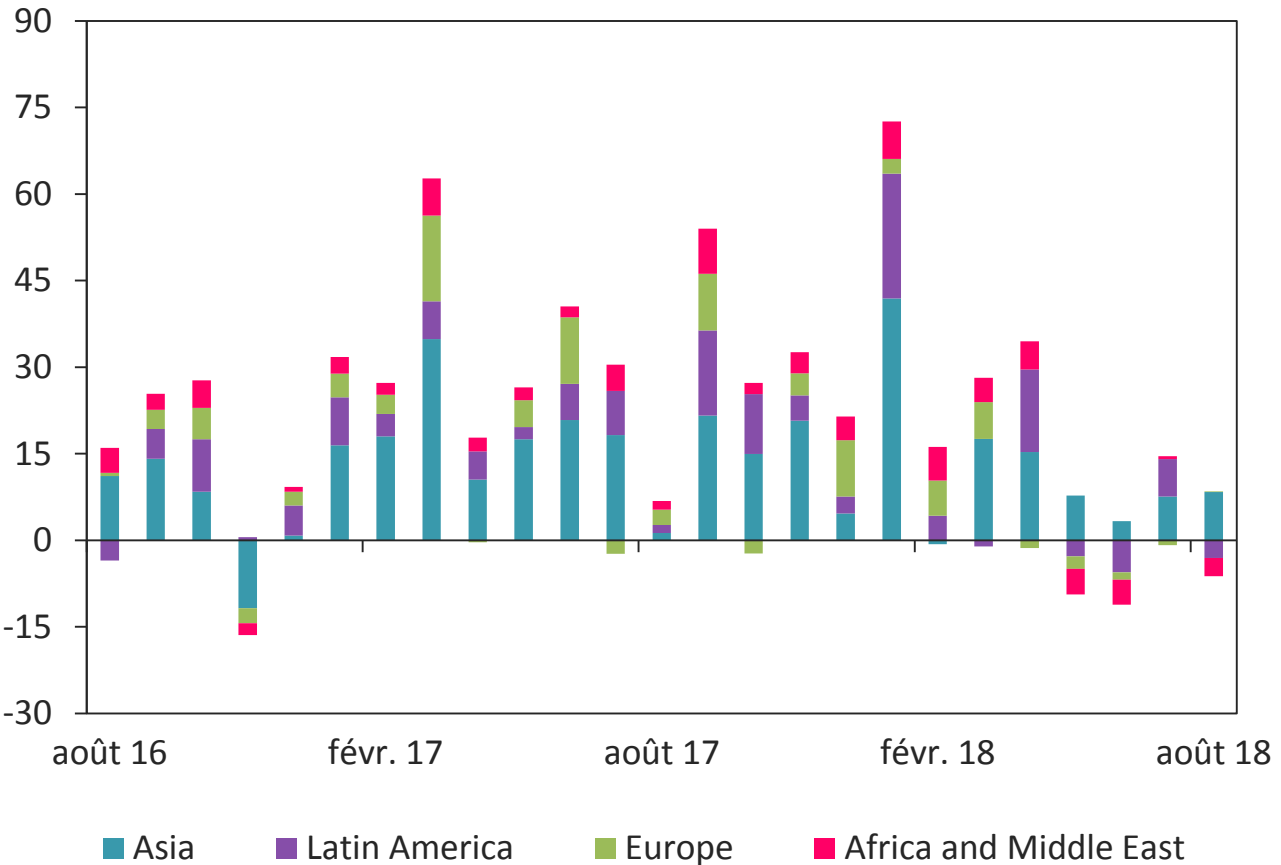
# Higher interest rates and dollar appreciation could generate a reversal of capital flows and an increase on the cost of financing for emerging economies.

**Dollar index**  
(2014=100. Weighted by international trade)



Source: Bloomberg and Banco de la República.

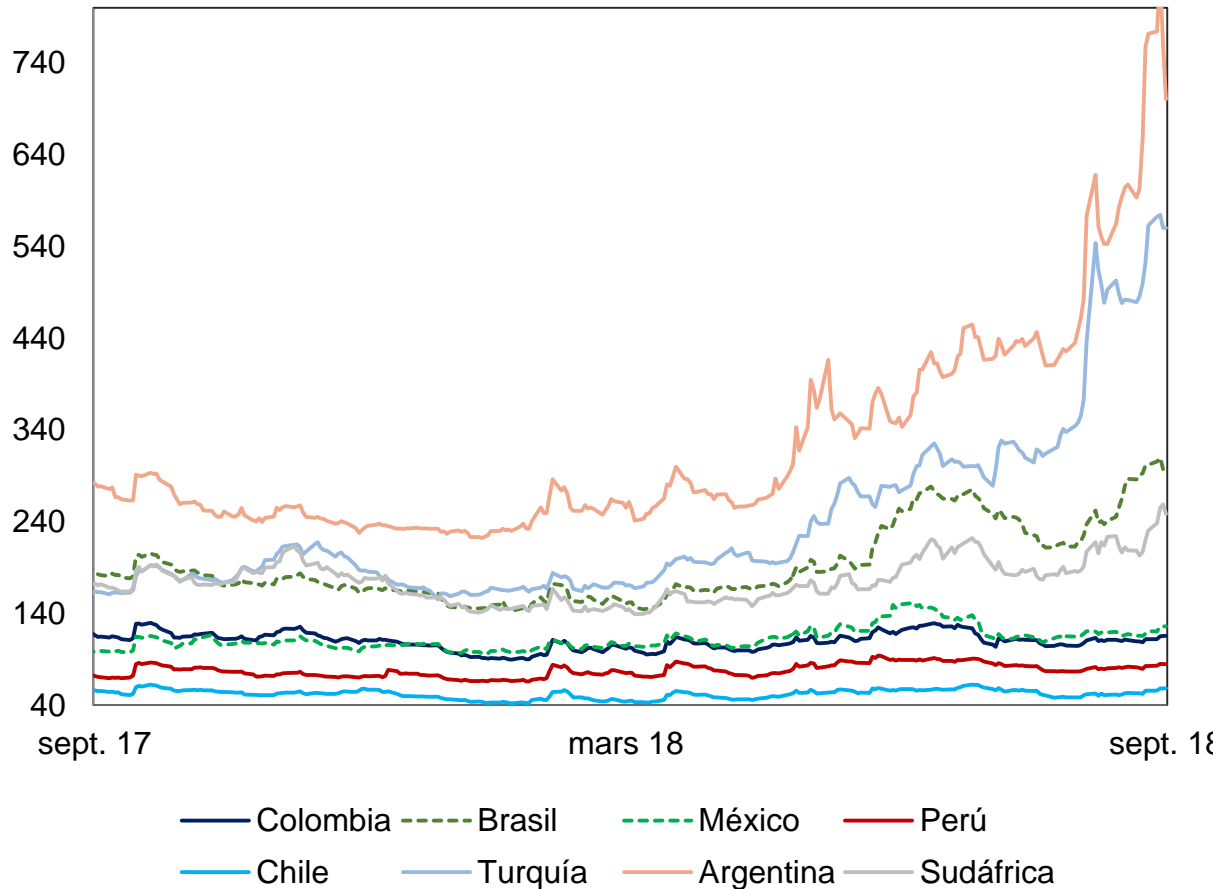
**Foreign Investment Flows**  
Emerging markets (Billions of U.S. dollars)



Source: IIF.

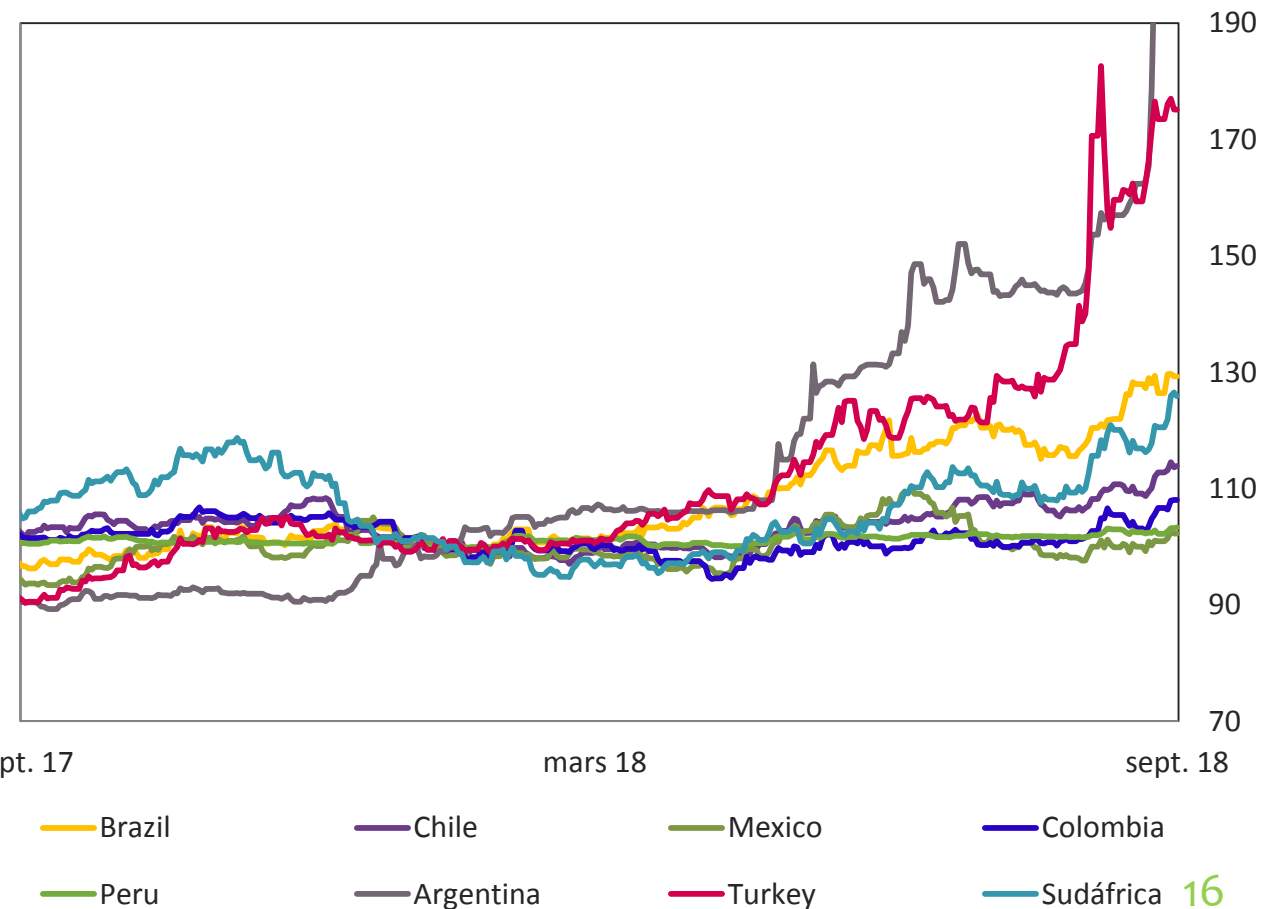
Volatility of the international financial markets have affected some emerging economies. Colombia has weathered this situation smoothly until now.

### CDS Emerging Markets



### Nominal exchange rate index

(Jan/2018=100) argentina





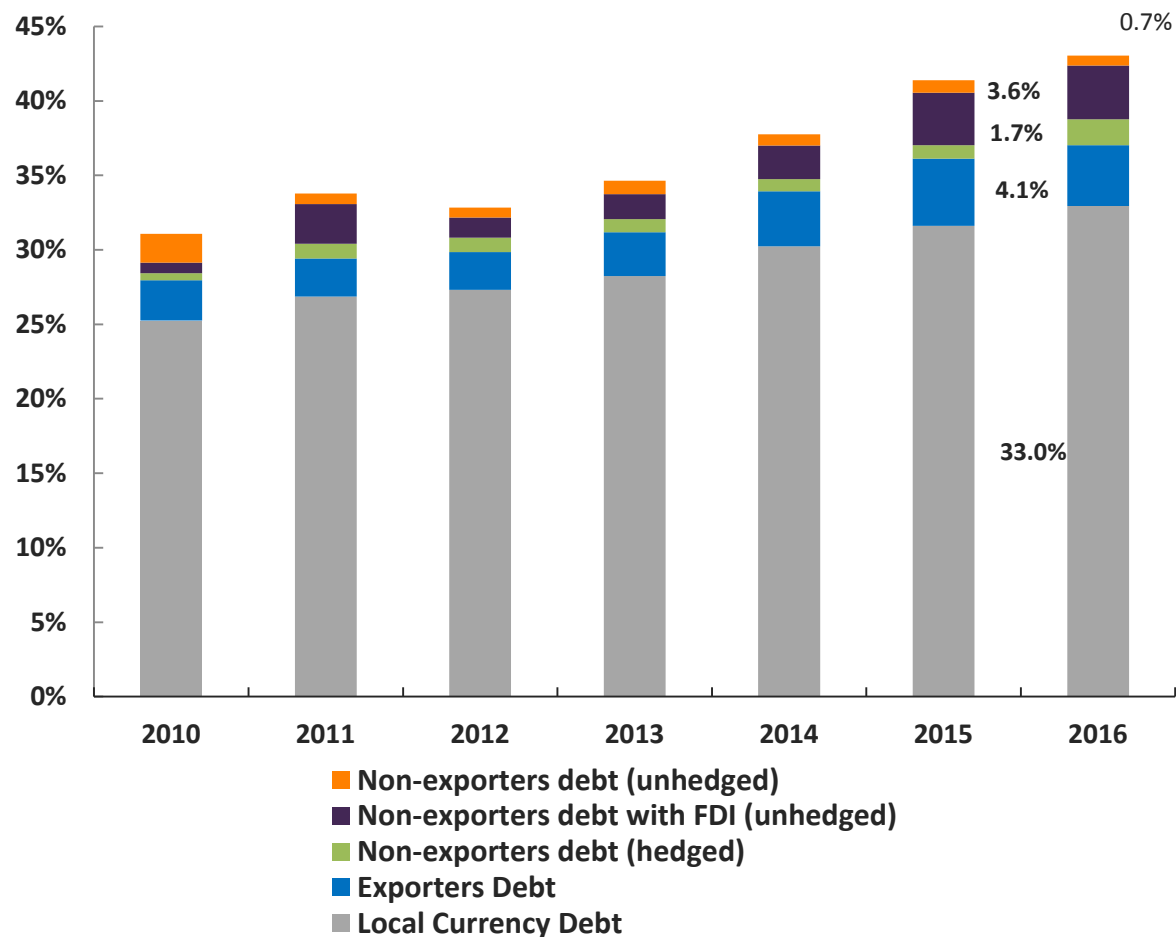
# Policy challenges

- External Risks and Policy Challenges
  - First line of defense: Exchange rate flexibility. But there are preconditions :
    - Limited currency mismatches (but high share of foreign investors in the public bonds market)
    - A credible monetary regime
    - Sound and robust financial sector
    - Sound fiscal policy
  - Second line of defense: External buffers (international reserves; Flexible credit line)

# Limited currency mismatches

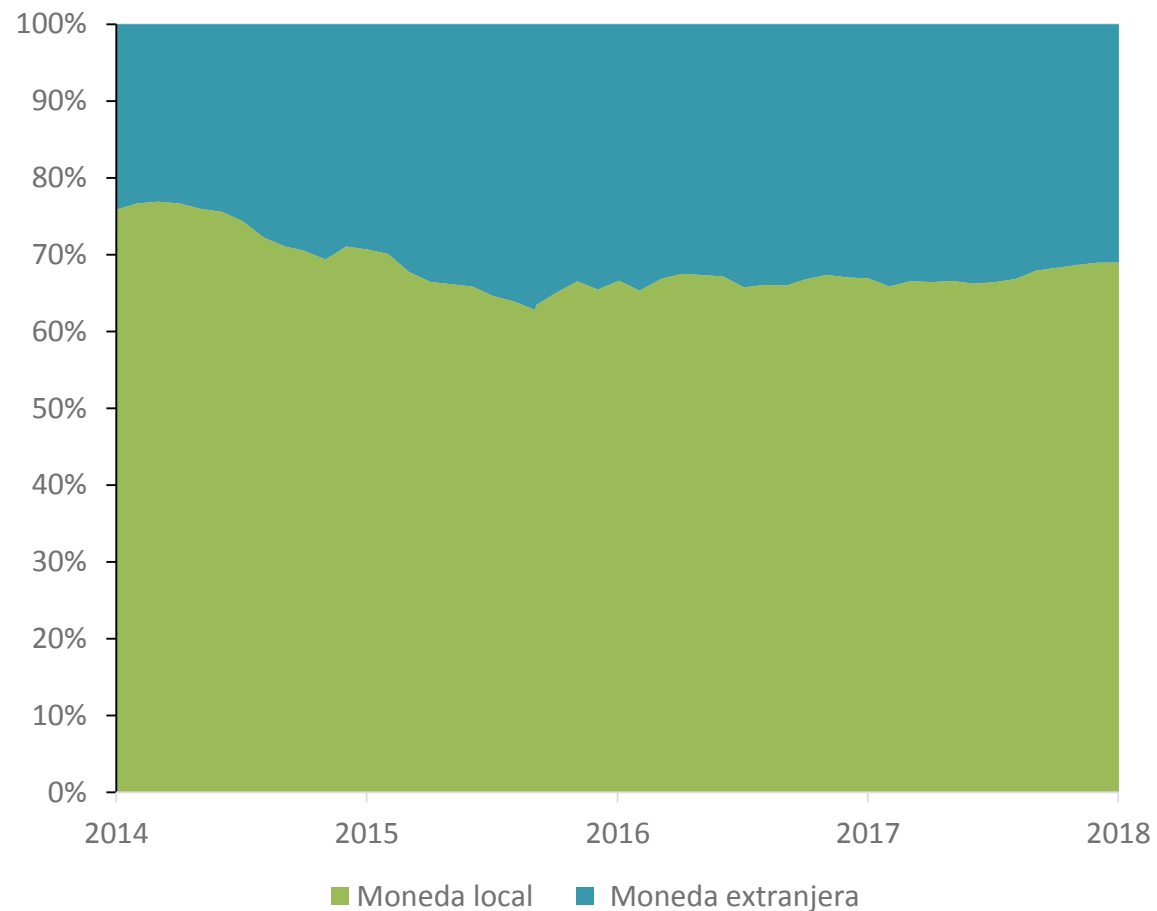
## Debt of the Non-financial Corporate Sector

(Percentage of GDP)



## Central Government Gross debt (local vs. foreign currency)

(Percentage)

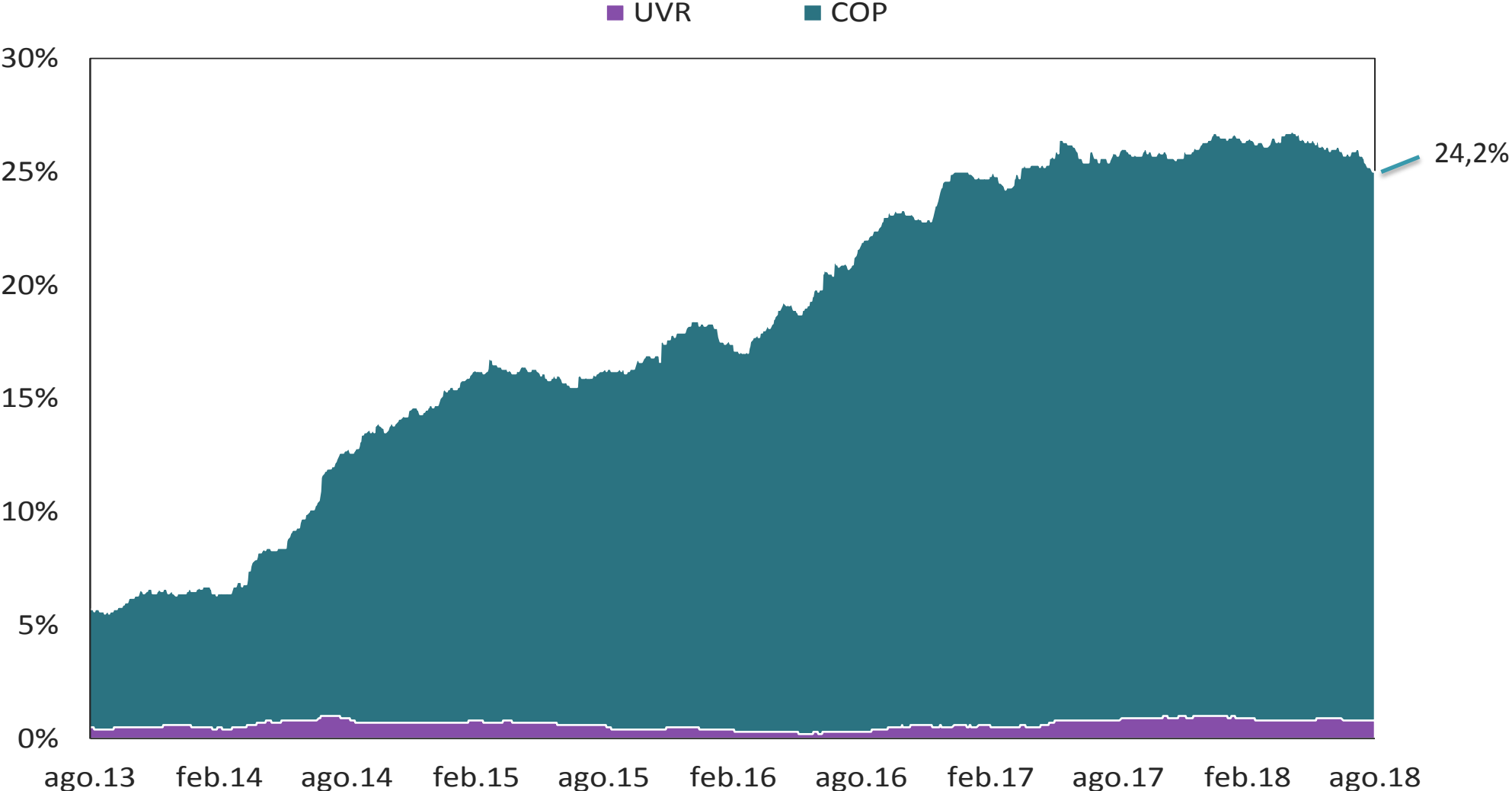


Source: Source: Ministry of Finance

**\*Updated results (2017) show low currency mismatches. The exposure of financial sector is limited.**

However, nearly 25% of public bonds are in the hands of foreign investors.

Share of Foreign investors in the public bonds market

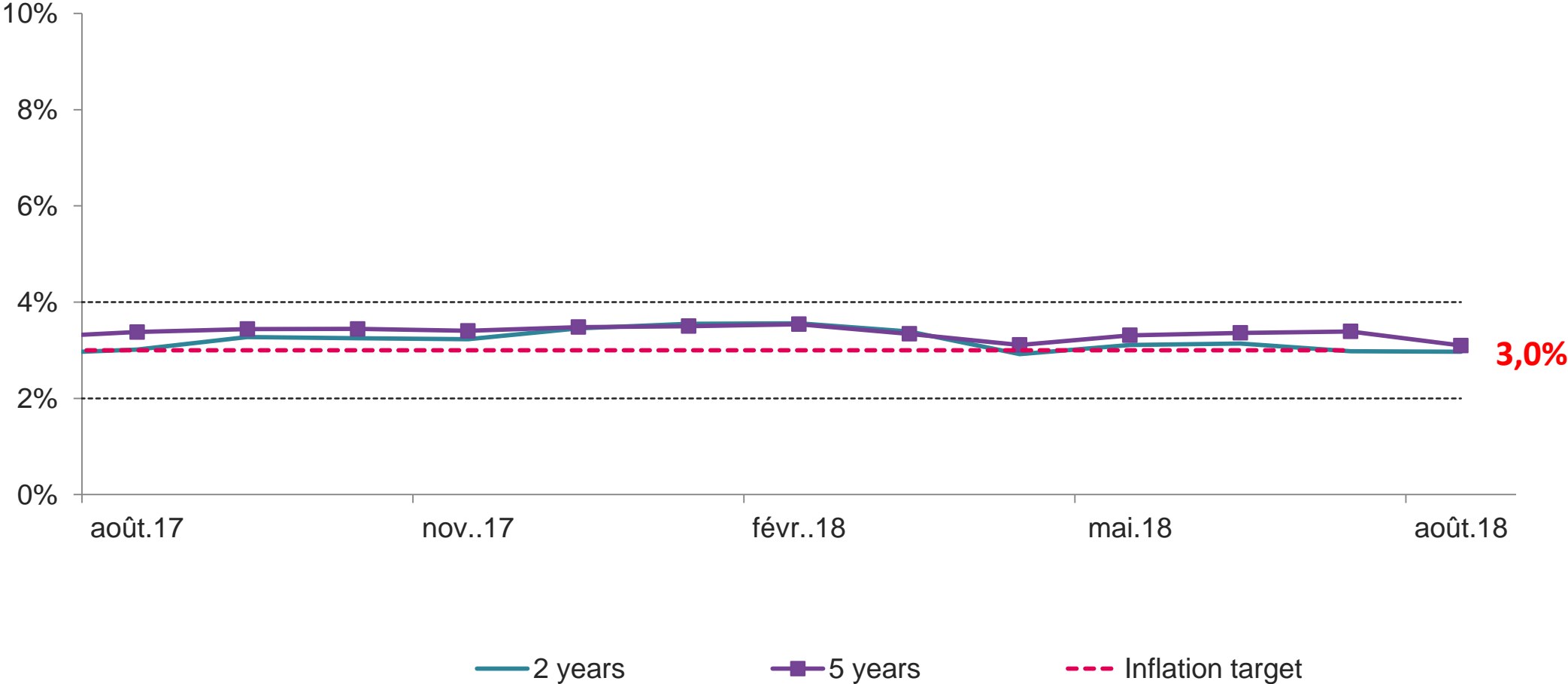


Fuente: Banco de la República – DODM.

# Inflation expectations are well anchored at the 3% target

## Expectations Implicit in Government Bonds (TES of 2 and 5 years)

(Percentage)

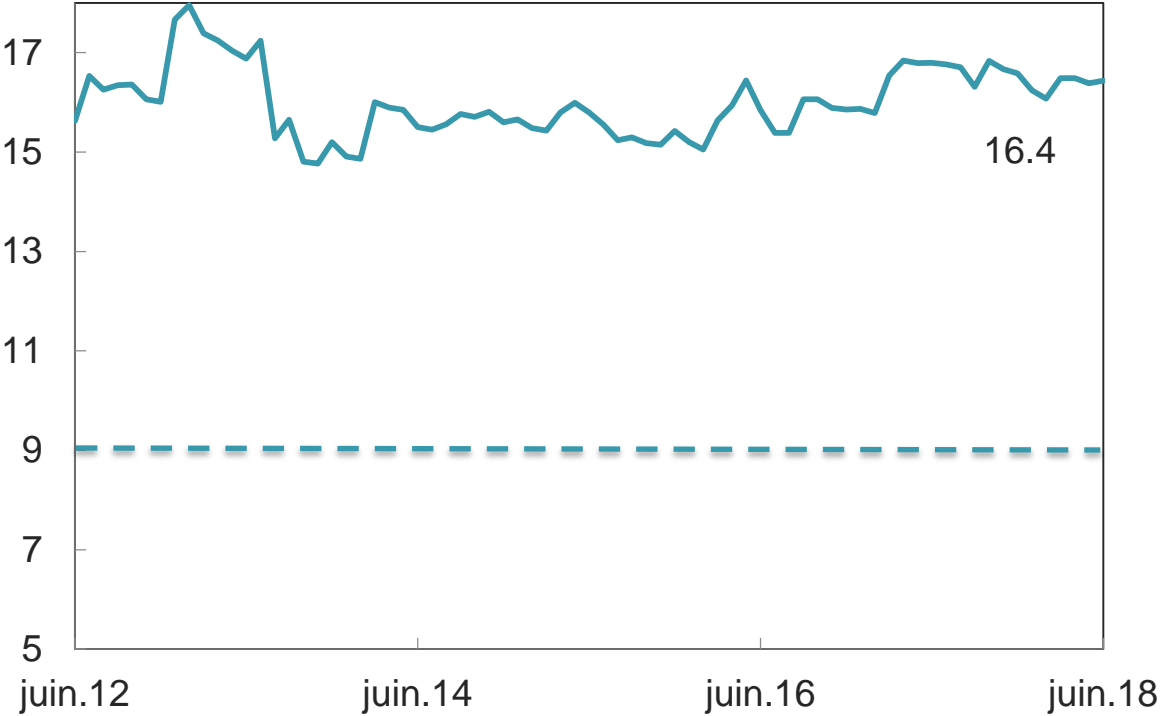


Source Fuente: Banco de la República.

# Solid liquidity and solvency indicators of the banking system

## Total Solvency Ratio (Tier II)

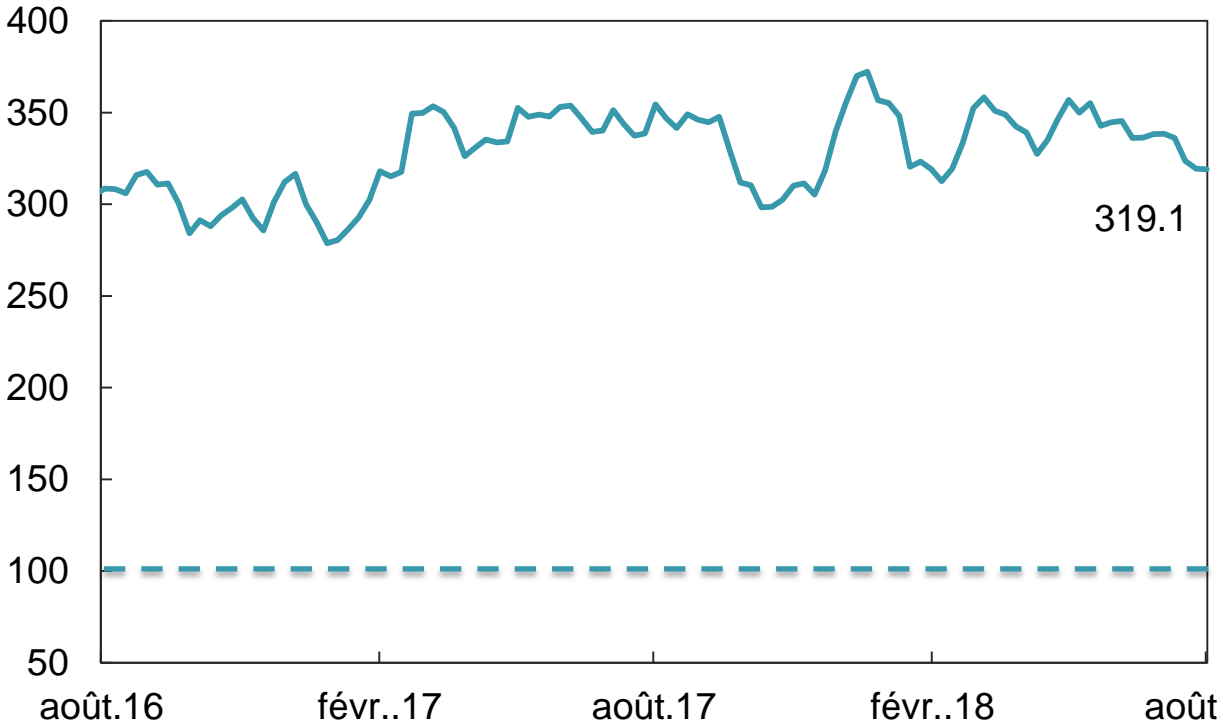
(Percentage)



Total Solvency Ratio = Technical capital / weighted assets + (11.11)\*Market Risk

## Liquidity Coverage Ratio (LCR)

(Percentage)

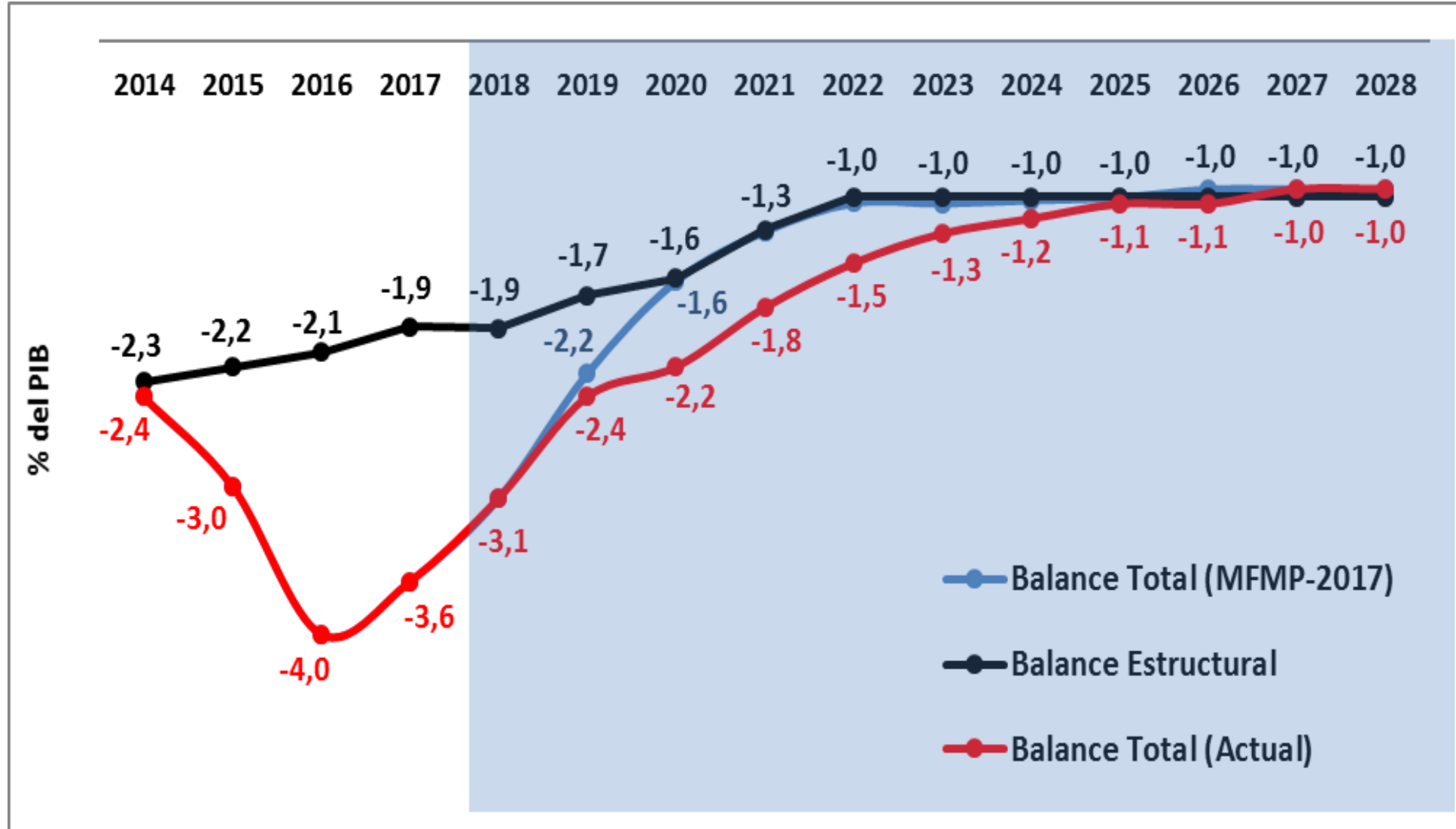


LCR= Liquid Assets / net cash outflows over the next 30 days

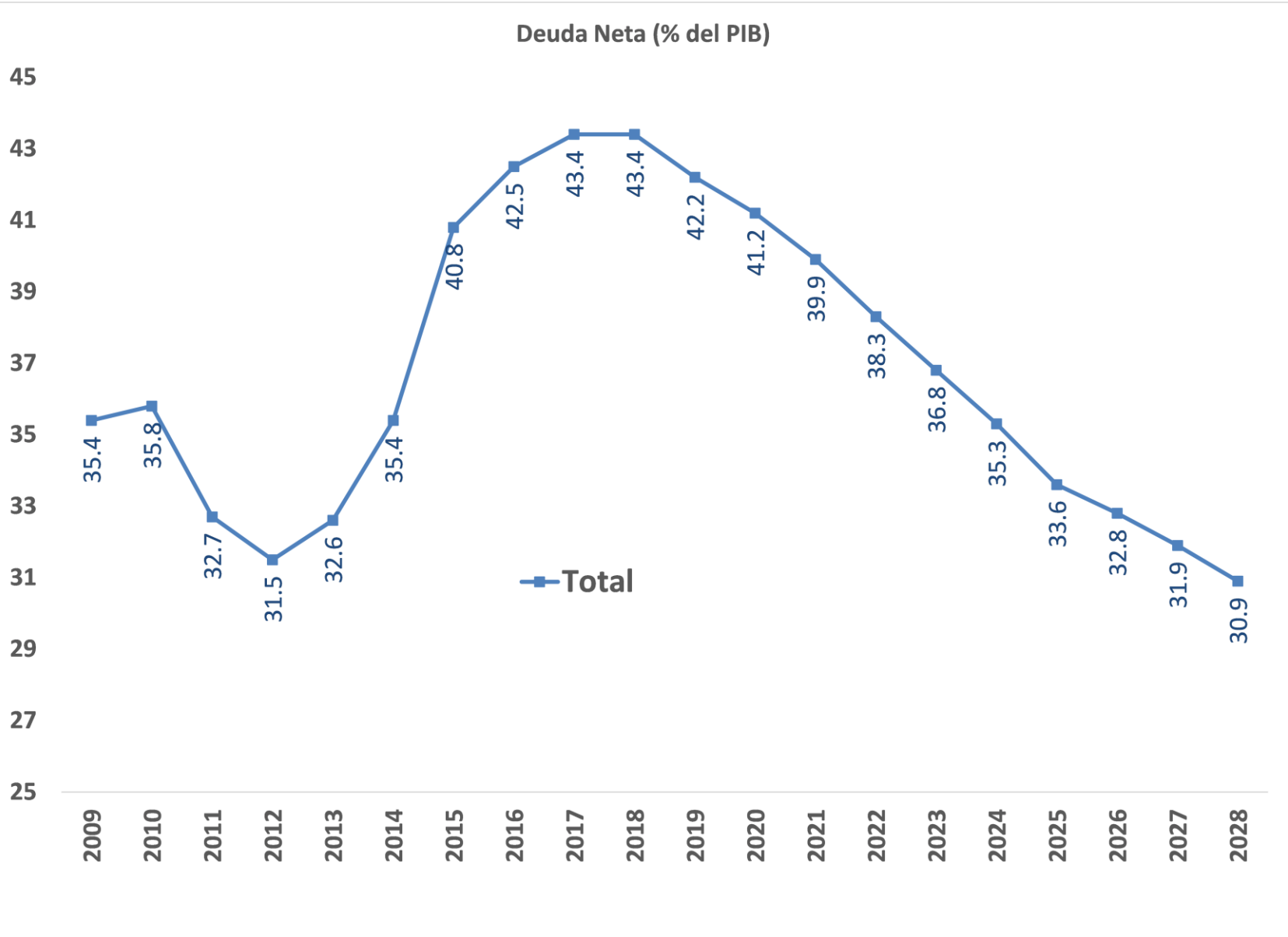
Source: Office of the Financial Superintendent of Colombia; Calculations by Banco de la República.

# The Government must continue narrowing its deficit, to comply with the fiscal rule as well as reducing its debt

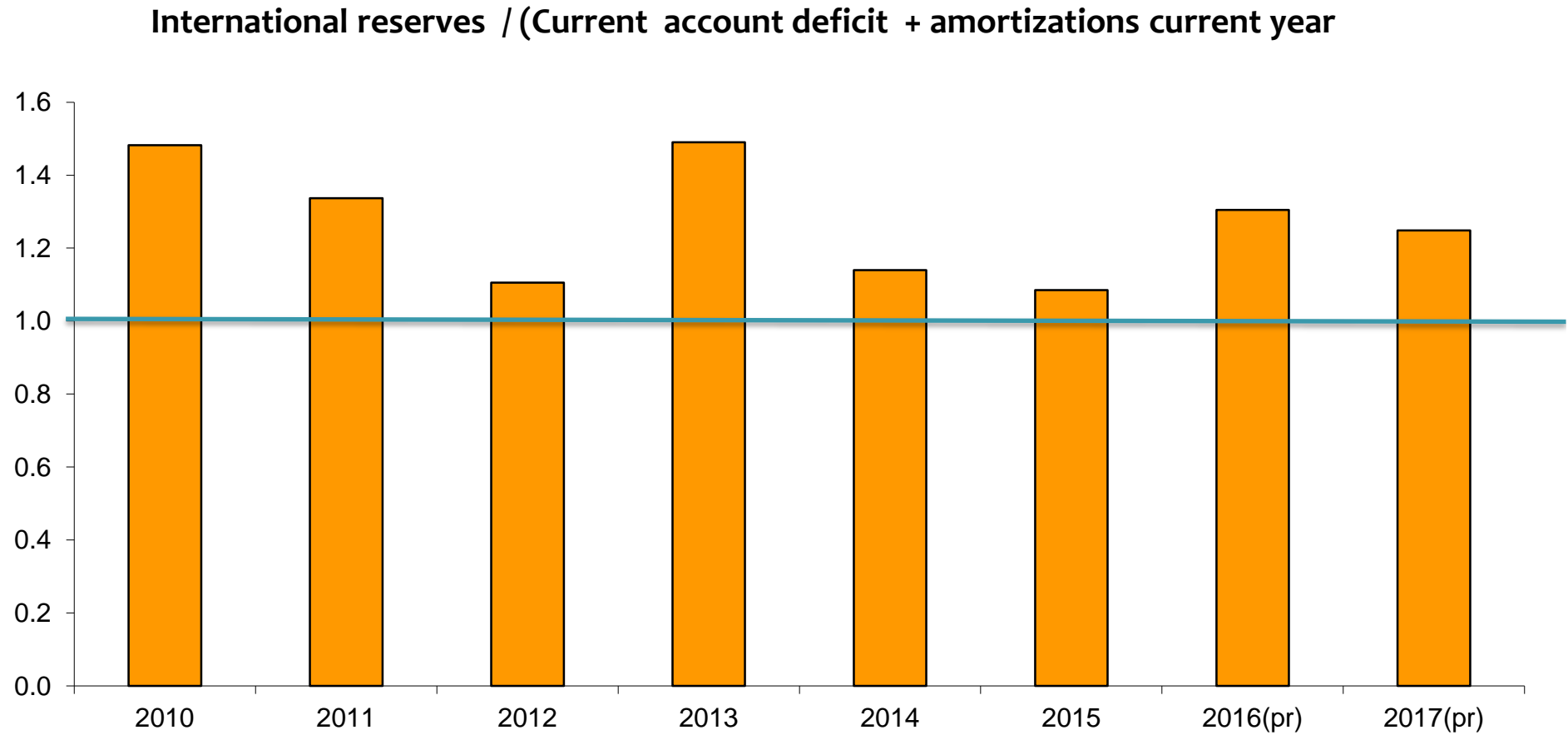
## Balance total y estructural del GNC



# Which will allow to reduce its total debt to safer levels.



An adequate level of international reserves provides a buffer against external shocks. The Flexible Credit Line (FCL) by the IMF has complemented the accumulation of international reserves.





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