MINISTERIO DE HACIENDA Y CRÉDITO PÚBLICO

Colombia's Economic Perspectives

Ministry of Finance and Public Credit

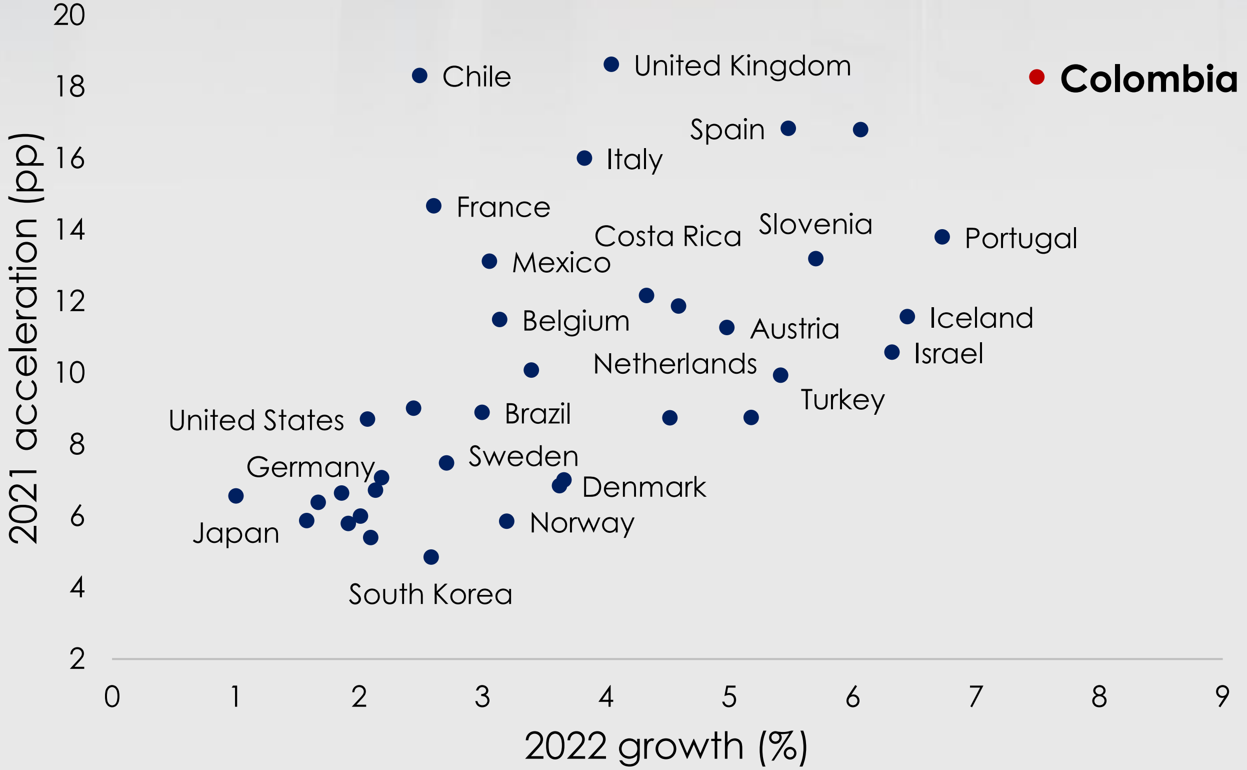
April 2023

1.

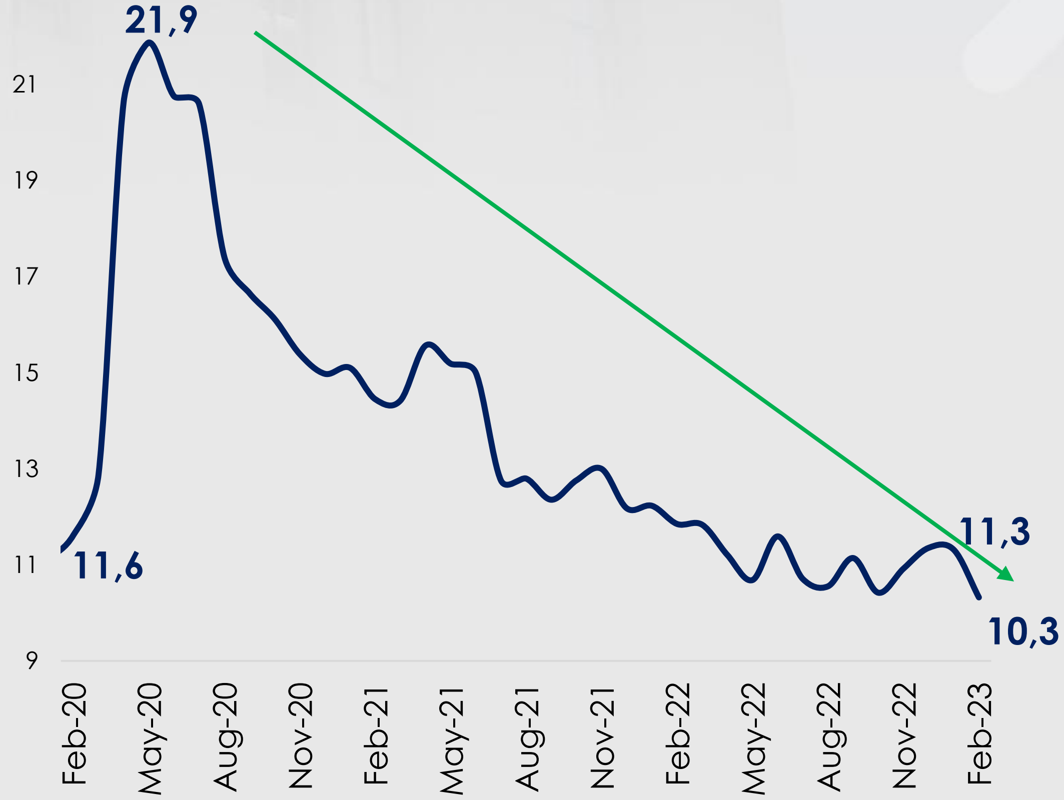
Macroeconomic outlook

In 2022, economic activity remained dynamic, contributing to a strong recovery of the labor market

2022 GDP growth vs 2021 GDP growth acceleration



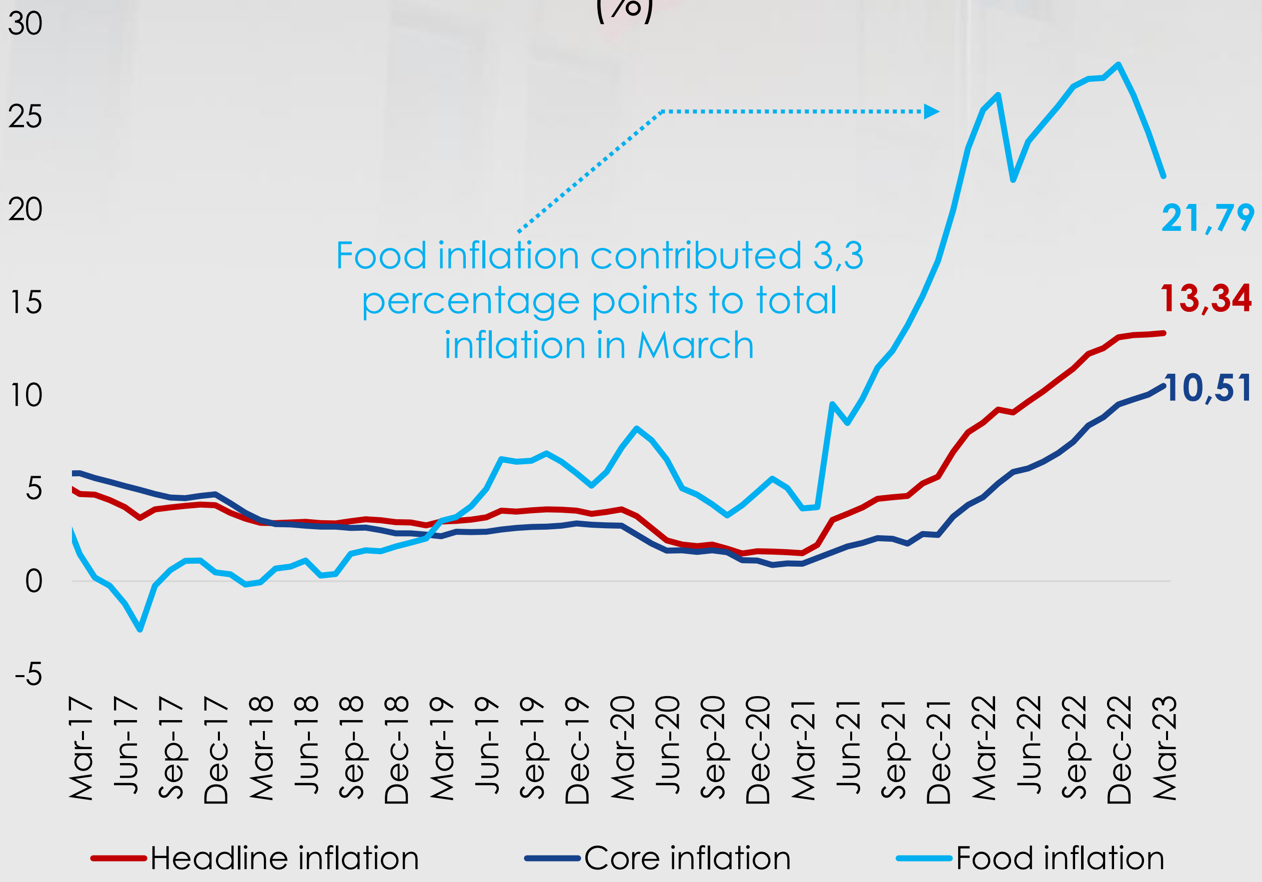
Unemployment rate
(National total, %)



Source: OECD & DANE. GDMP-MoF.

Inflation has registered a sustained acceleration, mainly explained by an increase in food prices. In response, the Central Bank began a process of monetary policy normalization, complemented by Government measures

Annual inflation
(%)



Sectoral measures and policies aimed at managing food prices: Temporary reduction of tariffs on agricultural inputs and goods used to produce goods consumed by vulnerable households.

Energy prices: agreements with firms from the energy sector, and the government of Colombia will implement the adjustment of energy prices from November 2022 onwards.

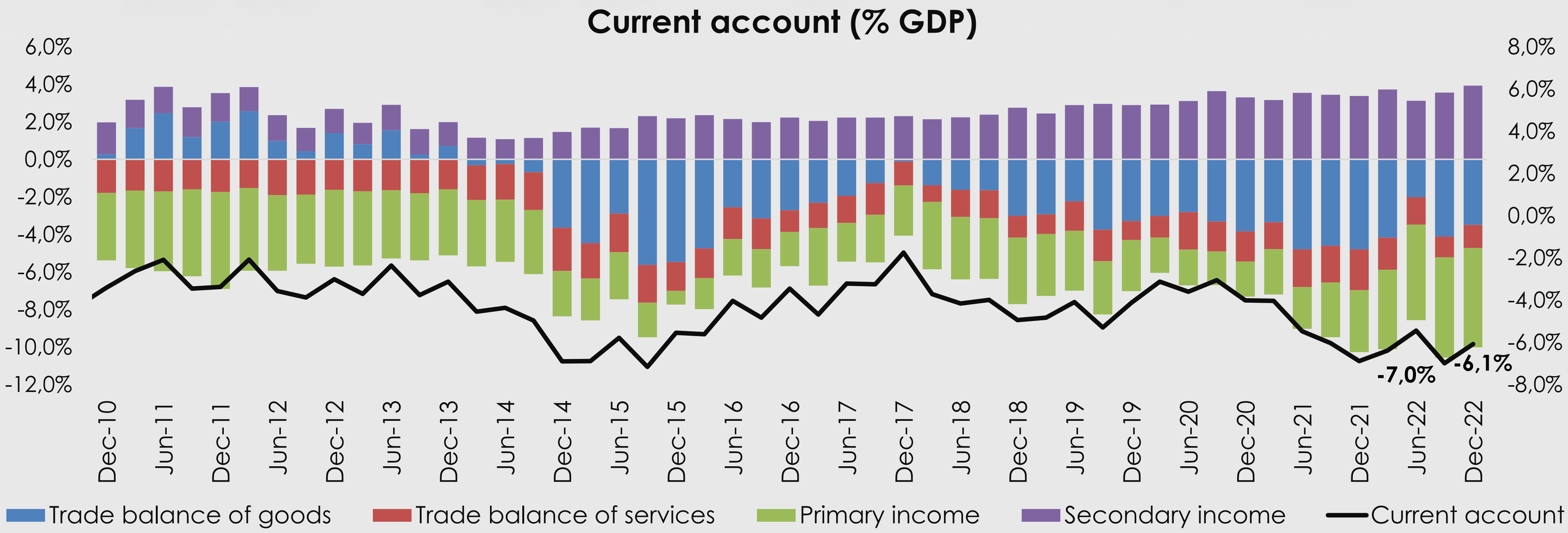
Fuel Price Stabilization Fund (FEPC): gradual increases in the prices of gasoline, which will avoid drastic increases in inflation. Likewise, the stabilization of diesel prices has been prioritized, given its potential impact on the costs of merchandise transportation.

Indexation: a broad set of goods and services have been deindexed from the minimum wage, mainly on the transportation, agricultural, education and housing sectors.

Source: Colombia's Central Bank. DANE.

The high current account deficit reflects the need for export diversification and an ambitious productive development policy

- In 2022 **the current deficit account widened due to higher international prices, the growth of the aggregate demand and an increase in the primary income deficit**.
- The increase in the current account deficit in 2022 was mitigated by the **strong growth in exports of goods (39.8%) and services (57.6%).**
- Goods exports were driven by **high commodity prices and non-mineral energy exports** reaching record highs. **Tourism services exports** grew by 127.5% and exceeded pre-pandemic levels.
- In the medium term, **the expected adjustment in the external deficit would be driven by non-traditional and services expor**t.

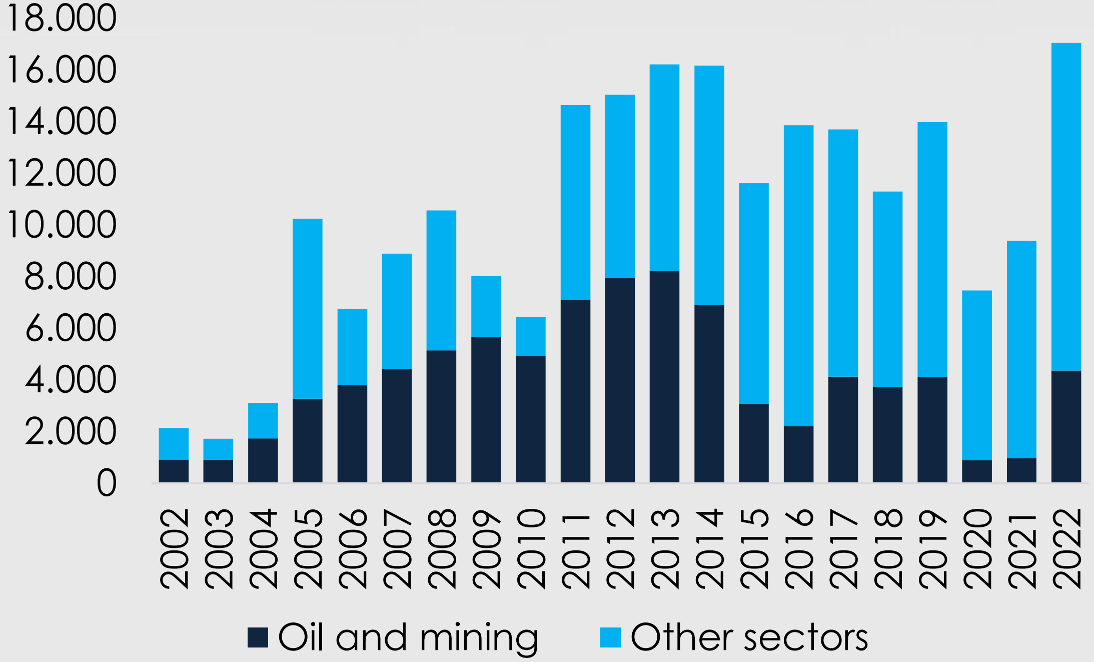


Source: Colombia´s Central Bank. **Primary income:** includes payments for returns on the factors used for production, such as capital and labor, and returns on financial assets. **Secondary income:** includes income and expenses from current transfers, which are not obtained in exchange for any product or factor of production.

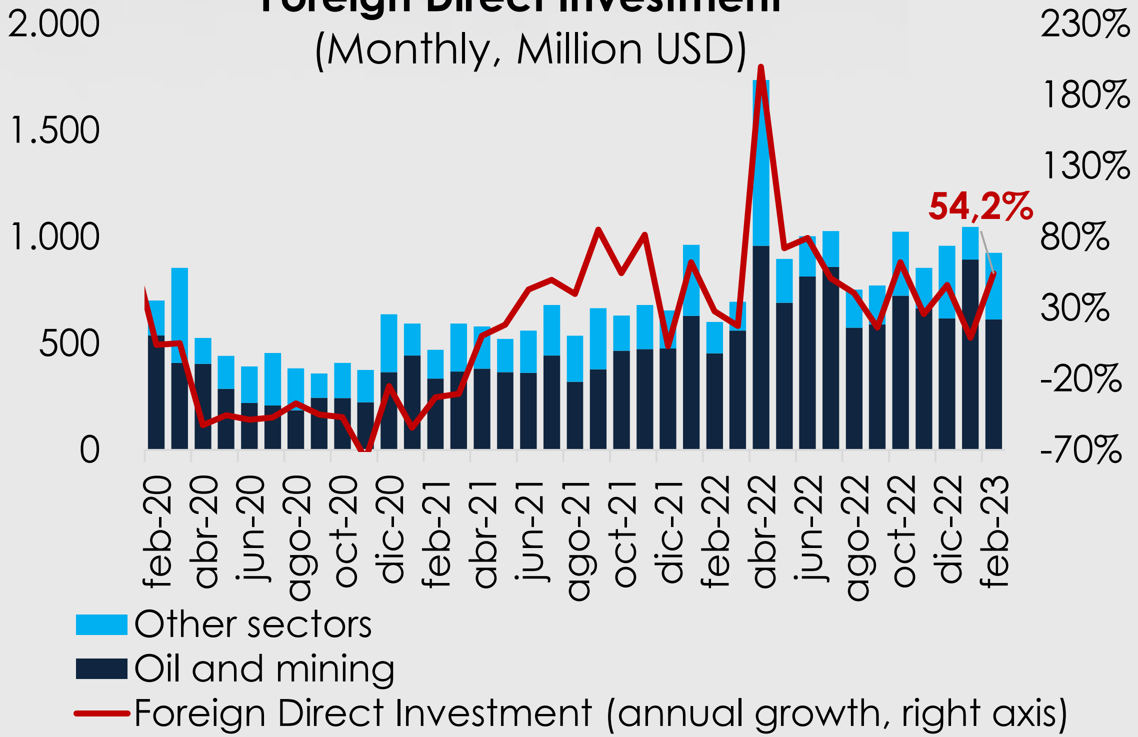
Foreign Direct Investment (FDI) has shown a remarkable behavior, and represents the main source of financing for the external deficit

- **FDI inflows** to the country (USD 17,048 million) reached the **highest level in history in 2022** and represented the main source of financing for the external deficit (accounting for 80%).
- **FDI to other sectors grew by 50,8%** and represented close to 75% of total FDI inflows, concentrated in **financial services and the transportation and commerce sectors.**
- So far in 2023, **FDI flows from the foreign exchange balance have remained dynamic.** In January, FDI showed an annual growth of 8,9%, while in February this growth was 54,2%.

Flows of foreign direct investment
(Annual, Million USD)

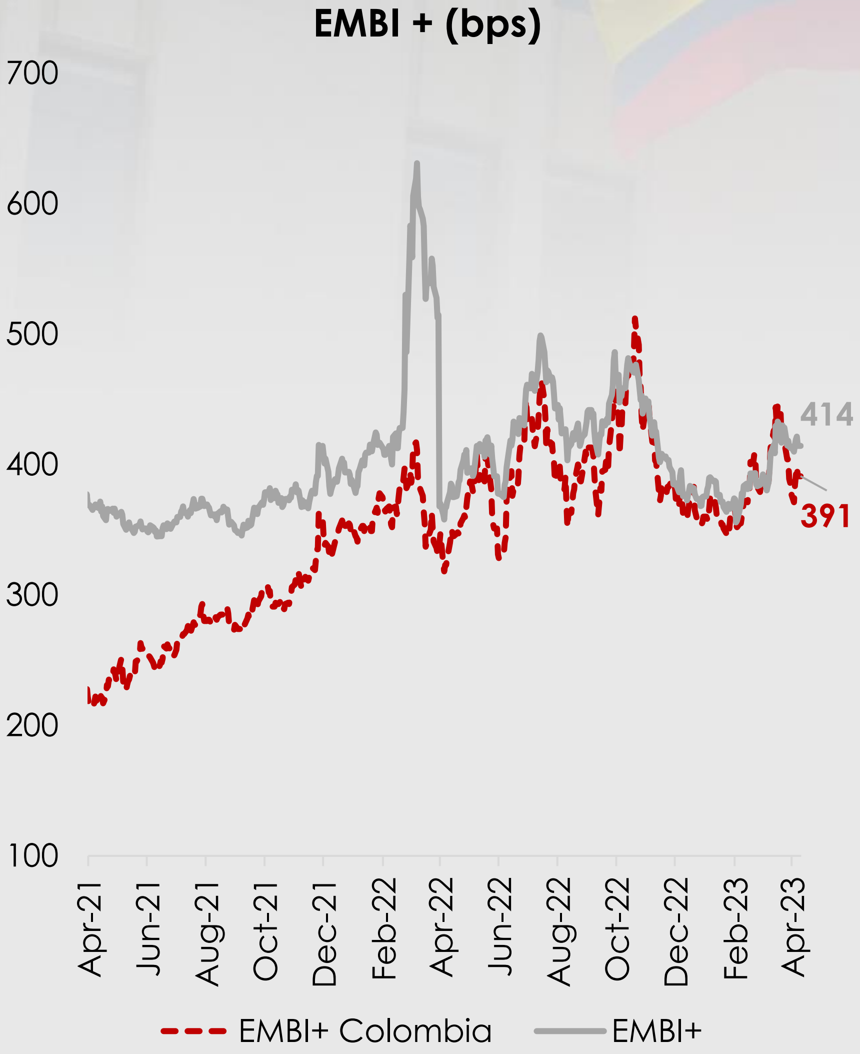


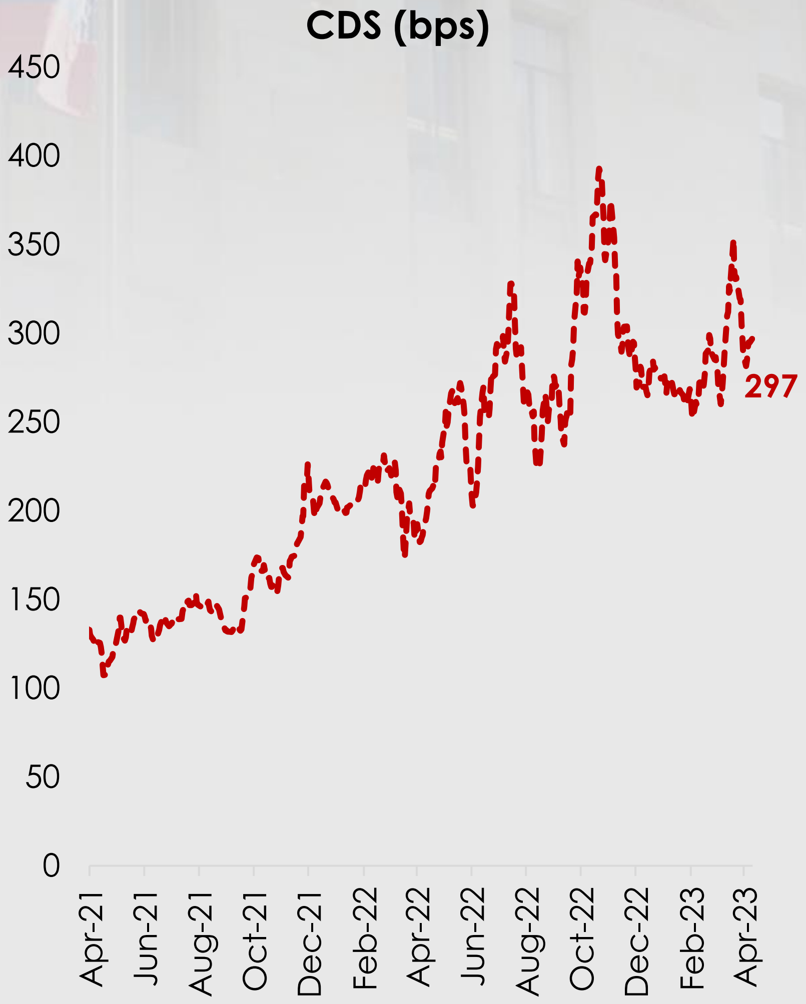
Foreign Exchange Balance Foreign Direct Investment*
(Monthly, Million USD)

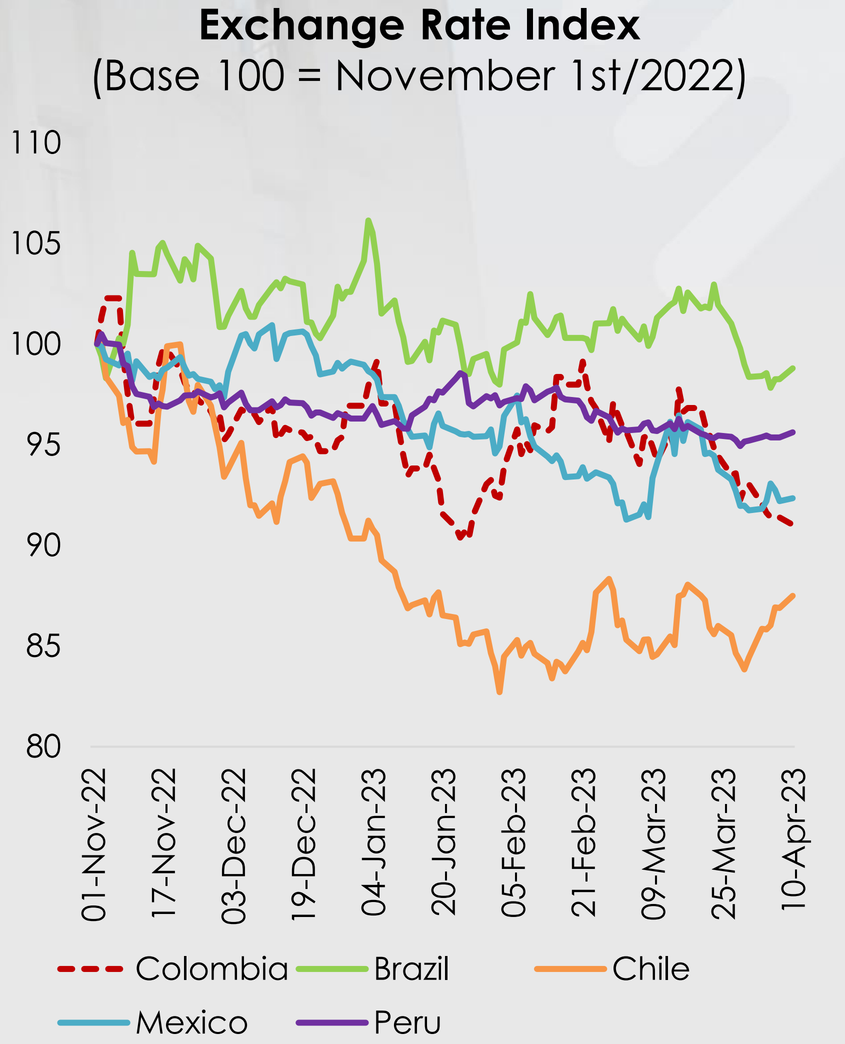


Source: Colombia´s Central Bank. **Primary income:** includes payments for returns on the factors used for production, such as capital and labor, and returns on financial assets.
*The monthly data are built with a methodology different from the balance of payments. This data do not include profits reinvested by firms that carry out FDI in Colombia.
Secondary income: includes income and expenses from current transfers, which are not obtained in exchange for any product or factor of production.

Currently risk indicators, interest rates and the exchange rate are showing a better performance than October 2022

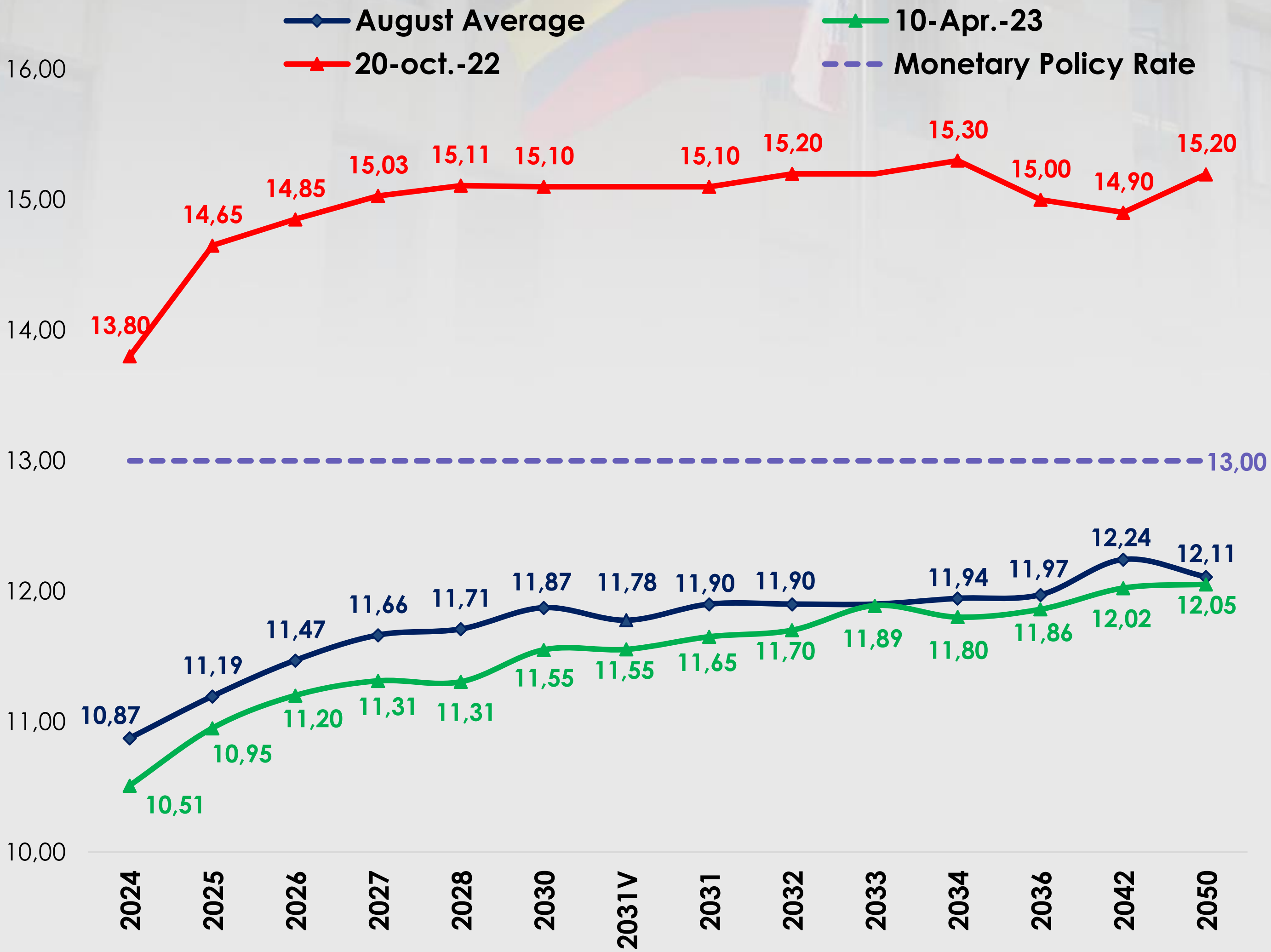






Source: Bloomberg. Last Update: April 10th, 2023.

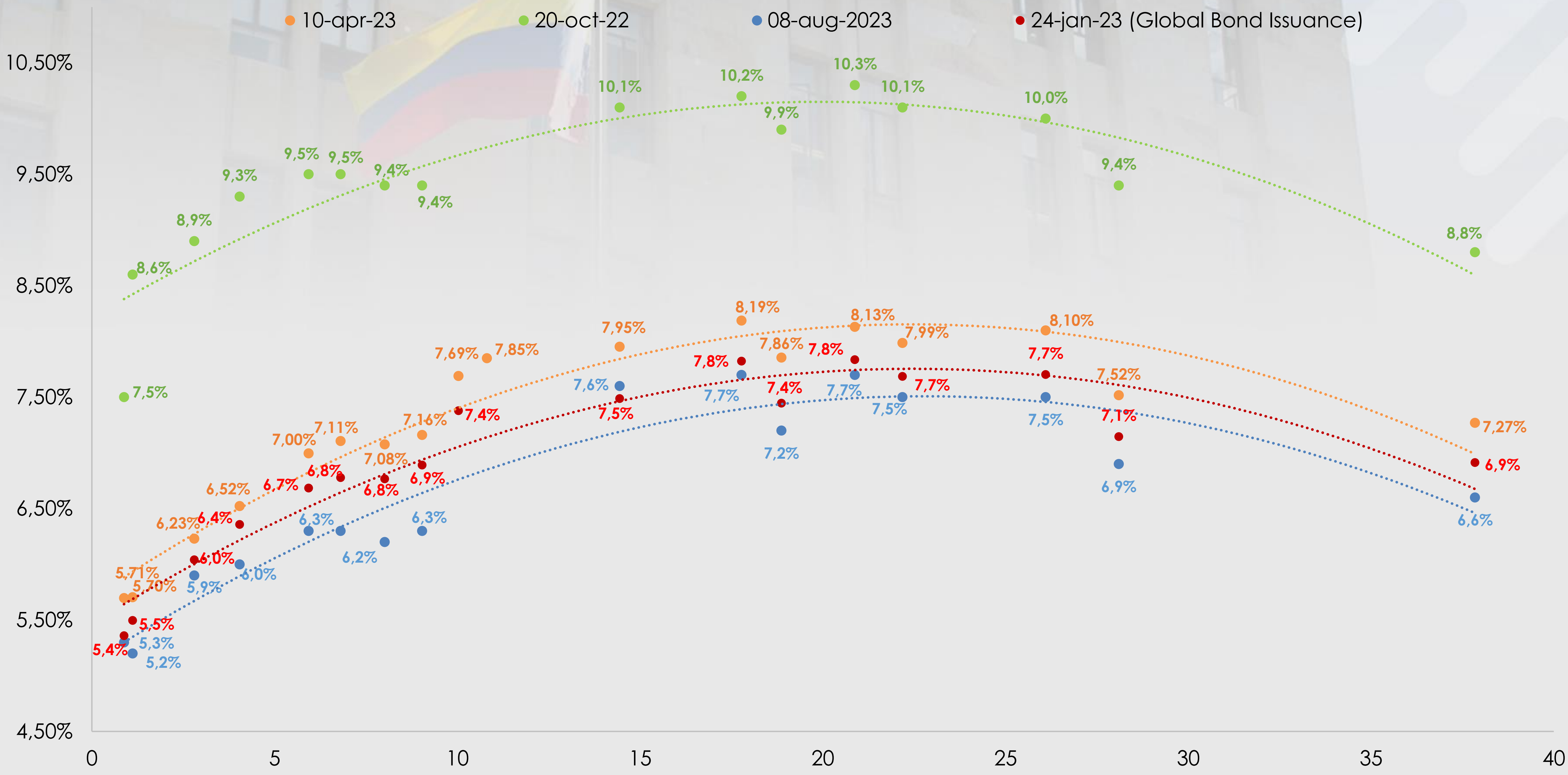
TES interest rates remain below the maximum levels of October 20. The COP TES have normalized in most of the references at levels below August and well below that of the central bank monetary policy and market interest rates



Maturity Bond	August Average	20-Oct	Last Day (10-Apr)	Last Day vs. Max Oct.
24-Jul-24	10.873	13.800	10.510	-329 BPS
26-Nov-25	11.194	14.650	10.950	-370 BPS
26-Aug-26	11.469	14.850	11.200	-365 BPS
3-Nov-27	11.663	15.030	11.312	-372 BPS
28-Apr-28	11.709	15.109	11.305	-380 BPS
18-Sep-30	11.873	15.100	11.550	-355 BPS
26-Mar-31 V	11.776		11.553	
26-Mar-31	11.900	15.100	11.650	-345 BPS
30-Jun-32	11.900	15.199	11.700	-350 BPS
09-Feb-33			11.889	
18-Oct-34	11.944	15.300	11.800	-350 BPS
9-Jul-36	11.972	15.000	11.860	-314 BPS
28-May-42	12.242	14.902	12.023	-288 BPS
26-Oct-50	12.109	15.196	12.052	-314 BPS

Source: DGCPTN. As of April 10, 2023.

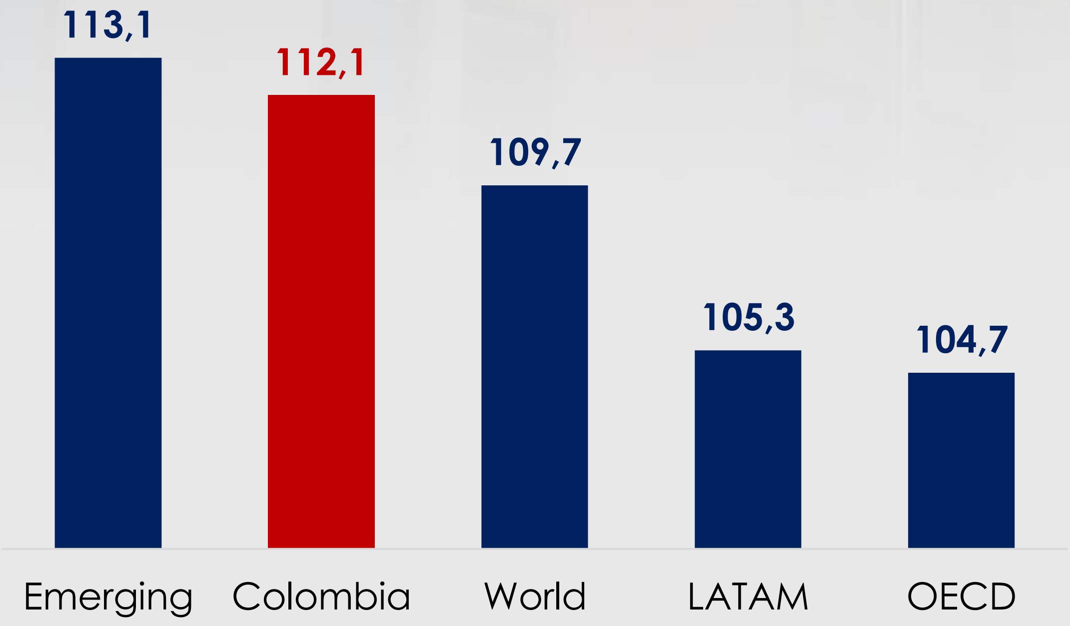
Yield Curves – Global Bonds (USD)



Source: DGCPTN, Bloomberg. As of April 10, 2023.

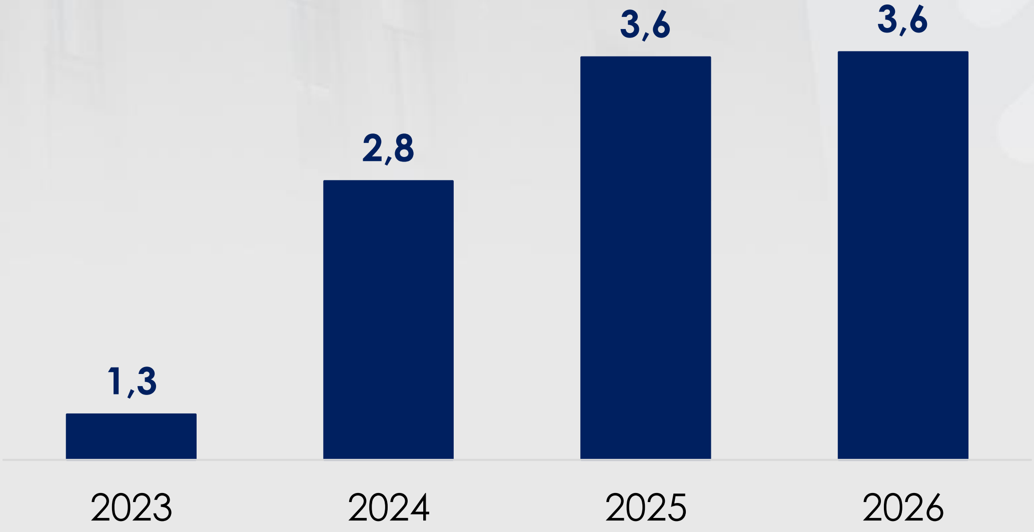
After the slowdown expected in 2023, from 2024 onwards the Colombian economy will show a gradual recovery, with economic activity consistently growing above 3% in the medium-term

2023 Real GDP level by country groups
(2019 = 100, seasonally adjusted series)



Despite the expected slowdown in 2023 (1.3% GDP growth in 2023 vs. 7.5% in 2022), **Colombia's economic activity, compared to pre-pandemic levels, would outperform the most relevant groups of countries** (World, OECD & LATAM).

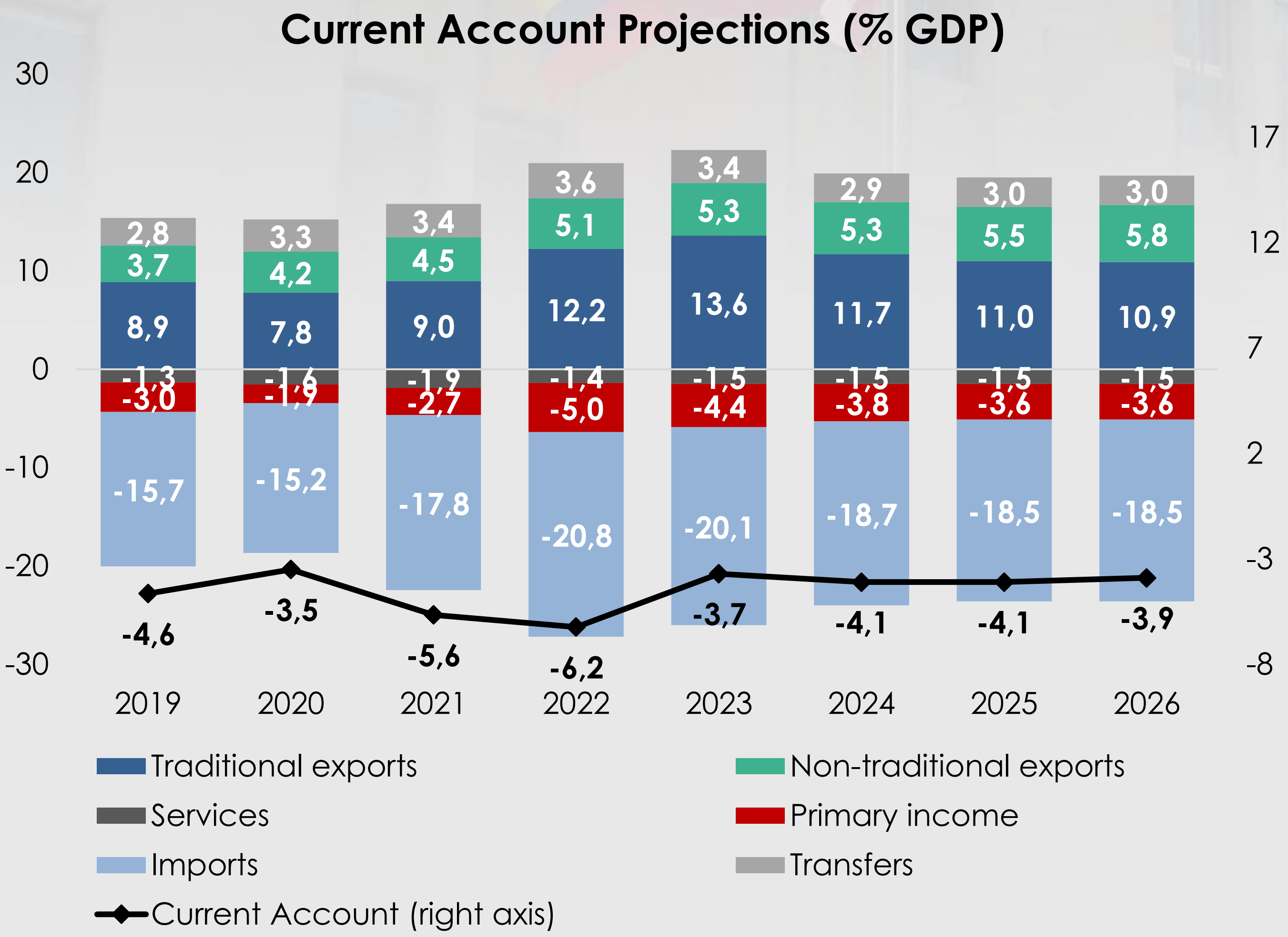
Medium-term real growth (%)



- Economic activity would be driven by the **productive transformation process**, through the reindustrialization and energy transition policies, higher public investment (especially in infrastructure), and the increase of trade flows with Venezuela.
- **The output gap is expected to close in 2026.**

Source: DANE and Central Bank. MoF calculations.

The external imbalance is expected to adjust in the medium term due to the productive transformation process, the moderation of internal demand and the correction of international prices



In the medium term, **the processes of reindustrialization and energy transition within the productive transformation policy framework will favor the dynamism of non-traditional exports and services**, allowing the external deficit to converge to **a level that stabilizes external liabilities.**

Other factors that are expected to contribute to the adjustment in the external deficit are:

- A moderation in the **growth of domestic demand.**
- Less pressure on the **factor income deficit**.
- A partial correction in the prices of **imported goods and services.**

In the medium term, this external deficit would be **financed mainly by Foreign Direct Investment flows.**

Source: DANE and Central Bank. MoF calculations.

2.

Social Reform Agenda

The Pension Reform effectively addresses the following challenges that the pension system currently faces

Voluntary savings pillar

Voluntary savings in private pension funds

Contributive pillar

Mandatory contributions to Colpensiones for up to 3 minimum wages, and the remaining contribution would go to individual savings accounts in private pension funds

Semicontributive pillar

People over 65 years of age who have contributed betwen 150 and 1000 weeks will receive an annuity based on their total contributions

Solidarity pillar

Monetary transfer equivalent to the extreme poverty line (approximately $223,000 COP in 2023) for those individuals over 65 years of age or older, that are classified as extremely poor, moderately poor or vulnerable (2.3 million people)*

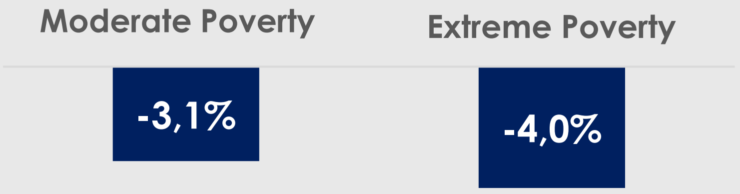
*This cash transfer would be focalized using the fourth version of Sisben. Among the vulnerable population, those focalized for this basic income only include those that are "border vulnerable", that is, those that have incomes just above the poverty line, and that with any income shock could fall in poverty.

Social impact of the reform: solidarity pillar

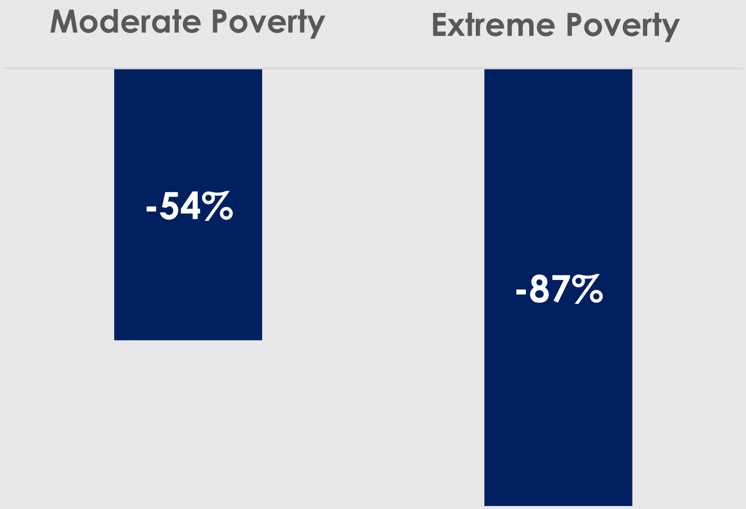
- The solidarity pillar seeks to guarantee a basic income for the elderly population who fall under poverty and economic vulnerability* through an **increase in the cash transfer provided to each beneficiary and in the coverage of the social transfers directed to the elderly population with respect to the current design of *Colombia Mayor*.**

The reform would contribute to reducing the incidence of poverty and income inequality, especially within the beneficiary population group.

Marginal effect over the number of poor with respect to the status quo
National Total



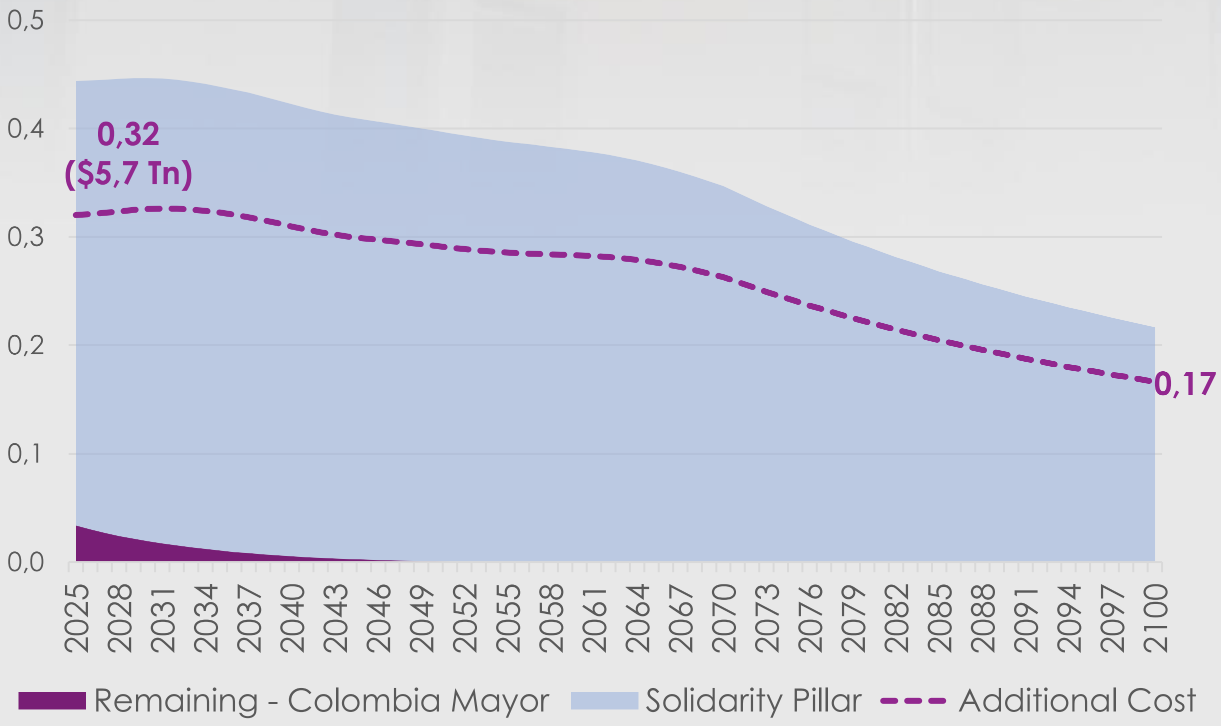
Marginal effect over the number of poor with respect to the status quo**
Population aged 65+



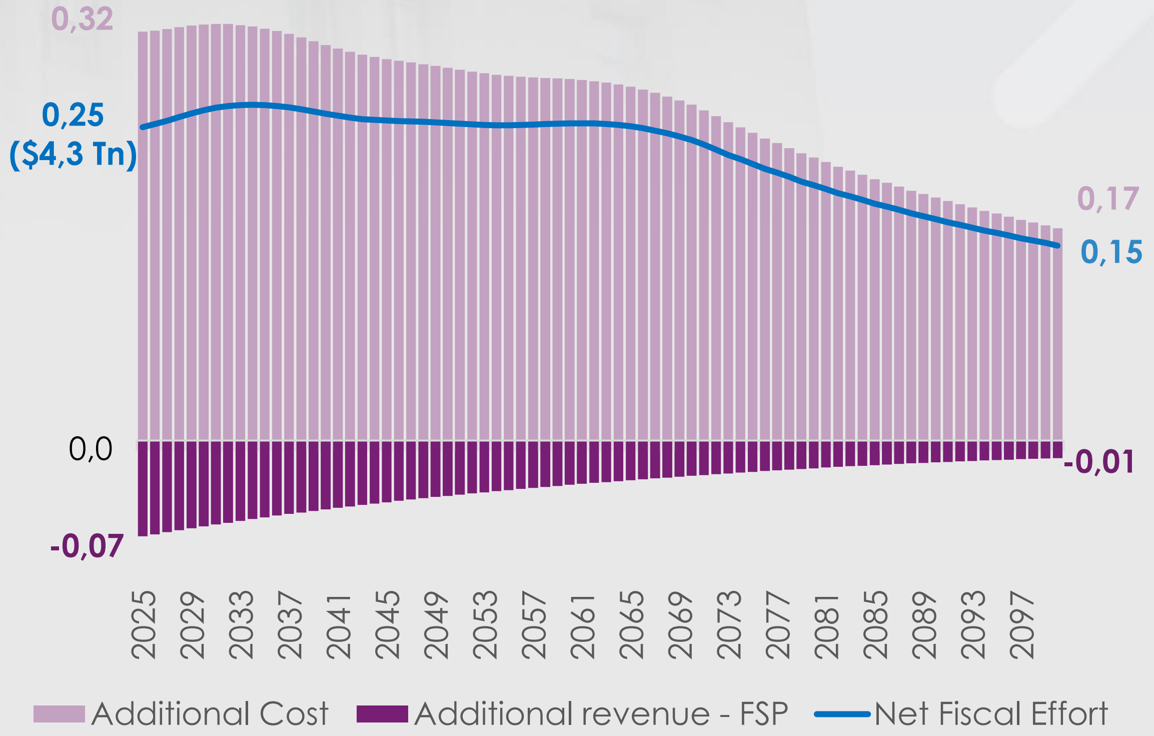
Source: Ministry of Finance based in DANE.
*Within the classification subgroup C1 to C3 of Sisbén IV. These effects correspond to the marginal effects of the measures included in the reform, compared to a base scenario in which no reform to the social protection system is implemented. **This poverty indicator is calculated as the proportion of people aged 65 or more who are below the monetary and extreme poverty lines, where the variation that the income of this population segment would present due to the solidarity pillar is included. ***To estimate this indicator, only the population aged 65 or over is considered. Then, it is distributed in income percentiles, and the relationship between the income of those in the 90th percentile and those in the 10th is estimated, both in the status quo and with the new income they would receive through the solidarity pillar.

The fiscal effort derived from the implementation of the solidarity pillar is consistent with the compliance of the fiscal rule

Total and additional cost of the solidarity pillar. % of GDP ($ Trillion COP)



Net fiscal effort – solidarity pillar % of GDP ($ Trillion COP)



Note: the additional cost is the difference between the total cost and a counterfactual scenario without reform.
Source: GDMP-MFPC

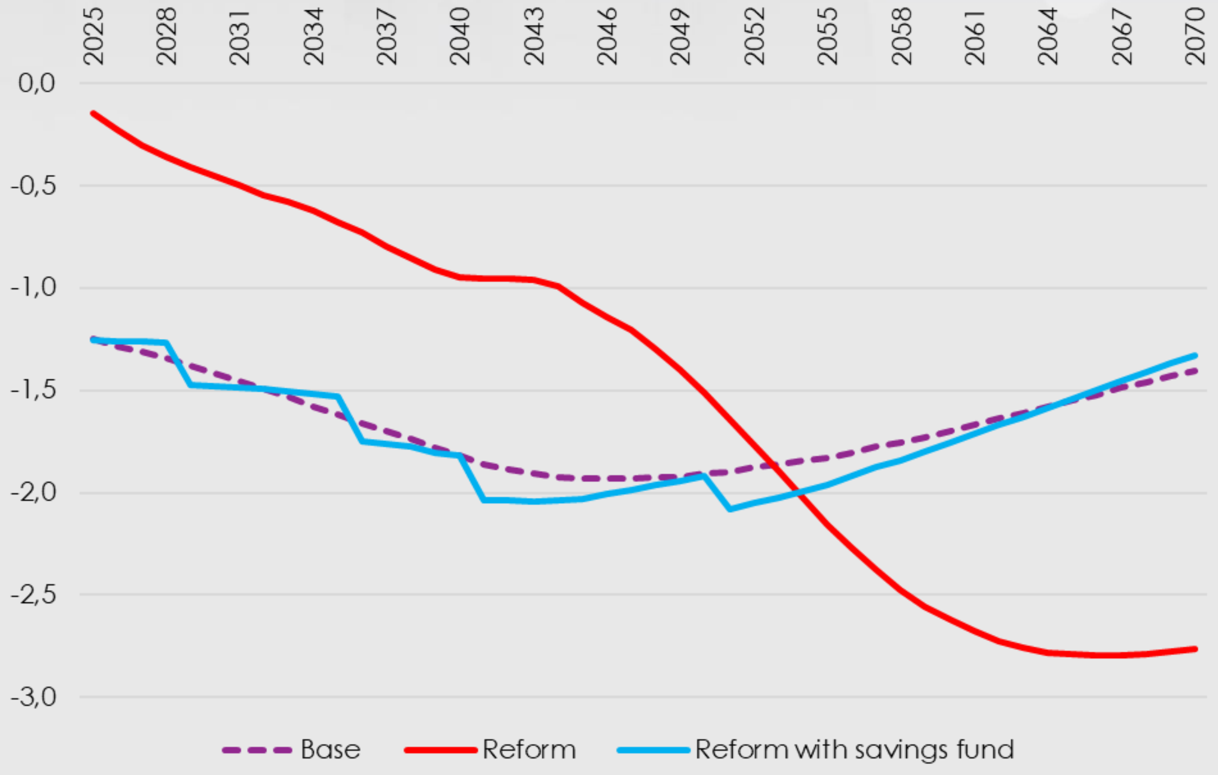
By 2070, the pension reform will have a favorable effect on the net present value of the deficit of the contributive and semi-contributive pillars

Net present value at 2070 for contributive and semi – contributive pillars
(% GDP)

	Base	Reform			
	Defined benefit (RPM)	Contributive pillar	Savings fund	Semi-contributive pillar	Total NPV
Revenues	51,4	95,1	7,1	0,0	102,3
Expenses	118,9	154,5		3,0	157,5
Deficit	**-67,5**	**-59,3**	**7,1**	**-3,0**	**-55,2**

Note: discount rate= 4%
The effect of the savings fund includes interest income derived from those savings.
Source: Ministry of Finance and Public Credit.

Balance by scenarios
(% GDP)



How will the savings fund operate?

- **The creation of the saving funds is a crucial element within the reform:**
  - **Prevents negative effects on the flow of national savings,** and therefore on capital markets, particularly public debt.
  - Creates an **asset that will help support the future obligations** that will be acquired by Colpensiones.
  - Will seek to have a **diversified portfolio**, which maximizes return and minimizes the risk.
  - Will have a **governance scheme that includes a management committee.** The administration of resources will be done through an investment trust fund, autonomous equities or financial entities.

- The savings fund will operate as follows:

Accumulation	**All additional net income** obtained by Colpensiones with the reform.
Transfers	**All transfers of assets** from pension funds to Colpensiones (transfers of the transition regime, decumulation phase) **will be allocated to the savings fund.**
Deaccumulation	The fund will only allocate resources to pay the pensions of persons who prior to the reform did not contribute to Colpensiones and do not fall under the transition regime.

The National Government will continue to work with the aim of ensuring that in the construction of the bill reflects this operation of the saving funds. In this context, the Ministry is open to any comments that may be raised in this regard within the public debate.

The Health Care Reform seeks to strengthen the system's universal and equitable access, improving health outcomes and the administration of resources

1 Strengthening Primary Attention

Creation of a Primary Attention Centers Network

2 More coverage

Expansion of territorial coverage

3 Improving working conditions

Improving the working conditions of the system's workers

The additional expenditures derived from the reform are consistent with the compliance of the fiscal rule and forecasted fiscal revenues (0,6% of GDP in 2024)

The Labor Reform Project “*Trabajo por el Cambio*" seeks to improve working conditions in terms of quality and formality, centered on the following elements:

1. **Improve labor stability** by removing barriers to enter and remain in employment

2. **Avoid any type of discrimination** against potentially vulnerable groups

The reform has no direct fiscal impact and is also consistent with the Medium-Term Fiscal Framework and the compliance of the Fiscal Rule

3.

Fiscal Strategy

Fiscal Policy Institutional Framework

Law 819 of 2003
Medium-Term Fiscal Framework

The Government will publish yearly a 10-year macroeconomic and fiscal roadmap, the Medium-Term Fiscal Framework, to guide policy decisions, while ensuring fiscal sustainability

Law 1473 of 2011 and Law 2155 of 2021
Fiscal Rule and Autonomous Fiscal Rule Committee

From 2022, the new Fiscal Rule sets specific targets for the fiscal balance and the debt of the National Government. This framework strengthens the link to fiscal sustainability, particularly by setting a debt limit and anchor

Law 2155 created the **Autonomous Committee of the Fiscal Rule**, as a technical, permanent and independent body, **whose purpose will be to monitor the fiscal rule and provide analysis on public finance sustainability**

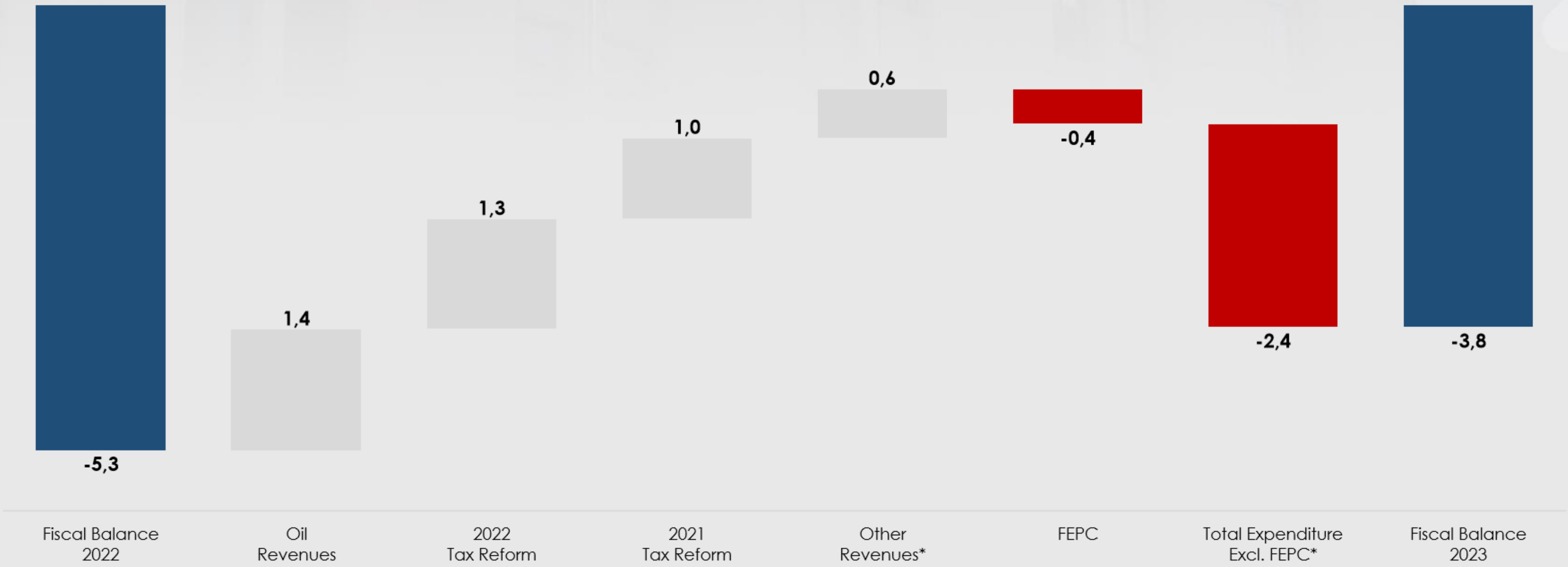
The fiscal rule is materialized through the Medium-Term Fiscal Framework. The Government's financial planning instruments **must be consistent with the fiscal rule contained in the Medium-Term Fiscal Framework.**

The social reforms presented by the Government and that are being debated in Congress must be consistent with this institutional framework

2023 Central Government Fiscal Balance

The **reduction in the fiscal deficit** between 2022 and 2023 is driven by **higher tax revenues** resulting from the 2021 and 2022 tax reforms, higher oil revenues and Non-oil Tax revenues*. It is partly counterbalanced by an **increase in primary expenditures** and FEPC.

Decomposition of 2022-2023 fiscal adjustment (% of GDP)



*Other revenues is mainly explained by non-oil Tax revenues (0.5pp), DIAN's modernization (0.1pp), Central Bank profits (0.1pp) and a drop in other capital receipts (-0.2pp).
**Due to a 2.3pp increase in primary expenditure and 0.1pp increase in interest spending.
Source: Ministry of Finance.

The tax reform would achieve additional sources of $20 trillion COP (1.3% of GDP) in 2023. An additional increase in revenues is expected by 2026 due to improved efficiency from DIAN.

Tax reform				
Category	% of GDP			
	2023	2024	2025	2026
Personal income tax	0,04	0,15	0,15	0,15
Wealth tax	0,11	0,11	0,11	0,11
Corporate income tax	0,27	0,33	0,37	0,41
Natural Resources	0,79	0,44	0,24	0,17
Healthy and environmental taxes	0,01	0,18	0,25	0,25
Other measures*	0,10	0,07	0,07	0,07
Total	**1,31**	**1,26**	**1,17**	**1,15**

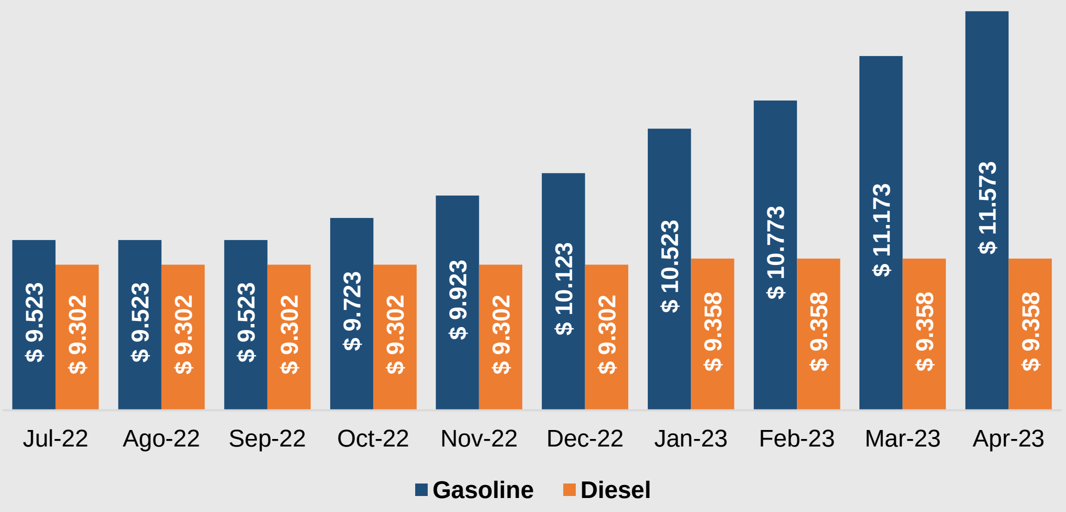
* Includes limit to tax benefits, free trade zones, and others.

Since October 2022, the National Government has been implementing a strategy of gradual and progressive increases in the fuel prices, with the aim of reducing the Fuel Price Stabilization Fund – FEPC deficit

Gasoline prices: since October, consecutive monthly adjustments have increased retail prices by around 21%.
Diesel prices: the National Government has maintained a stronger stabilization policy on the price of diesel in order to mitigate inflationary pressures.

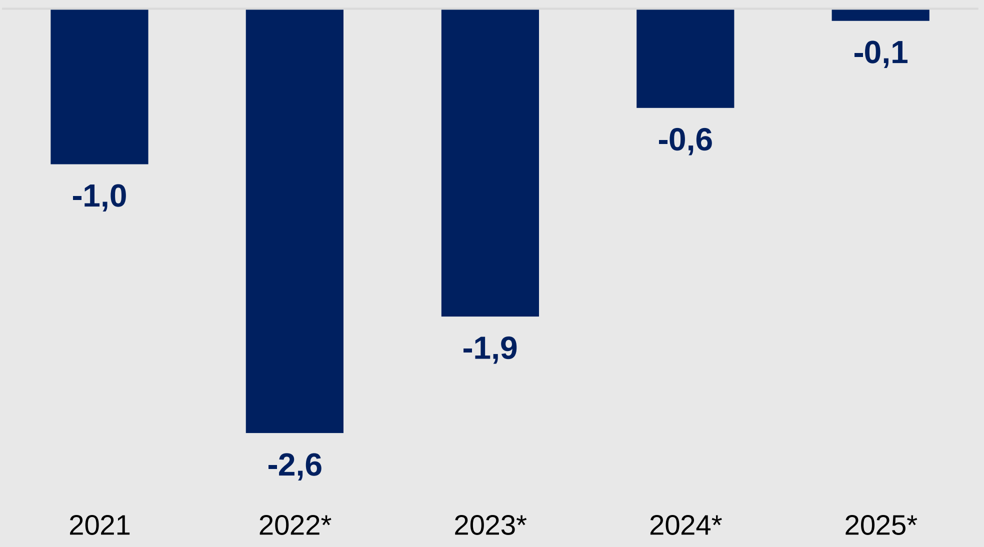
This strategy will generate a gradual reduction in the fiscal pressures derived from the FEPC. The current plan of price increases and forecasts of international fuel prices **would eliminate the deficit by 2025.**

Gasoline and Diesel retail prices
COP per gallon*



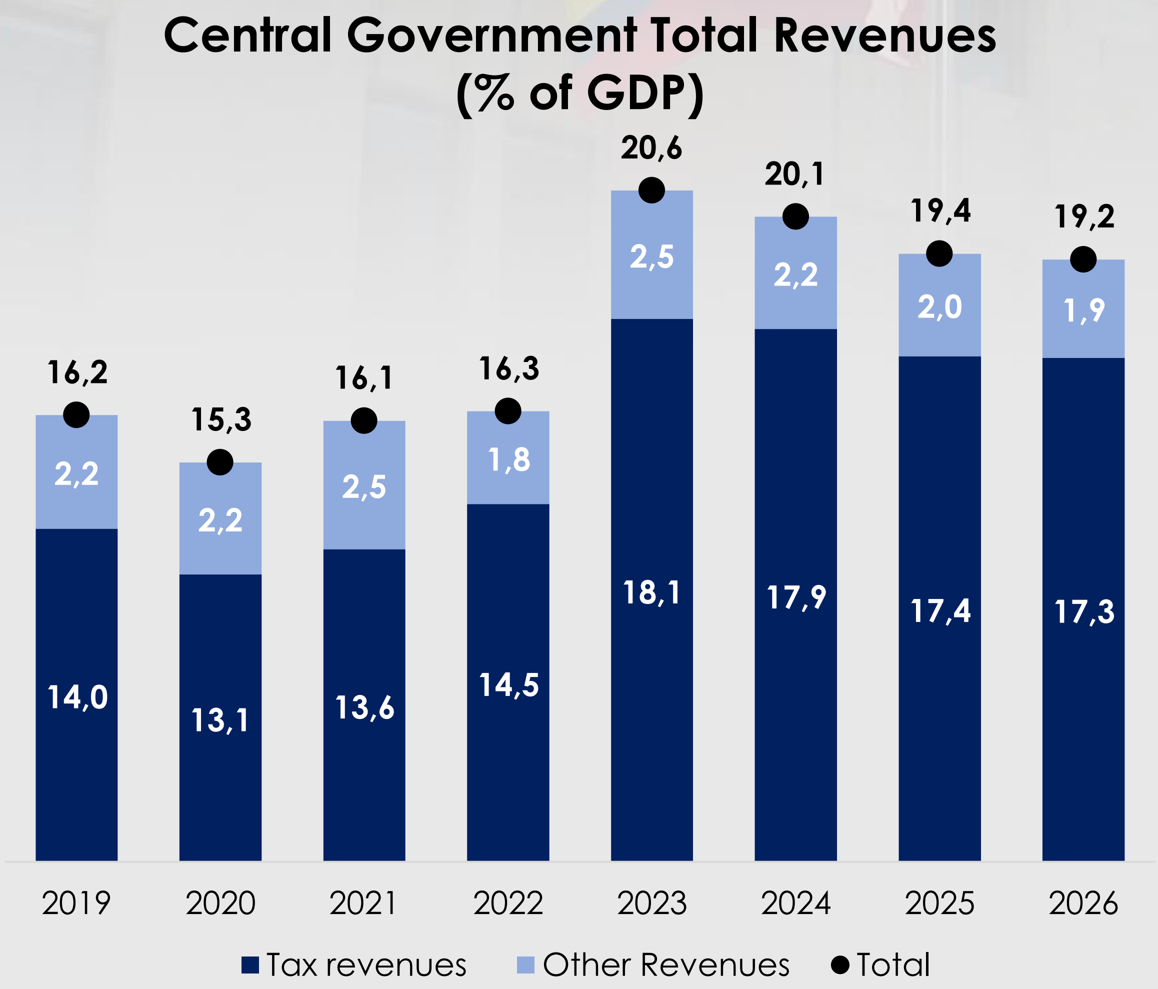
Source: Energy and Gas Regulation Commission (CREG by its acronym in Spanish).
* reference price for sale to the public in Bogotá.

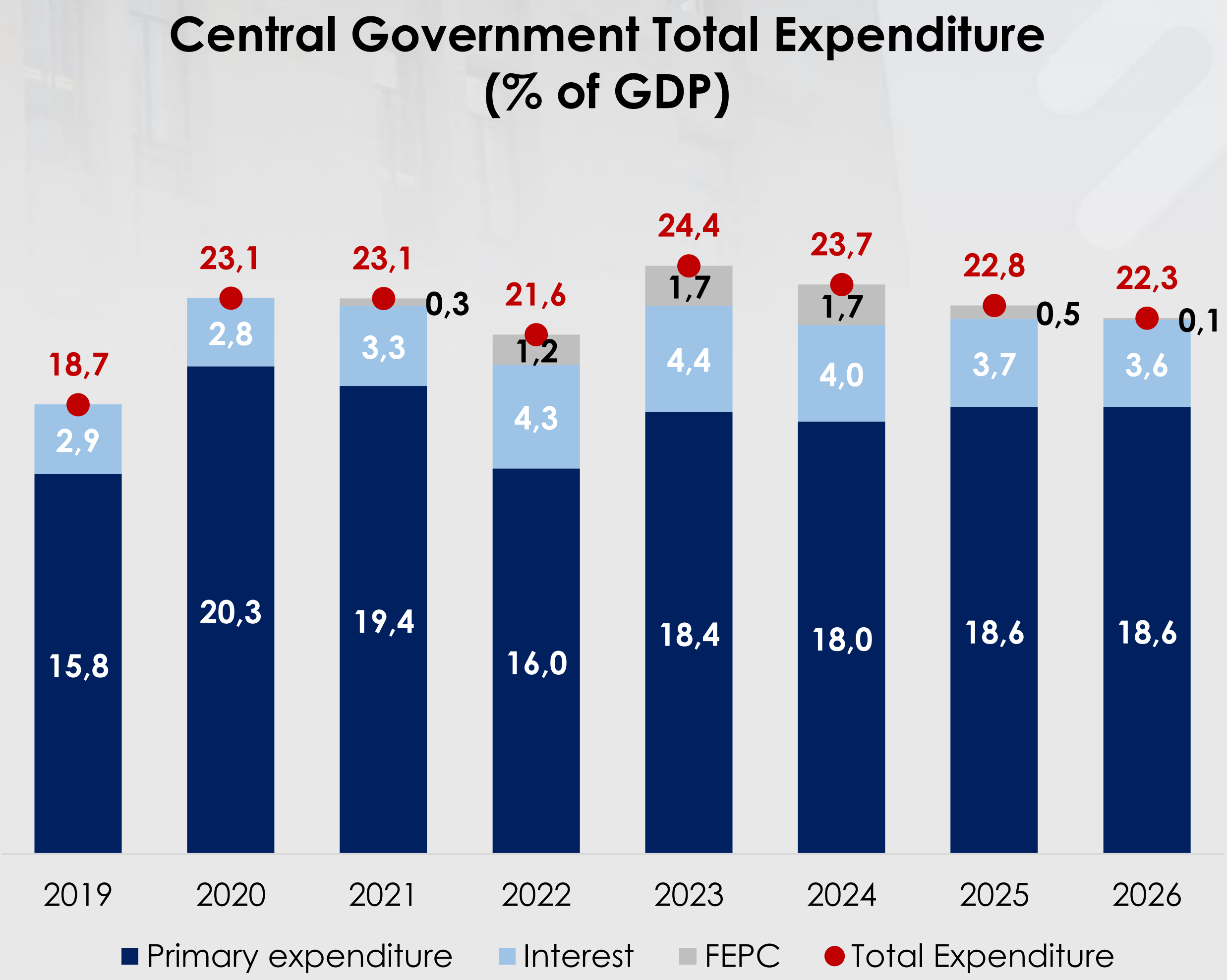
FEPC compensation differential with price adjustments
% of GDP



Source: Ministry of Finance.
* Projected figures

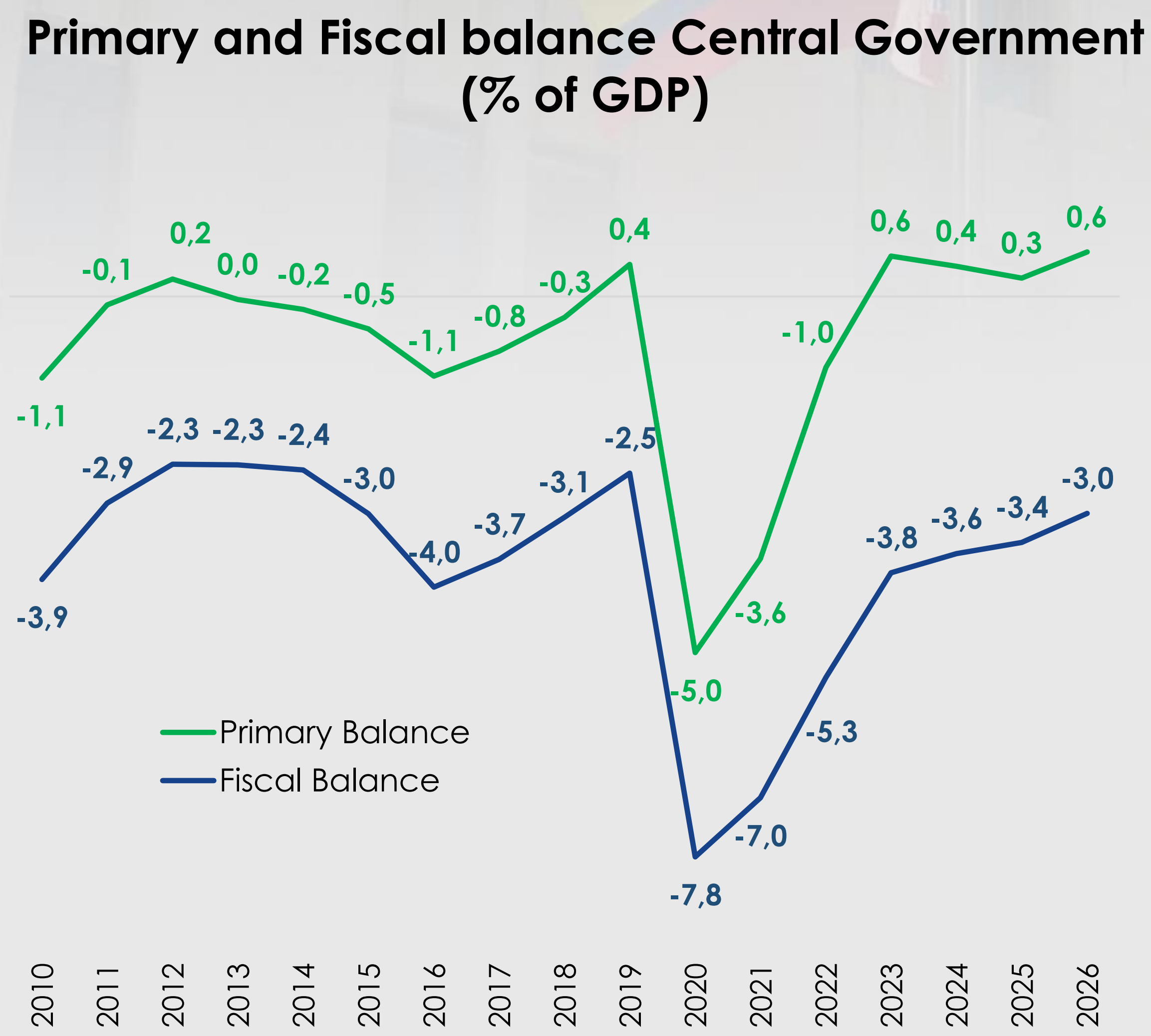
Between 2023 and 2026, total spending will have a decreasing trend, driven by FEPC and interest expenditures

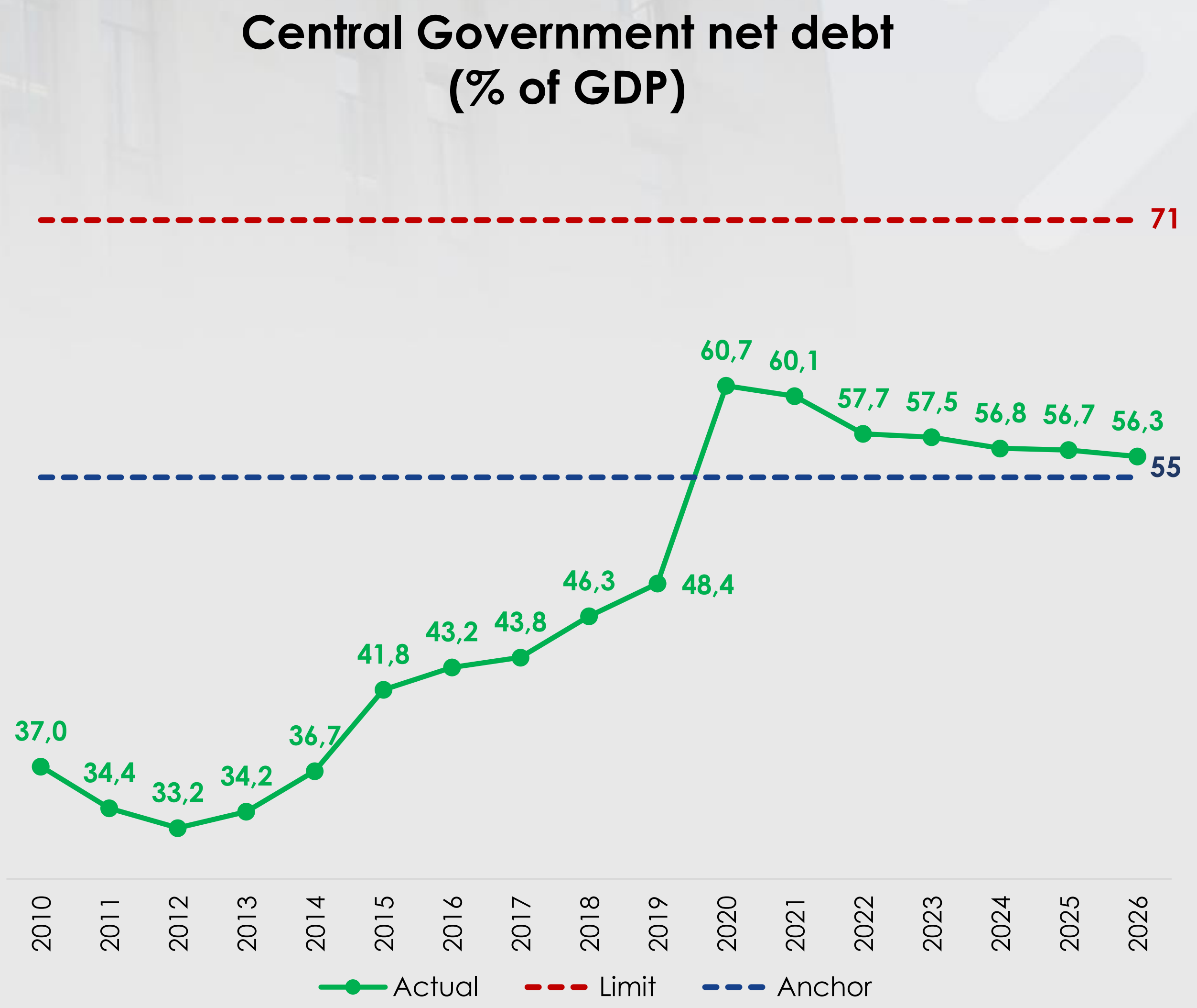




Source: Ministry of Finance.

Since 2023, the Central Government will run primary surpluses and a continued reduction in the fiscal deficit, consistent with compliance with the fiscal rule. This will lead net debt to gradually converge to its anchor in the medium-term

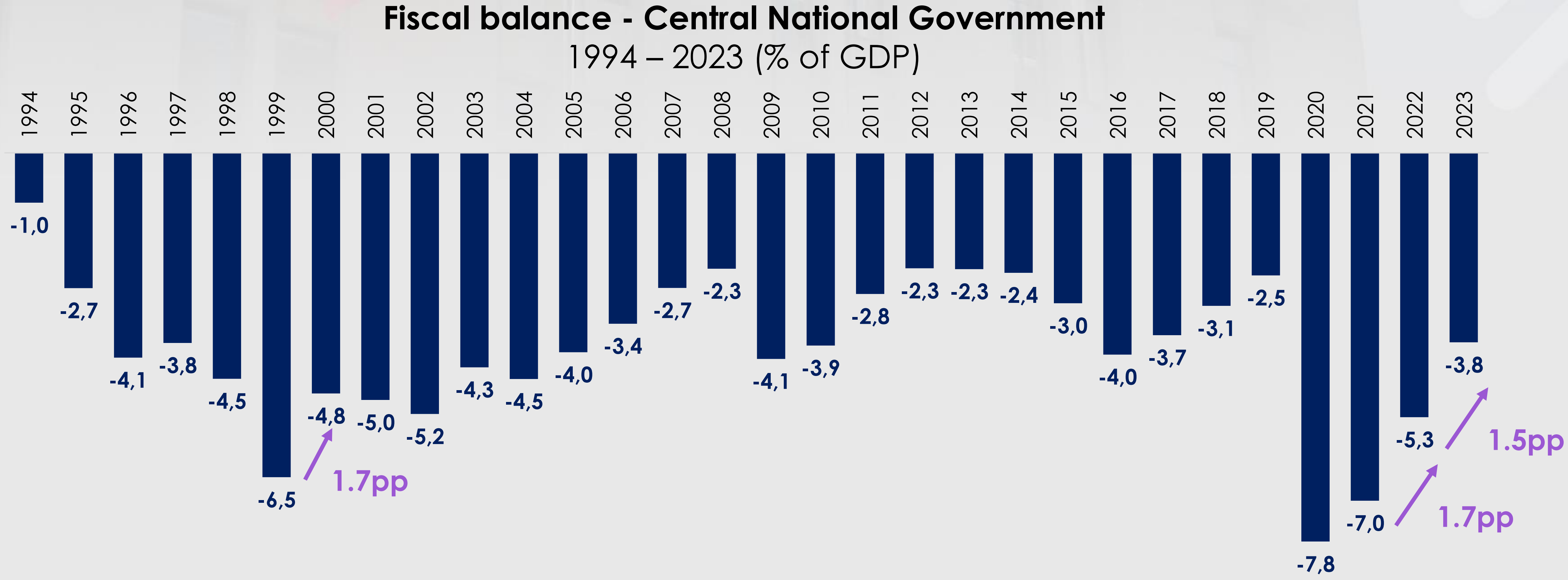




Source: Ministry of Finance.

Fiscal balance 2023

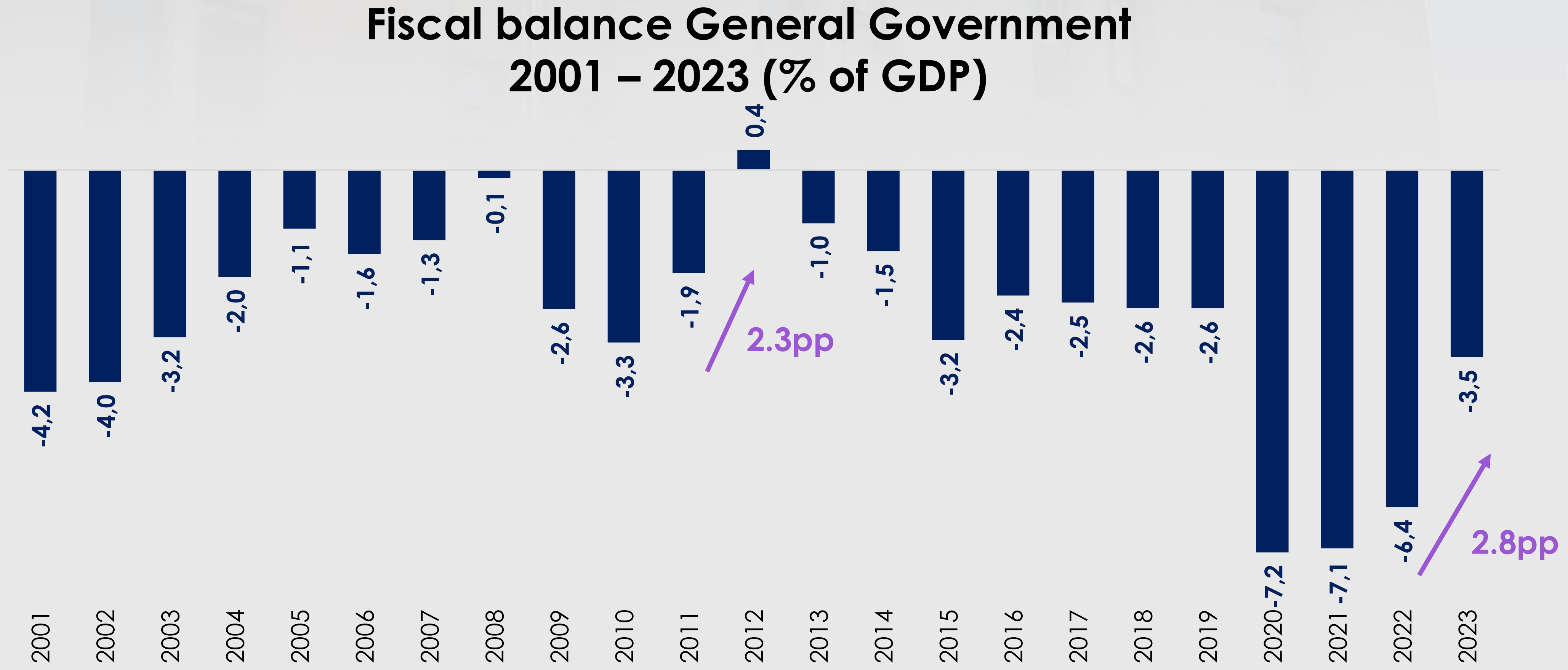
A **fiscal adjustment of 1.5pp of GDP** is expected between 2022 and 2023.



Source: Ministry of Finance.

General Government 2023 fiscal adjustment

A fiscal **adjustment in the General Government of 2.8pp of GDP is expected between 2022 and 2023**, the highest since there have been estimates of the fiscal balance of this level of government.



Source: Ministry of Finance.

The Republic reduced the risk of refinancing and improved the debt profile

Global Bond 2034	
Nominal Issued	**2.200**
Initial Offer	1.500
Maturity	2-feb-34
Coupon	7,50%
Yield	7,60%
Demand	9.000
Bid-to - cover	4,0

Million USD

1. **Financing for 2023:** The Republic financed **USD 1,683** million for the year 2023.
2. **Liability Management:** Reduction of the refinancing risk for 2024 by **USD 517** million.

Source: DGCPTN, February 3, 2023

Green, social, and sustainable bonds

- Promote the sustainability government agenda with the 2023-2026 National Development Plan, such as: i) environmental justice, ii) water and biodiversity and iii) development of social infrastructure.
- Strengthen the local capital market in terms of sustainable financial instruments.

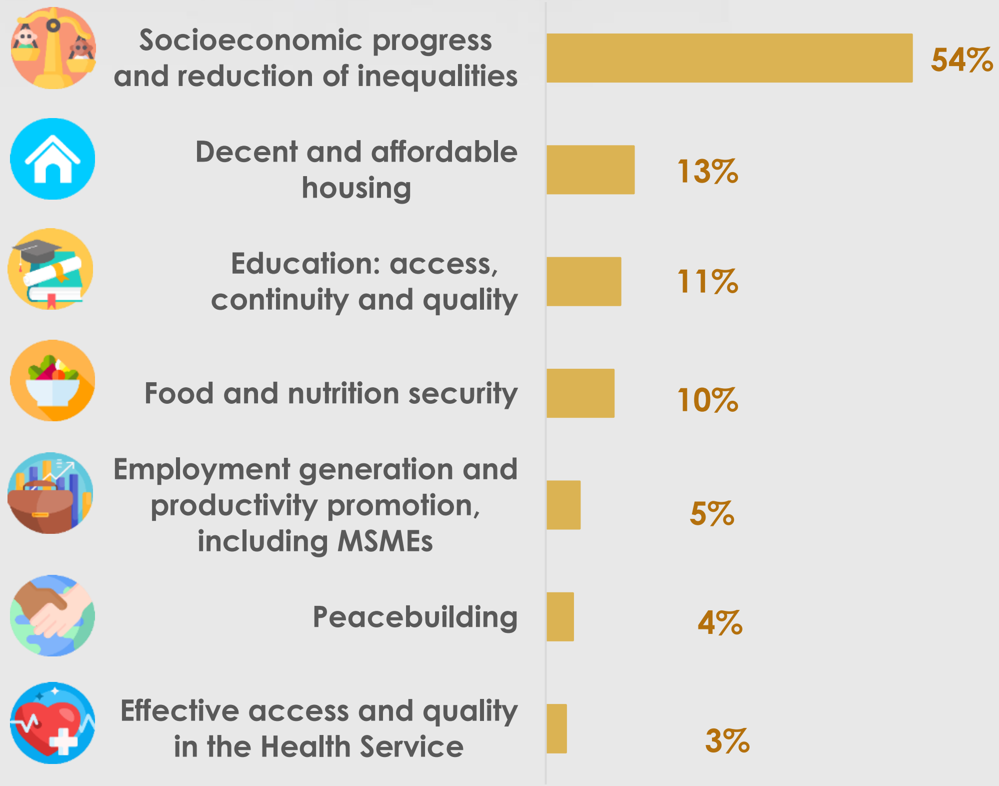
Social Bonds

- Colombia's Green, Social and Sustainable Sovereign Bond Framework was published in August 2022.
- The current amount of eligible social expenses amounts to **USD 3.8 billion**, distributed **among 47 projects and 7 categories.**

Next Steps:

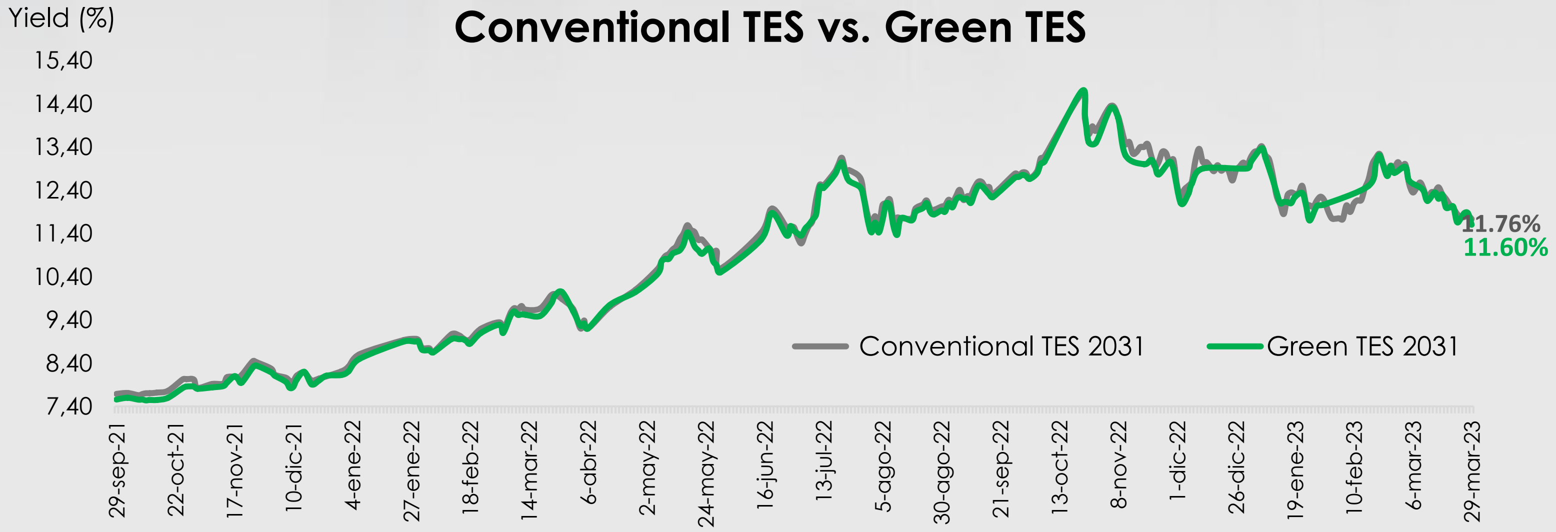
- Link the eligible social expenses identified in the budget 2022-2023 and **issue the first social bond of the Republic of Colombia**

Eligible social expenses in 2022



Green Bonds

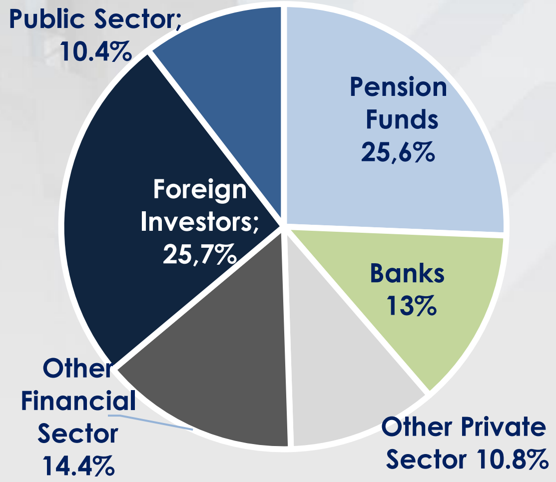
- First Green bond issued in September 2021 under the **twin bond** methodology.
- Continuity of issuance for 3 years.
- Historial greenium between 7 – 15 bps
- Highest interest of foreign investors in green TES



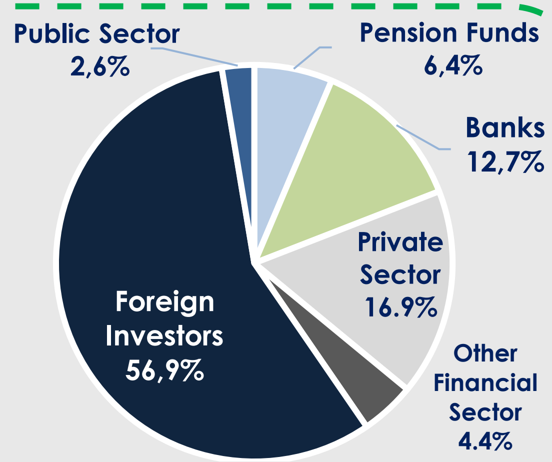
2023 – Next steps:

- **Maximum auction: USD 200 million (Local market)**
- Issuance: second semester.
- Definition of green eligible portfolio to support the issuance.

TES - Traditional



Green TES



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