LATIN AMERICA ECONOMICS UPDATE

Colombia: political risks back in the spotlight

- **The replacement of Colombia's market-friendly finance minister José Antonio Ocampo with a close ally of President Petro is likely to lead to a sell-off in Colombia's financial assets when markets open later today. This is especially worrying given the country's large external financing needs and may force the central bank to keep monetary tighter for longer.**
- Having made a promising start to his tenure by quickly forming a coalition with opposition parties and pushing through a tax reform bill, he has started to show his more radical side – something he doubled down on this week. After his coalition parties (Liberal Party, the U Party and the Conservative Party) refused to support some of his reform proposals, including the health reform bill, Petro announced a large cabinet reshuffle on Wednesday evening.
- **One of the casualties of the reshuffle was Finance Minister José Antonio Ocampo**, which is worrying given that he was one of the most moderate figures in Petro's cabinet and key in reassuring investors when Petro took office. Mr. Ocampo repeatedly pushed back against the president's radical ideas and eased investors' concerns about the direction of Colombia's public finances.
- Ocampo will be replaced by Ricardo Bonilla, who previously worked as an economics professor at the National University of Colombia and most recently was the head of national development bank Findeter. And, perhaps more importantly, he served as Finance Secretary of Bogotá from 2012 to 2015 when Petro was mayor and was one of Petro's his top economic advisors during his presidential campaign.
- Stepping back from the politics, there are a few points worth making from an economic perspective. **First, local financial markets are likely to react negatively to these developments when they open later today.** Admittedly, while Bonilla is a close Petro ally, he is unlikely to be fiscally reckless. He vowed to "maintain economic stability" and, when he was in charge of Bogotá's finances, the city ran budget surpluses and its debt load fell. By the same token, though, he is unlikely to be as market-friendly as Ocampo and will have a lot of work to do to regain investors' trust.
- **Similarly, capital inflows are likely to be weaker, which is particularly worrying given the fragile macroeconomic backdrop in Colombia.** The economy's large current account deficit of over 6% of GDP (see Chart 1) leaves it dependent on foreign capital inflows. If the political turmoil causes these to dry up, the peso is likely to experience renewed large falls.
- Fresh falls in the peso would add further upward pressure to already-high inflation (see Chart 2), which stood at 13.3% y/y in March and, unlike in the rest of Latin America, has yet to fall back. Against this backdrop, **the central bank will probably raise interest rates further (note that there's a central bank meeting tomorrow where we expect a final 25bp hike, to 13.25%) and/or keep them higher for longer.**
- And finally, the collapse of Petro's coalition is likely to lead to a more fragmented political landscape, which will make it (even more) difficult for him to push through his key proposals. While failure to pass Petro's more radical reforms might be good news for investors in the near term, there's a risk that Colombia descends into political gridlock, which would have negative medium-term consequences.

Chart 1: Current Account Balance (% of GDP 4Q Sum)

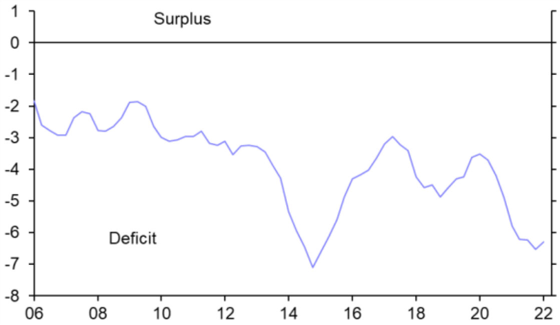
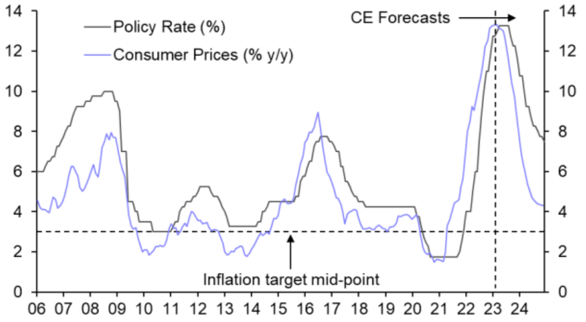


Chart 2: Consumer Prices & Policy Rate (%)



Sources: BanRep, Refinitiv, Capital Economics

Kimberley Sperrfechter, Latin America Economist, kimberley.sperrfechter@capitaleconomics.com

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