LATIN AMERICA ECONOMICS UPDATE

Colombia: investment set to remain weak

- **Fixed investment has been the weak spot in Colombia's strong post-pandemic recovery and it is likely to remain subdued over the next couple of years due to a combination of the fragile political backdrop, lower oil prices and weakness in the housing market. This feeds into our view that growth in Colombia will be weaker than most expect this year and next, at around 1%.**

- Colombia recorded one of the strongest post-pandemic recoveries in the emerging world, with output 10% above its pre-pandemic level in Q2. **But the recovery has been unbalanced. While private consumption has boomed, fixed investment has been extremely sluggish – it was 4% *below* its pre-pandemic level last quarter.** (See Chart 1.) As a share of GDP, investment fell to 18% in Q2, the lowest level (outside of the pandemic) since 2006 and one of the lowest rates in the emerging world.

- **A combination of factors explains the weakness in fixed investment, the obvious one being tight monetary policy**. The central bank (BanRep) delivered a cumulative of 1,150bp of interest hikes, to 13.25%, in this cycle, taking the policy rate well above its neutral level.

- **High interest rates appear to have taken a particularly heavy toll on Colombia's housing market.** Data from the Colombian chamber of Construction (Camacol) show that new home sales and launches have fallen by more than 50% over the past year and are now at near record lows. (See Chart 2.) On top of the headwind from high interest rates, changes to the government's "Mi casa Ya" social housing programme have contributed to the housing market's woes and weighed on residential investment.

- But there's more to the plunge in investment than just high interest rates. **A closer look at the breakdown of fixed investment shows that "other buildings and construction" has been the main drag on overall investment**. (See Chart 3.) Within this, weakness has been concentrated in public works, which have fallen by a whopping 45% over the past two years or so, with the government's investment plans (or lack thereof) and low levels of execution going a long way in explaining this weakness.

- Meanwhile, given that Colombia imports most of its machinery and equipment, the weakness in the peso (despite strengthening against the dollar this year, the currency remains weak by past standards) has weighed on investment in this category. (See Chart 4.)

- **Fixed investment is likely to remain subdued over the coming quarters.** Admittedly, with inflation now on a downward path, BanRep is likely to start lowering interest rates in the coming months. This will make new investments more affordable and also means that the housing downturn is likely to bottom out. But given the stickiness of core inflation in Colombia, we expect interest rates to remain in restrictive territory over the next couple of years. As a result, a sharp pick up in investment is unlikely.

- What's more, **the political backdrop isn't conducive to investment**. While recent political turmoil has made it less likely that President Petro's more radical proposals will see the light of day, his interventionist stance – as evidenced for example by the freezing toll rates at the beginning of the year – is still likely to weigh on investment. Indeed, Juan Martín Caicedo, the president of the Colombian Chamber for Infrastructure recently said that the climate for investing in infrastructure was "unfortunately (…) not the most flattering".

- And finally, oil prices, which have a decent relationship with machinery and equipment investment, are set to fall. **On past form, our oil price forecast points to decline in machinery and equipment over the next couple of years**. (See Chart 5.)

- Some of these headwinds might be offset by the government's plans to invest in the road transportation infrastructure projects outlined in the recently approved *National Development Plan*. But the fact that the Petro administration is aiming to run balanced primary budgets in the next couple of years suggests to us that it's more likely that capital spending will be axed in favour or social spending.

- **All told, weakness in fixed investment is one of the reasons why we expect Colombia's economy to slow more sharply than most anticipate this year (to just 1.0%) and remain weak, at around 1.3% in 2024.** (See Chart 6.) And further out, a prolonged period of weak investment will weigh on productivity growth and reduce Colombia's potential growth.

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Chart 1: GDP (Q2 23 vs. Pre-Pandemic Level, % Chg.)

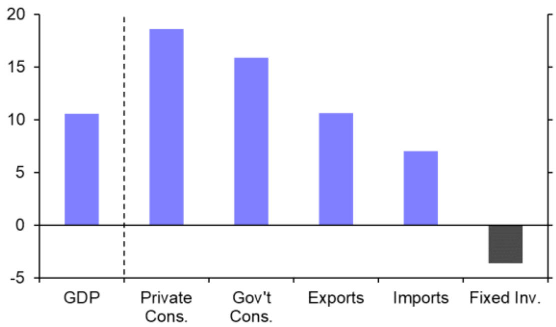


Chart 2: Sales and Launches of Housing Units (CE SA, 3m avg., Thousands)

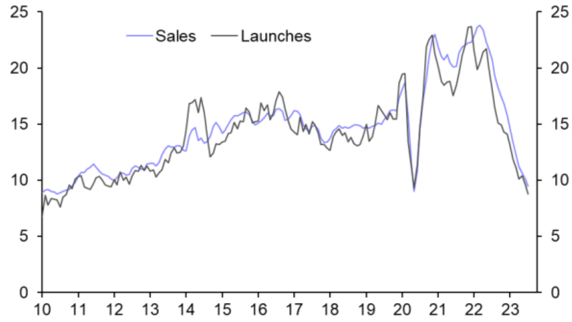


Chart 3: Real Fixed Investment (SA, Q4 2019 = 100)

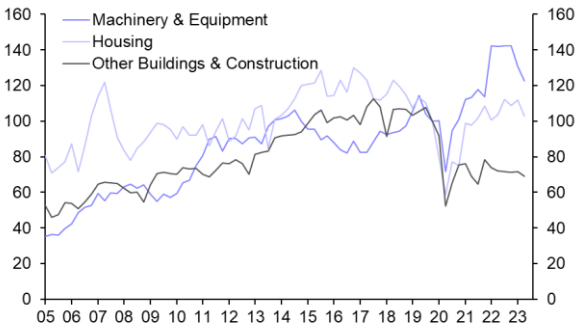


Chart 4: Machinery & Equipment Investment & Exchange Rate (% y/y)

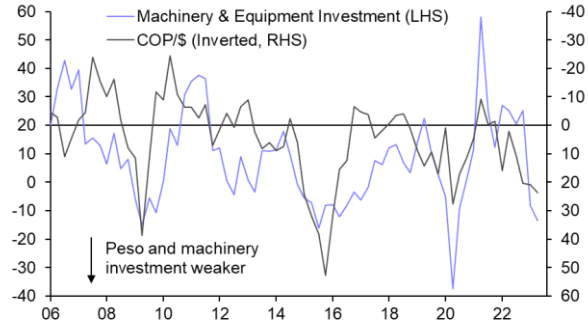


Chart 5: Machinery & Equipment Investment & Brent Crude (USD Terms, Q4 19 = 100)

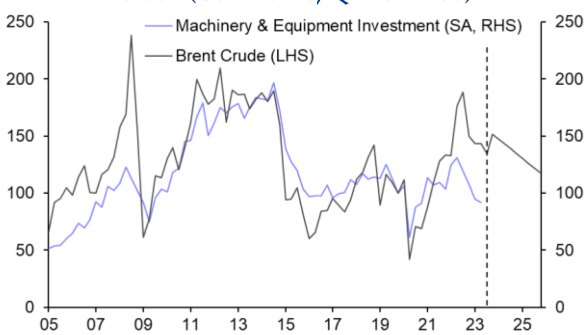
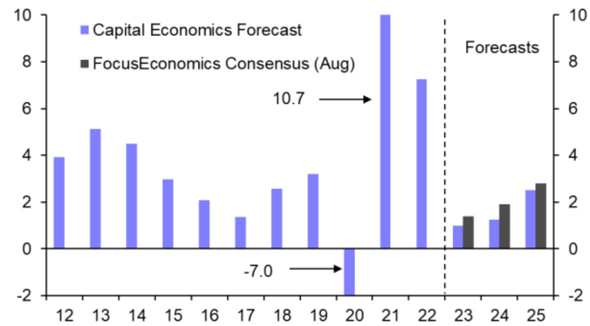


Chart 6: Real GDP (% y/y)



Sources: Refinitv, DANE, Camacol, Capital Economics

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