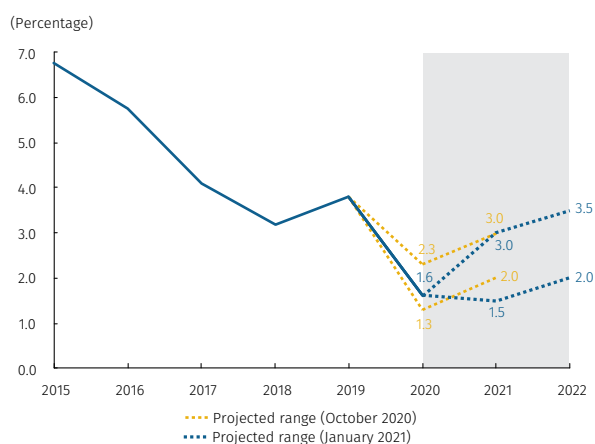


01 / Summary

1.1 Macroeconomic Summary

Overall inflation (1.61%) and core inflation (excluding food and regulated items) (1.11%) both declined beyond the technical staff's expectations in the fourth quarter of 2020. Year-end 2021 forecasts for both indicators were revised downward to 2.3% and 2.1%, respectively. Market inflation expectations also fell over this period and suggested inflation below the 3% target through the end of this year, rising to the target in 2022. Downward pressure on inflation was more significant in the fourth quarter than previously projected, indicating weak demand. Annual deceleration among the main groups of the consumer price index (CPI) was generalized and, except for foods, was greater than projected in the October report. The CPI for goods (excluding foods and regulated items) and the CPI for regulated items were subject to the largest decelerations and forecasting discrepancies. In the first case, this was due in part to a greater-than-expected effect on prices from the government's "VAT-fee day" amid weak demand, and from the extension of some price relief measures. For regulated items, the deceleration was caused in part by unanticipated declines in some utility prices. Annual change in the CPI for services continued to decline as a result of the performance of those services that were not subject to price relief measures, in particular. Although some of the overall decline in inflation is expected to be temporary and reverse course in the second quarter of 2021, various sources of downward pressure on inflation have become more acute and will likely remain into next year. These include ample excesses in capacity, as suggested by the continued and greater-than-expected deceleration in core inflation indicators and in the CPI for services excluding price relief measures. This dynamic is also suggested by the minimal transmission of accumulated depreciation of the peso on domestic prices. Although excess capacity should fall in 2021, the decline will likely be slower than projected in the October report amid additional restrictions on mobility due to a recent acceleration of growth in COVID-19 cases. An additional factor is that low inflation registered at the end of 2020 will likely be reflected in low price adjustments on certain indexed services with significant weight in the CPI, including real estate rentals and some utilities. These factors should keep inflation below the target and lower than estimates from the previous report on the forecast horizon. Inflation is expected to continue to decline to levels near 1% in March, later increasing to 2.3% at the end of 2021 and 2.7% at year-end 2022 (Graph 1.1). According to the Bank's most recent survey, market analysts expect inflation of 2.7% and 3.1% in December 2021 and 2022, respectively. Expected inflation derived from government bonds was 2% for year-end 2021, while expected inflation based on bonds one year forward from that date (FBEI 1-1 2022) was 3.2%.

Graph 1.1
Consumer Price Index (CPI)
(end-of-period; annual change)

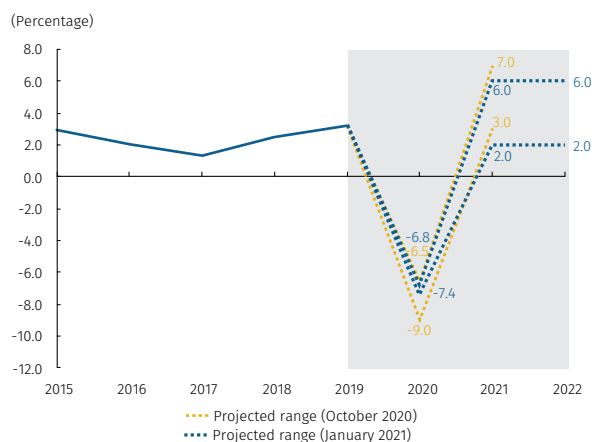


Source: DANE and Banco de la República.

Indicators of economic activity from the last quarter of 2020 suggest a larger recovery in output than anticipated in the

previous report, and would imply a fall in gross domestic product (GDP) for the year around 7.2% (previously -7.6%). This improvement in the path of economic recovery in 2021 would likely be somewhat offset by new restrictions on mobility, which have been necessary to address the ongoing COVID-19 pandemic. Given the above, the technical staff has revised its growth forecast for 2021 to 4.5% (previously 4.6%), with a range between 2% and 6%. Third-quarter GDP performance in 2020 was in line with expectations, though with some variations for large spending groups. Domestic demand over this period was better than expected, thanks to the performance of private goods consumption and investment in machinery and equipment. Meanwhile, public spending, public works, and exports were weaker than anticipated. The revised growth forecast for GDP in the fourth quarter of -4.4% (previously -5.5%) supposes that these broad trends will have continued, though new monthly figures from the economic tracking indicator (ISE), from retail commerce, and from the *Monthly Manufacturing Survey* suggest that both spending on durable goods and industrial performance could be more dynamic than suggested in this forecast. Public works, which was less dynamic in 2020 than expected, should perform better in 2021. An expected recovery in terms of trade, ample external financing, improved consumer and business confidence, and low interest rates should also contribute to a recovery in economic activity. Nevertheless, new restrictions on mobility put in place in Colombia at the beginning of this year could affect aggregate supply and demand, which would moderate the recovery in economic activity registered at the end of 2020. As was the case previously, the most recent mobility restrictions are expected to have more significant negative effects on aggregate demand than on supply. Given the above, this report estimates a smaller decline in GDP in 2020 (-7.2%) and a marginally reduced growth projection for 2021 (4.5%). This forecast supposes an absence of any further significant acceleration in COVID-19 cases or tightening of quarantine measures that would significantly affect economic activity for the remainder of this year or in 2022. It also does not anticipate any abrupt changes in the sovereign risk premium. The growth forecast for 2022 (3.5%) suggests a return to 2019 GDP levels at the end of next year, and accounts for the effects of a fiscal adjustment in line with the *Medium-Term Fiscal Framework*. Nevertheless, there remains a significant degree of uncertainty around the speed of recovery, primarily associated with the evolution of the COVID-19 health emergency. The pandemic represents a downward risk on the growth forecast in the short term, while an acceleration in the vaccination plan would represent an upward risk on growth in the medium term. Given the above, growth projection intervals are now between -7.4% and -6.8% for 2020, and between 2% and 6% for 2021 and 2022 (Graph 1.2).

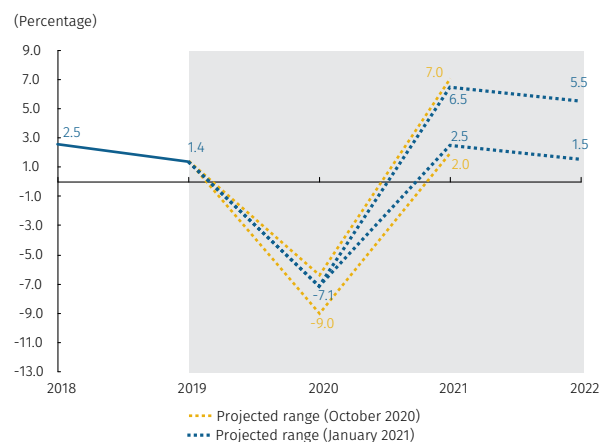
Graph 1.2
Annual gross domestic product
(annual change)



Source: DANE and Banco de la República.

Foreign demand likely fell by 7.1% in 2020 and is expected to recover in 2021 and 2022 by 4.4% and 3.5%, respectively. Nevertheless, there remains a high level of uncertainty surrounding the pace of the expected recovery in foreign demand and in oil prices, given the contrast between the challenge of new waves of COVID-19 and optimism over vaccine deployment. The global economy registered an

Graph 1.3
Assumed trade partner GDP
(annual change)

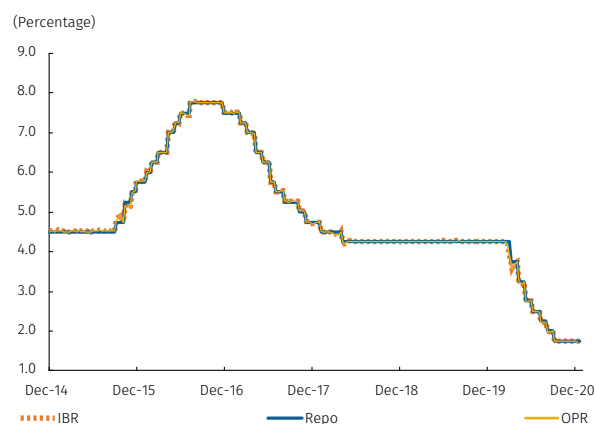


Sources: Bloomberg, statistics offices, and central banks; calculations and projections by Banco de la República.

observable recovery in the third quarter of 2020 following the unprecedented decline in economic activity over the preceding period. However, COVID-19 cases have intensified since the end of the year in various countries, particularly the United States and the euro zone. As a result, the subsequent tightening of quarantine measures has had a negative effect on economic activity. All this has come as COVID-19 vaccination campaigns get underway in several developed countries, with the potential for a positive effect on recovery in the global economy in 2021. In Latin America and the Caribbean, significant effects of the pandemic persist and vaccine deployment lags behind, leading to expectations of a slow recovery of growth. Overall, improved expectations for global economic activity, together with the extension of supply cut agreements by the Organization of Petroleum Exporting Countries (OPEC) and its allies, have favored oil prices after significant deterioration at the end of October. Moving forward there remains a high degree of uncertainty over the evolution of the international economic environment, which is also being affected by high levels of public debt, the deterioration of labor markets, the closure of businesses, and political and commercial tensions, among other factors. Given the above, this report projects growth in foreign demand for 2021 (4.4%) and 2022 (3.5%) to be between 2.5% and 6.5% and 1.5% and 5.5%, respectively (Graph 1.3). In 2021 the oil price is projected to be USD 52.8 (between USD 38 and USD 64) per barrel, and USD 56.4 (between USD 41 and USD 70) per barrel in 2022.

International financial conditions have improved amid high levels of global liquidity, low central bank interest rates, and optimism over the deployment of the first COVID-19 vaccines. This has been reflected in a reduction of global risk indicators, a recovery in stock indices, increases in long-term interest rates in the United States, and the appreciation of currencies against the dollar. The approval of the first COVID-19 vaccine toward the end of 2020, the early stages of vaccine deployment, and the potential arrival of additional vaccines, as well as the end of the election cycle in the United States, are likely significant factors favoring an improvement in international financial markets. Risk indicators for developed countries (VIX and VSTOXX) fell in the fourth quarter and by the end of 2020 returned to near pre-pandemic levels, while several major stock indices climbed above pre-pandemic levels. Over the same period, long-term interest rates on U.S. treasury bonds increased amid rising public debt and the expectation of additional fiscal stimulus. In emerging market economies, net capital inflows continued to recover, risk premiums fell, and currencies appreciated against the dollar, though they remained above pre-pandemic levels. So far in January international financial conditions have remained relatively favorable. The main credit-ratings agencies maintained Colombia's investment grade rating, and as of January 22 credit default swaps (5-year CDS) averaged 97.9 basis points, while the exchange rate was COP 3,462 per dollar. Despite this, it is assumed that increased public debt and the accumulation of external deficits could exert upward pressure on Colombia's risk premium on the forecast horizon. The evolution of global liquidity and its impact on access to international financing by emerging markets, as well as the effects of a possible change

Graph 1.4
Policy interest rate, interbank rate (IBR) and OPR^{a/}
(weekly data)



a/IBR: interbank rate.
Repo: policy interest rate.
OPR: overnight policy rate.
Sources: Office of the Financial Superintendent of Colombia and Banco de la República.

in the fiscal policy stance of the United States, are potential sources of risk on future financing costs.

Financial conditions in Colombia continue to improve and reflect significant transmission of reductions in the policy interest rate on savings and borrowing rates, though there is significant variation among different segments of the credit market. The Bank’s survey of the credit environment suggests an increased willingness on behalf of financial entities to provide loans, while interest rate spreads on credit compared to debt securities have fallen. Pre-payments on commercial credit have been observed over the last three months, contributing to a deceleration of growth in the commercial credit portfolio. At the same time, private bond placement by businesses has increased. The consumption portfolio in the consumer credit market has already returned to pre-pandemic levels, while growth in the mortgage portfolio has stopped accelerating. All of this comes in the context of a reduction in credit interest rates that has been more acute than for commercial loans, and less acute than for consumer and mortgage interest rates. Reduced interest rates, together with a recent recovery in portfolio levels, point toward an improvement in financing conditions.

1.2 Monetary Policy Decision

In its meetings in November, December, and January the BDBR held its policy interest rate unchanged at 1.75% (Graph 1.4).