Pandemic and the aftermath.

• We are now entering the third and worst wave yet, with rates of positivity in testing above 30%, and with an average of 600 deaths and 30,000 new reported cases per day.
• At the beginning of the crisis, the Colombian economy was hit hardest during the second quarter of 2020 when GDP fell by 15%.
• Unemployment reached roughly 20% (many LAC also exhibited a 50% increase in unemployment, but Colombia just started at a higher level). Unemployment dynamics were largely related to the informal sector and small businesses.
• Inflation reached the lowest number since the 1950´s, this allowed us to have more monetary space to conduct counter-cyclical policies.
• And regarding the banking sector: Deposits increased, but with a significant recomposition towards short term deposits, Corporate loans initially increased before falling, and Household and Microcredit loans fell sharply at the onset of the crisis.

Now for a variety of reasons, including monetary and fiscal policies, the economy performed better, and by that, I mean (not as bad) as previously expected.

• This year internal demand has shown positive signs, driven mostly by private consumption.
• The manufacturing industry has recovered, although with a marked heterogeneity in firms, sectors, and regions.
• The banking sector has had an adequate level of capital and liquidity buffers to withstand the shock.

Regarding Monetary Policy, let me highlight 3 actions undertaken last year by the central bank.

• First the policy rate was lowered by 250bp, so except maybe for Mexico and South Africa, this is the largest drop across emerging markets, and it represented an almost 50% increase in the monetary base.
• Second, the central bank purchased sovereign bonds and term deposits (in the amount of 1% of GDP) when the market for these was nearly collapsing.
• And third, it intervened in the FX market with non-deliverable forwards and FX swaps.

Looking into the future, it´s important for countries to maintain an expansionary stance, if it´s within their reach, in order to assist the economy as long as possible. But inevitably, the future of monetary policy for emerging and developed economies alike is to eventually raise interest rates.

• The reason is that there are dangers of low for long rates. For instance, there are more credit risks as the financial sector increases its appetite for riskier assets.
• Also, policy easing operates by shifting demand forward into the present by reducing savings and increasing borrowing. But there is a limit on the amount of private demand that can be moved intertemporally. If prolonged, it will gradually cease to stimulate demand.
• Having said this, Colombia will not increase rates directly in response to what other countries do, and this includes the US. So, the timing and amount will respond to our own objectives, embedded in the framework of an inflation targeting regime with an autonomous monetary policy. This is not to say that we don´t closely monitor external conditions and the effects of interest rate differentials, which we do.

Now let me transition over and say a few words about capital flows:

• Capital flows ultimately fit in one of two main categories: either a search for yield or a flight to safety, and I think Colombia is still in the former category.

• In general terms, capital inflows to the Latin American region took a dive in March and April of 2020 but then bounced back. And that was also the case for Colombia. Flows decreased during the 2nd and 3rd quarters of 2020 but then increased at the end of the year. And while we did see a dip in the first quarter of 2021, inflows have been quite high recently, especially in April and May, and this is in spite of two things:

o One, the social unrest and road blockages during May and part of June,
o Two, to the downgrade below investment grade by Standard & Poor's in mid-May.

• Now while mostly anticipated, I agree with Barclay´s report on May 20th in that the decision by S&P was premature. Ideally, you want decisions from rating agencies to be based on a more long-term basis, and also less pro-cyclical, and what I mean by that is you want a country to be rewarded if it is able to steer a crisis compared to what would have been in the absence of policies (i.e. its counterfactual outcome). Similarly, you want to know which countries fully take advantage of the good times and maybe red flag those that simply bank on a positive momentum.
• In sum, apart from the fact that maybe prices had already been factored in the announcement, other key issues also played a big role in Colombia, such as having a diversified investor base, and an overall high credibility, both in the central bank and in the medium to long-run outlook of public finances.

Let me conclude my statement with just a couple of words on public debt.

• First let me highlight the importance of having a balanced growth path. On this I think that it is incomplete to think that everything is ok as long as GDP (the denominator) grows faster than public debt (the numerator); because size matters at any given point in time.

o In fact, things like the fiscal multiplier can be a decreasing functions of the total stock of debt. In some cases, deterring loans to corporates and households and dampening investment.
o Unfortunately for Colombia, being an emerging country matters, and that's probably the case of why countries such as the US and Japan can borrow cheaply while having debt levels of 120% or 240% of GDP.

• Back to Colombia, after the crisis we now have public debt levels of 65% of GDP, and this might increase a little before it gradually converges to levels close to 60% during the next decade. The important thing here is to avoid a rapid, exponential debt growth, and also to obtain low interests, which I think so far, the government has been able to do.