Statement by Mr. Romero Tarazona on Colombia
March 25, 2022

On behalf of the Colombian authorities, I would like to thank all IMF staff for the excellent work during the Article IV consultation and FSAP review, their report on Colombia and the open discussion. The feedback provided will be crucial for the authorities' policy making decisions in the near future.

Recent developments and outlook

The Colombian economy has recovered rapidly from the COVID-19 shock. The growth rate in 2021 was 10.6 percent after a 7.0 percent contraction in 2020, the largest recession on record. With that growth rate, the output by the end of last year was already above the 2019 level. The Colombian vaccination campaign has been successful, currently being very close to the initial goal of 70 percent of the population being fully vaccinated, and our authorities are establishing a new target of 80 percent, expanding the coverage to the younger population.

Despite the strong growth, the job market is still in the process of recovering from the slump received in 2020, with a recovery of around 80 percent of the employment lost during the pandemic. Our authorities expect that, as long as the economic recovery continues during 2022, the unemployment rates will eventually achieve pre pandemic levels.

Inflation has increased, driven mainly by food prices and more persistent supply shocks, in the context of a strong recovery of domestic demand. Annual inflation reached 8.01 percent in February 2022, with annual food inflation standing at 23.3 percent, while inflation expectations began to deviate from the Central Bank's 3.0 percent target. The Colombian Central Bank started its policy normalization in September 2021 and has raised the policy interest rate by 225 bp since then. Because of large inflation surprises, the rising trend of inflation expectations and a faster than expected GDP growth, the pace of normalization was increased, with the Bank raising its policy rate by 100 bps in the latest Central Bank Board meeting at the end of January. The Central Bank has signaled that the process of tightening will continue, although the decisions on its pace and final point are uncertain and will be datadependent.

On the external front, the current account deficit widened to 5.7 percent of GDP in 2021, consistent with the strong recovery in domestic absorption. Thanks to better terms of trade, higher oil prices and increased service exports, the external deficit is expected to decrease in 2022. Financing of the external deficit should continue benefitting from ample access to international markets and resilient FDI flows, although risks to financial flows are elevated

now given considerable uncertainty in the current global situation.

Fiscal policy is adjusting, after a significant increase in expenditure, to support the most vulnerable households and more affected firms during the pandemic. The strong economic recovery has improved the outlook for public finances. Public deficit in 2021 was 7.1 percent of GDP, well below the level estimated by the Government at the beginning of last year (8.6 percent), due to the better performance of the economy and the associated higher tax collections. The improved economic activity will have a positive impact on Government revenues in 2022, which will allow the deficit to go as low as 6.2 percent of GDP this year, much lower than previously predicted. Although debt rose significantly due to the pandemic, the debt to GDP ratio started a declining trend in 2021, three years before previously forecasted, going down from 64.7 percent in 2020, to 63.8 percent of GDP in 2021 and it is expected to decline further, to 62.7 percent in 2022.

Looking ahead, Colombia should benefit from higher commodity prices and the recovery of investment, which is still lagging. The Central Bank's growth forecast of 4.3 percent for 2022 is likely to be revised upwards after positive surprises in economic activity data. Growth will remain strong partly due to statistical base effects and to dynamic investment and greater exports. The labor market has not yet recovered completely from the pandemic, but it should continue to improve, with the unemployment rate falling gradually throughout 2022. The successful execution of the national vaccination plan will continue supporting the recovery. Inflation would stay above target for the remainder of the year due to protracted supply shocks, but it should gradually decrease in the second semester and get close to target in 2023. Local food supply shocks should dissipate in the second half of the year, but external cost pressures affecting a wide array of sectors shall remain.

These forecasts are surrounded by significant uncertainty, especially stemming from the global economic outlook. On the one hand, although international liquidity is still abundant,the speed of monetary policy normalization in advanced economies is an important source ofrisk. On the other hand, the conflict in Ukraine adds to the uncertainty of the macro forecastsand economic outlook. As an oil exporter, Colombia's terms of trade have improved, and portfolio capital has apparently flowed into the country during the last weeks, increasing the Colombian treasury bonds' prices and inducing some currency appreciation, because of somerebalancing in portfolios away from countries more directly affected by the conflict.
However, the extent and duration of these effects are hard to discern. Moreover, the disruption of trade would likely heighten external supply shocks, especially in the food sector, complicating and challenging the already inflationary situation. It also creates uncertainty regarding capital flows to Colombia and risk perception towards emerging markets. Further waves of COVID-19 infections are also a downside risk that could slow down recovery, although new lockdowns are not expected in Colombia.

In this scenario, the Colombian authorities remain committed to the very strong economic policy framework that has distinguished the country, which has successfully helped it navigate through previous shocks and periods of uncertainty. Monetary policy will continue to be data dependent, executed by a credible and independent Central Bank that is focused on keeping inflation close to target. Fiscal policy will continue to focus on medium term sustainability, while financial regulation will guarantee a liquid, capitalized, and solvent financial system.

Monetary policy, exchange rate, and external buffers

Colombia follows a fully-fledged inflation targeting regime that has successfully responded to previous shocks. The Central Bank's response to the COVID-19 shock allowed it to stabilize key markets under stress, support credit supply, and stimulate aggregate demand. The adoption of a broad array of measures allowed the Central Bank to effectively address pressures arising from the shock and to support economic recovery.

As mentioned above, a gradual normalization of monetary policy started in September 2021. The policy stance is still expansionary, consistent with a lingering excess capacity. However, in the face of an increasing risk of de-anchoring inflation expectations, the authorities recognize that the policy response must bring the benchmark interest rate to the level required to control inflation and its expectations. Yet, due to the high level of uncertainty, this requires a data-dependent approach.

A flexible exchange rate regime is in place, within the Central Bank's inflation targeting framework strategy. Low currency mismatches and pass-through from the exchange rate to local prices allow for the use of the exchange rate as an important shock absorber, preserving a substantial degree of monetary policy independence.

The country's international reserves are adequate, remaining within the adequacy range suggested by the Fund's ARA metric during the last years. The Flexible Credit Line (FCL) has served as an additional important buffer to deal with external risks, and it has increased confidence in the country's economy among foreign creditors and investors. Also, it has signaled the presence of Colombia's very strong policy framework and sound economic fundamentals. The Colombian authorities remain committed to maintaining adequate international liquidity cushions and a flexible exchange rate as an external shock absorber.

Fiscal policy

In addition to the improved fiscal outlook mentioned above, it is very important to underline the political leadership and the compromise of the Colombian Government and Congress to propose, and successfully approve, the Social Investment Law on September 14th, 2021,

under difficult circumstances. Besides introducing social spending programs to protect the most vulnerable and to reactivate economic activity, this law includes measures to generate additional revenues for 1.4 percent of GDP, such as the increase of corporate income tax rate from 30 percent to 35 percent, corporate surtax to companies with higher profits during the pandemic, additional rules to strengthen the Tax Administration, and an adjustment program to reduce expenditures and significant improvements to the fiscal rule. Income tax sources would increase fiscal revenues starting in 2023.

Regarding the fiscal rule, the Congress approved a proposal based on a technical assistance program developed by the IMF, where the country's fiscal anchor was redefined in a way that better ensures medium-term sustainability of public finances. The new Fiscal Rule considers the debt level as a fiscal anchor, thus focusing on the adjustments necessary to return to a sustainable path in the medium term. Furthermore, an Autonomous Fiscal Committee has been appointed as a technical and independent Board, which is already in place and has played a very important role during recent challenging times.

In addition, the authorities remain committed to improve revenues through a more efficient tax collection, directly associated with the tangible advances of the process of modernization of the tax and customs authorities, including the successful implementation of an electronic invoice system that covers 95 percent of economic transactions, a system based in artificial intelligence and a very successful implementation of a new functional structure. In 2021 tax revenues grew 19% in comparison with the ones in 2020, which is explained with the reactivation of the economy and the important advances of modernization of the Colombia Tax Administration (DIAN).

Financial sector

The financial sector in Colombia remains liquid, solvent, and well capitalized. After the COVID-19 shock, the financial system proved to be largely resilient, and macro-financial risks remain contained. Moreover, exceptional measures to support credit and borrowers during the pandemic are now being phased out While credit growth is supporting economic recovery, the Colombian authorities are consistently monitoring credit quantity and quality.

The institutional framework for conducting macroprudential policy has been effective, and it has been enhanced in line with the Basel III recommendations, as found in the 2022 FSAP. My authorities are grateful to the Fund for the evaluation and recommendations of the 2022 FSAP. They are also committed to advance along the lines suggested by FSAP to further strengthen Colombia's effective supervisory and regulatory frameworks.

Final remarks

The Colombian economy traversed the pandemic shock well, and economic recovery has

been faster than expected. The soundness of our policies allowed the authorities to respond rapidly to different shocks. Fiscal and monetary policy supported economy activity, while financial policy and supervision guaranteed a resilient financial system in the midst of extraordinary circumstances.

While the country's political outlook is complex, due to the upcoming presidential elections, the authorities are committed to maintain very strong policy and institutional frameworks, as well as to preserve a prudent macroeconomic management. My authorities' main line of defense against the current uncertain global environment will be to maintain solid macroeconomic fundamentals and a sound institutional policy framework going forward. They remain committed to the country's inflation targeting regime with exchange-rate flexibility, public finances anchored by a fiscal rule, and to a strong financial regulation and supervision. This framework has helped Colombia to successfully navigate through previous shocks and gives economic agents confidence in the country.