COLOMBIA

AWAITING THE ELECTIONS

In Colombia, economic growth is rebounding after two years of poor performance, but several sectors are still lagging behind and investment is still weak. Attention is now turning to the 2026 parliamentary and presidential elections, which could lead to major shifts in economic and fiscal policy. The next administration will inherit a record-high fiscal deficit and a rapidly rising public debt. With the fiscal rule suspended for three years, it will need to act quickly to lay the foundations for fiscal consolidation before investor confidence is eroded further.

ECONOMIC GROWTH RECOVERS TO ITS POTENTIAL

In Q2 2025, economic growth (seasonally adjusted) rebounded to 2.5% year-on-year (y/y). The impact of US tariff increases on economic activity has been limited, given exemptions on oil (40% of exports to the United States). The rest of exports to the United States, particularly flowers, precious stones and metals, and coffee (33% of exports), could even become more price-competitive compared to the seven Latin American countries which have had reciprocal tariffs of above the 10% floor rate since August[1].

Economic growth is expected to continue accelerating in H2 and reach 2.6% in 2025, slightly above its potential rate. It should be supported by strong consumption (+3.6% y/y in Q2), thanks to falling unemployment (8.6% in August, compared to an average of 9.2% in H2 2024) and the government's expansionary fiscal policy (primary expenditure is up 15% y/y in January-August).

However, investment could be held back by investors adopting a wait-and-see approach ahead of the parliamentary and presidential elections in the first half of 2026. Despite its recent rebound (+3.1% y/y in Q2), investment remains 9% below its 2022 level and accounts for only 16.5% of GDP. Investment in machinery and equipment has contracted by 17% since 2022, while investment in construction (excluding housing) has increased by only 2%. This lack of investment is reflected in the sectoral breakdown of GDP, where the gross value added of capital-intensive sectors has contracted over the past two years. Thus, in Q2 2025, activity (measured over four quarters) in the mining, manufacturing and construction sectors remained 6%, 4% and 3% below the levels observed in 2022, respectively. A rebound in investment, driven by a catch-up dynamic, would improve the medium-term outlook for growth, which has slowed significantly compared to the past decade (average annual growth of 3.7% over 2010–2019). The new government, which will come to power in August 2026, could choose to lift the ban on new hydrocarbon-exploration licences introduced under President Petro, and even restart fracking projects that have been suspended until now. Investment would then rebound significantly.

FORECASTS	2022	2023	2024	2025e	2026e
Real GDP growth, %	7.3	0.7	1.6	2.6	2.4
Inflation, CPI, year average, %	10.2	11.7	6.6	5.0	4.2
Central governement balance / GDP (%)	-5.3	-4.2	-6.7	-7.7	-6.8
Central government debt / GDP (%)	60.8	56.3	61.6	64.7	67.5
Current account balance / GDP (%)	-6.0	-2.3	-1.7	-2.3	-2.6
External debt / GDP (%)	59.2	53.3	52.9	54.2	55.1
Forex reserves, USD bn	57.3	59.6	62.5	65.8	67.4
Forex reserves, in months of imports	7.8	9.3	9.5	9.3	9.2

TABLE 1 e: ESTIMATES & FORECASTS
SOURCE: BNP PARIBAS ECONOMIC RESEARCH

COLOMBIA: CENTRAL GOVERNMENT DEFICIT

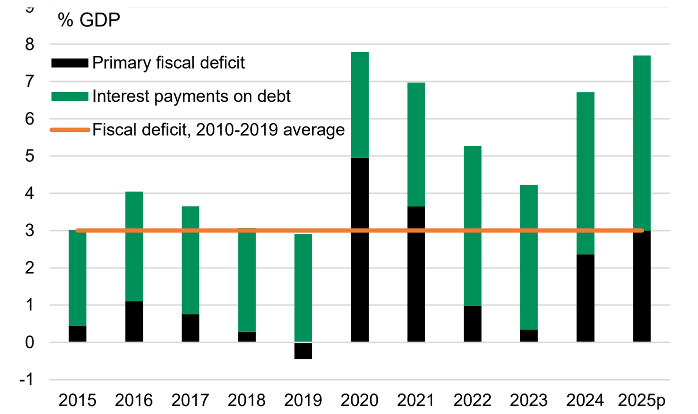

CHART 1 SOURCE: MINHACIENDA, BNP PARIBAS

LITTLE ROOM FOR MANOEUVRE IN MONETARY POLICY

Since the beginning of the year, the central bank has lowered its key rate by only 25 basis points (bp) in May, bringing it to 9.25%, despite numerous calls from President Petro to lower rates in order to support growth. The window of opportunity for a further rate cut by the end of 2025 has narrowed significantly in recent months. Since June, 12-month inflation expectations have risen significantly due to the fiscal rule being suspended; and since July, inflation has picked up again, reaching 5.2% y/y in September, driven by persistent inflation in services and food. Recently, the possibility of an 11% increase in the minimum wage on 1 January 2026 has also justified the central bank's caution. Inflation may not return to its 3% target until 2028.

KEEPING AN EYE ON THE DETERIORATION IN EXTERNAL ACCOUNTS

Measured over four quarters, the current account deficit widened to 2.1% of GDP in Q2 2025. It is weighed down by the trade deficit, which reached 2.8% of GDP, its highest level in two years. In value terms, growth in imports of goods and services (+8.1% y/y) exceeded that of exports (+2.9%), which were particularly hampered by the fall in oil prices (38% of goods exports). The deterioration in the trade balance was partly offset by the strong performance of diaspora remittances, which rose by 16% y/y in Q2 and amounted to 3% of GDP. However, in the coming months, the current account deficit is expected to continue

1 Brazil (50%), Nicaragua (18%), Bolivia, Costa Rica, Ecuador, Guyana and Venezuela (15%).

to widen. On the one hand, oil prices are expected to stagnate or even continue to fall until H1 2026. On the other hand, the trade deficit with China (Colombia's second largest trading partner) may widen further as China reconfigures its exports: in Q2 2025, the value of Chinese exports to Colombia was up 23% y/y, while falling 5% in Mexico and 4% in Brazil. Diaspora remittances are expected to remain robust thanks to the resilience of the US economy and despite the 1% tax on remittances abroad introduced by the Trump administration[2].

The performance of the financial account is also mixed. Net FDI flows rebounded slightly in Q2, but still accounted for only 2.3% of GDP, 0.5 pp below the 2015-2019 average. Net portfolio investment outflows, which have been ongoing since Q2 2023, slowed sharply (to 0.1% of GDP). However, with next year's elections approaching, foreign investors are likely to adopt a cautious stance, which would lead to a further decline in FDI and an accelerated recovery in portfolio outflows. Against this backdrop of deteriorating external accounts and political uncertainty, the Colombian peso is likely to weaken against the US dollar in the coming months.

FISCAL CONSOLIDATION POSTPONED

In 2024, the central government faced an unexpected decline in revenue[3], which contracted by 5% in nominal terms despite nominal GDP growth of 7.7%. Conversely, fiscal expenditure rose by 9% despite restrictions in the second half of the year that mainly affected public investment. Therefore, the central government deficit widened to 6.7% of GDP, a level close to the peak seen during the pandemic (*Chart 1*).

The corrective measures promised by the government in early 2025 were ultimately not adopted. On the contrary, last June, the government activated a derogation clause in the fiscal rule which allowed it to be suspended for a period of three years. In 2025, the deficit could exceed the official target of 7.1% of GDP: in January-August, it already reached 5.1% of the GDP forecast for the whole year, a level only exceeded in 2020, during the pandemic. A marked slowdown in spending in the last few months of the year is unlikely, given the backdrop of the upcoming elections.

2026 could well be a repeat of 2025. The central government forecasts a deficit of 6.2% of GDP, but the 2026 Budget recently approved by Congress is based on a number of optimistic assumptions – particularly regarding growth (3% in 2026) and interest payments on debt (4.2% of GDP, down 0.5 pp compared to our forecast for 2025), while i) the cost of bond borrowing for the government has been rising since 2024 and has even exceeded nominal growth, and ii) the debt ratio is increasing. Above all, part of the budget financing hinges on the adoption of a tax reform that could bring in COP 16 trillion (0.9% of GDP) to public finances. However, this reform does not enjoy unanimous support in Congress, where there have been criticisms of the introduction of new taxes without better control of spending. In addition, the CARF, an independent state body with more conservative forecasts, estimates that COP 29.4 trillion in additional measures (through spending cuts and/or revenue increases) would be needed in order to meet the deficit target. Under these conditions, and even assuming drastic spending cuts at the end of the year, the fiscal deficit could remain close to 7% of GDP next year.

Postponing fiscal consolidation each year will require a significant adjustment when the fiscal rule is reintroduced in 2028. This adjustment will be all the more difficult to achieve given that most of the central government's primary expenditure (86% in 2024) is rigid.

YIELD SPREAD WITH THE U.S. ON 10-YEAR SOVEREIGN BONDS DENOMINATED IN USD (CDS)

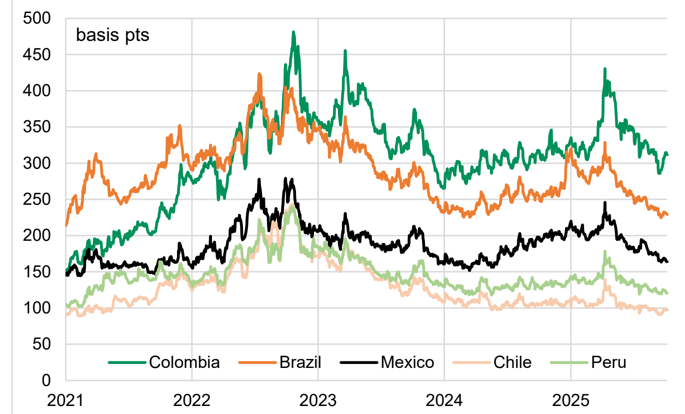

CHART 2

SOURCE: BLOOMBERG, BNP PARIBAS

On the expenditure side, eliminating diesel subsidies, bringing the public wage bill as a percentage of GDP back down to its historical average, rationalising social transfers and replacing healthcare subsidies with increased employer contributions would save 2 percentage points of GDP by 2028, according to the IMF. On the revenue side, the Fund suggests, among other things, fewer VAT exemptions and lower minimum thresholds for import taxation, as well as an increase in the carbon tax and the tax rate on gambling. This would result in a gain of 0.8 percentage points of GDP.

However, such measures would come at a high political cost for the next administration, which will take office in August 2026. If Congress remains fragmented after the parliamentary election, the next government's ability to pass a tax reform will be limited. So far, the markets have not reacted a great deal to the fiscal rule being lifted and are convinced that a major shift in fiscal policy will take place after the elections: since July, the yield spread between 10-year Colombian and US dollar-denominated sovereign bonds has been narrowing (*Chart 2*). But if fiscal consolidation is also postponed by the next administration, tensions in the bond market could rise rapidly, further increasing the interest burden.

Central government debt reached 61.4% of GDP in Q2 2025: it is 1 pp higher than a year earlier and 9 pp above its 2019 level. It is vulnerable to a tightening of external financing conditions, given its exposure to currency risk and foreign investor confidence shocks. In August, 28.7% of the debt was denominated in foreign currency. Despite the perception of increased sovereign risk, foreign investors still held 16% of Treasury bonds (6% of GDP). This share even rose to 20% in September after the Fed's new round of monetary easing. In addition, in order to reduce the interest burden, the government has favoured issuing short-term debt in recent months. It will most notably face a peak in external-debt amortisation in August 2026, when the new administration comes in. The average maturity of total debt has fallen by 0.7 years since December 2024, but remains comfortable, standing at 10.1 years in August.

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2 In 2024, 53% of diaspora remittances came from the United States.
3 The collection of tax revenue in 2023, which was done in advance, resulted in an overcharge that had to be deducted from tax revenues in 2024. In addition, in 2024, the contraction of the hydrocarbon sector (a sizable contributor to tax revenue) also led to lower collection than in 2023.