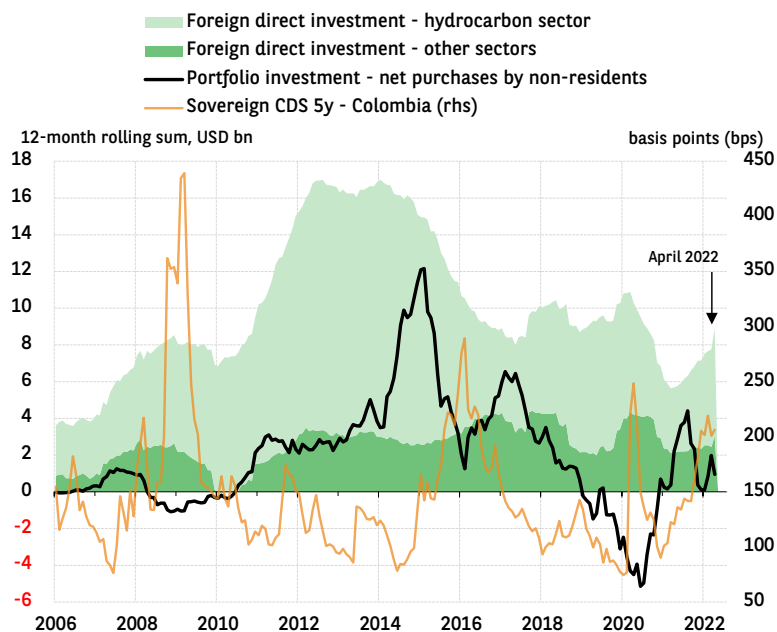


25 May 2022

COLOMBIA: RECENT BEHAVIOUR OF CAPITAL FLOWS AHEAD OF THE PRESIDENTIAL ELECTION

Salim Hammad

Non-resident capital flows and market-based perception of sovereign risk ahead of the presidential election



Source: BanRep, Refinitiv, BNP Paribas

As of late, political risk has not weighed as heavily as expected on investment flows into Colombia. The strong rise in oil prices this year (+50% for a barrel of WTI crude year-to-date) coupled to the country's distance from the Ukrainian conflict and the Central Bank's more aggressive stance since January (+300 bps rate hikes) have helped support investment inflows and have trumped, so far, concerns over the high level of uncertainty surrounding the upcoming presidential election (1st round on May 29th). Foreign direct investments (FDI) in the hydrocarbon sector (2/3 of total FDI on average) have continued to recover quite strongly and have not been fazed by the possible interruption of new oil and gas developments – proposed by poll-leading candidate Gustavo Petro. Meanwhile, foreign portfolio investors – despite episodic sell-offs – have remained net buyers of Colombia securities.

The prospects of potentially higher public spending and taxes are however affecting credit risk premia and feeding outward capital flows by households. The 5-year sovereign CDS spread – after widening in 2021 on the back of social protests and the loss of Colombia's investment grade status – is still about 100 bps above its historical average despite the economy's strong recovery from Covid-19 and a favourable commodity price cycle. Gustavo Petro's promise to tax the rich is also prompting some households to increasingly hold assets overseas. An additional USD +1.5 bn in currency and deposits was held abroad in 2021 compared to the average over the period 2016-2020. This trend could further accelerate depending on the outcome of the election.

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