

Colombia Update

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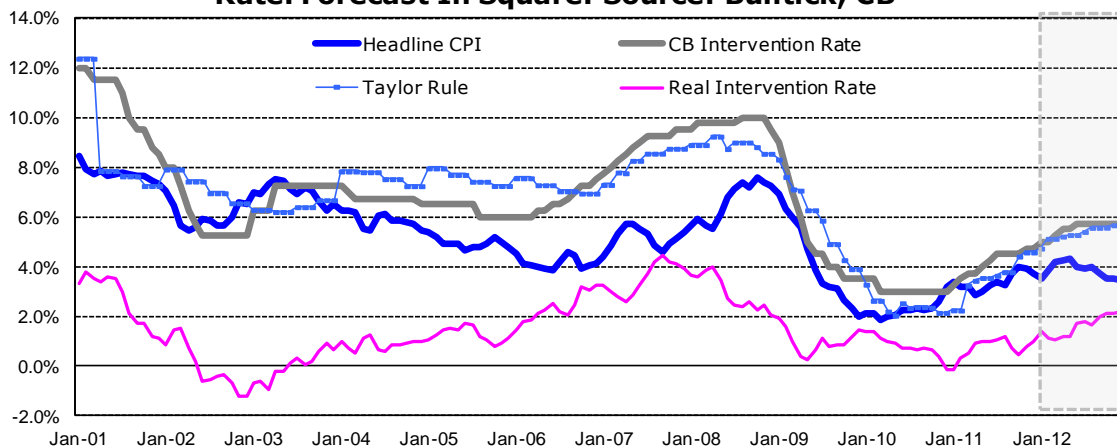
BullTick
Capital Markets

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COLOMBIA—CB Will Hike Intervention Rates To 5.75% By Year-End

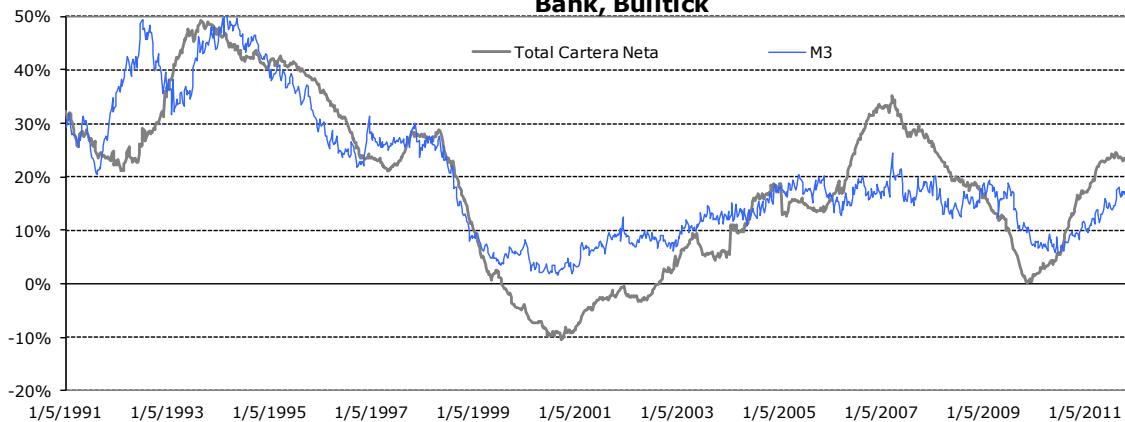
The Colombian Central Bank surprised literally everyone (us included) but one analyst in the market (based on the responses to the Bloomberg survey) with the decision to hike intervention interest rates by +25bps during the January meeting. As argued before, we clearly did not expect the Central Bank to hike rates at this meeting, but rather to wait until March before deciding in favor of lifting the intervention rate by +25bps (to 5%). As argued in our last monthly publication: "Our Taylor-Rule estimation is currently delivering that the neutral rate (for year-end 2012) currently stands at 5.8%, since the output gap has now most likely been fully erased. Therefore, we think that it is logical to expect the CB to hike interest rates another +50bps during the year, most likely in Q212. We think that the CB Board is likely to maintain a "wait-and-see" attitude until March, a time when markets will already "know" how Italy's critical €53.1 billion sovereign debt amortization exercise fared."

COLOMBIA--Y/Y CPI, CB Intervention Rate, Real Interest Rate. Forecast In Square. Source: Bulltick, CB



Clearly the decision by the Central Bank to hike interest rates this early during the year, coupled with the publication of a still slightly hawkish communiqué (*the CB mentioning high growth of domestic demand, high growth of credit, and record high property prices*), implies to us that the Central Bank is fully committed to bringing the intervention rate to the level hinted by the current estimation of the Taylor Rule (again, our estimation is hinting that the neutral rate stands at this time at 5.8% nominal). **Hence, we are revising our expectation of the year-end intervention rate finishing at 5.75% (our prior estimation was 5.25%).**

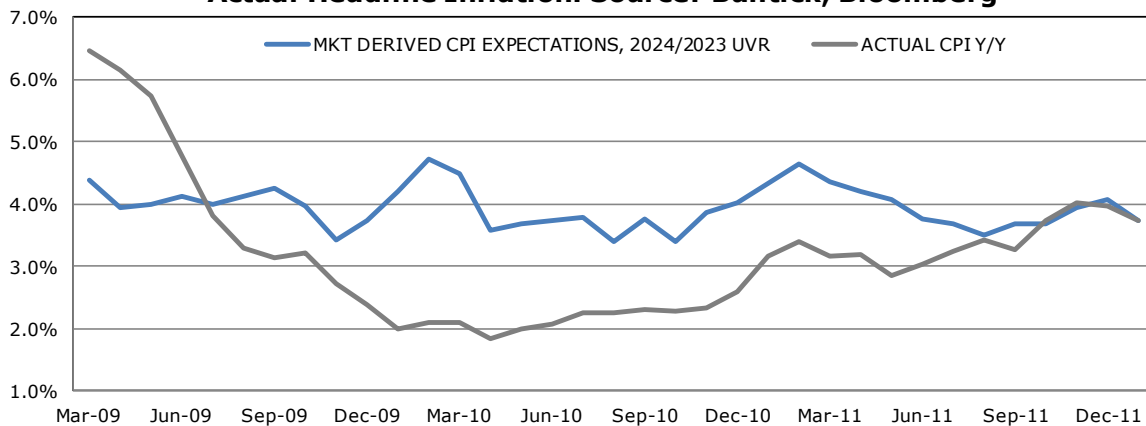
COLOMBIA--Y/Y Growth Loan Portfolio, M3. Weekly Data. Source: Central Bank, Bulltick



MARKET RECOMMENDATIONS

LOCAL RATES AND GLOBAL TES: *Hold For Local Accounts, Buy For USD-Based Accounts.* We consider that Colombia's fiscal, inflation, and growth fundamentals remain quite positive. We remain convinced that an emerging economy that is allocating more than 27% of its GDP in productive investment (capital deepening) likely enjoys from a potential GDP growth rate that surpasses the +5% year-over-year mark -- basing the argument on growth considerations following a production-function analysis and not on a time series exercise, such as a simpler Hodrick-Prescott filter. **In comparison, the rate of Investment/GDP in Brazil currently stands at around 18%, and most researchers give the Brazilian economy an estimated potential output rate somewhere around +4.5% year-over-year.** Under the guidelines of a production function analysis, the Colombian economy is currently growing at rates consistent with its current potential. As we argued in a recent research piece, we believe that the fiscal situation of Colombia is much better than analysts realize. We think that the amount of 2012 TES issuance published on the current financial plan will be revised DOWNWARDS at some point during the second half of 2012, following the likely outperformance of the established fiscal targets.

COLOMBIA--LT Market Derived Inflation Expectations And Actual Headline Inflation. Source: Bulltick, Bloomberg



Regardless of the possible future actions by the Central Bank, we consider that the local curve remains a HOLD. **We think that the 2024's are likely to finish 2012 some -10bps tighter from current levels, following good fiscal and growth fundamentals, a strong USDCOP, and lingering very low international interest rates.**

SPREADS: *Bearish.* As we argued in our January monthly publication, expect 2012 to be a difficult year for high grade Latin America hard-currency paper (USD-denominated paper), in large part because we think that US Treasuries and German Bunds will sell-off somewhat in 2012. We find no viable argument to maintain an aggressive position on US treasuries at current levels, since we do not foresee a US double-dip recession taking place, and since our base case scenario is that the VIX will remain stable at around 20. Needless to say, our scenario is mutually exclusive with the 10-year rate of the US trading below the implied 10-year CPI delivered by the TIPS market.

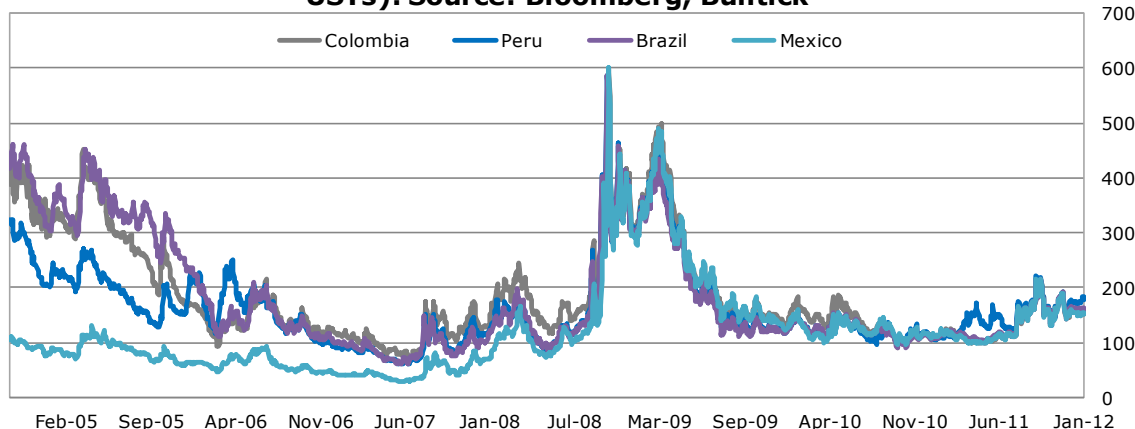
Sensitivity Analysis, Hold Exposure Of A Brazil 2041 Until December 31, 2012 Total Return On Investment. Carry At Time t, 4.69%. 30-Year Treasury, 2.9%

30-Year UST Yield	Brazil 2041 (Spread Elasticity To Current Spread)			
	0.5	1	1.5	2
2.50%	27.4%	11.2%	-2.4%	-13.4%
2.75%	22.4%	7.1%	-5.7%	-16.3%
3.00%	17.7%	3.3%	-8.8%	-18.8%
3.25%	13.3%	-0.3%	-11.8%	-21.4%
3.50%	9.2%	-3.7%	-14.7%	-23.6%
4.50%	-5.3%	-15.8%	-24.6%	-31.9%

Source: Bulltick Capital Markets, Bloomberg

As we show in our simulation table (prior page), we consider that it will prove difficult for investors to make good returns on USD-denominated high grade paper if our macroeconomic forecasts on the future of the world economy turn out to be accurate. We consider that high grade investors are unlikely to earn any positive return in their investments, especially after taking into account that 2011 turned out to be such a great year for Latam USD-denominated debt instruments –according to our calculations, an investor that held a Colombia 2037 from the beginning of the year to the end of the year amassed a very decent total return of 16.8%. As should be clear, we consider that US rates will increase in 2012, and we doubt that sovereign spreads will come-in much more than they already have.

Colombia, Peru, Brazil, Mexico, Five-Year CDS Level (Bps Over USTs). Source: Bloomberg, Bulltick



The main counter-argument to our bearish view on sovereign bonds remains the fact that supply of sovereign paper will likely remain constrained in 2012, because the region will likely continue to show a very healthy performance of the aggregate fiscal accounts (we expect the region to run a total deficit of only 2.5% of GDP, or about USD \$136 billion in 2012, and we expect most of those resources to be raised in the local markets). In terms of total 2012 public debt amortizations, between Mexico, Brazil, Argentina, Colombia, and Chile, total USD amortizations will number USD \$250 billion (some 4.5% of GDP), and we doubt that the ratio of new debt issuance to debt amortizations will come above unity in 2012 –this being a clear positive for the technicals in the market.

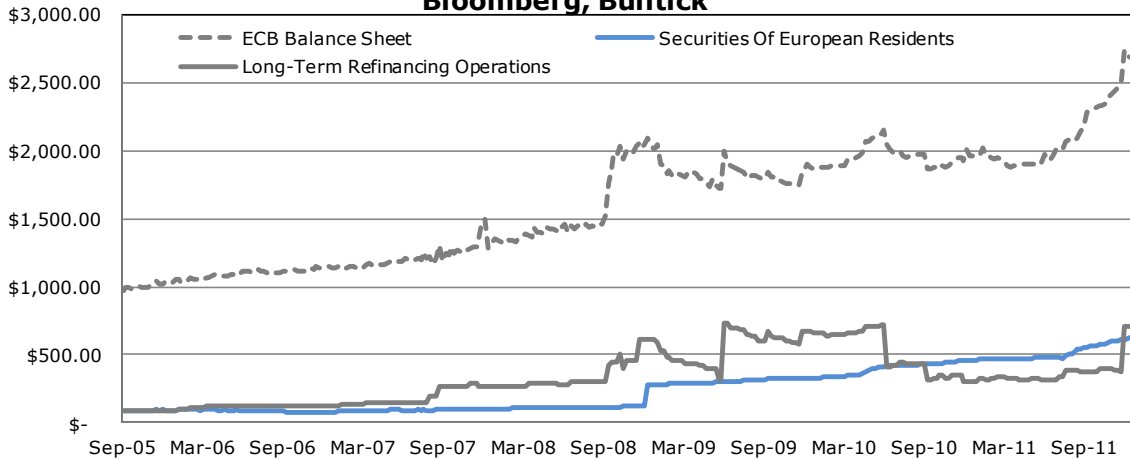
Still, we think that the negative price effect of US interest rates increasing will prime in this investment story (hence our decision to maintain a cautious exposure in this asset class).

External Accounts--COLOMBIA											
Source: Central Bank, Bulltick											
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011*	2012*
Current Account	(\$1,643)	(\$1,021)	(\$1,110)	(\$1,930)	(\$2,861)	(\$5,698)	(\$6,789)	(\$5,001)	(\$8,944)	(\$10,436)	(\$12,835)
.....Goods	\$225	\$524	\$1,134	\$1,594	\$322	(\$594)	\$971	\$2,546	\$2,136	\$2,223	(\$482)
.....Services	(\$1,463)	(\$1,433)	(\$1,725)	(\$2,089)	(\$2,109)	(\$2,605)	(\$3,072)	(\$2,728)	(\$3,465)	(\$4,124)	(\$4,549)
.....Rent	(\$2,812)	(\$3,446)	(\$4,185)	(\$5,525)	(\$5,858)	(\$7,888)	(\$10,333)	(\$9,432)	(\$12,096)	(\$13,810)	(\$13,813)
.....Current Transfers	\$2,407	\$3,334	\$3,667	\$4,089	\$4,785	\$5,390	\$5,646	\$4,614	\$4,481	\$5,275	\$6,009
.....Flows from Col. Expatriates	\$2,711	\$3,568	\$3,935	\$4,349	\$5,037	\$5,642	\$5,898	\$5,253	\$5,349	\$5,701	\$6,009
Capital Account	\$1,315	\$737	\$3,384	\$3,333	\$2,677	\$10,403	\$9,491	\$6,315	\$11,877	\$16,339	\$15,136
.....Long-Term	(\$1,481)	\$1,000	\$1,700	\$3,736	\$6,423	\$11,811	\$9,936	\$12,591	\$6,739	\$12,665	\$12,262
.....FDI	\$1,974	\$1,793	\$2,739	\$10,192	\$6,295	\$9,028	\$10,596	\$7,207	\$6,760	\$11,592	\$12,444
.....Portfolio Inflows	(\$1,029)	\$104	\$743	(\$167)	\$457	\$222	(\$195)	\$4,822	\$913	\$2,677	\$2,142
.....Short-Term	\$2,796	(\$263)	\$1,685	(\$402)	(\$3,747)	(\$1,408)	(\$445)	(\$6,276)	\$5,138	\$3,674	\$2,874
Omissions	\$467	\$100	\$267	\$326	\$206	\$8	(\$80)	\$32	\$202	\$225	\$0
Res. Build-up/depletion	\$138	(\$184)	\$2,541	\$1,729	\$23	\$4,714	\$2,623	\$1,347	\$3,136	\$6,128	\$2,301
Gross Reserves (Average)	\$10,657	\$10,728	\$12,149	\$14,103	\$15,020	\$20,126	\$23,282	\$24,517	\$26,921	\$32,298	\$35,112
Current Account/GDP	-1.81%	-1.09%	-0.96%	-1.34%	-1.69%	-2.82%	-3.03%	-2.16%	-3.23%	-3.19%	-3.54%
*Bulltick Forecast											

FX: Positive. We maintain our long-held call that the USDCOP will be trading at \$1,750 by the end of 2012. The external accounts of Colombia are likely to show a very good performance in 2012, following market

friendly economic policy formulation, high economic growth, a still weak USD (i.e. lingering high commodity prices), high and recurrent levels of FDI, and still relatively high local yields. We still consider that the risks to the Colombia FX trade are mostly external. In our view, the most relevant risk remains the disintegration of the European monetary system, one that would, among other things, force the Spanish and Italian banking sector into complete and unprecedented havoc. Clearly, the USDCOP would most likely enter into a very complicated dynamic if such a scenario were to materialize in the future.

EUROPE--ECB's Balance Sheet (In € Billions). Source: Bloomberg, Bulltick



As we argued in our January monthly market strategy, we think that 2012 will be a year in which investors will be "forced" to embrace carry trading once again. **We think that increasing levels of base money around the world will translate into forcing world-wide accounts to "unwillingly" search for investment alternatives, and most of those monies will continue to make their way into the markets that present the investor with the highest possible return of investment.** Also of high relevance, we think that 2012 will be the year in which € weakness will decouple from the "risk-off" trade.

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