BOX 1
Behavior of the current account deficit and its long-term relationship with some critical determinants in the case of Colombia and other regional countries

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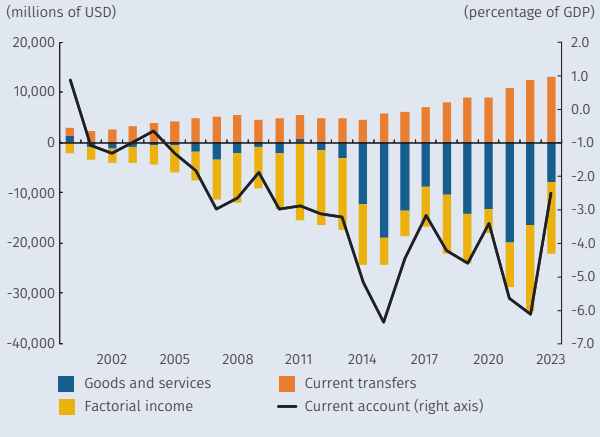
1. Introduction

After facing the adverse effects brought on by the COVID-19 pandemic, in 2021 and 2022 the Colombian economy grew at a remarkable pace, reflected in a widening of the current account deficit to levels close to its historical maximums (-5.6% and -6.1% of GDP, respectively). In contrast, 2023 saw a slowdown in local economic growth due to a restrictive monetary policy and a reduction in the fiscal deficit. This, together with the revitalization of tourism and high levels of remittance income, resulted in a significant correction to the current account deficit, which reached its lowest level in the last thirteen years (-2.5% of GDP). This Box seeks to explain the dynamics that drove the widening of the deficit in 2021 and 2022 and those that facilitated its correction in 2023. It also evaluates the level of the current account deficit against a projection of its long-term relationship with some key determinants for Colombia and for other economies in the region.

Graph B1.1
Behavior of the current account by components



Source: *Banco de la República.*

2. Recent behavior of the external imbalance from a balance of payments perspective

In Colombia, the current account of the balance of payments has historically presented a deficit. Recently, this imbalance has been driven by the trade balance and factorial income (Graph B1.1). In contrast, current transfers have traditionally shown a surplus, driven mainly by the flow of remittances to Colombia. During 2021 and 2022, the trade deficit in goods and factorial income widened compared to that observed in 2020, which explained the more significant external current account imbalance. In the same years, the trade deficit in goods was due to accelerated growth of imports, coupled with the country's economic recovery and higher freight costs reflecting the challenges seen in global supply chains once the pandemic ended. As for factorial income, during this same period, there was an upturn in profit outflows from the mining and oil sector amid rising international commodity prices following Russia's invasion of Ukraine.

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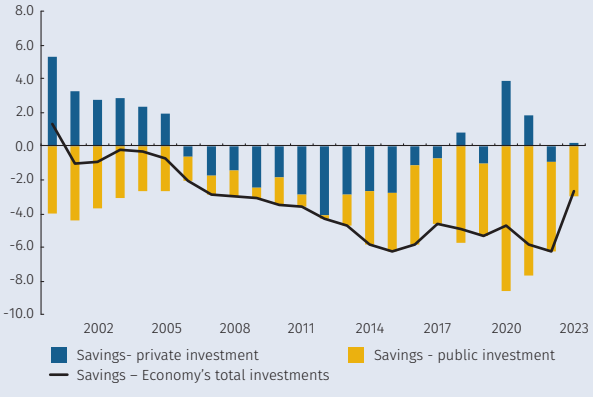
By 2023, a correction was observed in the current account deficit under a restrictive monetary policy, which contributed to the adjustment of domestic demand, resulting in lower imports and a decrease in the goods trade deficit (Graph B1.1). Furthermore, the same year saw a significant decrease in the services deficit, mainly due to higher exports in the tourism sector, coupled with a tempering in freight rates once global supply chains stabilized. In addition, the factorial income deficit decreased in an environment of falling international commodity prices and lower profitability of foreign companies established in the country. Moreover, current transfers reached their highest historical level, driven by income from workers' remittances favored by a rebound in the migration of Colombians abroad and tight labor markets in the advanced economies where Colombian migrants work. All these factors allowed the external imbalance to close, narrowing from -6.1% of GDP observed in 2022 to -2.5% by 2023.[1]

3. Outlook from a local savings and investment perspective

The current account of the balance of payments also reflects the imbalance between an economy's investment and savings. If national savings are insufficient to finance investment, it would be necessary to resort to savings from the rest of the world, resulting in a current account deficit. From this perspective and according to National Accounts figures, since 2013 the public sector has been the primary component of the current deficit, in tandem with an increase in the level of public debt of the General Government.[2] In 2021 and 2022, the private sector led the expansion of Colombia's external deficit (Graph R1.2),[3] amid the recovery of private consumption following the savings surpluses accrued during the pandemic, the growth of credit, and higher investment above its trend, mainly in machinery and equipment. In 2023, both the public and private sectors contributed to closing the external imbalance owing to a lower public sector deficit as a percentage of GDP and a private sector whose investment fell more than its savings.

Graph B1.2
Savings-Investment Balance

(percentage of GDP)



Source: DANE, own calculations.

4. Current deficit versus the level based on specific key determinants

To assess the current account deficit against one based on some fundamental determinants, we follow the methodology proposed by Torres and Cote (2017) to estimate the long-term relationship between the current account and a group of variables commonly used in the literature as determinants of its behavior. This estimation uses a panel data cointegration model employing the Fully Modified Ordinary Least Squares (FMOLS) methodology.

For this purpose, panel data was constructed for 26 countries[4] using annual information from 1980 to 2023, which, in addition to current

1 The current account deficit decreased from USD 21,205 million in 2022 to USD 9,154 million in 2023.

2 From 2013 to 2019, the increase in public debt occurred in a context of low interest rates, consistent with the recovery of Colombia's investment grade in 2011. By 2020, debt increased markedly as a direct result of the resource needs arising from the pandemic's health emergency.

3 The savings-investment balance is constructed from the historical series of private and public savings and investment data derived from DANE's Integrated Economic Accounts (CEI). The public sector is understood as the General Government, and the private sector is understood as all other institutional sectors.

4 Barbados, Belize, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, Guatemala, Honduras, Jamaica, Panama, Paraguay, Peru, El Salvador, India, Indonesia, Israel, Jordan, Korea, Malaysia, Nepal, Pakistan, Papua New Guinea, and the Philippines.

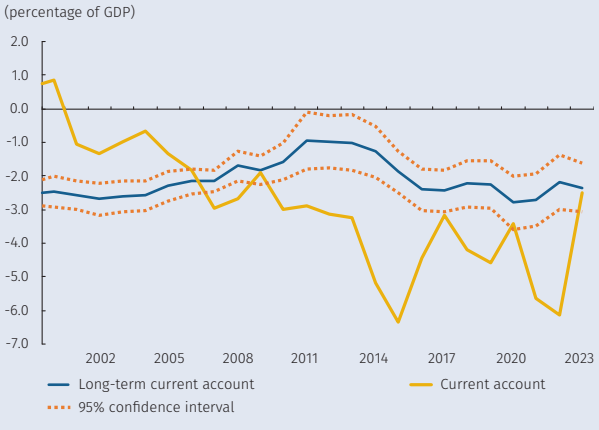
account information, includes a series of financial, demographic, and macroeconomic variables that the literature commonly identifies as determinants of external imbalance[5] (Arteaga et al., 2011; Gossé and Serranito, 2014; Torres and Cote, 2017). With this, the following estimate for a long-term level of the current account was made:

$$cc_{i,t} = \alpha_i + x'_{i,t}\,\beta + u_{i,t}$$

Where $cc_{i,t}$ is the current account as a percentage of the country *i*'s GDP in year *t*, t, $x'_{i,t}$ is a matrix of the long-term determinants of the current account, and $u_{i,t}$ is the error term. Consequently, the value estimated by the model corresponds to the current account level that would be compatible with its fundamentals in the long term. These values were obtained for each of the 26 countries included in the data panel.

In the case of Colombia, the results suggest that the current account deficit evidenced a particularly notable misalignment against those levels resulting from its long-term relationship with some fundamental determinants for three specific periods during the last 25 years. The first period, in the early 2000s, corresponds to the sharp economic contraction seen at the end of the last century. The second period, spanning from 2012 to 2016, suffered a significant reduction in exports following the rupture of trade relations with Venezuela, which deepened as of 2014 with the fall in international oil and other raw materials prices. Finally, the increase in the current deficit experienced in 2021 and 2022 shifted it away from the long-term relationship levels estimated for those years (-2.7% and -2.2% of GDP, respectively), while the correction observed in 2023 would have brought it considerably closer to the long-term projections (-2.4% of GDP).

Graph B1.3
Current account and long-term current account as a percentage of GDP - Colombia



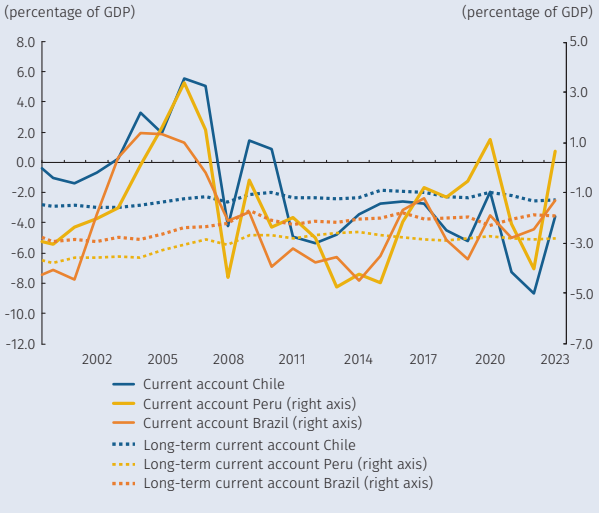
Source: Own calculations.

5. External imbalance of some countries in the region

Some regional countries such as Chile, Peru, and Brazil, experienced situations similar to that of Colombia, whereby the current account deficit increased in 2021 and 2022 and then fell in 2023 (Graph B1.4). Notably, among the common characteristics and events that explain the widening of these countries' deficits in '21 and '22 are the increase in imports of goods and services, together with significant recovery in economic growth and domestic demand (especially in Chile and Colombia, whose growth in private consumption was remarkable), as well as high freight costs that reflected the global supply chain difficulties and costs associated with logistics and transportation during the post-pandemic recovery. However, it is essential to note that the widening of the post-pandemic deficit in Peru and Brazil was consistent with the levels derived from the long-term estimate relationship, while in the case of Chile and Colombia, the deficit's widening conflicted with these projections. (Graphs B1.3 and B1.4)

Subsequently, among the common factors that explain the decrease of the deficit in 2023 for the aforementioned countries are the fall of imports as economic activity domestic and demand tempered, the decrease in freight costs, and the lesser factorial income (the latter being particularly significant for Colombia and Peru). Additionally, in Colombia, Chile, and Peru, higher tourism exports also contributed to closing the deficit. Colombia and Peru also benefited from the favorable performance of remittances, which further drove the

Graph B1.4
Current account and long-term current account as a percentage of GDP – Latin America



Source: Own calculations.

5 Among the variables used are: private sector credit as a percentage of GDP, public debt as a percentage of GDP, the population dependency ratio as a percentage of working-age workers, the interest rate differential of each country versus the US rate, the logarithm of GDP per capita of each country relative to GDP per capita of the US., the lag of net foreign assets (excluding gold) as a percentage of GDP recovered from Milesi- Ferretti (2022), and the oil balance as a percentage of GDP.

correction of the current account imbalance. Thus, for Colombia, Brazil, and Chile, the deficit reduction in 2023 brought them close to long-term levels. The exception in this regional sample is Peru, where the surplus registered surpassed the long-term level (Graph B1.4).

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