Box 1
The Process of Adjusting and Expanding the Current Account Deficit

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Occasionally, the demand for goods and services in an economy exceeds its capacity to finance that demand with its own resources. When a country has access to international financial markets, this imbalance between income generation and the rate at which it is spent is financed with external resources. In macroeconomic terms, the current account (CA) is defined as the difference between a country's national revenue and its domestic demand, or as the shortfall between national savings and the investment made during a given period. These resources can come from capital flows for direct investments, portfolio investments, debt or the liquidation of external assets. In this sense, persistent deficits in the CA generate a reduction in the balance of external assets or an increase in obligations with international creditors, which translates into possible deterioration in a country's position in terms of international investment.

Such was the Colombian case between 2006 and 2014. In effect, GDP growth during that period was 4.8%, on average, while the increase in domestic demand was 5.9%. Meanwhile, the current account deficit in the balance of payments went from 1.8% of GDP in 2006 to 5.2% in 2014. As has been pointed out on numerous occasions, the sharp decline in terms of trade witnessed since mid-2014 negatively affected the country's productive apparatus and led to a sharp setback in external revenue. The resulting slowdown in GDP growth revealed the effects of this shock on real activity. As will be explained, the process of macroeconomic adjustment observed between 2015 and 2017 was reflected in the momentum in the CA and its components, both on the side of the balance of payments (BP) and in the national accounts (CN).

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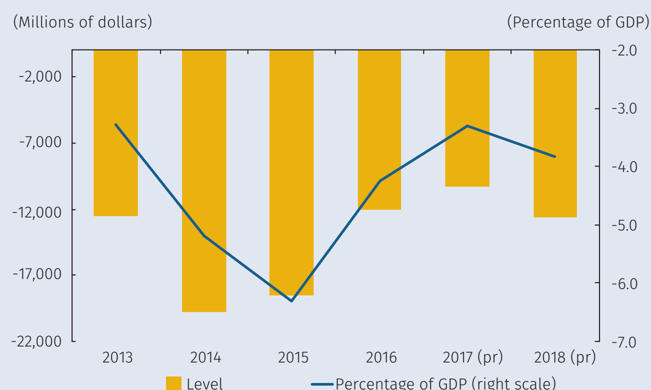
Recent developments with respect to the current account deficit and its increase on the aforementioned fronts last year are analyzed in this section. According to the data at hand, the current deficit in the BP increased again in 2018. This external imbalance suggests the adjustment that was observed up to 2017 would have been interrupted. According to the BP accounts, that expansion was due to an increase in imports of goods and certain outlays of factor income that were not offset by the good performance witnessed in foreign sales of mining and energy goods, in dollars. This is consistent, on the other hand, with what has been observed in terms of the figures for the national accounts (NA), which indicate the rise in the deficit in 2018 would have been related to an increase in the rate of private investment and, less so, to fewer public savings as a result of more consumption in this sector.

1. Recent Developments in the Current Account, According to the Balance of Payments

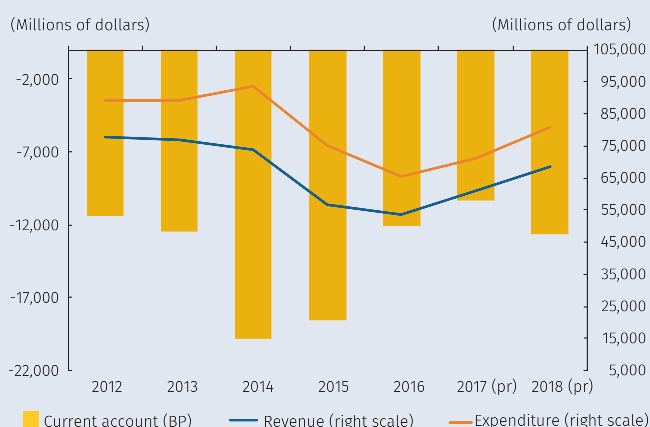
The decline in terms of trade during 2014 initially translated into a sharp contraction in the country's export earnings. This situation, coupled with growth rates that sustained current expenditure in a context of broad external financing, implied an increase in the CC deficit, which went from 3.3% to 5.2% of GDP between 2013 and 2014 (Graph B1.1). Subsequently, the Colombian economy entered a period of adjustment. In the case of the external sector, the CC process could be divided into two stages. The first covers the period up to 2016, characterized by a drop in exports of goods and more of an adjustment in external spending (Graph B1.2). The second refers to 2017, when the current deficit continued to decline, but aided by the rebound in exports of goods and the growth in other types of external revenue which, on the whole, exceeded the moderate recovery in imports of goods and services.

Graph B1.1
Current Account Deficit
(Balance as a percentage of GDP and in millions of dollars)



(pr): preliminary
Source: *Banco de la República.*

Graph B1.2
Current Account, Revenue and Expenditure
(Balance in millions of dollars)



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Source: *Banco de la República.*

Between 2014 and 2016, the current deficit declined from -5.2% of GDP in 2014 (USD -19,762m) to -4.2% of GDP in 2016 (USD -12,027m) (Graph B1.1). During that period, the momentum in the CC was associated with a steady reduction in exports of goods from the mining and petroleum sector and, to a lesser extent, industrial goods, which were affected by the drop in international prices and by weak growth on the part of Colombia's trading partners. However, the deterioration in national revenue generated by the drop in the country's terms of trade, together with nominal depreciation, was reflected in an adjustment in the economy's spending, especially in less demand for tradable goods.

Consequently, from 2014 to 2016, the reduction in the current deficit was explained largely by a significant drop in imports (USD -21.377 m, -28%) and in the profits of companies with foreign capital (USD -7.142 m; 62%). The increase in other types of external revenue also helped to the lower deficit. An added stock of domestic capital abroad, coupled with a better return on portfolio assets and international reserves, was reflected in an increase in the profitability of investments abroad (USD 999 m; 25%). Revenue from worker remittances was more dynamic (USD 758 m; 19%), and there was an improvement in exports of services (USD 615m, 9%), particularly those related to tourism, which were favored by better internal conditions in terms of security and by depreciation of the peso.

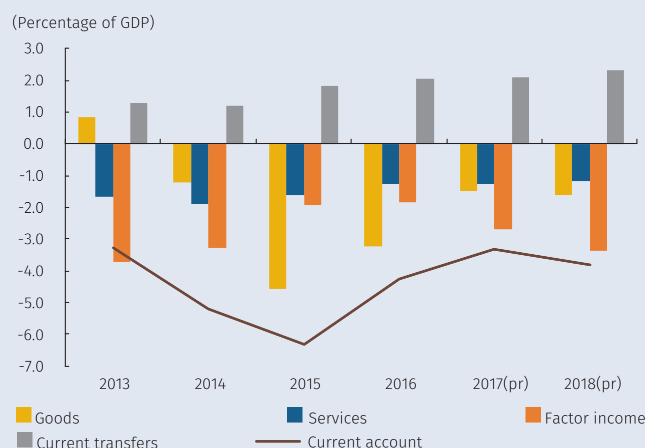
An additional reduction in the current deficit occurred in 2017, when it came to 3.3% of GDP (USD 10,296 m), reaching the same proportion of GDP observed in 2013 prior to the shock in oil prices. Unlike the period from 2014 to 2016, this adjustment was characterized by a simultaneous increase in external revenue and expenditure, although the former did so in a larger proportion (Graph B1.2). The recovery in terms of trade and the growth experienced by our trading partners was reflected in an increase in exports, although at levels lower than those observed prior to the oil shock. Shipments abroad of oil and coal were what contributed most to export growth, although "all other" exports increased as well, but to a lesser extent. Other external income (the profitability of investments abroad, exports of services, and current transfers) continued to contribute to the adjustment in the CC.

The orderly adjustment in the CC between 2014 and 2017 was backed by permanent and favorable access to external financing, which originated largely with resources from direct foreign investment and liabilities acquired by the public sector (TES, bonds and loans). The latter were reflected in an increase in the public debt, both domestic and foreign, and are consistent, in turn, with the public sector's added contribution to the saving/investment difference in the national accounts (NCs), as described below.

The momentum in the main sources of external revenue continued during 2018, propelled largely by mining and energy exports. However, this growth did not entirely offset the significant rise in imports of goods and outlays for factor income. The latter was consistent with the added growth in local spending and investment and with the increase in profits for companies with foreign capital. As a result of this situation, the CC deficit widened in 2018 to 3.8% of GDP, which is USD 2,364 m more (0.5 pp of GDP) than the year before.

When analyzed by components, most of the increase in the current deficit during 2018 (0.5 pp) would be explained by the increase in net outlays for factor income (0.7 pp) and, to a lesser extent, by the larger trade deficit in goods (0.1 pp) (Graph B1.3). In contrast, the factors that would contribute to external closure would include the improved momentum in transfers (0.2 pp) and the reduction in net imports of services (0.1 pp). It should be noted

Graph B1.3
Current Account and its Main Components



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Source: *Banco de la República.*

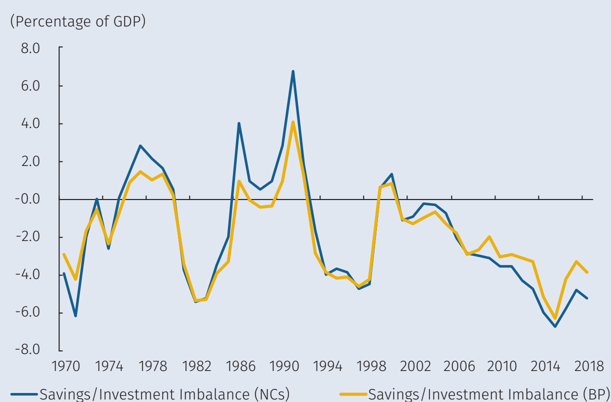
that income from remittances rose by 15.3% annually, surpassing the average rate observed between 2015 and 2017 (10.4%), while exports of services continued to register positive growth rates, drawn by the growth in revenue associated with tourism, which increased 12.7% in annual terms.

2. Recent Developments in the Current Account, According to the National Accounts

To analyze the momentum in the CC with figures from the NCs, we used the annual series, in current pesos, for savings and aggregate investment in the economy. The disaggregation used by the National Bureau of Statistics (DANE) to publish this information allows us to understand the role played by the public and private sectors in the behavior of demand for external savings. The public sector includes the national central government and regional and local governments. The private sector includes financial and non-financial corporations,[1] households and non-profit institutions that serve households. Although there are methodological differences between the BP and the NCs, the two measurements of the current deficit share a high historical correlation (Graph B1.4).

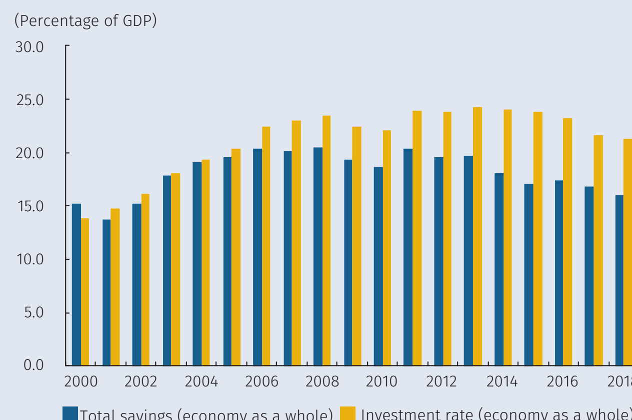
Prior to the shock to the terms of trade, the increase in the CC deficit on the side of the NCs was due to an important momentum in investment, which could not be financed with domestic savings in the Colombian economy. In fact, according to DANE's latest published data on the NCs, the nominal investment rate reached 24.3% in 2013, the highest in the decade, while the savings rate (19.6%) was similar to the one observed in previous years (Graph B1.5). Following the drop in terms of trade, macroeconomic adjustment began with more of a reduction of national savings than in investment. This being the case, the savings / investment imbalance in 2015 was the highest it had been since 1970 and reached -6.7%.

Graph B1.4
Savings/Investment Imbalance According to the NCs and the Current Account Deficit in the BP



Source: DANE; calculations by *Banco de la República*.

Graph B1.5
Savings/Investment Imbalance According to the NCs
(Savings and investment rates)



Source: DANE; calculations by *Banco de la República*.

Between 2015 and 2017, it was evident how the shock to the country's terms of trade negatively affected the investment rate via the different channels for pass-through, although it was the private sector that contributed the most to the adjustment. When broken down by types of goods, we see the lowest momentum in investment occurred initially in the areas of machinery and transport equipment, which responded more quickly to changes in relative prices and less momentum in private income. Investment in construction also reacted, although to a lesser degree. Public investment, in contrast, was more rigid and remained relatively stable, focusing on spending resources to develop infrastructure products.

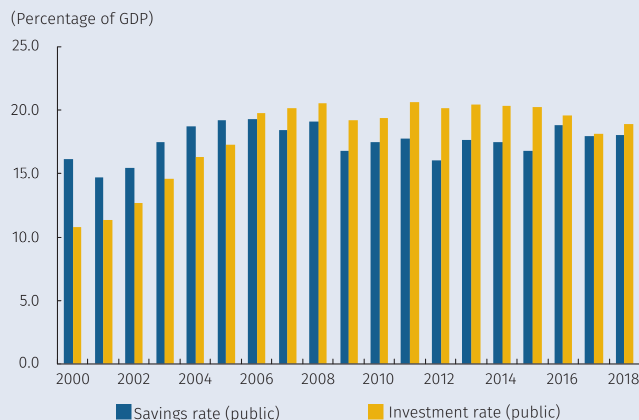
On the other hand, although there was no significant change in the aggregate savings rate of the economy between 2015 and 2017, the performance of the different sectors was mixed. Private savings increased by slightly more than one percentage point of GDP, while public savings declined. In fact, the public sector has posted dissaving rates since 2016, which implies net indebtedness on the part of the public sector. This was consistent with the increase in the fiscal deficit on record for the same period (see the *ESPE Journal*, No. 90, Graph B1.6, panels A and B).

In conclusion, the savings/investment imbalance went from -6.7% of GDP in 2015 to -4.8% in 2017 (Graph B1.7). This adjustment was propelled by the private sector, which lowered its investment rate and raised its savings rate. For its part, the public sector kept its investment rate relatively stable, while its net savings went from surplus to deficit. As a result, the saving / investment imbalance began to be explained largely by the public sector. This is contrary

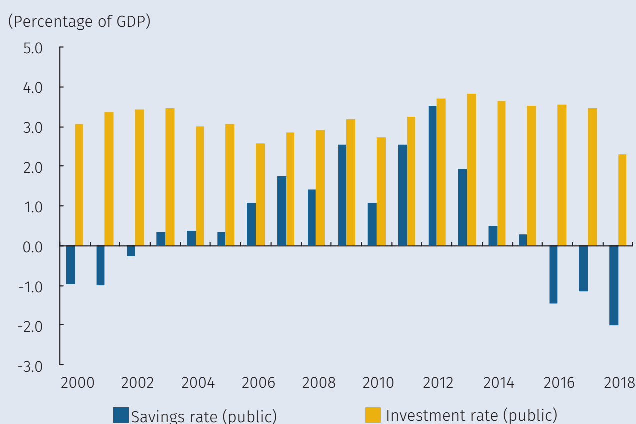
1 Including public-sector companies that operate in the real sector of the economy, such as Ecopetrol and EPM.

Graph B1.6
Savings/Investment Balance According to the NCs
(Savings and investment rates)

A. Savings/Investment Balance: Private Sector



B. Savings/Investment Balance: Public Sector

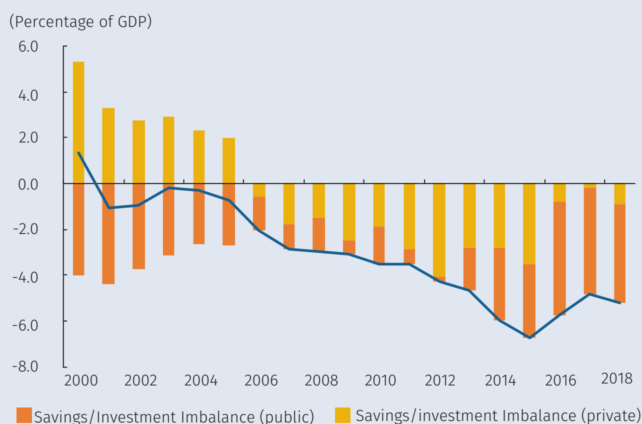


Source: DANE; calculations by *Banco de la República*.

to what was observed prior the start of the oil shock and deepened what is known in the literature as twin deficits.

However, the current deficit in 2018 widened again with respect to the figure in 2017. This is according to estimates developed by the technical staff at *Banco de la República*, using the latest figures from the NCs. The private sector contributed more to the increase in the deficit than the public sector. In this sense, the private savings rate remained stable between 2017 and 2018, but the private investment rate rose by 0.8% of GDP. Meanwhile, the government's savings would have been more negative, as a result of significant real and nominal growth in public consumption. However, this would have been offset by an equally important adjustment in its investment rate (Graph B1.7).

Graph B1.7
Savings/Investment Balance According to the Institutional Sector
(Differences between savings and investment rates, according to the institutional sector)



Source: DANE; calculations by *Banco de la República*.