



Peace for Colombia: What Might Peace Mean for Economic Growth?

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Winning the Peace: Ending Five Decades of Conflict

After protracted talks lasting nearly four years, the Colombian government led by President Juan Manuel Santos and the rebel leaders of the Marxist Revolutionary Armed Forces of Colombia (FARC) agreed to a formal peace accord on August 23rd.¹ The agreement portends the end of the longest running civil war in South America dating back fifty years. The most decisive chapter of this conflict now begins.

The peace process will test the capacities of the Colombian government and society. Nearly 7,000 rebel fighters must be reintegrated into society and provided with a livelihood replacing income earned from the drug trade and other illicit activities estimated at \$600 million annually. Other countries in the region seeking to rebuild after ending their civil wars, such as El Salvador and Guatemala, highlight the difficulties of winning the peace. Colombia possesses one advantage, its stronger economy should help facilitate the transition.

Colombia, Latin America's fourth-largest economy, experienced an annual growth rate from 2001 to 2015 averaging 4.23%. However, lower growth is expected for 2016, at only 2.5%, due in part to declining oil and commodities (e.g. coal, coffee, and minerals) prices. With falling oil prices, the current account deficit widened over time (-6.65% of GDP in 2015) as well as negatively impacting its fiscal account (-3.09% of GDP in 2015). The Colombian peso depreciated approximately 35% in 2015 and inflation has been creeping upward. Nevertheless, the IMF's recent Article IV Consultation was upbeat highlighting a strong policy framework and projecting growth of about 4% over the medium term.²

The Peace Dividend: Increased Growth and Foreign Direct Investment

A successful peace agreement could markedly improve the country's economy. Though how much is a matter of disagreement. Conservative estimates suggest peace will bring only slight economic gains, about 0.3% GDP growth annually. President Santos contends that peace will add 1.5 to 2% to annual GDP growth. His projection is in line with outcomes for the post-conflict economies of Peru and the Philippines.³

A 2014 study claims that if not for the armed conflict Colombia's GDP growth rate would be double (8.7%) the current average of 4.3%.⁴ The Centro de Recursos para el Analisis de Conflictos (CERAC) concludes that such growth would have been possible through a combination of factors, including reduced incidents of violence, a lower homicide rate, and reduced military/security spending, occurring absent the conflict. Others suggest the likelihood of a 2% increase given reduced military expenditures, ending attacks on the oil infrastructure, and capturing previously illicit activities in gold mining and agriculture.⁵

As for foreign investment, the government's department of planning (DNP) authored a report claiming investment would triple in the event of peace, going from \$12bn per year to

\$36bn. In developing its conclusions, the DNP analyzed data regarding outcomes for 36 post-armed conflict countries. The government also recently secured a flexible credit line with the IMF for up to \$11.5bn.⁶ Both the US and EU have proposed foreign aid for expenditures related to the peace plan totaling nearly \$900 million combined.

Securing the Peace: Hurdles Yet to Clear

The Colombian people have the last word on the peace plan as it is subject to majority approval through a national referendum, scheduled for October 2nd. So far, polling results have offered a mixed picture of public opinion. While most are optimistic about the public's support, significant new peace-related spending could fuel "no" votes or abstention. As one observer notes, the government is "essentially committing itself to massive state-building in Colombia's guerrilla-controlled territories."⁷ The ambitious program comes at a difficult time. Low oil prices continue to squeeze the national budget and increased government spending raises inflationary concerns. Lumped into this is President Santos' low approval rating (below 30%), putting into question his ability to effectively advocate for the plan.⁸ Additionally, opposition leaders, including former President Uribe, are vocal critics of the deal and actively campaigning against the agreement.

Conclusion: Positive Momentum Long-Term

While difficulties abound, the peace settlement should help to stimulate the economy. However, an overhanging concern is a potential credit downgrade. The rating agencies are expecting passage of a significant tax reform package before the end of the year. Santo has promised to send the measure to Congress in October. However, the intense focus and campaigning for the peace plan could crowd out such a major legislative initiative until 2017. If such a delay occurs, a downgrade by at least two of the three major agencies is possible, although the country would remain at investment grade.

In a cross-comparison with other sovereigns, our internal credit rating model assesses Colombia as a BBB- credit (S&P=BBB+; Moody's=Baa2). We view Colombia as exhibiting above average fiscal and structural positions but suffering from below average external and fiscal positions. One offset, which might improve given recent events, is a below average governance position. A successful peace should translate into higher economic growth in the medium and longer term. In the near-term, however, a possible credit downgrade warrants restraint. Accordingly, we continue with a strategy of being underweight, focusing on longer duration.

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¹ Vargas, Marc Frank and Carlos. "Tears of Joy as Rebels Sign Ceasefire with Colombian Government." Reuters. June 23, 2016. Accessed June 24, 2016. http://ca.reuters.com/article/topNews/idCAKCN0Z81JJ?utm_source=Sailthru.

² "COLOMBIA: 2016 ARTICLE IV CONSULTATION-PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR COLOMBIA" IMF Country Report No.16/129. Published May 2016.

³ "¿Qué Ganará Colombia Con La Paz?" CERAC. Accessed June 24, 2016. <http://www.cerac.org.co/es/publicaciones/otros/2014/qué-ganará-colombia-con-la-paz.html>.

⁴ "CERAC - Centro De Recursos Para El Análisis De Conflictos." CERAC - Centro De Recursos Para El Análisis De Conflictos. June 10, 2014. Accessed June 24, 2016. http://www.slideshare.net/CERAC-Colombia?utm_campaign=profiletracking.

⁵ De Angelis, Martin. "Financing Peace: Colombian Economy after the FARC." Global Risk Insights. October 12, 2015. Accessed June 24, 2016. <http://globalriskinsights.com/2015/10/financing-peace-the-colombian-economy-after-the-farc/>.

⁶ "COLOMBIA: 2016. IMF

⁷ Cohen, Steven. "For Colombia, After Peace Is When the Trouble Begins." New Republic. April 1, 2016. Accessed June 24, 2016.

<https://newrepublic.com/article/132293/colombia-peace-trouble-begins>.

⁸ Forero, "Colombian Peace Plan Heads for Vote."