Investigaciones Económicas

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Public Finances: On the edge of the cliff?

- The Ministry of Finance and Public Credit (MHCP, by its acronym in Spanish) presented the 2025 Medium-Term Fiscal Framework (MTFF), which includes updated macroeconomic and fiscal projections for the next 10 years.
- In 2025, the total deficit of the National Central Government (GNC, by its by its acronym in Spanish) is projected at 7.1% of GDP, two percentage points (p.p.) higher than forecast in the January's FP update and near the upper bound we had anticipated (see Informe Semanal – Junio 9 de 2025). While the MTFF adjusted the revenue outlook downward in line with our expectations, it unexpectedly increased primary expenditure, signaling a lack of political will for meaningful fiscal consolidation. **This forecast remains optimistic and we anticipate the fiscal deficit will reach 7.5% of GDP in 2025.**
- Such a deficit level implies noncompliance with the Fiscal Rule (FR). However, the MHCP officially activated the escape clause to suspend the rule for three years, despite the negative opinion issued by the Independent Fiscal Rule Committee (CARF, by its acronym in Spanish). The government justified the decision by citing "*the persistent growth in inflexible expenditures mandated by the Constitution and the law, without equivalent sources of financing*" arguing that "*the institutional framework finds in the escape clause the only viable alternative to ensure the State's short-term operation*". **This decision challenges the integrity of the fiscal rule and undermines a key pillar of Colombia's macro stability.**
- The growing need for funding has driven diversification and innovation in financing sources. Of the additional COP 38.8 trillion deficit projected for this year, 75% will be financed through treasury operations, 21.2% via TES auctions, and 4.8% through international bond placements. **In addition, the MHCP plans to establish a COP 20 trillion strategic reserve in TES to ease liquidity pressures—one of the market's primary sources of uncertainty.** This is an ambitious strategy that remains pending implementation.
- For 2026, the government projects a fiscal deficit of 6.2% of GDP, contingent upon the approval of a tax reform aimed at generating COP 19.6 trillion (1.0% of GDP), a scenario we consider unlikely given the current political climate. **In the absence of tax reform and expenditure adjustments, we estimate the fiscal deficit could reach 7.6% of GDP in 2026.**
- The fiscal roadmap presented in the MTFF shows a very challenging outlook. The fiscal deficit between 2025 and 2027 is expected to exceed the ceiling allowed by the Fiscal Rule by 1.4 percentage points (p.p.), pushing the net debt-to-GDP ratio up by 4.5 p.p. to a historic high of 63,8% in 2027. **We anticipate that Fitch Ratings, Moody's, and Standard & Poor's will downgrade Colombia's sovereign credit rating in the coming months.**
- The most significant concern lies in the medium term. In 2028, when the Fiscal Rule is reinstated, the MTFF calls for a primary balance adjustment of 3.2 p.p. of GDP compared to 2025, an effort equivalent to more than three tax reforms. Such an adjustment will not be feasible without structural reforms to public spending and/or taxation, which are necessary to prevent the public finances from falling off a fiscal cliff. **Without a structural fiscal adjustment and a strategy to drive sustained economic growth, we estimate that net public debt could exceed 100% of GDP within the next decade.** The proposed "Fiscal Pact" offers little room for action, deferring responsibility to the next administration.
- Additionally, the MTFF's projection that interest payments on public debt will decline from 4.8% of GDP in 2026 to 3.9% in 2028 is inconsistent with recent interest rate trends. **On the contrary, we see a significant risk that the interest burden will surpass 5% of GDP once the Fiscal Rule suspension ends.**

Done by: Macroeconomics and markets

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Public Finances in 2025 and 2026: No Light at the End of the Tunnel

Last week, the Ministry of Finance published the Medium-Term Fiscal Framework (MTFF), a key policy document that outlines the macroeconomic assumptions and fiscal strategy for the next ten years, including projections for revenues, expenditures, the fiscal balance, and public debt. The assumptions for 2025 and 2026 appear broadly reasonable and deviate only marginally from our forecasts (Table 1).

Table 1. Macroeconomic forecasts for 2025 and 2026

	2024	2025			2026	
		FP	MTFF	Corfi	MTFF	Corfi
Real GDP (%)	1.6	2.6	2.7	2.6	3.0	2.8
Nominal GDP (%)	7.7	5.8	6.4	7.7	6.3	6.7
CPI close YoY (%)	5.2	3.6	4.5	5.00	3.2	3.8
Exchange rate, yearly average (USD/COP)	4,073	4,360	4,265	4,308	4,408	4,211
Brent oil, yearly average ($ USD)	80.6	74.3	67.2	67.2	62.3	61.3

Source: Ministry of Finance and Corficolombiana

The MTFF also formalized the government's decision to suspend the Fiscal Rule for a three-year period (2025–2027), invoking the escape clause established under Law 2155 of 2021. This decision was made despite a negative—though non-binding—opinion from the Independent Fiscal Rule Committee (CARF). The government justified the move by citing "*the persistent growth in inflexible spending mandated by the Constitution and the law, without equivalent sources of financing*," further arguing that ***"the country's institutional framework finds in the escape clause the only viable alternative to ensure the functioning of the State in the short term."***

In particular, the Ministry highlighted fiscal pressures stemming from extraordinary expenditures, such as outstanding liabilities with the Fuel Price Stabilization Fund (FEPC), subsidies for electricity and gas tariffs, and the credit arrangement with the International Monetary Fund (IMF).

With the fiscal rule suspended, the fiscal deficit is projected to reach 7.1% of GDP in 2025, two percentage points above the forecast in the Financial Plan (FP) and at the upper end of our projected range of 6.3%–7.4% of GDP (ver "Suspensión de la regla fiscal: finanzas públicas a la deriva" en Informe Semanal – Junio 9 de 2025).

Relative to the Financial Plan, the MTFF revised its 2025 revenue forecast downward by COP 18.5 trillion, reflecting the weak tax collection observed through April. It also incorporated COP 7 trillion in additional revenues from Decree 0572, which raised tax rates. However, the government increased its primary expenditure projection by COP 20.7 trillion, signaling a limited commitment to meaningful fiscal adjustment. This stance was viewed negatively, particularly considering the government's earlier decision to disregard the COP 12 trillion budget deferral decreed at the start of the year.

Against this backdrop, we now estimate the fiscal deficit will reach 7.5% of GDP in 2025, incorporating higher interest payments and tax revenues falling short by COP 5 trillion relative to the MTFF projections (Table 2).

Table 2. Fiscal balance forecast, 2025

	Trillion pesos			% of GDP		
	FP 2025	MTFF 2025	Corfi	FP 2025	MTFF 2025	Corfi
Total revenue	**327.9**	**309.3**	**304.3**	**18.2**	**17.1**	**16.6**
Taxes	299.9	281.4	276.4	16.6	15.6	15.0
Others	28.1	27.9	27.9	1.6	1.5	1.5
Total expenditure	**418.7**	**438.9**	**442.9**	**23.2**	**24.3**	**24.1**
Primary	332.4	353.1	353.1	18.4	19.6	19.2
Interest	86.4	85.8	89.8	4.8	4.8	4.9
Total fiscal deficit GNC	**-90.8**	**-129.6**	**-138.6**	**-5.1**	**-7.1**	**-7.5**
Primary deficit GNC	-4.4	-43.8	-48.8	-0.2	-2.4	-2.7

Source: Ministry of Finance and Corficolombiana

Table 3. Fiscal balance forecast, 2026

	Trillion pesos			% of GDP		
	MTFF	Without tax reform	Corfi	MTFF	Without tax reform	Corfi
Total revenue	**350.7**	**331.1**	**325.0**	**18.3**	**17.3**	**16.6**
Taxes	321.7	302.0	296.0	16.8	15.7	15.1
DIAN	300.9	300.9	294.8	15.7	15.7	15.0
Tax reform	19.6	0	0	1.0	0	0
No DIAN	1.2	1.2	1.2	0.1	0.1	0.1
Others	29.0	29.0	29.0	1.5	1.5	1.5
Total expenditure	**470.3**	**470.3**	**473.9**	**24.5**	**24.5**	**24.2**
Primary	378.6	378.6	378.6	19.7	19.7	19.3
Interest	91.7	91.7	95.3	4.8	4.8	4.9
Total deficit GNC	**-119.6**	**-139.2**	**-149.0**	**-6.2**	**-7.3**	**-7.6**
Primary deficit GNC	-28.0	-47.6	-53.7	-1.5	-2.5	-2.7

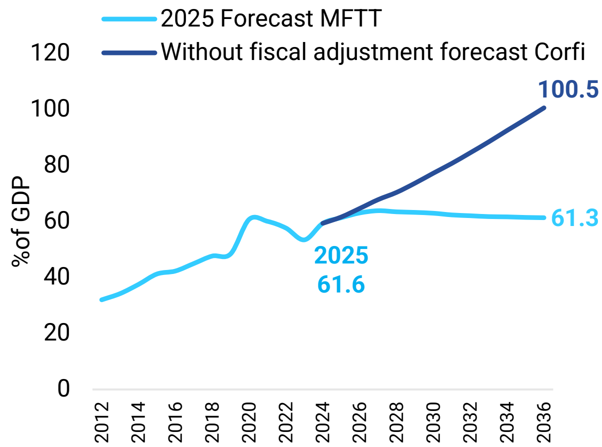
Source: Ministry of Finance and Corficolombiana

For 2026, the government projects a deficit of 6.2% of GDP, conditional on the approval of a tax reform expected to generate COP 19.6 trillion (1.0% of GDP). **However, this scenario appears unlikely given the current political landscape. Absent tax reform or spending cuts, our estimates suggest the deficit could climb to 7.6% of GDP in 2026 (Table 3).**

Heading toward the fiscal cliff

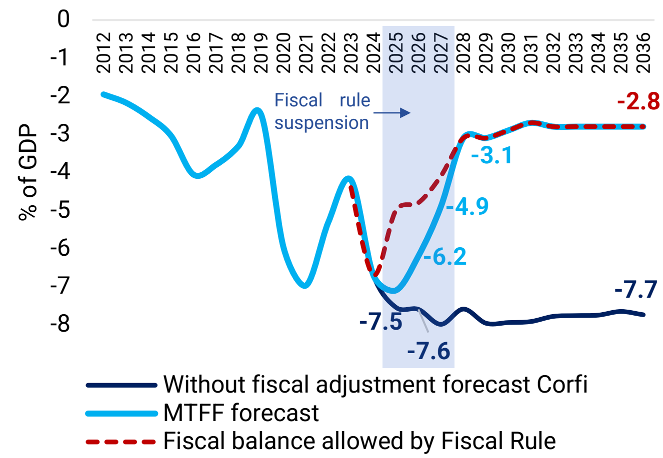
The fiscal roadmap presented in the MTFF outlines a highly challenging outlook for the country, particularly over the medium term. According to government projections, the fiscal deficit between 2025 and 2027 will exceed the Fiscal Rule limit by 1.4 percentage points (p.p.), pushing the net debt-to-GDP ratio up by 4.5 p.p. and reaching a historic high of 63.8% in 2027. In 2028, when the Fiscal Rule is reinstated, the MTFF anticipates a primary balance adjustment of 3.2 p.p. of GDP relative to 2025, an effort equivalent to the revenue impact of more than three tax reforms (Charts 1 and 2).

Chart 1. Net debt



Source: Ministry of Finance and Corficolombiana.

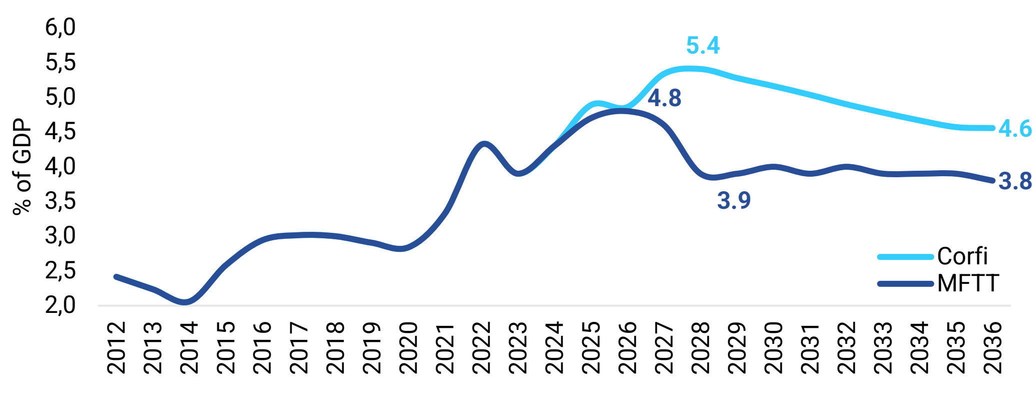
Chart 2. Fiscal deficit



Source: Ministry of Finance and Corficolombiana.

An adjustment of this scale will be unfeasible without undertaking structural reforms to both the tax system and public spending. Achieving such consolidation will require a broad-based political and social consensus to prevent the country from approaching a fiscal cliff. Under this scenario, net debt would begin to decline in 2028, reaching 61.3% of GDP by 2036. **However, in the absence of fiscal consolidation and a comprehensive strategy to boost investment and long-term growth, we estimate that net debt could exceed 100% of GDP within the next decade**. Notably, the government itself outlines an inertial scenario in Chapter 0 of the MTFF—one that assumes no adjustment—under which debt also surpasses 100% of GDP over the coming years (MTFF 2025, Chapter 0, Chart 0.4).

Chart 3. Interest payments



Source: Ministry of Finance and Corficolombiana

Moreover, the MTFF's forecast that interest payments on public debt will decline from 4.8% of GDP in 2026 to 3.9% in 2028 and appears inconsistent with current interest rate dynamics (Chart 3). On the contrary, we see a significant risk that the interest burden could peak at 5.4% of GDP by the time the Fiscal Rule suspension ends and remain near 5% of GDP in subsequent years. As we have previously warned, the combination of sluggish economic growth and elevated interest rates may generate a "snowball effect" on public debt, potentially placing it on an unsustainable trajectory in the years ahead (ver "Recuadro

VII.2 La neblina fiscal en América Latina: Riesgos y sostenibilidad en juego" en Informe Anual – Diciembre 3 de 2024).

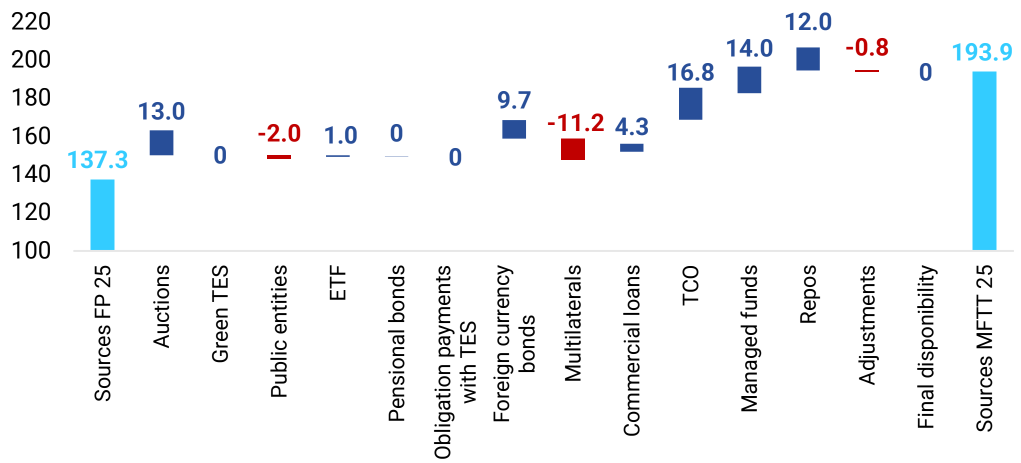
Innovation in the financing strategy

The growing need for additional resources has driven diversification and innovation in financing sources. In 2025, the fiscal deficit increased by COP 38.8 trillion, rising from COP 90.8 trillion to COP 129.6 trillion. To finance this gap, MHCP introduced innovative tools aimed at mitigating the impact on interest rates of government debt securities and reducing liquidity risk. The main sources of financing are: (i) treasury operations (75.4%); (ii) domestic disbursements through an increase in TES auctions, which rose from COP 45 trillion to COP 58 trillion (23.0%); and (iii) external disbursements via a rebalancing between bond issuance and multilateral development bank financing.

Treasury operations include the additional issuance of short-term securities (TCOs) totaling COP 16.8 trillion, the use of managed funds amounting to COP 13.9 trillion, and a repo operations program involving loans from international banks for COP 12 trillion. Under this program, the Ministry of Finance plans to establish a strategic reserve of COP 20 trillion, aimed at improving end-of-year cash availability in 2025 and alleviating the liquidity stress the government has been facing for over a year.

These loans will be collateralized with Colombian government debt securities and may be denominated in either pesos or foreign currency, depending on the agreements reached with each institution. However, it remains unclear whether the interest rates on these loans will be lower than the yields of the TES used as collateral. The Public Credit Office intends to use the proceeds to build a TES portfolio, without a defined preference along the yield curve. According to the government, these loans will not be hedged against exchange rate risk, making this an ambitious strategy that is still pending implementation.

Chart 4. Sources, 2025. Trillion of pesos



Source: Ministry of Finance and Corficolombiana

Looking ahead to 2026, the government plans to raise approximately COP 40.1 trillion through external disbursements, with more than half expected to come from foreign currency bond issuance, 28.5% from multilateral banks, and 16.4% from commercial loans. On the domestic side, the government aims to secure COP 60 trillion via TES auctions, COP 1 trillion in green TES, and COP 9.25 trillion from public entities, pension bonds, and obligations paid in TES.

Additionally, the Ministry of Finance has set a domestic amortization target of COP 8 trillion, suggesting that the Public Credit Office will continue to carry out liability management operations regularly throughout the year. These operations could match or exceed those conducted in the previous year (COP 28.4 trillion), with a primary focus on fixed-rate TES maturing in 2026 and potentially incorporating the two bonds maturing in 2027 at a later stage.

There's still time to avoid the cliff

Financial markets in Colombia had already partially priced in the 2025 fiscal scenario presented by the Ministry of Finance in the MTFF. We anticipate that Standard & Poor's, Fitch Ratings, and Moody's will downgrade Colombia's sovereign credit rating in the coming months, consistent with the recent widening of the country's risk premium. However, we believe that markets still lack full visibility on the medium-term fiscal outlook, which supports our view that long-term TES yields will remain in double digits for an extended period (ver "Tasas de los TES a doble digito por más tiempo" en Informe Renta Fija – Mayo 22 de 2025).

According to MTFF projections, the overall fiscal deficit will reach 4.9% of GDP in 2027, exceeding the Fiscal Rule limit by 0.8 percentage points. Moreover, during the suspension of the rule, the primary balance is projected to remain in deficit, requiring significant consolidation in preparation for its reinstatement in 2028. Given that the Fiscal Rule caps the deficit at 3.1% of GDP in 2028, this would require a sharp and likely unrealistic adjustment of 1.8 percentage points from the previous year. In our view, such a consolidation effort appears excessively ambitious and may ultimately result in either a parametric revision of the rule or a prolongation of the suspension period.

Looking ahead, the MTFF calls for a cumulative increase in national revenues of 1.0% of GDP in both 2026 and 2027, followed by an average of 1.4% of GDP per year between 2028 and 2036. On the expenditure side, the framework projects a reduction of 1.0% of GDP in 2027 and an average annual cut of 2.3% of GDP over the 2028–2036 period. These figures underscore the need for structural adjustments on both the revenue and expenditure fronts.

Addressing Colombia's fragile fiscal position will require politically challenging and potentially unpopular structural reforms, which must be prioritized by both the next administration and the incoming Congress. The country currently faces a narrow window of opportunity to avert a fiscal cliff. Failure to build a broad-based social and political consensus would lead to further increases in the interest burden, pushing public debt beyond 100% of GDP and placing the country's fiscal trajectory on an unsustainable path, with serious and lasting consequences for the well-being of Colombian citizens.

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