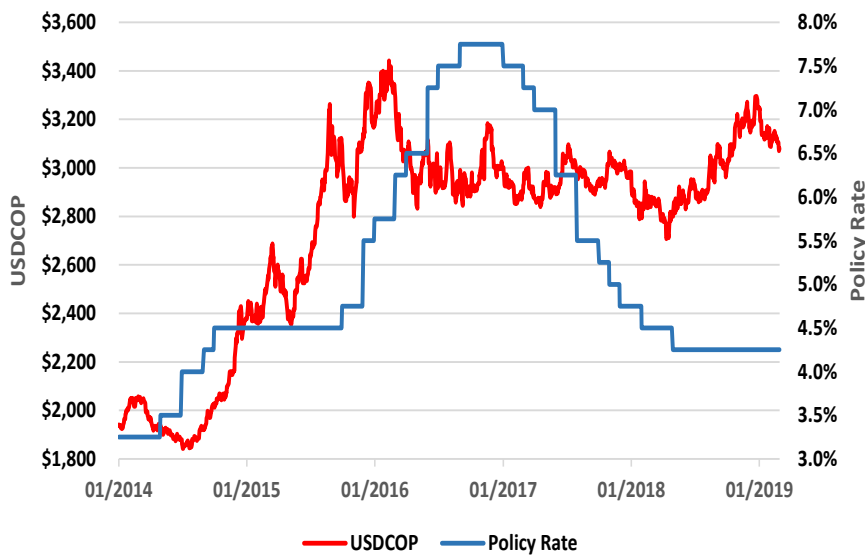


Colombia: Short-Run Opportunity on USDCOP?

Colombia has a flexible exchange rate framework. So strong is Banco de la República's commitment to the flexible exchange rate regime that it was willing to miss the inflation target rather than intervene in the foreign exchange market to prevent a depreciation of 60% in the COP in 2015 and 2016. This policy of non-intervention led to a rise in inflation that required higher interest rates as the economy started to decelerate (Chart 1).

Chart 1. Historical Policy & Exchange Rate



Source: SFC, Banco República, Scotiabank.

A consequence of this free floating exchange rate framework is that makes it very difficult to forecast the COP in the short run, since its trend and volatility depends on many variables (i.e. external risk appetite, domestic events, domestic liquidity, external liquidity, supply shocks among others). Identifying regular patterns in movements of the COP in the midst of this volatility can therefore be quite rewarding.

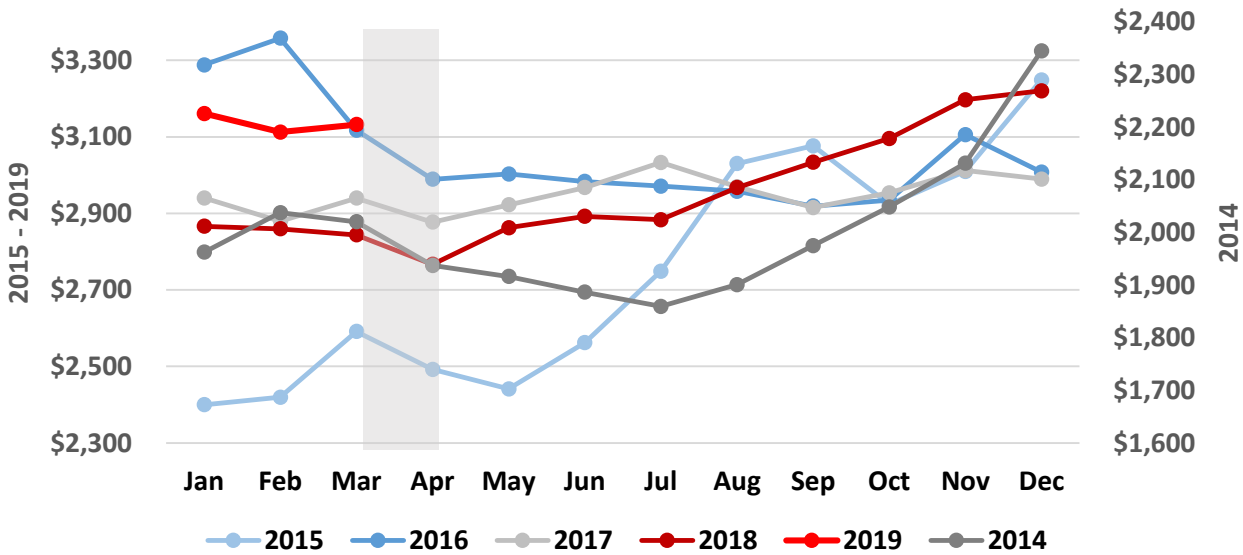
Over the last six years, the COP has demonstrated significant seasonality in April. In fact, since 2014 the COP has appreciated significantly every April on the back of a corporate tax remittances and dividend payments (Chart 2). The reason behind this pattern is that many companies that hold revenues abroad monetize some of those revenues to pay taxes and dividends in Colombia, temporarily increasing dollar supply in Colombia and, therefore, producing a temporary appreciation of the local currency. This temporary appreciation has occurred even when there were fundamental factors pushing the currency to depreciate.

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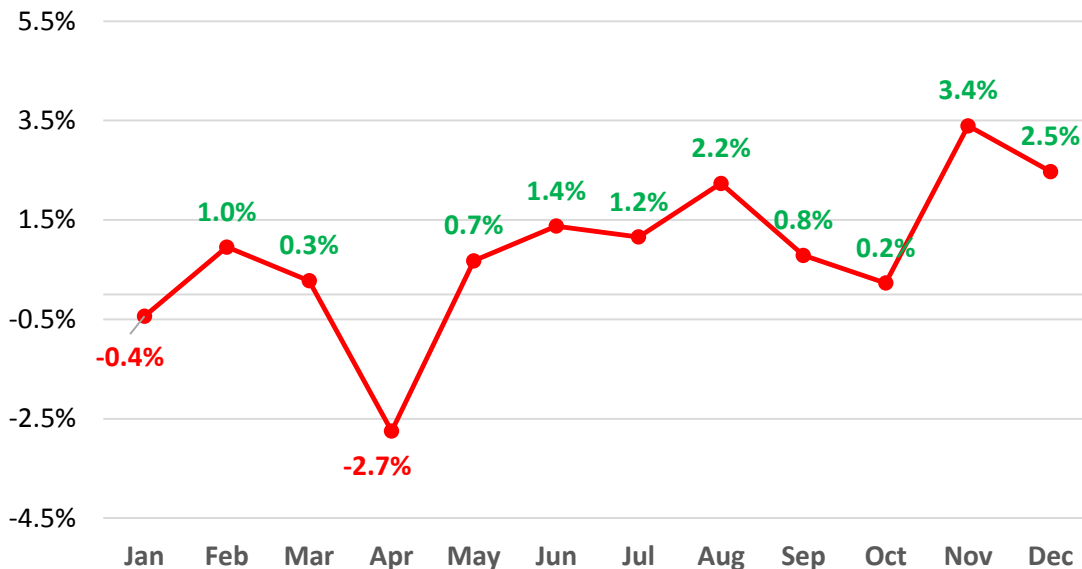
Chart 2. Historical Exchange Rate



Source: SFC, Scotiabank.

This year, tax season will be between the second and third week of April. Chart 3 shows that on average (2013–2018) the COP appreciated by 2.7% m/m with the highest monthly valuation in the first week of the tax season.

Chart 3. USDCOP Average Monthly Variation (2013 - 2018)



Source: SFC, Scotiabank.

Bottom line, exploitable seasonal effects in currencies are rare. Such an exploitable effect appears to be at work in Colombia, in which the COP consistently appreciates in April. Equally interesting, this appreciation has been present even under more structural depreciation trends.

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