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LATAM FLASH

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Colombia—BanRep Pauses Easing Cycle Amid Inflation Convergence Uncertainty

Today, the board of Colombia's central bank (BanRep) held the monetary policy rate steady at 9.50% in a split decision, with five members voting for no change, one for 25bps, and another for a 50bps cut. The decision was aligned with Scotiabank Colpatria's expectations but surprised the majority of economists surveyed that expected a 25bps cut. Today's rate hold would seem like an unusual decision by BanRep after 325bps in cuts since last March to a still-high level of 9.50%.

However, uncertainty has significantly increased since the previous meeting, in December, especially regarding the likelihood that inflation enters the target range in 2025 after a minimum wage increase that was well above expectations. At today's announcement, the central bank emphasized that it prefers to wait and see how inflation evolves before the resumption of rate moves. Additionally, they argue that international financial conditions could tighten.

At Scotiabank Colpatria, we see the two forthcoming inflation readings as the most relevant to assess the impact of the minimum wage hike. For now, we think inflation will not achieve within-target levels consistently during the year, as some disinflationary forces of the past are vanishing in groups such as food, tradable goods, and utilities, while the stickiness of services inflation remains amid the indirect indexation of some items to the minimum wage. We project inflation to close the year at 4.5%, which means that the convergence of inflation to the target would be delayed by around one year when compared to our previous estimates (prior to the minimum wage increase decision).

Finance Minister Guevara (who voted for a 50bps cut) also confirmed today that Roberto Steiner and Jaime Jaramillo will conclude their duties on the board and will be replaced by Cesar Giraldo and Laura Moisá, with their appointment in February leaving March as their first rate-voting meeting. At Scotiabank Colpatria, we anticipate a 25bps cut in March, as we expect the new board members will initially join the more moderate group (two) who voted for a cut today. We project BanRep's rate will close 2025 at 7.75%.

Key points from the press conference:

- In today's meeting, the board analyzed the staff's updated macroeconomic projections. In terms of GDP growth, they estimate 1.8% for 2024 (vs 1.9% prior), followed by 2.6% in 2025 (vs 2.9% prior), which are very close to Scotiabank Colpatria's projections and suggest a gradual economic recovery. Having said that, next week we will have further information about the rest of the variables; the most critical one being inflation and the timing of its expected convergence to target. On Tuesday, February 4th, BanRep will release the Monetary Policy Report with the traditional press conference on Thursday, February 6th.
- Domestic fiscal uncertainty remains a constraint on monetary policy. Minister Guevara said during the press conference that the government is demonstrating its commitment to debt repayment, saying that the S&P confirmation of Colombia's credit rating is good news. However, Governor Villar said that concerns remain, and that one new source of risks would be the increase in the minimum wage and the required spending level of the government.
- Minister Guevara is now voting for 50bps. As the reasons for changing his vote, he listed that real interest rates are increasing across the globe, changing inflation expectations, and the willingness to reach consensus. We think Minister Guevara could continue switching his vote in the future, probably calling for a more modest cut of 25bps to build a majority that would allow restarting the easing cycle since March.

- Regarding international reserves, Governor Villar said that while the board is not considering increasing them for now, it should not cast aside this possibility if needed.
- When asked about the international backdrop and how it could impact local financial stability, Governor Villar said that the local banking system is robust, has a solid solvency ratio above regulatory levels and liquidity levels are appropriate.