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jackeline.pirajan@scotiabankcolpatia.com**Colombia—BanRep Holds Interest Rate at 9.25%****BanRep holds interest rate at 9.25%, fiscal sustainability is a concern**

The board of Colombia's central bank (BanRep) maintained its monetary policy rate at 9.25% in a split vote: four members voted to keep the rate unchanged, one voted for a 25 bps cut, and two voted for a 50 bps cut. The decision aligned with market consensus but was above Scotiabank Colpatría's expectation of a 25 bps cut. In both the communiqué and the press conference, the central bank emphasized that inflation expectations remain above target and that economic activity in Q1-2025 exceeded projections. However, they also noted that the MTFF-2025 projections increase the challenges for fiscal sustainability, which constrains monetary policy.

Although the press conference was intended to focus on monetary policy, most questions centered on fiscal policy and the recent credit rating downgrades. Finance Minister Germán Ávila stressed that the inflexible nature of fiscal spending is contributing to wider deficits. Meanwhile, Governor Villar stated that the credit downgrade was one of the factors considered in the decision to maintain the interest rate. Given these developments, we believe the room for further rate cuts this year is limited, especially as we expect inflation to rebound in the second half of the year. We now project a 9.00% rate by December 2025 (previous 8.75%) and 7.50% by the end of December 2026.

Highlights from today's decision

- During the press conference, Governor Villar emphasized that the decision to maintain the interest rate was not solely due to the S&P and Moody's downgrades as he pointed to stronger-than-expected growth and persistent inflation as key reasons for holding the rate steady. He also noted that fiscal policy and the outlook for high deficits are constraints on monetary policy.
- The central bank is not currently considering increasing international reserves.
- Regarding the Ministry of Finance's operation involving the purchase of COLTES to constitute the Strategic Reserve, Governor Villar said the central bank will evaluate the impact on market liquidity. However, it is too early to anticipate a response. In our view, if these purchases prove distortionary, the central bank could consider offsetting the effect through its own COLTES operations.
- On whether fiscal risk implies a higher neutral interest rate, Governor Villar noted that the real neutral rate has been rising in recent years as Colombia's credit risk increases. Although it is difficult to estimate precisely, he stated that the current monetary policy stance is contractionary and consistent with the goal of bringing inflation back to target.
- The next policy meeting is scheduled for July 31st. By then, the central bank will have updated macroeconomic projections. As usual, the neutral real rate and inflation forecasts will be key points of focus.

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