Scotiabank

GLOBAL ECONOMICS

LATAM FLASH

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Colombia—Monetary Policy Preview

- **BanRep is expected to accelerate its hiking cycle**

BANREP IS EXPECTED TO ACCELERATE ITS HIKING CYCLE

BanRep will hold the fourth monetary policy meeting of the year on Thursday, June 30. In April's meeting, the vote was split between four Board members voting for a 100 bps hike and three members who voted for a 150 bps hike. New information since that meeting could skew the decision to the hawkish side as private consumption remains strong, core inflation reached its highest level since 2003, and inflation expectations remain above the central bank target even over a two-year window. **We expect the central bank to accelerate the pace of hiking and increase the policy rate by 150 bps to 7.50%.**

Key points to have in mind ahead of Thursday's BanRep vote:

- **In April's meeting, the hawks on the Board argued that inflation expectations increased** and were pointing to a persistent price shock. **They also highlighted that credit, especially for consumption, was increasing at a strong pace.** While the majority group, who voted for a 100 bps hike, expressed some concerns about a potential deceleration in economic activity, they argued in support of a gradual approach.
- **Since April's meeting, incoming information showed robust economic activity.** GDP growth was 8.5% in Q1-2022, while in the YTD to April it was 9.3%. **Consumption remains strong despite the inflationary environment** and some indicators such as consumer credit growth which is above the 20% y/y, and demand, boosted by the VAT holiday, could justify more aggressive monetary policy.
- **Despite an easing of May headline inflation, core inflation reached the highest level since 2003 at 6.5%** because of high indexation effects and price increases in services due to the strong demand amid the total reopening.
- **An additional risk is the possibility of a surge in inflation owing to the potential increase in gasoline prices announced by the government.** For each additional 200 pesos in gasoline prices, inflation could increase by 0.6 ppts, which would move year-end inflation expectations above the 10%, again triggering significant indexation effects in 2023.
- **Inflation expectations have increased and by the end of 2022 inflation is expected to close at 8.78%.** Meanwhile, two-year ahead inflation expectations are above the ceiling of the target range (defined between 2% and 4%).
- **International conditions point to tighter financial conditions down the road.** In recent weeks the Federal Reserve has turned more hawkish, increasing its monetary policy rates by 75 bps, the strongest pace since 1994. The Fed also signaled that its terminal rate would be around 4%, which is an important consideration for the BanRep Board, and could motivate an acceleration in the hiking cycle.
- **The political environment could trigger a higher risk premium in Colombia.** The USDCOP reached a historical high and international turbulence would make consider the Board to speed up the hiking cycle.
- **Finally, any signal from BanRep that it is close to the end of its hiking cycle is key since market and Scotiabank Economics expectations point to a terminal rate of 8.50%.**

All in all, ahead of June's meeting our base case scenario is a 150 bps hike, with a split vote. The vote and communications around it will be key to assessing future steps in the hiking cycle. Inflation developments in the coming months will determine the terminal rate; for now, we expect the current tightening cycle to end at 8.5% with the policy rate remaining at this level for around twelve months. However, if inflation increases more than anticipated, the policy rate would clearly go even higher.