Scotiabank

GLOBAL ECONOMICS

LATAM FLASH

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Colombia—100bps Increase with More to Come

- **BanRep increased the policy rate by 100bps to 12% in a split vote; four voted for 100bps, one for 25bps, and one for 125bps**
- **Fitch affirmed Colombia's rating at BB+ outlook stable, highlighting that the government has adhered to the institutional framework**

BANREP INCREASED THE POLICY RATE BY 100BPS TO 12% IN A SPLIT VOTE; FOUR VOTED FOR 100BPS, ONE FOR 25BPS, AND ONE FOR 125BPS

The Board of Colombia's central bank (BanRep) increased the monetary policy rate by 100bps to 12% in line with market consensus; however, the decision was a split vote. Four members voted for a 100bps hike, one member voted for 125bps, and one for 25bps. In the communiqué and in the press conference, Governor Villar highlighted that the economy is expanding at a robust pace, the current account deficit is historically high (7.2% of GDP in Q3-2022), and inflation expectations remain well above the central bank target. Additionally, Governor Villar said that the Board is not considering intervening in the FX market since liquidity is sufficient and negative pressures have eased.

We maintain our call an additional hike in January's meeting. Given today's signal, it is unclear if the central bank wants to slow down the pace of the hiking cycle. We think that seeing the peak in inflation will be the critical signal for a pause. Our current projections are that inflation would peak in December; however, as uncertainty remains high, we expect the central bank to continue in a wait-and-see mode in the forthcoming months. For now, we expect a 12.50% as a terminal rate.

Some key features of the decision included:

- Economic activity is expected to expand by 8% in 2022, one of the highest rates of expansion around the world and pointing to a strongly positive output gap. Governor Villar said that the consumer credit growth has slowed, but private consumption is still growing above its long-term trend. The forecast for real GDP growth in 2023 remains unchanged at 0.5% GDP which, according to Villar, will reflect a healthy slowdown of the economy.
- Inflation expectations for one and two years ahead and are well above the central bank target. The central bank estimates a moderate FX passthrough, and Minister Ocampo said that part of the inflation pressures are due to supply shocks in the agricultural sector. Either way, Governor Villar emphasized that the central bank tightening cycle contributes to achieving the inflation target in the long term.
- The current account deficit stood at 7.2% of GDP in Q3-2022, a historical high that makes the economy more vulnerable to international shocks. Governor Villar highlighted that contrary to what was observed from other central banks (decelerating the hiking cycle), BanRep decided to maintain the hiking pace to create a better buffer against international shocks.
- On the FX side, governor Villar said that negative pressures have eased for the currency and since liquidity remains good, the board is avoiding intervening in the market.

Today's meeting showed us that the balance of risk is tilted towards further rate hikes in the future. The central bank emphasizes that the economy is growing above the trend, making us think that we will have a new rate hike in January. In January, the central bank staff will release the *Monetary Policy Report*, which will be key to affirming the possibility of a pause in the hiking cycle. For now, we affirm our expectation of a new hike in January and a pause strongly dependent on inflation reaching a peak.

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FITCH AFFIRMED COLOMBIA'S RATING AT BB+ OUTLOOK STABLE, HIGHLIGHTING THAT THE GOVERNMENT HAS ADHERED TO THE INSTITUTIONAL FRAMEWORK

On Thursday, December 15, Fitch Ratings affirmed Colombia's sovereign credit rating at BB+ (table 1) (one notch below investment grade) with a stable outlook. Fitch highlighted that the "Petro administration has pledge to adhere to Colombia's fiscal and monetary policy framework". However, Fitch also said that the rating is constrained by the high fiscal deficits and a still high debt burden. They also noted that political uncertainty will remain as the reform agenda in 2023 includes a controversial pension reform. It is worth noting the previous Fitch assessment about Colombia's rating was on June 10/2022, also affirming the BB+ with a stable outlook.

Table 1: Colombia—Credit Rating

	Rating	Outlook
Fitch	BB+	Stable
S&P	BB+	Stable
Moody's	Baa2	Stable

Sources: Scotiabank Economics, Bloomberg.

Macro picture:

- Fitch expects the economic growth to slow from a 7.7% expansion in 2022 to a 1.1% growth in 2023 due to headwinds such as tighter financial conditions and higher taxes. Fitch highlighted that expectations remain well above the central bank target, proving inflation's stickiness.
- On the fiscal side, the general government deficit is expected to fall from 6.7% of GDP in 2022 to 4.5% of GDP in 2023, reflecting the reduction in fuel subsidies, the impact of the tax reform on revenues, and the offsetting effects from increases in social expenditures. That said, general government debt is expected to stabilize around 60% in 2022, rising gradually over the forecast period and staying modestly above BB peers' median. They believe further efforts to reduce the debt in a meaningful way are required.
- Fitch said that the net external debt is projected at 22% of GDP in 2022, higher than the BB median. However, they highlighted that international reserves, including the IMF Flexible Credit Line, are an appropriate buffer.

Our take:

Although Fitch's release would be considered a non-event, the assessment recognized that the government is playing under the rules and that Colombia's institutional framework is working as usual. Political noise will be for granted in 2023 since October's regional elections will make the government more proactive in delivering new political gains. The pension reform will have a more challenging discussion since many society groups want to present a proposal, and the negotiation will be more complex. Either way, local assets are paying a decent premium due to the country's idiosyncratic issues. However, the volatility will remain as the communication of reforms will continue to be very active in 2023.

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