Scotiabank

GLOBAL ECONOMICS

LATAM FLASH

July 31, 2023

Contributors

Sergio Olarte, Head Economist, Colombia
+57.1.745.6300 Ext. 9166 (Colombia)
sergio.olarte@scotiabankcolpatria.com

Jackeline Piraján, Senior Economist
+57.1.745.6300 Ext. 9400 (Colombia)
jackeline.pirajan@scotiabankcolpatria.com

Santiago Moreno, Economist
+57.601.745.6300 Ext. 1875 (Colombia)
santiago1.moreno@scotiabankcolpatria.com

Colombia—BanRep Keeps Policy Rate at 13.25%

- **BanRep maintained its interest rate at 13.25% in a unanimous vote for the second month in a row. Lower inflation is critical to start rate cuts discussion.**

The Board of Colombia's central bank (BanRep) keeps the policy rate at 13.25% in a unanimous vote for the second month in a row. In the communique, the board highlighted that while headline inflation is decreasing, core inflation remains stubbornly high due to indexation effects. That said, during the press conference, Governor Villar and Minister Bonilla indicated that the board will maintain a strong data-dependent approach, while emphasizing that inflation has to go down further before considering rate cuts.

The next monetary policy meeting with a rate decision will be in September. By this time, the board will have a couple more inflation readings, and the GDP growth data for Q2-2023. However, since inflation is expected to remain above the double-digit mark, we see a low probability for rate cuts in September.

Inflation remains the most critical variable for BanRep. The last quarter of the year is the most important season for Colombia in terms of inflation since this is when minimum wage negotiations will begin, along with other dynamics that will define how strong the indexation effects will be ahead of 2024. Additionally, there are still many uncertainties surrounding the outlook, such as the potential impact of the El Niño weather phenomenon, whether the government will decide to increase toll fees and diesel prices, and whether the minimum wage will be set well above inflation. All of these issues could lead BanRep to wait for more information before starting the easing cycle. That said, despite our base case scenario calling for cuts in October, the risk is tilted toward having a later start but with more aggressive cuts.

Key points about today's decision:

- **The assessment of inflation remained cautious**. The board continued to express concerns about core inflation dynamics. During the press conference, Minister Bonilla said that the delay in increasing gasoline prices is making inflation go down at a slower pace relative to the region. He also said that Colombia has to wait for more clear signals that inflation is under control before starting to discuss rate cuts.

- **Weaker than expected economic activity**. In the communique, the board said that economic activity during Q2-2023 was weaker than expected, and is driven by slower credit growth and a deterioration in credit quality. However, they said that it is not a strong concern for the central bank since the financial system remains robust.

- **COP appreciation is a result of lower risk premiums.** During the press conference, Governor Villar said that a stronger exchange rate could help with inflation; however, the pass-through effect could take time before being reflected in lower prices.

- **Today's employment data was a positive surprise:** Minister Bonilla explained that today's employment results were due to better hiring dynamics by the government. He also mentioned that other sectors are contributing to job creation, which is good news for the economy.

- **The start of the easing cycle in Chile and potentially in Brazil does not pressure BanRep to cut its rate sooner**. During the press conference, Governor Villar and Minister Bonilla said that other countries in the region are reducing their interest rates because their inflation has declined significantly. It is interesting to note that even the Finance Minister is not pushing for a rate cut and that he is aware that inflation has to come down further to start this discussion.