Scotiabank

GLOBAL ECONOMICS

LATAM FLASH

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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

Colombia—BanRep Affirms a Cautious Approach with a 25bps Rate Cut in a Split Vote

The board of Colombia's central bank (BanRep) cut the monetary policy rate by 25bps to 12.75% in a split vote, with five members voting for the 25bps cut and two voting for a 50bps cut. It was a surprise for market consensus and us, as the median expectation was for a 50bps cut. In the communiqué, the central bank was cautious in recognizing the inflation progress as they said again that the core services prices didn't reflect the same progress observed in the headline inflation. In addition, they still see risk around inflation, with the minimum wage having been set above the central bank's expectation. There is still uncertainty around the effect of the "El Niño" weather phenomenon and regulated prices.

The split vote is now tilted to the hawkish side, suggesting that there are 3 "swing" board members between the previous and current meetings. This time, a cautious approach prevailed, and the majority of the board preferred to wait and see how inflation evolves, especially in response to the minimum wage increase of 12%. In our opinion, the fact that the minimum wage inflation was set 4pps below its 2023 level (16%) will bring about significant disinflation in forthcoming months, which could be an argument for a larger rate cut in March. While we continue to expect a faster reduction in inflation in Q1-2024, allowing BanRep to cut 100bps in the March 29th meeting, we also believe the bias should be to the hawkish side given upside risks to inflation, with the potential for a 50 to 75bps cut instead.

All in all, today's decision reflects that BanRep is maintaining a cautious approach. This time, the focus turned from economic growth to inflation. Governor Villar quoted again a mantra that wasn't highlighted in December's meeting. "Pursuing lower inflation increases the possibility of better and sustainable economic growth in the future." The excess of graduality from the central bank suggests that the board will be reactive to inflation reduction, especially when we start to see a decrease in services inflation.

That said, the easing cycle could accelerate in H1-2024 since, during this period, we expect inflation to deliver the most significant reduction amid statistical base effects in indexed items. Current surveys point to an 8.0%–8.50% rate by the end of 2024; in Scotiabank Colpatria Economics, we project a 7% level.

Key points about today's decision:

- **During the press conference, Governor Villar emphasized that the central bank prefers a cautious approach to achieve a sustainable path of lower rates.** Speeding up the easing cycle today was a wild bet to the central bank, and uncertainty around inflation remains. We take this as a preference for wait and see what happens with indexation effects given the 12% minimum wage increase. We think that in forthcoming inflation reports, BanRep will find progress in core prices that will make them consider speeding up the easing cycle. However, we are aware that BanRep will always prefer to proceed with caution.

- **GDP growth projections remain at 1% for 2023 and 0.8% for 2024.** Both suggest a very weak performance in economic activity, and forecasts point to a negative output gap that the central bank can tolerate to pursue the inflation convergence to the target.

- **BanRep is vigilant about climate events.** Despite the "El Niño" phenomenon being in its most decisive phase, the central bank said that its inflation impact is not clear for now; in fact, they said that after "El Niño" usually comes "La Niña". As both are supposed to be temporary phenomena, in Scotiabank Colpatria, we expect the impact on prices to depend on how long the phenomena last.

- **Next Monday, February 5th, minutes will be released.** However, we anticipate those minutes will affirm the cautious approach from the central bank, which is in wait-and-see mode of what happens with core inflation after the minimum wage adjustment.
- **On Tuesday, February 6th, the central bank's staff will have the Monetary Policy Report press conference.** This publication provides a broad picture of the risk assessments around GDP and inflation.
- **The MoF anticipates the fiscal deficit was 4.2% of GDP in 2023.** Minister Bonilla said that the government is closer to publishing the Financing Plan 2024; however, no date was specified.