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Colombia—BanRep Cuts by 50bps in a Split Vote

- **Villar said it is important to have confidence in the inflation convergence to the target. The central bank doesn't see a negative output gap in the economy.**

The board of Colombia's central bank (BanRep) cut the monetary policy rate by 50bps to 12.25% in a split vote. Five members voted for a 50bps cut, one member for a 75bps cut, and one member (the Minister of Finance) for a 100bps cut. The decision aligns with the market and economist consensus and materialized the acceleration in the cutting cycle. BanRep preferred to keep a cautious approach in accelerating the easing cycle, aiming to affirm their credibility and gain more confidence in achieving the inflation target by mid-2025.

Today's move was lower than projected by Scotiabank Colpatría. The board is trying to fine-tune the balance between being cautious about inflation progress and supporting economic activity recovery. However, it was interesting to note that the central bank is not estimating a negative output gap after the weaker than expected GDP growth in 2024, which suggests potential GDP was revised down and that the cautious approach in the easing cycle could continue.

The central bank also revised their macro projections; they increased the GDP growth forecast from 0.8% to 1.1% in 2024, and reduced the inflation projection from 5.9% to 5.4% for the year-end, which in our perspective, is an encouraging combination. Either way, during the press conference, Governor Villar said they don't expect to reach inflation target before mid-2025. However, Governor Villar emphasized the importance of maintaining the central bank's credibility during the disinflation process to allow them to continue taking down interest rates and supporting the economy. Governor Villar didn't discard the possibility of changing the easing cycle's pace if needed.

All in all, at Scotiabank Colpatría, we still believe the central bank has room to accelerate the easing cycle. However, today's meeting showed a dominant cautious approach that could prevent the board from accelerating the easing cycle in the first half of the year. In our opinion, a year-end rate of around 7.50% is appropriate for Colombia, given the expected inflation progress and the economic activity deceleration. However, we think that the central bank would prefer to accelerate the easing cycle in later stages instead of accelerating now. The next monetary policy meeting will be on April 30th, at which we are expecting a 75bps cut. However, it will strongly depend on the assessment of the board at the time of the meeting regarding the economic activity deceleration and the progress of inflation. Remember that the next meeting will include an update on macroeconomic projections and scenarios from the central bank's staff.

Key points about today's decision:

- After this meeting's 50bps cut, the central bank has now 100bps in cumulative cuts, and according to Governor Villar, they expect to continue reducing the interest rate with moves that will depend on forthcoming data. Villar said that the credibility that inflation will continue going down could help transmit the current easing cycle in long-term interest rates in the economy, which could help the economy recover in the future.
- About the economic activity: Governor Villar said the Colombian economy is operating aligned with its capacity (output gap zero). After the negative surprise on GDP in 2023, growing by only 0.6%, it is interesting to note that the central bank still believes that the economy is running close to its capacity. This implies that potential GDP was revised down after the 2023 GDP surprise and implies that the board does

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not have to accelerate the easing cycle too much. On the other side, Governor Villar repeated again that credibility in the disinflationary process is key to having the possibility of continuing to consistently bring down interest rates.

- About GDP and inflation tradeoff: Governor Villar said that the board projects to achieve the inflation target by mid-2025, which is a sufficient scope of time to reach an inflation adjustment without negatively impacting economic activity. In our opinion, this shows that BanRep has a low willingness to accelerate the easing cycle more than the current 50bps pace.
- About the exchange rate: Governor Villar said that the put options program to accumulate international reserves has been successful, with more than USD 400 million executed. Villar noted that the recent increase in international reserve has improved Colombian buffers in case the IMF's Flexible Credit Line diminishes in the future.
- Despite the Finance Minister's support for having more aggressive rate cuts, he thinks monetary policy will support economic activity. However, he sees that the transmission of the lower monetary policy rate to credit rates has moderated since the banking system widens the spread between deposit rates and credit rates.

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