Scotiabank

GLOBAL ECONOMICS

LATAM FLASH

October 31, 2024

Contributors

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

Colombia—BanRep Maintains a Cautious Approach

- **BanRep cuts rate by 50bps to 9.75% amid international volatility and domestic fiscal uncertainty**

The board of Colombia's central bank (BanRep) cut the monetary policy rate by 50bps to 9.75% in a split vote, with four members voting for a 50bps cut and three voting for a 75bps cut. The board maintained a cautious approach as international volatility increased during the last month, and heightened uncertainty around fiscal sustainability because of local discussion around the General Participation System. BanRep emphasized that the uncertainty around fiscal accounts should be clarified to restore the country's macroeconomic stability. In the communique, the Board dropped the reference around the minimum wage; however, during the press conference, it remained an important topic. The Board also highlighted their concerns about the FX volatility and announced the end of the international reserves accumulation program. It is worth noting that the central bank said that if part of the recent FX depreciation proves structural, increasing inflationary pressures, it could slow the pace of future rate cuts. At Scotiabank Colpatria, we think that part of the recent movement will be temporary, so we don't expect a slowdown in the easing cycle.

On the macroeconomic front, the Board received a fresh set of macroeconomic projections and scenarios from the central bank staff. That said, the staff revised their projection for GDP growth upwards to 1.9% in 2024 and 2.9% in 2025. At the same time, the inflation expectation for December 2024 decreased to 5.3%. These revisions tell us that the macroeconomic scenario is improving. However, BanRep has less room to manoeuvre due to the surge of global and domestic uncertainties.

The next meeting will be on Friday, December 20th; the split vote, four vs three, suggests there is a chance to accelerate the easing cycle. However, it will strongly depend on having better clarity on the international scenario, the minimum wage negotiations, and fiscal initiatives. Our call remains for a 75bps rate cut to close the year at 9%. The terminal real rate is still estimated at 5.50%; however, if we observe a permanent shock in risk premiums, we might consider a moderate upward revision in the future.

Decision highlights:

- **Governor Villar said that today's decision contributes to reducing the real interest rate;** however, it remains restrictive because current inflation is still above the target. Economic activity is recovering, something that was reflected in the upward revision of GDP growth projections, suggesting that there is no rush to accelerate the easing cycle.

- **Governor Villar also said that despite the Board's decision to maintain a cautious approach, there is credibility in a consistent and continuous nature of the easing cycle.**

- **Is fiscal uncertainty increasing the neutral rate?** Governor Villar said that a wide range of variables defines the neutral rate. However, he said that if there is uncertainty around fiscal sustainability, the neutral rate could be higher. He emphasized that there is high uncertainty around this.

- **About fiscal concerns.** During the press conference, the spotlight was on fiscal concerns. Minister Bonilla said that since the transfer bill was presented as a constitutional proposal, it is being discussed in eight debates, and it does not require fiscal approval by the government. However, he said that to implement the bill, it is necessary to approve a law defining new regional responsibilities, which is expected to be an ordinary bill that requires fiscal availability and a discussion of four debates. The fiscal debate could take longer than expected, so in our opinion the local assets will continue to reflect the volatility attributed to this debate.

- **What about the minimum wage negotiations?** Governor Villar said that the discussion should consider that the staff reduced the inflation projection to 5.3%, which should serve as a base for the negotiation, while recalling that in 2024, the minimum wage increase was 12%, well above current inflation. At Scotiabank Colpatria, we project a minimum wage increase between 7% and 7.5%, which should continue to support the disinflationary process in the services sector.
- **Concerns around the international context.** Volatility due to upcoming US elections was an issue for the meeting, especially as it translated into FX depreciation, reducing the central bank's margin to manoeuvre. Next week will be critical to assess how structural the recent impact on assets has been.
- **About international reserves.** The international reserves accumulation program announced in December 2023 will be interrupted as the target of USD 1.5 bn has been technically met. International reserves in Colombia are hovering at USD 63 bn. Given the international context, it will be necessary to monitor whether the central bank decides to launch a program to reduce FX volatility. However, we see a low probability of that.
- **The Monetary Policy Report will be released on Tuesday, November 5th, minutes on Wednesday, November 6th, and a press conference of the Monetary Policy Report will be on Thursday, November 7th led by the Chief of BanRep's staff, Hernando Vargas.**