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LATAM FLASH

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Colombia—BanRep Surprises with Smaller Cut Amid Local and External Risks

Today, the board of Colombia's central bank (BanRep) surprised economists and markets with a 25bps cut to its monetary policy rate, bringing it to 9.50% in a split decision. Five members voted for a 25bps cut, one member for 50bps, and another for 75bps. In the communique, the Board emphasized that inflation will continue falling but more slowly amid recent FX pressures in the context of tighter financial conditions abroad and fiscal uncertainty domestically.

Today's action is a strong message of independence by the central bank. A board member who had previously voted for a 75bps cut (Acosta) is no longer voting in the same way as the Finance Minister, now Guevara (who succeeded dove Bonilla as Fin Min a couple of weeks ago).

Gov Villar highlighted that fiscal and minimum wage negotiations were supportive of a less aggressive cut. Moreover, the Fed's hawkish guidance earlier this week was also cause for the central bank to be more cautious today, demonstrating that the board is keeping a close eye on financial variables and seeks to prevent additional shocks to Colombian assets.

At the press conference, Minister Guevara heavily emphasized that lower rates could impulse economic growth and help to improve tax revenue (which would supposedly help with the perception of Colombian fiscal risks). However, Governor Villar argued that economic activity is delivering better-than-expected results, allowing the BanRep board to slow the pace of cuts and remain in a sustainable easing cycle.

The board is also drawing attention to the impact of variables such as the minimum wage. Yesterday, Colombia's labour minister said that if the business association and labour unions fail to reach an agreement on pay rises, next year's minimum wage increase could be set at 9%, which would further complicate the reduction of inflation towards target in 2025.

In that regard, Governor Villar said that productivity calculations that point to such a large increase probably reflected that in 2024 where new labour regulations reduced the maximum number of work hours. Elsewhere, Governor Villar said the central bank is not considering a new program of accumulation of international reserves as he considers that for now central bank buffers are enough.

The next meeting will be on Friday, January 31st, when the central bank's staff will also carry out a quarterly update of BanRep's macroeconomic scenario. Prior to today's decision we had expected BanRep to roll out another 50bps move in early-2025, but given today's events, we now think that officials will opt for another 25bps move.

In February, two BanRep board members are due to be replaced with their first rate decision coming in March (the second of the year). Despite Minister Guevara's insistence that he will pursue a 75bps cut in coming meetings, we think the likelihood of this is low. In the most optimistic scenario, an acceleration back to 50bps per meeting could take place.

We think that discussions around the real neutral rate and the cycle's terminal rate will be in focus in the near-term. Prior to today's meeting, we projected a 6.75% end-2025 BanRep rate, which would still be within reach for the board were they to accelerate cuts at some point next year. Nevertheless, our projection is now tilted towards a higher BanRep rate at end-2025.