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Colombia—BanRep Cut Monetary Policy Rate by 25 bps to 13% in Split Vote

- **BanRep cut the monetary policy rate by 25 bps to 13% in a split vote. Governor Villar emphasized that BanRep should be cautious in implementing the easing cycle**

The board of Colombia's central bank (BanRep) cut the monetary policy rate by 25 bps to 13% in a split vote, with five members voting for the 25 bps cut and two voting for a hold. The decision was aligned with market consensus and Scotiabank Colpatría expectations. The central bank emphasized that the economic activity is decelerating and is now operating closer to its potential capacity (output gap close to 0); in fact, the central bank staff reduced its GDP growth projection for 2023 from 1.2% to 1%. Meanwhile, the view about inflation remains cautious since lower food prices mostly explain recent headline inflation reduction. By the end of the communique, the central bank suggested that minimum wage negotiators be careful in negotiating the increase for 2024. The board emphasized that in 2023, the purchasing power of the minimum wage increased due to the reduction in inflation.

As we highlighted in previous reports, today's meeting would be challenging. However, the vote balance surprised us since the "5 vs. 2" is a dovish guidance. During the press conference, Governor Villar emphasized that the board will adopt a cautious approach in the easing cycle, saying that uncertainty remains high.

Our take is that the central bank will continue the easing cycle in forthcoming meetings. However, the pace will strongly depend on the inflation deceleration. That said, we think the easing cycle could accelerate during 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 a policy rate around 8.25%–9.0% by the end of 2024; at Scotiabank Colpatría Economics, we project the policy rate to end 2024 at 7%.

Key points about today's decision:

- **The split vote of 5 vs 2 was a surprise.** This vote balance suggests that the board had more confidence than expected starting an easing cycle at this meeting. Recent weak activity numbers seem to have weighed more in today's risk balance than the uncertainty around minimum wage negotiation and the possibility of having higher-than-expected indexation effects on inflation in 2024.
- **The assessment of the economic activity suggests the board estimates a close to 0 output gap.** Today's communique and press conference highlighted the cooling economic activity, allowing the Colombian economy to operate closer to its production capacity, which was also reflected in the significant narrowing of the current account deficit, estimated at 2.8% of GDP in 2023. Despite the economic slowdown, Governor Villar emphasized that BanRep is not projecting a technical recession. Instead, he considers that Colombia's economy will normalize towards more sustainable levels. Either way, today's remarks show us that the board will continue to closely watch the evolution of economic activity.
- **On the inflation front, the board emphasized that the main risk is the minimum salary increase, which is currently under negotiation.** Governor Villar said that the two board members who voted to hold in today's meeting said they prefer to wait and see what happens with the minimum wage increase since it determines a significant part of the indexation effects on service sectors. Our take is that the potential minimum wage increase for 2024, which we estimate around 11%–13%, will be lower than the 16% observed in 2023—this will contribute to reducing headline inflation, especially in the H1-2024.

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- **The next meeting will be on January 31st.** This meeting will include a fresh set of economic projections by the central bank staff, which will guide thinking about the speed of the easing cycle. From our perspective, projected inflation and economic conditions could allow the central bank to take the monetary policy rate below the 8.25% projected in recent economists' surveys. Scotiabank Colpatría projects that by the end of 2024, it will be 7%.
- **The MoF will release the financing plan this week.** At the end of the meeting, Minister Bonilla said that the MoF expects to publish the Financing Plan 2024 in the forthcoming days. It is worth noting that this plan will include the most recent macro projections, a preliminary result for the fiscal deficit in 2023, and the issuance plan for 2024.

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