Colombia | Economic Analysis

Banco de la Republica reduced its policy rate by 50 bp to 10.75%

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The Board of Banrep reduced its monetary policy rate by 50 bp, bringing it to 10.75%. This decision was divided, with 5 members voting for the 50 bp reduction and two members voting for a larger reduction of 75 bp. The balance of voting and the speed of the rate adjustment observed in recent meetings continued in the current meeting. With this reduction, the rate accumulates 250 bp of cuts since the beginning of the downward cycle in December 2023.

- The statement of the Board of Banrep highlights that the stability observed in headline inflation, around 7.2% in the last months, is in line with the expectations of the Bank's Staff. The Manager highlighted that the most important news in these data is that core inflation continued to decline. Specifically on inflation without food and administered prices, it is highlighted that it reduced from 6.1% to 6.0% and that a good part of the stability in headline inflation is due to the fact that food inflation presented an increase, due to climatic effects that are transitory. The press release also refers to administered items inflation, which decreased from 13.7% to 13.3%, which despite still being a high level, helped to compensate for the increase in food. At the press conference, the Governor highlighted that inflation risks are still present, although they present adjustments and do not remain immobile. In particular, he highlighted that there is still some concern about the risks associated with the weather, although estimates on their intensity have reduced somewhat in recent weeks; also due to the adjustment in the price of diesel; and, although there has been some recent appreciation of the exchange rate, there is still some risk on this front. Regarding diesel, the Minister highlighted that a significant adjustment is required, around 6,000 pesos and that this year they should reach an adjustment between 2,000 and 3,000 pesos, being higher than the previous estimates of most analysts. Regarding its inflationary effect, the Minister highlighted that his team's studies point to an aggregate impact of 1.4pp upwards in inflation.
- On the inflation expectations, the statement highlighted that some downward movement was observed in those derived from financial instrument negotiations, while those of analysts remained stable. This result, in a context of stable inflation in recent months, is favorable.
- On the activity front, the Bank's Staff revised the growth forecast upward, from 1.4% to 1.8% y/y for 2024. This improved performance is based on the activity indicators that have been published so far this year. They emphasize that this performance has been uneven across sectors but that the recovery path will continue to materialize in the remainder of the year. Regarding the impact of this revision on the output gap, the Governor emphasized that this adjustment should imply a somewhat less comfortable output gap, but that in the opinion of the Board this adjustment did not cause an impact or change in the stance of the members. When asked at the press conference about the labor market figures, the Governor pointed out that the figures were published during the Board meeting and that they must prepare the analysis with the required detail. However, he commented that the data are possibly affected by a relevant base effect, but that their evolution in the coming months is relevant and requires the detailed analysis of the team responsible for this issue at the Bank.On the inflation expectations front, the statement highlighted that some downgrade is observed in those derived from

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- On the external front, the Bank highlighted that financing conditions have improved and are looser, mainly due to an expectation of more accommodative policies in some of the main central banks. The Governor directly associated this issue with the behavior of the exchange rate. He pointed out that the strong depreciation of the exchange rate observed in June had moderated in the last month, especially in the first weeks of July. This moderation, he believes, was linked to the more accommodative discourse of the FED and the possibility of observing rate cuts among these major central banks.
- Regarding the interest rate, once again the consensus among the members of the Board to lower rates was highlighted, and that the differences remain in the rate, not in the trend. In his opening remarks, the Minister emphasized that although the reduction was not the one he had proposed, a reduction in the real rate was achieved as inflation remained stable. Thus, the real rate would have been reduced from 4.1% to 3.6%, according to the Minister.
- One of the topics that came up in the press conference was related to fiscal issues. In this regard, the Governor emphasized that the reduction of the deficit in recent years is supporting monetary policy and the moderation of demand. For his part, the Minister emphasized that spending in Colombia is highly inflexible and that efforts should focus on transfers, which are the most rigid. Regarding the budget presented, the Minister highlighted that it is accompanied by a financing law, although he did not provide details, but he considers that there should be an effort to allow a lower and perhaps flexible corporate rate.

Our view:

- The Board's decision to cut the policy rate by 50 bps, with a split vote, is in line with analysts' expectations and ours at BBVA Research. The balance of the vote continues to show a sharp division among members over the speed of the adjustment and for the moment no significant changes in the positions of the two groups are evident.
- The balance presented in the press release leaves a mixed feeling. Domestic factors include an upward revision of growth that may have some impact, albeit not a major one, on the output gap. This is accompanied by inflation that has remained stable in recent months but without affecting inflation expectations. Thus, there are no changes on the local front that would justify, for the time being, an acceleration in the reduction of rates. On the other hand, external factors include a more accommodative stance by the main central banks, especially the FED, for the remainder of the year. This stance, if it materializes, could favor a faster rate reduction at the local level.
- With this in mind, the evolution of local indicators over the next two months are of high importance for the stance of monetary policy. We expect headline inflation to resume its downward trend, and a continuation of this trend in core inflation in July. At the same time, activity data is expected to continue to show some recovery, but with marked differences between sectors, where it is anticipated that the services sectors will begin to show weaker dynamics, which we believe will reduce the pressure on inflation and together will favor the possibility of an acceleration in the reduction of rates. On the other hand, we expect the Fed to start cutting rates in September and this will support the possibility of a sharper rate cut at the local level, moving from 50bp per meeting to 75bp at the next meeting at the end of September.

- All in all, we continue to expect a policy rate cut to 8.5% by the end of 2024, a development consistent with Fed rate cuts in September and December of this year and a downward path for total and core inflation for the remainder of the year.

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