Creando Oportunidades

BBVA Research

**Colombia | Economic Analysis**

# Banco de la Republica reduced its policy rate by 50 bp to 10.25%

Alejandro Reyes González

**September 30, 2024**

The Board of Banrep reduced its monetary policy rate by 50 bps, bringing it to 10.25%. This decision was split, with 4 members favoring the 50 bp reduction and three members voting for a larger reduction of 75 bp. While maintaining the pace of tightening of recent meetings, the balance of the vote, more even between the two blocks, may send a signal of proximity to a more accelerated rate easing in the future. With this decision, the policy rate adjusts 300bp of reductions since December 2023.

- **The statement of the Board of Banrep highlights that inflation in August stood at 6.1% and that it was below market expectations**, highlighting that the surprise came especially in food due to good supply behavior and in administered price inflation due to lower adjustments in some utilities, moderating a little the tone of the surprise due to its source. However, inflation without food and administered prices also presented a strong reduction. The Governor highlighted that despite the strong reduction in inflation, it is still high, the highest after Argentina and Venezuela in the region, arguing in favor of maintaining a contractionary monetary policy stance.

  **It was highlighted in the press conference that inflation still faces important risks** in the coming months. Among them, the Minister of Finance highlighted the need to continue closing the diesel price gap, the risks to gas supply and energy availability in the coming years, and the possible effects of the observed exchange rate depreciation on inflation.

  **On the inflation expectations front, it was highlighted that those derived from the public debt markets were slightly reduced; however, those of analysts remained stable.** During the press conference, the Governor pointed out that the expectations derived from public debt for the next year are close to the inflation target and that for two years are already at the 3% target, which sends a signal of confidence from the markets regarding the Central Bank's capacity to bring inflation to its target. On the other hand, he pointed out that analysts were expecting a rate reduction higher than the one registered by the Central Bank in today's meeting and that this could be inconsistent with the fulfillment of the inflation target.

- **Activity in the second quarter showed a higher result than anticipated, especially on account of private consumption, although it also highlighted that investment showed some recovery in this figure.** At the same time, available indicators for the third quarter also point to a continuity in the gradual recovery faced by the economy. At the press conference, the Governor pointed out that there could be some upward bias in the growth estimated by the Bank's Staff to be published in the monetary policy report at the beginning of November, but that more information is required to be able to make the revision, in case it materializes. The Governor highlighted that the annual growth observed in the second quarter of 2024 is considerably higher than the contraction observed in the third quarter of 2023, which shows that the economy is already on a gradual recovery path. He also highlighted that although monetary policy is in contractionary territory, the economy is showing signs of recovery and that employment and unemployment data confirm that they have not been strongly affected by monetary policy decisions, with a labor market that has been relatively resilient.

- **On the external front, they highlighted the decision of the US Federal Reserve to lower its policy rate by 50 bp and the expectations of additional cuts in the coming months.** However, they highlighted that this reduction was not accompanied by a reduction in risk premiums in Latin America and Colombia, which limits the effect of this measure on the Colombian economy and they highlight that it is associated with lower oil prices and the challenges in the fiscal front. Probably, once the effects of the Fed's rate reduction materialize in other assets, beyond risk assets within the United States, and a moderation in the risk premiums of the countries of the region, especially Colombia, may support some additional adjustment in monetary policy in the economies of the region.
- **During the press conference, the Governor highlighted that the full Board supports the rate cut and that differences remain on the magnitude required.** However, the vote moved slightly in favor of sharper adjustments with a balance of 4 to 3 versus 5 to 2 in past meetings. On the other hand, the Minister of Finance highlighted that banks have been more agile in reducing interest rates than the Board of Banco de la República, emphasizing that mortgage loan interest rates are below the Central Banks' policy rate. In this regard, the Governor emphasized that the commercial banks' rate reductions recognize that in the future policy rates will be lower and that they are anticipating this expected trend. However, the question remains as to whether the Central Bank is lagging behind the market or whether the speed of the credit interest rate reductions are working against the Central Bank accelerating the reduction of its policy rate to at least partially contain this strong movement.
- Regarding fiscal issues, the Minister highlighted the need for a program to recover the economy and that this requires the support not only from the Central Bank through interest rates but also from Congress with a budget that allows boosting the sectors that the Government considers fundamental for the economic reactivation. **However, in response to several queries related to the budget process and the noise that this may have on the country's risk premiums, the Minister emphasized that if on January 2 of next year the resources required to finance the budget are not available, they will freeze the difference and stressed that the government's commitment to the fiscal rule is unwavering.** He added that one of the factors that puts the greatest pressure on the budget is debt service and particularly interest payments. For his part, the Governor made no direct allusion to these issues, but did include in the communiqué a mention of fiscal issues as factors that have put upward pressure on the country's risk premiums, especially in recent weeks.

***Our take:***

- **The decision to reduce the policy rate by 50 bps is lower than our expectations, those of analysts and the market, which at the end of last week expected cuts of 75 bps for this meeting.** This is due, among other factors, to the good performance of total and core inflation; economic activity still with low growth; and; greater room to reduce rates without affecting the exchange rate thanks to the 50bp reduction in the FED rate. However, uncertainty about future inflation, exchange rate risks and a somewhat more dynamic activity than initially anticipated by the Bank, prevented the balance in favor of a more accelerated rate cut from materializing and the vote remained divided in favor of continuing with the gradual 50bp cuts made to date.
- In this context, we believe that with the gradual decline in inflation, both total and core, but especially from the more favorable signal in the services basket and a stabilization near the current level of the exchange rate will open space to accelerate rate cuts from the Central Bank.

- The change in the balance of the voting in the Board also constitutes a signal in favor of a change of stance in the coming months.

# AVISO LEGAL

El presente documento, elaborado por el Departamento de BBVA Research, tiene carácter divulgativo y contiene datos, opiniones o estimaciones referidas a la fecha del mismo, de elaboración propia o procedentes o basadas en fuentes que consideramos fiables, sin que hayan sido objeto de verificación independiente por BBVA. BBVA, por tanto, no ofrece garantía, expresa o implícita, en cuanto a su precisión, integridad o corrección.

Las estimaciones que este documento puede contener han sido realizadas conforme a metodologías generalmente aceptadas y deben tomarse como tales, es decir, como previsiones o proyecciones. La evolución histórica de las variables económicas (positiva o negativa) no garantiza una evolución equivalente en el futuro.

El contenido de este documento está sujeto a cambios sin previo aviso en función, por ejemplo, del contexto económico o las fluctuaciones del mercado. BBVA no asume compromiso alguno de actualizar dicho contenido o comunicar esos cambios.

BBVA no asume responsabilidad alguna por cualquier pérdida, directa o indirecta, que pudiera resultar del uso de este documento o de su contenido.

Ni el presente documento, ni su contenido, constituyen una oferta, invitación o solicitud para adquirir, desinvertir u obtener interés alguno en activos o instrumentos financieros, ni pueden servir de base para ningún contrato, compromiso o decisión de ningún tipo.

El contenido de la presente comunicación o mensaje no constituye una recomendación profesional para realizar inversiones en los términos del artículo 2.40.1.1.2 del Decreto 2555 de 2010 o las normas que lo modifiquen, sustituyan o complementen.

Especialmente en lo que se refiere a la inversión en activos financieros que pudieran estar relacionados con las variables económicas que este documento puede desarrollar, los lectores deben ser conscientes de que en ningún caso deben tomar este documento como base para tomar sus decisiones de inversión y que las personas o entidades que potencialmente les puedan ofrecer productos de inversión serán las obligadas legalmente a proporcionarles toda la información que necesiten para esta toma de decisión.

El contenido del presente documento está protegido por la legislación de propiedad intelectual. Queda expresamente prohibida su reproducción, transformación, distribución, comunicación pública, puesta a disposición, extracción, reutilización, reenvío o la utilización de cualquier naturaleza, por cualquier medio o procedimiento, salvo en los casos en que esté legalmente permitido o sea autorizado expresamente por BBVA en su sitio web www.bbvaresearch.com.

INTERESADOS DIRIGIRSE A:
BBVA Research Colombia Carrera 9 No 72-21, piso 10. Bogotá, (Colombia).
Tel.: 3471600 ext 11448
www.bbvaresearch.com