Colombia | Economic Analysis

Banco de la Republica reduced its policy rate by 25 bp to 9.50%

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The Board of Banrep reduced its monetary policy rate by 25 bps, bringing it to 9.50%. This decision was split, with 5 members in favor of the 25 bp reduction, one in favor of a 50 bp reduction and one in favor of a 75 bp reduction. This is an important change in the Board's stance, after completing 6 consecutive meetings with rate cuts of 50bp per meeting. On this occasion they again highlighted the importance of global volatility and uncertainty, exchange rate depreciation and uncertainty about the fiscal situation. In 2024, the policy rate was reduced from 13.0% to 9.5%, a very significant reduction of 350bp but less than the reduction observed in 11 months of inflation (from 9.3% to 5.2%, 410 bp).

- **Banrep's Board statement highlights the reduction in inflation in November, reaching 5.2% (from 5.4% in October) but warns that non-food and non-regulated inflation remains stable with high persistence in services inflation.** Among the concerns outlined by the Governor is the potential effect of the exchange rate on inflation in the coming months. In particular, the Bank's Staff considers that inflation will approach the target in 2025 but believes that the trend will be slower than anticipated due to, among other factors, the depreciation of the exchange rate. Another issue highlighted by the Governor was that there is currently high uncertainty regarding the minimum wage increase for 2025 which, depending on its outcome, may generate some additional pressure on inflation in 2025, especially on services that maintain greater inertia and persistence.
- **On the activity front, the 2.0% growth in the third quarter and a cumulative growth of 1.6% for the year to date stand out, figures that show a recovery compared to what was observed in 2023.** Particularly noteworthy is the performance of gross investment, which grew by more than 20%. Linked to this, they highlight that the labor market is in good shape, at levels observed before the pandemic. Despite this reference, activity lost importance in the balance of the Bank's Board decision. The press conference focused on fiscal issues and volatility and uncertainty in the financial markets.
- **The main focus of the press release and the press conference was the uncertainty and volatility in the financial markets due, among other issues, to the observed depreciation of the exchange rate and its potential effect on inflation, but also on the economy.** Among the factors adduced for the exchange rate movement, most of them are associated to external factors, such as the FED decisions, the US electoral results and the drop in oil prices. However, they also highlight the fiscal uncertainty that has been growing in recent months. On this particular point, the press conference highlighted the recent behavior of Brazil's economy and its recent fiscal and exchange rate difficulties. Given this scenario, the Governor emphasized that it has always been the objective of the Bank's Board to achieve a smooth and gradual path of rate reductions aimed, among other factors, at avoiding an abrupt reversal of the trend as occurred in Brazil, which helps to reduce the general uncertainty about the economy. The Governor stated that gradual but predictable and continuous cuts in rates are more conducive to the consolidation of the recovery and growth than sharp but uncertain cuts.

- **On the fiscal front, as mentioned in the previous section, the Board is concerned about the uncertainty associated with this factor and its impact on economic issues.** However, due to the presence of the new Minister of Finance, Diego Guevara, many questions focused on fiscal issues. In summary, the Minister highlighted the Government's commitment to fiscal stability and the fiscal target, commenting that in 2024 they will meet the target and that they have used different tools provided by law to achieve it. He emphasized that fiscal responsibility and the fiscal rule is a constitutional law. Regarding 2025, he highlighted that it will be a year with ample difficulties on the fiscal front and that they start with the objective of complying with fiscal sustainability and the fiscal rule. He did not give details on possible spending cuts beyond what was already mentioned in previous meetings in which he highlighted that they will be from the investment budget and that this will be reduced from $81tn to $69tn.
- **There was no further response regarding the appointments of the new co-directors, despite having been consulted on a couple of occasions.** The Minister commented that this is the President's decision and that he would not comment on the matter, and in the case of the Governor, he emphasized that the decision taken today had no influence whatsoever with the changes in the Board. However, it was suggested that they would be appointed at the end of January and therefore it is likely that they would not participate until the March policy meeting.

Our take:

- *After 6 consecutive meetings with 50 bp cuts, the Board marks an important reversal in its monetary policy stance, with a 25 bp cut. This despite the fact that inflation maintains its downward trend, although one of the arguments is that inflation without food or regulated products remained stable in the last month and that there is still a high persistence in services. But the reversal in the stance is greater when it is highlighted that in the October and September meetings, the vote was divided with 3 members in favor of a 75bp cut. Thus, this time around, all but one (possibly the Minister), veered towards a more hawkish or less accommodative stance. This is a very strong message, especially at the current juncture where exchange rate volatility and fiscal uncertainty have been observed.*
- *In the last two meetings, in October and September, the vote pointed to a balance more inclined to a more accelerated rate cut, although the language of the press release, the press conference and some individual speeches of several Board members leaned more towards a warning message about the risks to inflation and doubts about fiscal issues. They first highlighted the concern with the vote against the government's budget in Congress, then with the doubts left by the passage of the transfer law and more recently with the risk of compliance with the fiscal rule this or next year. Compounded to all this was the marked and accelerated deterioration observed in Brazil in recent weeks, as a result of a more adverse fiscal scenario and a doubt in the commitment to recompose the fiscal path.*
- *This change of stance may lead to a more gradual cycle of rate cuts, at least until some doubts are dispelled on the fiscal, exchange rate and inflationary fronts, especially associated with the minimum wage increase and the indexation at the beginning of the year.*

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