

## Colombia Watch

## Monetary policy decision: Pounding the table

## Key takeaways

- The Central Bank of Colombia hiked the policy rate by 25bp, to 13.25%, in line with price-based expectations.
- The statement maintained the explicit tightening bias. However, we believe it is unlikely that BanRep will hike rates more.
- We expect rates on hold for the rest of the year, and BanRep to start cutting in January 2024.

## 25bp hike, in line with price-based expectations

The Central Bank of Colombia (BanRep) hiked the policy rate by 25bp, to 13.25%, in line with market prices (IBR swap) and contrary to our view (rates on hold). The Bloomberg survey had 14 firms/analysts expecting a 25bp hike and 13 forecasting rates on hold.

## Very split decision: three camps

Out of the seven votes, four board members voted for a 25bp hike, one for 50bp, and two for staying put. The decision was made against the backdrop of high inflation (13.3% yoy), slowdown in economic activity, and negative pressure on Colombian assets.

## Market selloff: lifting hawkish spirts

Last Wednesday President Petro reshuffled his ministerial cabinet, including the ousting of the Finance Minister, Jose Antonio Ocampo (see report, [Cabinet Reshuffle: Silver Linings](#)). Ocampo was perceived as an influence of moderation in the design of the government's structural reform agenda. The Colombian Peso has weakened almost 5% versus the dollar (USDCOP) since the day of the cabinet reshuffle. We believe this nudged some board members to take a more hawkish stance.

## Written statement: small changes (GDP growth and FCL)

The written statement doesn't have much meat. The main changes are that BanRep is revising the GDP growth forecast for 2023 (to 1%, from 0.8%), given better than expected data in the first four months of the year; and the inclusion of a paragraph that mentions the IMF concluded Colombia's macroeconomic policy framework is strong enough to make it eligible for an extension of the Flexible Credit Line. BanRep takes comfort on the IMF's assessment.

## Written statement: Tightening bias remains in place

The explicit tightening bias remains in place. This is the last sentence of the written statement. It reads, *"With the decision adopted at the session, monetary policy continues with its objective of taking inflation to the target of 3%. Future decisions will depend on new available information"*. We believe BanRep has refrained from eliminating the tightening bias in the statement to maximize its degrees of freedom and prevent further cuts from getting priced into the curve.

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## Press conference: Villar commended Bonilla

As almost always, the press conference was more interesting than the written statement. Perhaps the most interesting part was when Governor Villar commended the new Finance Minister, Ricardo Bonilla. He said they both worked together in Fedesarrollo (think tank) and highlighted the participation of Bonilla in the expert committee that supported the 2017 tax reform. Villar stated he expects BanRep to work in harmony with Bonilla, just like they did with Minister Ocampo. In fact, Ocampo was also present at the press conference. He stressed Bonilla has already mentioned publicly he plans to respect the Fiscal Rule, as a positive message to markets. However, we note that during those same remarks to the press, Ricardo Bonilla said “he hopes BanRep will cease hiking rates”, revealing a dovish stance on monetary policy.

### Exhibit 1: BofA's inflation forecasts for Colombia

We do not expect headline inflation to return to the tolerance range of BanRep (below 4%)

	CPI		Core (CPI ex food & energy), DANE measure		Food (food & non-alcoholic beverages)		Energy (electricity, residential gas, fuel for transportation)	
Weight (%)	100.00		78.05		15.05		6.90	
Period	mom	yoy	mom	yoy	mom	yoy	mom	yoy
<b>Dec-21</b>	<b>0.73</b>	<b>5.62</b>	<b>0.33</b>	<b>2.84</b>	<b>2.07</b>	<b>17.23</b>	<b>1.66</b>	<b>10.20</b>
Jan-22	1.66	6.94	1.17	3.84	3.79	19.94	1.73	11.75
Feb-22	1.63	8.00	1.25	4.42	3.26	23.29	1.60	12.99
Mar-22	1.00	8.53	0.60	4.76	2.84	25.37	0.42	11.35
Apr-22	1.25	9.23	0.86	5.44	2.75	26.18	1.44	11.36
May-22	0.84	9.06	0.63	5.99	1.56	21.60	1.20	12.10
Jun-22	0.51	9.68	0.38	6.22	0.64	23.64	1.44	13.66
Jul-22	0.80	10.20	0.57	6.52	1.17	24.62	2.28	15.56
Aug-22	1.02	10.84	0.71	6.96	1.85	25.56	2.04	17.34
Sep-22	0.93	11.44	0.69	7.42	1.61	26.62	1.52	18.17
Oct-22	0.72	12.22	0.53	8.24	1.21	27.02	1.23	19.03
Nov-22	0.77	12.53	0.58	8.61	1.49	27.08	0.71	18.67
<b>Dec-22</b>	<b>1.26</b>	<b>13.12</b>	<b>0.90</b>	<b>9.23</b>	<b>2.66</b>	<b>27.81</b>	<b>0.98</b>	<b>17.88</b>
Jan-23	1.78	13.25	1.61	9.71	2.47	26.18	1.62	17.75
Feb-23	1.66	13.28	1.65	10.15	1.59	24.14	1.84	18.03
Mar-23	1.05	13.34	0.95	10.53	0.91	21.80	2.54	20.52
Apr-23	0.83	12.87	0.68	10.34	0.85	19.55	2.27	21.51
May-23	0.55	12.55	0.48	10.17	0.34	18.13	1.83	22.27
Jun-23	0.37	12.40	0.45	10.25	-0.13	17.22	0.93	21.66
Jul-23	0.37	11.91	0.35	10.01	0.14	16.03	1.14	20.30
Aug-23	0.31	11.12	0.29	9.54	0.03	13.96	1.31	19.43
Sep-23	0.43	10.58	0.37	9.19	0.35	12.55	1.30	19.18
Oct-23	0.28	10.10	0.27	8.92	-0.05	11.14	1.22	19.17
Nov-23	0.45	9.76	0.31	8.63	0.69	10.27	1.19	19.74
<b>Dec-23</b>	<b>0.53</b>	<b>8.96</b>	<b>0.51</b>	<b>8.20</b>	<b>0.31</b>	<b>7.75</b>	<b>1.23</b>	<b>20.04</b>
Jan-24	1.26	8.41	1.35	7.92	1.05	6.25	1.00	19.31
Feb-24	1.16	7.88	1.38	7.63	0.35	4.95	1.19	18.55
Mar-24	0.70	7.50	0.63	7.30	0.81	4.85	1.07	16.85
Apr-24	0.51	7.16	0.33	6.92	1.00	5.01	0.98	15.37
May-24	0.37	6.96	0.33	6.76	0.25	4.92	1.01	14.45
Jun-24	0.25	6.83	0.35	6.64	-0.22	4.82	0.50	13.96
Jul-24	0.26	6.72	0.25	6.53	0.05	4.73	0.90	13.69
Aug-24	0.13	6.52	0.18	6.42	-0.06	4.63	0.10	12.33
Sep-24	0.25	6.32	0.26	6.31	0.26	4.54	0.11	11.01
Oct-24	0.13	6.16	0.19	6.22	-0.14	4.44	0.20	9.89
Nov-24	0.15	5.84	0.20	6.11	-0.06	3.67	0.20	8.82
<b>Dec-24</b>	<b>0.37</b>	<b>5.68</b>	<b>0.40</b>	<b>6.00</b>	<b>0.24</b>	<b>3.59</b>	<b>0.39</b>	<b>7.91</b>

Source: BofA Global Research, Statistics Institute (DANE)

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## BofA scenario: first rate cut in January 2024

In our view, it is unlikely to see further rate hikes in Colombia. The written statement maintains the explicit tightening bias, and during the press conference Governor Villar said it is impossible to rule out more hikes because decisions will be data dependent. However, we believe there is a high probability that inflation will start falling in April (see forecast in Exhibit 1) and BanRep will use the observed disinflation as an argument to stay put at the next meeting (June). Looking forward, we expect the board to start cutting rates in January 2024, in 50bp clips. In our scenario, the policy rate will go down to 9.25% by December 2024 (400bp of cuts).

## LDM: Prepare to receive... but don't receive just yet

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BanRep's decision to hike 25bp in its April meeting was in line with market expectations. While our baseline was that BanRep would remain on hold, we have acknowledged that risks were most certainly to the upside. For instance, Colombia has arguably the most severe domestic inflation problem in the region (see [Common drivers of uncommon inflation](#)). A high level of indexation, the withdrawal of fuel subsidies and a still overheated economy are all domestic factors that will keep putting pressure on inflation, even if the global inflation outlook provides some downside.

After this most recent hike, BanRep is most likely done with the hiking cycle. Risks are more balanced now, as we expect inflation to be on a downward path by the next meeting in June. However, while investors may be tempted to start building receiving positions in Colombia, we believe that it is better to avoid exposure to the level of the curve for now. Two reasons support our view. First, policy uncertainty remains high given the recent cabinet reshuffling. Our expectation is that the government will keep a fiscally responsible stance, but we are concerned about lingering headline risk. Second, while risks are more balanced than before, it is still the case that Colombia's inflation remains very high. The market is pricing cuts as early as October. In contrast, we believe BanRep will need to keep rates high for longer to contain inflation.

As a result, our view is that investors are better off maintaining positions in flatteners between the very front end and the belly, rather than outright receivers. Given the higher policy risks, steepeners between the belly and the back end might also be attractive. However, we believe current risks are relatively well priced by now, and we have more confidence that the curve could flatten between the very front-end and belly. In particular, we like [1s5s IBR flatteners](#) (current: -332). Risks to the trade are a significant drop in core inflation, an aggressive dovish turn in BanRep that signals cuts in the very short term, or a very significant policy shock that steepens the curve further. We believe risk-reward for outright receivers will become attractive once we have more clarity about the policy and inflation outlook.

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