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GLOBAL ECONOMICS

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Contributors

Juan Manuel Herrera
Senior Economist/Strategist
+44.207.826.5654
Scotiabank GBM
juanmanuel.herrera@scotiabank.com

Guillermo Arbe, Head Economist, Peru
+51.1.211.6052 (Peru)
guillermo.arbe@scotiabank.com.pe

Sergio Olarte, Head Economist, Colombia
+57.1.745.6300 Ext. 9166 (Colombia)
sergio.olarte@scotiabankcolpatria.com

Jorge Selaive, Head Economist, Chile
+56.2.2619.5435 (Chile)
jorge.selaive@scotiabank.cl

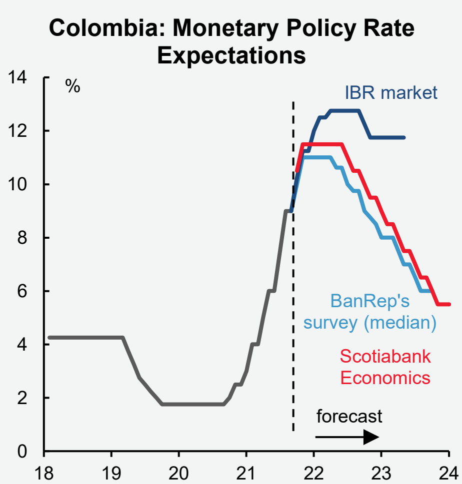
Eduardo Suárez, VP, Latin America Economics
+52.55.9179.5174 (Mexico)
esuarezm@scotiabank.com.mx

TODAY'S CONTRIBUTORS:

María (Tatiana) Mejía, Economist
+57.1.745.6300 (Colombia)
Maria1.Mejia@scotiabankcolpatria.com

Jackeline Piraján, Senior Economist
+57.1.745.6300 Ext. 9400 (Colombia)
jackeline.pirajan@scotiabankcolpatria.com

Chart 1



Sources: Scotiabank Economics, BanRep.

Latam Daily: Colombia—BanRep Preview

- **Colombia: Monetary Policy Preview—A third 150bps hike is expected, but again in a split decision**

COLOMBIA: MONETARY POLICY PREVIEW—A THIRD 150BPS HIKE IS EXPECTED, BUT AGAIN IN A SPLIT DECISION

BanRep will hold its sixth monetary policy meeting of the year on Thursday, September 29. The central bank is expected to hike its monetary policy rate by 150bps again, but will likely show a more divided vote than at the July decision. A split vote from BanRep is usually a sign that the Board is prepared to change its stance in the future. However, despite the split vote in July, information since has suggested that private consumption remains strong, while core inflation metrics have increased more than expected. Both elements, plus a more hawkish environment from central banks in developed countries, will lead the Board to remain in a hawkish mood and a data-dependent approach.

That said, after Thursday's meeting Colombia's monetary policy rate will be at its highest point since the beginning of the inflation-targeting regime in 1999. For now, we affirm our expectation of a final 100bps move at the October meeting to reach a terminal rate of 11.50%. However, elevated rates could last longer than usual, maintaining negative pressure on Colombian fixed-income markets in the medium-term.

The IBR market is pricing a cumulative move of 225bps by October, and a terminal rate at 12.75% by March 2023 (chart 1). We disagree with the market's opinion as we expect BanRep to end its hiking cycle sooner, and we see the policy rate at 9% at end-2023 with inflation projected to be lower by then. In the case of the Colombian peso, we do not expect any intervention by the central bank.

Key points ahead of Thursday's BanRep vote:

- **In July's meeting, we had a split vote of 6 vs 1.** The dissenting vote for a 100bps hike argued that the economy is currently experiencing a crowding out effect and the hiking cycle has had an asymmetrical impact on households and enterprises.
- **Although a split vote usually signals a change of stance in forthcoming meetings, this time would be different.** Since July, inflation continued to surprise to the upside, while international financial conditions tightened more than expected. These factors should again see a split vote from the board, with the majority still supporting the larger 150bps move. Additionally, as uncertainty regarding inflation remains high, we don't expect the data-dependent approach to be removed.
- **Inflation expectations deviated further from BanRep's target according to recent surveys.** In BanRep's latest survey, one- and two-year ahead inflation expectations are at 7.05% and 4.59%, while by the end of 2022 and 2023 inflation is expected at 11.22% and 6.47%, respectively. Expected increases in gasoline prices are a thing to keep an eye on since, although the initial impact could be moderate (per +1% in gasoline prices = +6bps in headline inflation), the second round effects would be higher in the future, especially ahead of 2023.
- **As always, it will be relevant to monitor signals that the hiking cycle is reaching a terminal phase.** In October's meeting, the staff will release a fresh set of macroeconomic projections and it would affirm the expected pause. However, in the September's meeting a more split vote with more members in favour of a lower hike would be a good signal.
- **On the FX side, the COP remains under pressure originating from international developments. The BanRep probably won't react.** Governor Villar emphasized that the floating regime is appropriate and that intervention in not effective to fight against global trends. That said, we don't expect any announcement on that front.

All in all, we anticipate again a 150bps hike to leave the rate at 10.50%. Increasing inflation expectations and tighter international financial conditions will continue to support a hawkish move. The yield curve will continue under pressure until the central bank signals a pause. However, even if we reach the terminal rate, a discussion about future cuts would take time, which would make it difficult to ease pressures in the short and the belly of the curve. In terms of the FX a 150bps move could be enough to contain volatility that would come from rate differentials vs the US. That said, the currency would continue oscillating around the 4,500 pesos level. The end of the hiking cycle is expected at 11.50% but it will continue to depend on the inflationary developments in the forthcoming months.

—Sergio Olarte, María (Tatiana) Mejía & Jackeline Piraján