Latam Daily: Colombia MPR Decision Curtain-Raiser; Peru Raises Reserve Requirements

- **Colombia: Preview to Friday's monetary policy meeting: lack of consensus to continue**
- **Peru: BCRP continues withdrawing monetary stimulus with new increase in reserve requirements**

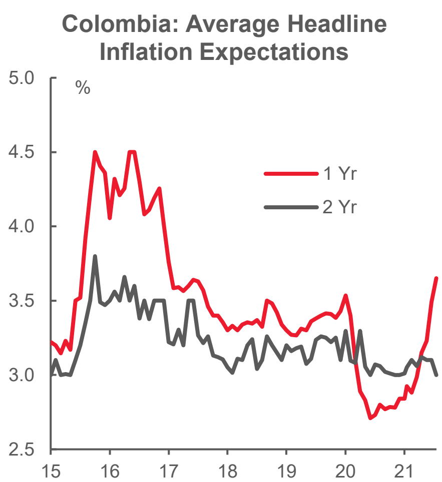
COLOMBIA: PREVIEW TO FRIDAY'S MONETARY POLICY MEETING: LACK OF CONSENSUS TO CONTINUE

Tomorrow (Friday, October 29), the central bank, BanRep, will hold its regular monetary policy meeting. The majority of analysts expect the Board to increase the policy rate by 25 bps to 2.25%, which is aligned with our own projection. At its last meeting (September 30), BanRep started its hiking cycle in a surprise split vote (4 voting for + 25 bps versus 3 voting for +50 bps). The hawkish side of the Board emphasized concerns on the current core inflation and expectations dynamics; while the dovish side underscored the still prevailing uncertainty in the economic recovery. Since the last meeting, macro data for August showed a reduction in the core inflation print as well as inflation expectations remaining anchored. On the economic growth side, however, August's economic activity showed that recovery still faces challenges, leading us to think that the Board is not getting significant hawkish data to more evidently accelerate its hiking cycle.

Key points to have in mind ahead of Friday's BanRep vote:

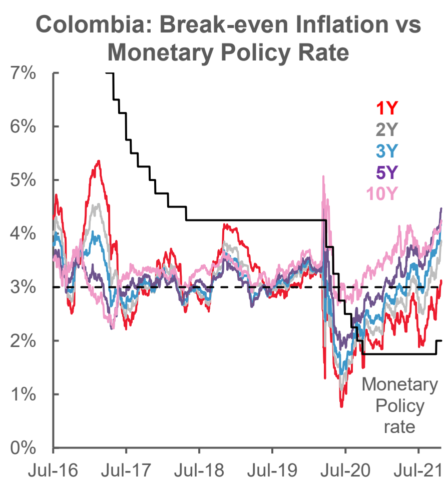
- **The Board will have updated forecasts from the Central Bank's staff for GDP, inflation, FX, implicit policy rate, and the balance of payments, which will have important information on how BanRep's staff is thinking about the normalization of the policy rate.** We expect the staff to signal a more steep hiking cycle due to the output gap closing at a faster pace, and in the same vein inflation forecast would be revised to the upside due to the indexation effect ahead of 2022.

Chart 1



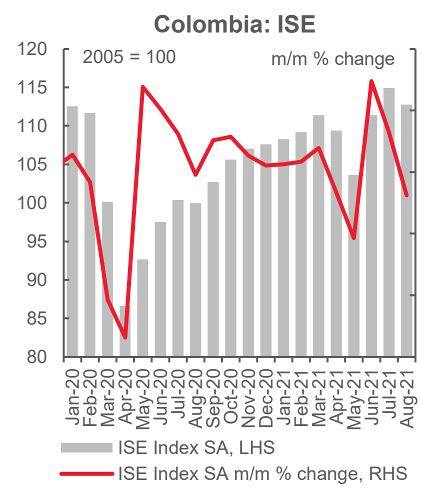
Sources: Scotiabank Economics, BanRep.

Chart 2



Sources: Scotiabank Economics, Infovalmer.

Chart 3



Sources: Scotiabank Economics, DANE.

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- **Relevant data since the last meeting.** We think recent data is not strongly affirming a hawkish view:
  - ◊ **Inflation:** Headline inflation surprised to the upside, however, the core metric retreated, and more importantly, inflation expectations remained anchored over the medium term (chart 1), specifically core inflation expectations which fell in the last BanRep survey. Previous data would not be a game-changer signal for the dovish side of the Board. However, breakeven inflation has increased and, metrics beyond two years are hovering the 4% (chart 2).
  - ◊ **Economic growth:** Economic activity in August weakened (-1.9% m/m sa) as certain activities that were initially boosted by the pandemic started to lose ground (chart 3). The previous result showed that, although the economic recovery remains solid, further gains would be challenging. We think this supports the idea of a 25 bps hike for October's meeting.
  - ◊ **External sector:** The trade balance deficit will likely keep widening as domestic demand recovery and international prices are leading to a strong expansion of imports. On the other side, the US Federal Reserve has been signalling a sooner-than-expected start to reducing stimulus.

Taking all the above into account, we expect BanRep's staff to continue showing upward revisions in GDP growth and inflation forecasts. That said, staff would point to a higher terminal rate in the hiking cycle. However, they usually do not publish the explicit rate path; instead, they qualitatively compare their path against analysts' consensus (currently pointing to a 2.50% rate by the end of 2021 and 4% by the end of 2022). On our end, we expect the hiking cycle to continue at a 25 bps pace for now. That said, breakeven inflation deserves monitoring, although recent increases are likely due to market dynamics and not necessarily reflecting structurally higher inflation expectations. Therefore, we affirm our expectation of policy rate closing 2021 at 2.50% and 4.50% by the end of 2022.

—Sergio Olarte & Jackeline Piraján

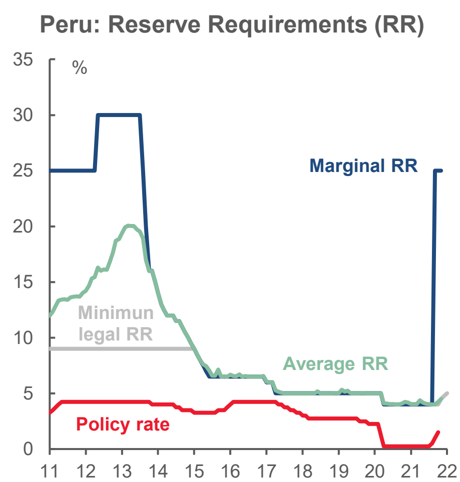
PERU: BCRP CONTINUES WITHDRAWING MONETARY STIMULUS WITH NEW INCREASE IN RESERVE REQUIREMENTS

Peru's central bank (BCRP) raised its reserve requirements on bank deposits for the second time this year, which were at historically low levels. This complements increases in the policy rate of a cumulative 125 bps since August. The new measure is a sign that the BCRP is willing to expand its tools to strengthen monetary control in a context in which inflation reached 5.2% y/y in September.

The BCRP raised the minimum legal reserve requirement from 4.0% to 4.5% in November 2021; to 4.75% by December 2021; and to 5.0% for January 2022, which represents a return to pre-pandemic levels. This could reflect a desire on the part of the BCRP to gradually return to more normal monetary conditions, in line with an economy that would reach pre-pandemic levels in Q4–2021, according to BCRP forecasts.

The new measure given is potentially more potent, in that it affects total bank deposits, than if it had only raised the reserve requirement on new deposits (known as the marginal reserve requirement), as it did in August. Thus, three measures expand and strengthen the measures from August 2021, when the BCRP increased the reserve requirements on new deposits from 4% to 25%, and raised the average reserve requirement from 4% to 4.25% as of October and to 4.50% as of November.

Chart 4



Sources: Scotiabank Economics, BCRP.

We see room for the BCRP to continue interspersing increases in the reference rate with increases in reserve requirements (chart 4), in order to prevent inflation expectations from accelerating. We recently raised our policy rate forecast to 2.50% to end-2021 and to 3.50% to end-2022. These adjustments are also in line with the BCRP's vision that the economy requires monetary stimuli but with less intensity than before.

—Mario Guerrero