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VIGILADO SUPERINTENDENCIA FINANCIERA DE COLOMBIA

Colombia Monetary Policy Preview: BanRep expected to deliver another hike as uncertainty and inflation risk remains elevated

On Friday, July 31st, the central bank will hold a new monetary policy meeting to set the interest rate. After delivering a surprising 75 bps hike, economists and markets expect a 50 bps increase to 12.50%, and according to BanRep's survey, this move is expected to be the last one of the contractionary cycle. At DAVIbank, we see the possibility of maintaining the pace of tightening at 75 bps. At the same time, it will be important to see whether the communication suggests that the central bank is comfortable with the new level of rates and whether we can enter a period of stability. This meeting is also special because the central bank staff will provide a fresh set of macroeconomic projections for the board, which will be published in detail next week in the Monetary Policy Report. What we know for now is that the staff is revising its inflation expectations upward, and in fact, that is why at June's meeting the board highlighted the need to increase the degree of monetary policy tightening.

July's meeting takes place against a challenging backdrop. The latest inflation reading surpassed 6%, specifically reaching 6.14%, above economists' consensus. Inflation expectations have not shown significant progress. Year-end expectations increased by 17 bps to 6.68% y/y, while expectations at one- and two-year horizons (5.49% y/y and 4.13% y/y, respectively) remain above the upper bound of the inflation target range (defined between 2% and 4%). To this, we must add that projections regarding the El Niño weather phenomenon have worsened, pointing to a scenario of greater intensity and longer duration.

Economic data has also remained robust. Consumer confidence is at a high level, while the economic activity indicator (ISE) continues to show that growth has been fueled not only by an expansive public sector but also by still-strong private consumption. The international environment has been extremely volatile, as in just one month we have moved through two cycles of optimism and escalation in the Iran conflict, while commodity prices remain under pressure. **In terms of risk premium, Colombian assets continue to benefit from the market's vote of confidence, as investors view positively the new administration's willingness to pursue fiscal sustainability;** however, we are approaching the point at which markets will shift their focus toward policy implementation, and we will learn how much of this optimism can be sustained.

All in all, monetary policy is operating under a highly uncertain scenario, especially because of shocks that could delay inflation's convergence toward the target. This challenge is even greater

considering that inflation in Colombia has not yet reached its peak and will probably do so by the end of the year. That is why it is likely that, after delivering another rate hike, the central bank may not feel comfortable explicitly stating that the hiking cycle has ended. For now, we maintain our year-end policy rate forecast at 12.75% and project a rate of 10% by December 2027. We expect rate cuts to begin only once inflation expectations return to the target range, which according to our projections will occur during the second half of 2027.

Key points to consider ahead of June's meeting:

- **New projections from BanRep's economists staff.** In this meeting, the board will have access to a new set of macroeconomic forecasts and scenarios. The previous update was presented at April's meeting, and at that time the staff still saw a path for inflation to return to the target range in 2027. The implicit monetary policy path underlying this scenario required a more contractionary stance than that projected by analysts for 2026, but a less restrictive position than consensus expectations for 2027. **Based on Governor Villar's remarks during June's meeting, the staff appears to be shifting its baseline scenario toward achieving compliance with the inflation target in 2028.** Having said that, it will be important to assess whether the current degree of monetary policy tightness is sufficient to provide a reasonable probability of achieving this scenario. **In terms of economic activity, adjustments to estimates of potential growth may be introduced.** Likewise, **regarding structural parameters such as the neutral real interest rate, currently estimated at 3.1% in 2026 and 3.4% in 2027, it will be interesting to see the central bank's assessment of the positive market reaction reflected in Colombia's risk premiums after the elections.**

- **Economic activity continued to beat expectations.** Activity data for May (+4.1% y/y) showed solid growth, largely explained by the strong performance of service-related sectors (+5.4% y/y). The sector that includes public administration and leisure activities expanded by 10.5% y/y, reflecting salary adjustments for public employees, election-related spending, and, on the leisure front, the continued strength of online gambling and entertainment events. In fact, retail sales expanded by 11.7%, highlighting still-robust demand for durable goods, while expectations regarding future consumption also remain positive, according to Fedesarrollo's consumer confidence indicator, which continues to show a strong positive balance. At DAVIbank, we project economic growth of 2.4% in 2026, with a potential acceleration to 2.7% in 2027, supported by the inertia of strong private consumption and an improvement in investment activity. All

VIGILADO SUPERINTENDENCIA FINANCIERA DE COLOMBIA

of the above will continue demonstrating that the economic activity is far from been a restriction to further rate tightening.

- **Inflation surpassed 6%, inflation expectations remain sticky, and uncertainty regarding supply shocks remains high.** In June, inflation stood at 6.14%, above economists' consensus, reflecting pressures from both food and regulated prices. In the case of regulated prices, utility tariffs are beginning to reflect the impact of a different electricity generation mix in preparation for the *El Niño* weather phenomenon, while food prices continue to exhibit erratic behavior. Following the upside surprise, year-end inflation expectations for 2026 and 2027 increased to 5.68% and 4.98% y/y, respectively. Risks to the inflation outlook remain elevated, particularly as projections for the *El Niño* phenomenon point to a stronger event, while the conflict involving Iran remains an ongoing concern that could generate more significant pressures on input prices in the future. **At DAVIbank, we project that inflation will peak at 6.9% in December 2026, while the disinflation process in 2027 will depend heavily on factors such as the minimum wage adjustment and the impact of weather conditions on agricultural supply and food prices. For now, our forecast stands at 4.9% for December 2027, assuming a minimum wage increase of no more than 8.5%. In fact, this issue remains a critical concern for the central bank, and it will be interesting to see whether the board highlights this risk during the meeting.**

- **Markets continued to support expectations of fiscal adjustment.** The exchange rate is at its strongest level since mid-2019, the 5-year CDS stands at 150 bps, and the COLTES yield curve has retained most of the appreciation observed after the elections. During the June meeting, the board highlighted that the lower exchange rate has contributed to moderating inflationary pressures. However, policymakers also noted that strong domestic demand is driving higher imports in response to the appreciation of the currency. In this meeting we will keep an eye on the board's reading of the consistent outperformance of local assets.

VIGILADO SUPERINTENDENCIA FINANCIERA DE COLOMBIA

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Macroeconomic forecast DAVIbank Economics Colombia

Forecast	2019	2020	2021	2022	2023	2024	2025pr	2026pr	2027 pr
National Accounts									
Real GDP growth (yearly %)	3.2	-7.2	11.1	7.6	0.9	1.5	2.6	2.4	2.7
Domestic demand (y/y. %)	4.0	-7.5	13.8	10.5	-2.3	1.6	3.9	2.9	3.2
Consumption (y/y. %)	4.3	-4.3	14.1	9.5	0.7	1.4	4.4	3.4	3.1
Private (y/y. %)	4.0	-5.0	15.3	11.1	0.6	1.6	3.5	3.2	3.6
Goverment (y/y. %)	5.5	-0.9	10.3	2.2	1.1	0.0	8.3	4.4	0.8
Gross capital formation (y/y. %)	3.2	-7.2	11.1	7.6	0.9	1.5	2.6	2.4	2.7
Exports (y/y. %)	3.3	-22.3	15.7	13.6	3.1	0.3	1.8	1.9	1.7
Imports (y/y. %)	7.7	-19.8	28.5	25.0	-9.8	1.3	8.8	3.0	4.2
Laboral Market									
Unemployment (%. Average)	10.9	16.7	13.8	11.2	10.2	10.2	8.9	9	9.4
Balance of Payments									
Trade Balance (USD$. B)	-14.15	-13.10	-20.00	-16.10	-7.81	-9.77	-14.89	-16.61	-19.91
Exports (USD$. B)	51.3	38.2	50.9	73.5	68.7	69.1	71.5	79.22	82.1
Imports (USD$. B)	65.5	51.3	70.9	89.6	76.5	78.9	86.3	97.05	103.10
Current account (USD$ Balance. B)	-14.81	-9.27	-17.95	-20.88	-8.32	-7.10	-11.02	-13.4	-16.18
Current account (% of GDP)	-4.6	-3.4	-5.6	-6.0	-2.3	-1.7	-2.4	-2.3	2.7
Prices. Rates & Exchange Rates									
CPI (y/y. %. End period)	3.80	1.61	5.62	13.12	9.28	5.20	5.10	6.87	4.87
CPI (y/y. %. Average)	3.52	2.53	3.49	10.15	11.77	6.63	5.14	6.01	5.67
CPI without food (y/y. %. End period)	3.45	1.03	3.44	9.99	10.33	5.60	5.11	6.50	4.77
COP ($. End period)	3297	3422	4077	4850	3902	4405	3780	3567	3701
COP ($. Average)	3281	3694	3766	4254	4322	4153	4052	3643	3629
BanRep's rate (%. End period)	4.25	1.75	3.00	12	13.0	9.50	9.25	12.75	10
Fiscal projections*									
Net Debt of CNG (% of GDP)	48.4	60.7	60.1	57.6	53.4	59.3	58.5	61	62.9
Primary Balance of CNG (% del PIB)	0.4	-5.0	-3.6	-1.0	-0.3	-2.4	-3.5	-4.1	0.5
Deficit of CNG (% of GDP)	-2.5	-7.8	-7.1	-5.3	-4.3	-6.8	-6.4	-7.4	-5.1

*Source: CARF Report June 2026 about MTFF. For 2027 the projection assumes a 3.7% of GDP adjustment

Source: DAVIbank Economics Colombia.

VIGILADO SUPERINTENDENCIA FINANCIERA DE COLOMBIA

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