DAVIbank

Economics Colombia

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Colombia Monetary Policy Preview: A New Hawkish Hold Awaiting Minimum Wage Definition

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On Friday, December 19, BanRep will hold its last monetary policy meeting of 2025. Since the previous meeting in October—and particularly after some board members' speeches following the IMF meetings—markets have started to view rate hikes as a potential new base-case scenario. This expectation has also been fueled by volatile announcements regarding the possible increase in the minimum wage.

Ahead of tomorrow's BanRep session, DAVIbank expects the monetary policy rate to remain on hold at 9.25%. However, the central bank is likely to maintain a hawkish tone, emphasizing strong economic growth, inflation expectations above the target through the end of 2026, and political tensions surrounding the minimum wage decision—all within a context of global uncertainty and a still-challenging fiscal outlook.

At DAVIbank Economics, we project rate stability at least until the last quarter of 2026, which contrasts with the median economist consensus according to BanRep's survey. **Our assessment assumes a minimum wage increase of 11%, which, based on our calculations, should not accelerate inflation since it is similar to the increase observed in 2025.** Nevertheless, we acknowledge that our expectation depends on the final minimum wage decision, the degree of pass-through to consumer prices, and other unforeseen shocks in relevant fronts such as regulated and food prices. In our view, the central bank will remain cautious, waiting to see how inflation responds to higher labor costs before acting in any direction. A strong signal to consider hikes is unlikely before February-2026 inflation data is available; acting earlier would require certainty of stronger shocks.

Key Points to Consider Ahead of December's Meeting

- **Economic Activity:** GDP expanded 3.6% in Q3 2025, well above the central bank's projection of 3.0%. This stronger activity was driven by resilient household consumption and a surprising increase in public spending. According to our calculations, the output gap is nearly closed. BanRep officials have noted that robust economic activity provides a buffer for maintaining a contractionary stance, reducing the sacrifice ratio of keeping it restrictive for longer. Today, the Economic Activity Index (ISE) showed a more moderate performance (+2.9% y/y), but we do not believe this is a game-changer for the decision.

- **Inflation:** After a significant rebound in October, inflation surprised to the downside in November. Annual headline inflation stood at 5.30%, reflecting substantial relief in food prices, while core metrics (ex-food at 5.20%) also eased slightly. We believe this reduces speculation among some market participants about a "U-turn" in inflation dynamics. Regarding expectations, year-end 2026 inflation is projected around 4.50%, which poses a challenge for the central bank as it begins the year with odds against meeting its target.

- **Minimum Wage Debate:** Negotiations between labor unions and business associations ended without agreement. Labor unions requested a 16% increase, while business associations proposed 7.21%. The government is expected to set the increase before December 30, with expectations ranging between 11% and 12%.

- **External Sector:** The current account deficit stood at 2.2% of GDP year-to-date through September. In Q3 2025, the trade deficit widened to 3% of GDP, a recent concern highlighted by BanRep. Despite this, the wider trade deficit has not translated into a more depreciated currency ad remittances inflows remains strong. The central bank attributes the higher trade deficit to robust domestic demand, while at DAVIbank, we are concerned that financing increasingly relies on public sector indebtedness.

- **Fiscal Situation:** Since the October meeting, COLTES markets have depreciated significantly, reflecting tighter liquidity conditions combined with still-high government financing needs. The Fiscal Reform was rejected in the Congress, while Fitch downgrades the credit rating to BB, arguing low credibility in the fiscal sustainability. All of this will continue supporting BanRep's cautious stance on the matter.

Research Colombia

- **Jackeline Pirajján – Head Economist**
- **Valentina Guio – Senior Economist**

Banco Davibank S.A.

Buzón: economicscolombia@davibank.com

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