All Signal, No Noise

MARKET ANALYSIS

Colombia Central Bank Preview: October 2021

Details:

Monetary policy decision and statement press release: 1900BST/1400ET, Friday 29th October 2021.

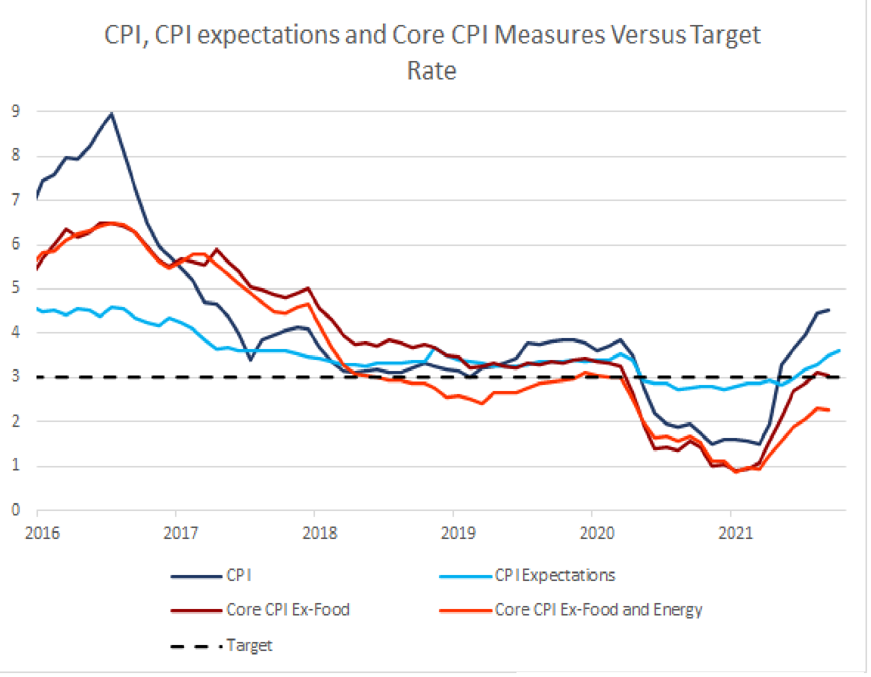
MNI Point of View: Tightening Pace In The Balance

BanRep will continue their hiking cycle at their October meeting, however, due to the previous 4-3 split board vote and the ongoing upward pressure on headline CPI, the decision to accelerate the pace of hikes to 50bps hangs in the balance. Arguments for a continuation at the initial 25bp increment focus on anchored core inflation and central bank rhetoric committed to a gradual approach. This narrative is also reflected in differing opinions among sell-side analysts.

Headline CPI Expectations Creep Further Above Target

Headline annual CPI rose to 4.51% in September versus an estimate of 4.49% and up from a prior reading of 4.44% Additionally, in the latest central bank survey, 12-month ahead CPI forecasts have continued to increase, highlighting a gradual de-anchoring of expectations from target. Combined with this acceleration, analysts note that higher energy prices as well as near-term base effects (low prints across Oct-Nov 2020) will likely keep upward pressure on the headline rate. For the dissenters at the September meeting, advocating for a 50bp hike, this may reiterate their viewpoint conveyed where they "signalled their uncertainty over how transitory or permanent the shocks to inflation will prove to be".

On the other hand, core CPI moderated slightly in September to 0.3% m/m versus an estimate of 0.32% keeping the annual ex-food figure close to the 3% target and the ex-food and energy figure also well below 3%.



Source: MNI/Bloomberg

Villar and Jaramillo Highlight Anchored Expectations - Central Bank Governor Leonardo Villar, speaking at a virtual event organised by the Inter-American Development Bank on October 15, stated that inflation expectations are anchored to the target, which allows for gradual interest rate increases, in principle. He went on to suggest the overall process of normalisation could take around one year, which does not mean the monetary policy stance will stop being expansionary.

Additionally, Colombia Central Bank Co-Director Jaime Jaramillo, the day after the CPI release, said he's not worried about inflation expectations as breakeven inflation shows them anchored long-term to the 3% target. He added that he expects inflation pressures from external supply shocks to ease in 2022. It is worth noting that both these comments came before the most recent central bank survey of expectations.

With the minutes highlighting the "majority emphasised the temporary character of the current pressures on prices", there is still a good chance the board continues to be tilted towards 25bp increments. Furthermore, weaker than expected August economic activity data (13.2% vs. 15.5% estimate) may embolden the more gradual approach to the reduction of monetary stimulus.

Markets – The COP IBR Swaps Curve has flattened since the September meeting, with 1-year swap rates rising around 60 basis points amid higher US yields, inflationary pressures and perhaps in response to more aggressive action taken by regional EM central bank peers. A larger than expected 50 basis point hike would likely accelerate the pressure on the front-end. USDCOP has faded from around 3807 down to 3756 with considerable Peso tailwinds in the form of buoyant crude prices. Hawkish messaging may affirm the short-term downtrend that has been in place for the pair from the early August peak around 4000.

mni Central Bank Watch - Colombia

MNI Colombia Data Watch List

Inflation		Current	3m ago	3m Chg	6m ago	6m Chg	2Y History	Hit / Miss	Vs Trend	Surprise Index	Z-Score
CPI	% y/y	4.51	3.6	↑	1.5	↑					1.55
Core CPI	% y/y	3.03	2.7	↑	1.1	↑					0.97
Oil Price (WTI Active)	$	84.68	70.13	↑	56.85	↑					1.38
Economic Activity		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
PMI Manufacturing	Index	55.5	48.3	↑	52.4	↑					0.83
Manufacturing Prod.	% y/y	22.9	8.5	↑	0.6	↑					0.17
Economic Activity NSA	% y/y	13.20	12.10	↑	-3.60	↑					
Trade Data		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Trade Balance	$ M	-1624.1	-1011.7	↓	-714.6	↓					-1.22
Exports FOB	$ M	3318.1	3102.0	↑	2940.8	↑					
Consumer / Labour Market		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Retail Sales	% y/y	32.0	24.7	↑	20.1	↑					2.82
Consumer Confidence	Index	-3.0	-22.3	↑	-11.4	↑					1.15
National Unemployment Rate	%	12.3	15.6	↓	15.9	↓					-1.75
Urban Unemployment Rate	%	14.2	16.6	↓	18.1	↓					-1.59
Markets		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Bolsa de Valores	Index	9,960	11,250	↓	12,010	↓					-1.45
Local 10-Year IBR Swap Rate	%	6.62	5.86	↑	5.51	↑					1.92

Note: For quarterly data the 3m ago column will display the previous data point and the 6m ago column will display the data point prior to that.
Source: MNI, Bloomberg

Analyst Views

As of publication, 14 of 20 surveyed analysts on Bloomberg are expecting a 25bp rate hike to 2.25%. The remaining 6 are forecasting a more aggressive 50bp hike of the overnight lending rate to 2.5%.

Barclays: Inflation Expectations 12 Month Ahead Point To 50bps Hike

- Expect an acceleration of its tightening cycle and the bank to hike its policy rate by 50bp.
- Since the last meeting, inflation crept higher reaching 4.5% y/y, but probably the most important change has been in terms of inflation expectations 12 month ahead, which continued to deteriorate reaching 3.6%, further distancing from the 3.0% target.
- Additional risks on inflation could come from recent rains and La Niña phenomenon that could affect agricultural production and result in higher food prices in the coming months.
- On the other side, August GDP registered an expansion of 13.2%, which was weaker than we were expecting (14.9%), and adds some risks to our rate call for this month.
- Nonetheless, the GDP print still points to faster growth in 2021 than estimated by Banrep (8.6%), which implies a faster closing of the output gap. Meanwhile, the labor market has shown further signs of improvements that should make the authorities more comfortable with continuing to reduce the size of the monetary stimulus.

Goldman: Very Close Call Between Another 25bp Hike And A Bolder 50bp

- In their view, the bar to accelerate the pace to 50bp is relatively low, nonetheless, given the macro-financial data and policy developments since the previous meeting their model call is for a 25bp increase. GS assess a substantial 40 percent probability of a bolder 50bp hike.
- Headline inflation increased 7bp in September to 4.51% y/y. The monthly variation (+0.38%) was only slightly above the 0.35% mom consensus expectation, however inflation has surprised to the upside in eight of the past ten months. On the positive side, core measures of inflation marginally receded during the month and remain at or below Banrep's 3% target mid-point.
- Headline inflation expectations deteriorated at the margin, but improved for core. According to the October central bank monthly survey, inflation expectations for 12-month ahead rose by +16bp to 3.65%. 12-month ahead core inflation expectations improved by -4bp in October to 3.23%.
- In their view, the underlying inflation dynamics are turning less favorable and inflation is likely to continue to accelerate as the Covid backdrop improves and the economy normalizes. In addition, headline inflation is likely to accelerate further as we lap the October-November 2020 low prints (a 0.13% mom decline on average during those two months). Lastly, higher energy prices are also likely to contribute to inflation pressures.
- In their assessment, reducing the degree of monetary accommodation is warranted given the expected real economic activity dynamism, high inflation prints, deteriorating headline inflation expectations, and a large and widening current account deficit.
- In addition, hawkish regional and global monetary developments, high risk-premia given the challenging fiscal picture, sovereign rating downgrades, and an uncertain political and policy backdrop also justify the central bank's move towards monetary policy normalization. GS anticipate further hikes at subsequent MPC meetings with the policy rate reaching 2.75%-3.00% by the end of 2021, and 3.50%-4.00% by end-2022.

Morgan Stanley: Market Underestimating The Potential For Banrep To Accelerate Hiking Pace

- Their economist expects BanRep to deliver a 50 bp hike and bring the policy rate to 2.50%, while the market is pricing in ~30bp, suggesting an expectation for a smaller move.
- Given the split board and recent upside surprises in data, MS think that the market is underestimating the potential for BanRep to accelerate the pace in the coming months, which would also be in line with the broader pattern we have seen among EM central banks in the latest cycle.
- As such, they continue to recommend 1s5s COPxIBR flatteners, particularly as the spread remains one of the highest in EM, surpassed only by South Africa's, where the hiking cycle has not begun yet. They continue to target 100bp.
- MS also maintain a constructive view on COP and stay short ZAR/COP, as the peso should broadly outperform other metal exporters, given still attractive valuations, supportive oil prices and the expectation for more USD sales by the Treasury into year-end.

Scotiabank: BanRep To Maintain Gradual Tightening Cycle

- As the central bank started its hiking cycle with a hawkish split vote, the probability of seeing a 50bps hike in October increased.
- However, after September's inflation result and inflation expectations survey showed that core inflation expectations are still well anchored, they think that lack of consensus will prevail.
- For now, Scotiabank still believe that the hiking cycle will mainly be gradual with the policy rate closing 2021 at 2.50% and by the end of 2022, they anticipate the monetary policy rate to close at 4.50%.