Colombia Central Bank Preview: January 2022

Details:

Monetary policy decision and statement press release: 1800GMT/1300ET, Friday, January 28, 2022.

MNI Point of View: Pace Acceleration

The majority of surveyed analysts expect the Colombian Central Bank to accelerate the pace of tightening at their January meeting, with a 75bp hike to 3.75% touted as the most likely option. Continued domestic and global inflationary pressures, strong growth momentum and more hawkish rhetoric from global central banks should support the decision for stronger action. Indeed, with three members already voting for a 75bp hike in December, the decision should not come as a surprise for markets. The risks appear skewed to the hawkish side, with some analysts forecasting a bolder 100bp hike.

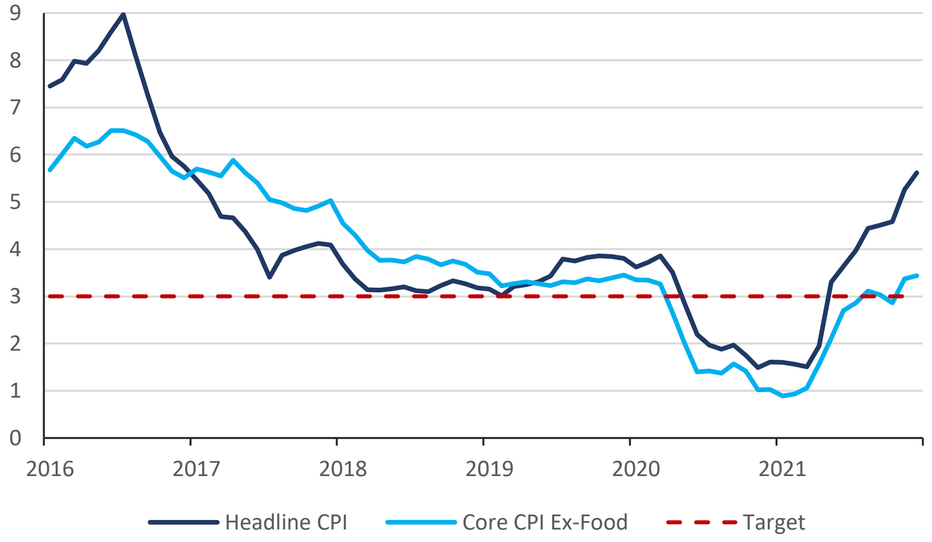
Growth and Inflation Point To Tightening Pace Acceleration

Growth momentum remained firm with November economic activity printing at 9.6%, above the 8.6% median estimate and versus 9.3% in October. There have been no new major covid related restrictions and analysts expect the strong pace of growth to be sustained through 2022. Increasing domestic demand and recovering activity point to a rapidly narrowing output gap which bolsters the argument to accelerate the pace of tightening. Moreover, large external financing needs amid tightening external market conditions add weight to the call.

December inflation continued to surprise to the upside, showing a 0.73% M/m advance, bringing the annual headline rate to 5.62%, the highest level seen in five years. Core CPI rose to 3.44% Y/y from 3.37%, edging further away from the target rate of 3%.

Inflation expectations have also continued to deteriorate. In the latest central bank survey, the median estimate of Colombia economists for year-end 2022 CPI was raised substantially to 4.48% Vs. 3.86%. Furthermore, evidence of a contamination of medium-term expectations, the 2023 year-end forecast was revised to 3.5% from 3.3% in December. Within the survey, economists expect the next rate move to be a 75bp move this month.

Figure 1: Headline and Core Consumer Prices Extend Advance



Source: MNI/Bloomberg

Hawkish Fed Rhetoric, Election Uncertainty May Weigh On COP

The 2022 election timetable is as follows: Congressional and Presidential primaries are scheduled in March, followed by the first round of the presidential election on May 29. In the likely scenario that no candidate receives a majority of the vote, the second-round runoff will then take place in June.

Given the recent regional shift towards the political left, evident in neighbouring elections, headwinds for the Colombian Peso and local asset prices may be likely. Left-wing senator, Gustavo Petro, is currently leading in polls and he has already stated the first thing his government would do is revoke the 2019 tax reform during the first TV debate.

Additionally, the almost certain March lift-off from the Federal reserve should place upward pressure on the USD/COP rate. Indeed, in the latest central bank survey, there were upward adjustments to the median exchange rate forecasts: 2022 year-end raised to 3800 from 3723 and 2023 year-end raised to 3785 from 3650.

BanRep Majority Rhetoric Should Rule Out Even Bolder Hike

We note that in the December minutes the four-member majority continue to believe it is advisable to “gradually increase interest rates in order to avoid the financial tensions that sharp and sudden changes could cause in the markets.” While the inflation outlook and sustained growth momentum should tilt the overall majority, the likelihood of a 100bp hike in January remains very low. However, there is a strong chance of another split vote with central bank Co-Director Roberto Steiner not ruling a 100bp out in a webcast just one week ago.

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	5.62	4.5	↑	3.6	↑					1.99
Core CPI	% y/y	3.44	3.0	↑	2.7	↑					1.20
Oil Price (WTI Active)	$	87.68	72.99	↑	68.17	↑					0.95
Economic Activity		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
PMI Manufacturing	Index	53.1	55.5	↓	48.3	↑					0.39
Manufacturing Prod.	% y/y	13.9	22.9	↓	8.5	↑					-0.46
Economic Activity NSA	% y/y	9.60	12.00	↓	12.10	↓					
Trade Data		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Trade Balance	$ M	-2010.2	-1624.1	↓	-1011.7	↓					-1.63
Exports FOB	$ M	3987.6	3465.2	↑	3096.9	↑					
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	7.4	15.3	↓	24.7	↓					0.40
Consumer Confidence	Index	-7.0	-3.0	↓	-22.3	↑					0.31
National Unemployment Rate	%	10.8	12.3	↓	15.6	↓					-1.41
Urban Unemployment Rate	%	12.2	14.2	↓	16.6	↓					-1.18
Markets		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Bolsa de Valores	Index	10,960	9,700	↑	11,250	↓					-0.51
Local 10-Year IBR Swap Rate	%	7.31	6.59	↑	5.86	↑					0.56

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, the majority of surveyed analysts (20/23) believe the MPC will hike the overnight lending rate by 75bps to 3.75%. One analyst is calling for a more modest 50bp hike and two forecasters expect a bolder 100bp hike to 4%.

Barclays: Accelerate Tightening Pace To Prevent Over-Heating

- Economic activity in Colombia maintains strong momentum. GDP grew 9.6% y/y in November, 1pp above market expectations (8.6%) and close to Barclays forecast (10%).
- So far, no new major mobility restrictions have been announced and Barclays think the strong pace of the economy is likely to be sustained through 2022, driven by strong domestic demand, business confidence that remains high despite electoral uncertainty, and the possibility of a rebound in oil production.
- These factors are likely to push Colombia to grow more than 6% in 2022 after having grown around 10% last year.
- On the fiscal side, this is helping with consolidation. According to MoF data, central government debt remained stable last year, closing at 61.5% of GDP. The continuity of this strong growth in 2022 and the additional revenues that the government will receive next year from the tax reform approved in 2021 should bring the beginning of the reduction of debt levels forward.
- On the monetary policy front, the strong growth supports their call for a 75bp hike in the reference rate on January 28.
- Even if inflation in Colombia remains more contained than in LatAm peers, Barclays think Banrep is likely to accelerate the tightening pace to prevent a potential over-heating of the economy that could reinforce pressures in the current account as well as domestic prices.

Goldman Sachs: 30% Probability Of Bolder 100bp Increase

- Goldman Sachs expect the MPC to accelerate the pace of normalization and hike the policy rate by at least 75bp to 3.75%. GS assess a 30% probability of a bolder 100bp increase.
- Short- and medium-term inflation expectations deteriorated further. According to the January central bank's monthly survey, inflation expectations for 12-month ahead rose by +9bp to 3.95%. For 24-month ahead, inflation expectations also rose by +9bp to an above-target 3.39%. In addition, 12-month ahead core inflation expectations increased by 20bp in January to 3.62%. Finally, 24-month ahead core inflation expectations increased for the first time above the central bank's 3.0% inflation target and stand at 3.10%.
- In their assessment continuing to reduce the degree of monetary accommodation towards an above-neutral policy stance is warranted given above-target inflation, drifting inflation expectations, and a large and widening current account deficit whose funding could become more challenging were global financial conditions to tighten.
- In addition, high risk-premia, given the challenging fiscal picture and an uncertain political and policy backdrop, also justify a careful calibration of the central bank's monetary stance.

JPMorgan: Forecast A Bolder 100bp Rate Hike

- The data flow in recent weeks should prompt BanRep to move more aggressively to avoid falling behind the curve, in JPMorgan's view.
- December's higher-than-expected inflation was driven by high food prices, but coupled with the announced 10% nominal minimum wage hike, and related indexation effects expected in the coming months, pushed their own forecasts for 2022 inflation well above the target range, while analyst consensus as revealed by BanRep's monthly survey was even higher.
- Incremental data on the activity front and related to Colombia's external imbalance should bolster the arguments of BanRep's hawkish minority that wanted to accelerate the hiking pace from 50bp to 75bp at the December meeting.

- While the more dovish minority has been cautious that economic momentum may begin to subside, and in previous meetings have cited concern over new variants, JPM think that the strong momentum for growth in 4Q should outweigh what is likely to be a strong but fleeting dose of Omicron in the country at the outset of 2022.
- With tighter DM monetary policy now more clearly impacting borrowing costs, and political uncertainty rising ahead of the election cycle, Colombia's external imbalance stands out among peers as a glaring vulnerability.
- In this context, and with rising inflation expectations offsetting the nominal tightening so far in the cycle when considering BanRep's real policy rate, JPM now believe the monetary authority should and will act more boldly to pay heed to latent financial instability concerns and to reinforce its inflation target.
- JPM now call for a 100bp hike at the January 28 meeting, to take the policy rate to 4%. They then call for hikes of 50bp per voting meeting to 5.5% by June, with a final 25bp hike in July to leave the terminal rate at 5.75%.

Scotiabank: Expect Terminal Rate for 2022 at 5%

- Despite anticipating BanRep to increase the monetary policy rate more quickly—to 3.75% in January and to 4.25 % in March, Scotiabank still expect the terminal rate for 2022 at 5%.
- This projection reflects our expectation that inflation should ease after April and the fact that economic growth is likely to face a challenging H1 due to inflation's impact on consumption, but also owing to investor uncertainty regarding the elections.
- However, risks regarding monetary policy are tilted to the upside; new price shocks and the projected reversal of price pressures does not occur, Scotia estimate the hiking cycle to reach 6.25% in a hawkish scenario.
- BanRep's recent economic expectation survey shows that, on average, analysts are not expecting a terminal rate above 5.50%. In fact, rate cuts are expected as early as 2023 on average, which would indicate that current pressures are still perceived as temporary.
- To sum up, local and international conditions are triggering a stronger reaction from central banks. In Colombia, however, as inflation is expected to reverse, the anticipated terminal rate is not significantly different from what is considered a neutral rate (nominal 5%, and real at 1.5%—deflated by expected inflation of 4.5%).