Colombia Central Bank Preview: October 2022

Monetary policy decision and statement press release: 1900BST/1400ET - Friday, October 28, 2022.

MNI PoV: Decisive Response Needed

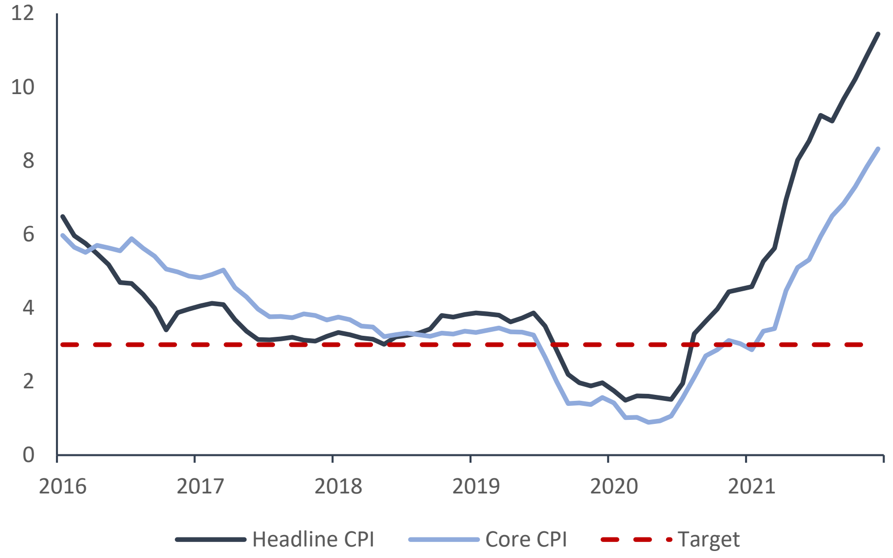
The majority of surveyed analysts expect BanRep to hike the overnight lending rate by 100bps to 11.00%. Further aggressive monetary tightening is deemed necessary amid rising inflation data, deteriorating inflation expectations and concerning pressures on domestic financial markets.

President Petro's most recent comments relating to the inefficiency of rate hikes to tame inflation and his rhetoric surrounding capital controls provide a complicated backdrop for the MPC at the October meeting. Surveyed outcomes range from +50bp to +150bp hikes, with some analysts highlighting the possibility of an FX intervention announcement despite the board's comments suggesting it will not be implemented.

September Inflation Data Shows Steep Rise To 11.44%, Expected To Climb Further

Both annual headline and core readings have continued their upward trajectory. In September, CPI rose to 11.44% from 10.84% Y/y and annual core CPI clocked in at 8.32%. Furthermore, expectations have also deteriorated. Within the October central bank survey of economists, the median forecast for year-end inflation was revised up to 11.88% from 11.33%. Additionally, the further contamination of medium-term expectations was also evident, 2023 year-end inflation rising to 6.74% from 6.30%.

Figure 1: Steep Acceleration For Headline and Core CPI Extends



Source: MNI/Bloomberg

Firmer August Economic Activity (+8.6% Y/y vs 6.4% in July) suggests that excess domestic demand is continuing to assert upward pressure on prices and contributing to large external imbalances. The relentless profile of inflation and sour current account balance data should tilt the majority of the board to opt for at least a 100bps hike and retain 2022's hawkish bias in the post-rate decision press conference. This view is bolstered by the consensus view of a further acceleration for CPI in October, with the annual headline rate estimated to climb to 12.14%, while an improving unemployment rate only adds to the expected tightness of labour markets into year-end.

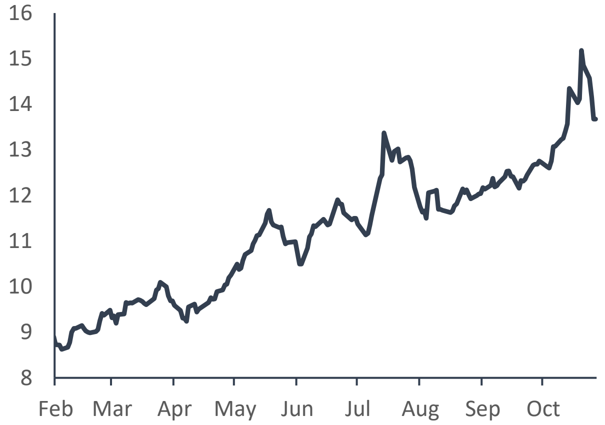
Alarming Petro Comments Spark Domestic Asset Selloff

Colombian asset markets have been roiled over recent weeks by heightened uncertainty over the policies of the Petro administration. Proposals such as capital controls were floated and despite then being rescinded, the impact on domestic financial markets was relentless.

Despite moderating its decline in recent sessions the peso weakened to a record low of 4,998.75 per dollar, while the yield on the nation's 10-year local government bonds briefly surged above 15%.

Figure 2: USDCOP Trades Within Close Proximity To 5,000 Level

Figure 3: Sharp Rise In Colombian Bond Yields (Coltes 7.25 10/18/34)



Sources: MNI/Bloomberg

FX Intervention Remains Unlikely At This Juncture

Analysts remain in agreement for the central bank to deliver a firm response and there is a wide range of forecasts heading into the meeting. These range from between 50bp-150bp rate hikes and some have argued that an announcement of FX intervention measures may be required through instruments to reduce volatility.

Nothing should be ruled out, especially as the most recent comments from finance minister Ocampo have indicated that it will be discussed on Friday. However, it is worth noting that he reiterated the central bank's analysis is that it would not necessarily yield positive outcomes. The finance minister bolstered his point by comparing it to the 25 billion USD Chilean intervention program, announced in July, claiming "it had no more effect than the Colombian regime of letting the exchange rate float".

All Signal, No Noise

MARKET ANALYSIS

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	11.44	9.7	↑	8.5	↑					1.76
Core CPI	% y/y	8.32	6.8	↑	5.3	↑					1.45
Oil Price (WTI Active)	$	88.13	95.56	↓	89.60	↓					-1.59
Economic Activity		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
PMI Manufacturing	Index	52.8	55.7	↓	52.1	↑					0.12
Manufacturing Prod.	% y/y	9.1	46.2	↓	10.7	↓					-0.50
Economic Activity NSA	% y/y	8.60	17.22	↓	9.00	↓					
Trade Data		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Trade Balance	$ M	-2168.2	-1732.5	↓	-1101.8	↓					-1.41
Exports FOB	$ M	4582.2	4662.5	↓	4209.2	↑					
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	8.1	17.2	↓	12.0	↓					0.22
Consumer Confidence	Index	-11.5	2.9	↓	-17.8	↑					-0.05
National Unemployment Rate	%	10.6	10.7	↓	12.9	↓					-0.84
Urban Unemployment Rate	%	10.8	11.0	↓	12.7	↓					-0.88
Markets		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Bolsa de Valores	Index	7,670	8,980	↓	9,400	↓					-1.64
Local 10-Year IBR Swap Rate	%	10.74	9.01	↑	7.75	↑					1.66

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 writing, 24/27 surveyed analysts on Bloomberg are expecting a 100bp hike, bringing the overnight lending rate to 11.00%. Two analysts are calling for a bolder 150BP hike and one within the survey expects a smaller 75bp increase. Scotiabank economists are calling for just a 50bp increase, as noted below.

Bank of America: Expect 50BP Hike With Some Voting For Bolder Hike

- BofA forecast the BanRep board to hike the policy rate by 50bp (to 10.50%) on October 28, in a split vote (with some board members voting for 100bp). Both activity and inflation have been surprising to the upside, but BanRep decided to underwhelm markets at the last meeting (September) by hiking less than what was priced in.
- The recent sell-off of Colombian assets is putting pressure on BanRep to continue hiking. Meanwhile, President Petro has criticized BanRep's actions arguing that interest rate hikes are not helping to reduce inflation.
- It will be interesting to see/test in the next month how insulated BanRep really is from political power. At the outset, BanRep's independence is written in the Constitution.

Goldman Sachs: Do Not Rule Out A Hike Larger Than 100BPs

- Goldman Sachs expect the MPC to hike its policy rate by another 100bp to 11.00% given the challenging domestic and external macro-financial backdrop and recent market and policy developments.
- In their view, another 100bp hike is warranted given: (1) the negative inflation surprise in Sep, with headline inflation surging to two-decade record high; (2) broad-based deterioration of short- and medium-term inflation expectations; (3) sharp COP depreciation pressures (8% depreciation against the USD since the last MPC meeting) potentially exacerbating the pass-through to domestic prices; (4) still buoyant economic

activity (ISE grew 1.4% mom sa in Aug); (5) record high trade balance deficit (-US$2.2bn in Aug); (6) market unsettling policy statements by senior government officials (including remarks suggesting an inclination towards the adoption of capital controls); and (7) local debt market distress.
- A decisive hike is also warranted by the fact that a dovish/milder hike may invite further pressure on the COP and the next MPC meeting will only take place Dec 16 and in the interim there will be two FOMC decisions.
- Given the intense currency and local rates pressures GS do not rule out an even larger hike (up to 150bp), particularly if financial market pressures persist throughout this week.

JPMorgan: Expect Bolder 150BP Hike In Response To Deteriorating Local Markets

- Colombian local assets have materially deteriorated in recent weeks in response to waning confidence domestically, a weak position of external and fiscal accounts, and a hostile global environment.
- The deteriorating conditions in local markets are unlikely to resolve without a credible and convincing policy response. In an extreme scenario, left unchecked, the negative dynamic between currency depreciation, FX passthrough to higher inflation expectations, and lower ex-ante real rates runs the risk of triggering a "sudden stop" episode of capital flows.
- JPMorgan think BanRep will now have to step up in the face of the market pressure and expect BanRep to hike the policy rate 150bp on Friday, up from the 100bp move of September.
- Their forecast then looks for a 100bp hike in December (November in theory is a non-voting meeting), to leave the policy rate at 12.5% positive in ex-post real terms versus JPM's inflation forecast for year-end, and around 5.5% in ex-ante real terms.
- Such a move would show the authorities are keeping pace with what would be implied by a permanent shock to Colombia's sovereign risk premium. If the neutral real rate was around 2% in the old regime, JPM think BanRep should be thinking of now getting well above 4% in order to be sufficiently restrictive in the current context.
- Should the market fail to stabilize, the risk is BanRep will need to do more. In this scenario, JPM now think BanRep will need to stay high for longer than before (until 3Q23) and easing would later occur to keep the real ex-ante rate from going much more restrictive amid a strong growth slowdown, but not with space to get into easy territory. The policy rate would now end 2023 at 10.5% versus their prior scenario of 9%.

Scotiabank: Crucial Moment For Monetary Policy

- We are in a crucial moment in which "too much" tightening would be negative for the real economy, while "too little" would be bad for markets.
- Domestically, many things are occurring in parallel to global monetary policy developments. The fiscal reform under discussion is increasing uncertainty in the business sector that now expects higher taxes against already troublesome high rates and consumers with lower disposable income.
- As for the real economy, data are still supportive, but confidence indicators are showing weaker consumer and business sentiment and expectations. Regarding inflation, forecasts continued increasing as expected indexation effects and still relevant supply-side upside pressures are reducing BanRep's capacity to achieve a faster reduction in inflation.
- Meanwhile, despite the technical staff of the MoF sending strong messages of fiscal and macroeconomic responsibility, communications from other government officials are preventing agents to be completely comfortable with their positioning in Colombia. All of the above has been reflected in a weakening of Colombian debt with the COLTES curve sitting at 14.5% yields on average, accompanied by increases to record highs in CDS spreads and the USDCOP.
- Increasing the rate by 100bps would be a "market-friendly" move, but it would weigh negatively on investment decisions on the real-economy side. A 50bps will be compatible with gradual signalling that the end of the hiking cycle is approaching but would trigger even more negative effects on the COP. It is difficult to anticipate what is a good mix, but for now, Scotiabank affirm their call of a 50bps rate hike, with a high probability of announcements of FX intervention through instruments to reduce volatility (forwards, or options, but not direct sales from international reserves) if markets continue showing strong pressure on the domestic currency.

SocGen: Risk Is Tilted Towards Sharper Tightening, Possibly By 150BP

- There are several problems with the central bank's return to a dovish approach. To begin with, the economy is clearly overheating and looks set to grow at over twice its potential in 2022 too. This overheating has created sharp external sector imbalances that are putting pressure on the currency, which was already under pressure due to high imports and the tightening in global financial conditions.
- However, the recent discussions in the Petro administration on issuing debt to buy land for the poor and introducing capital control measures to check outflows have really jolted the bond market, leading to a further sharp decline in the peso. This is bound to create further challenges for financial/fiscal stability and worsen the inflation outlook too.
- Both headline and core inflation increased further in September, making it difficult to predict if the disinflation process will begin this year or not. In the past two cycles, BanRep has not necessarily chased inflation all the way when it needed to support the economy.
- Nevertheless, things are different this time, with demand well above potential. The policymakers have ruled out using FX reserves to support the currency. While we expect BanRep to lift rates by another 100bp (to 11.0%) in October, the risk is tilted towards sharper tightening (possibly by 150bp).
- The central bank will most likely leave the door open for additional adjustments in December (and beyond, particularly if inflation continues to surprise on the upside over the next two months). If the pressure on the currency worsens again, the possibility of sharper tightening, even between meetings, cannot be ruled out either.

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