Colombia Central Bank Preview: March 2023

Monetary policy decision and statement press release: 1900BST/1400ET - Thursday, March 30, 2023.

MNI POV: Final Hike Expected

According to surveyed analysts, the most probable outcome for this week's BanRep meeting will be a 25bp hike, bringing the overnight rate to 13.00%. However, there are several analysts that believe the committee will vote for a bolder 50bp increase to 13.25%.

Improvements for longer-term inflation expectations alongside central bank rhetoric regarding the risks to economic activity should prompt BanRep to opt for the less aggressive course of action at this juncture. Indeed, several analysts believe this could be the final action of the current tightening cycle.

Co-Director Villamizar Emphasises Downside Risks To Economic Activity

While the inflation picture outlined below still denotes a hawkish stance from the Colombian central bank, there is an argument that the risks may be tilted to the downside at Thursday's meeting. Focusing on an interview with central bank co-director Mauricio Villamizar, the policy-maker made it very clear that the risks of a sharp economic slowdown are now greater than the threat of faster inflation.

The former head of the central bank's economics research department said that "we are now thinking that we're at a sufficiently contractive monetary policy stance to reach the target in the medium term". While Villamizar did add the caveat that "this doesn't necessarily mean that we're done hiking, or that we can't rule out reacting to unexpected shocks", his comments are interesting, especially in the context of the latest banking distress affecting global markets as well as the previous dissents at the previous meeting.

Recall that in January, two members voted for just a 25bp increase against the majority who were successful in voting for a 75bp rate hike. From the minutes, those members emphasized that the demand for the economy entered contractive terrain in November and December, as can be deduced from various indicators such as trade sales, fuel consumption, automobile sales, and the behaviour of imports; the latter have registered consecutive falls for several months and also fell in December. Furthermore, we should not forget that finance minister Jose Antonio Ocampo indicated in January that he does not see the need for further monetary tightening, indicating that to be his opinion and the government's opinion.

Analysts point out that surprising the market at this point may not be the dominant strategy and therefore a 25bp hike remains the most likely outcome on Thursday, in particular to avoid any excessive pressure on the currency. However, we consider it likely for there to be further dovish dissents, advocating an immediate pause to monetary tightening.

Core CPI Continues Ascent, Inflation Expectations Provide Cautious Optimism

Both annual headline and core readings have continued their upward trajectory, however February headline data did clock in below the median surveyed estimate. In February, headline CPI rose to 13.28% from 13.25% Y/y and annual core CPI registered at 10.86%, up from 10.43% a month ago.

On a brighter note, inflation expectations slightly improved at the margin. Despite the latest central bank survey of economists revising 2023 year-end inflation expectations to 9.00% from 8.83%, longer term measures were more steady and in some cases actually saw an improvement. 12-month inflation was cut to 7.21% from 7.28% and inflation expectations 24 months ahead feel to 4.01% from 4.10%. While caution must remain at the elevated levels of current CPI and core readings, the gradual re-anchoring of medium-term inflation expectations will be a very

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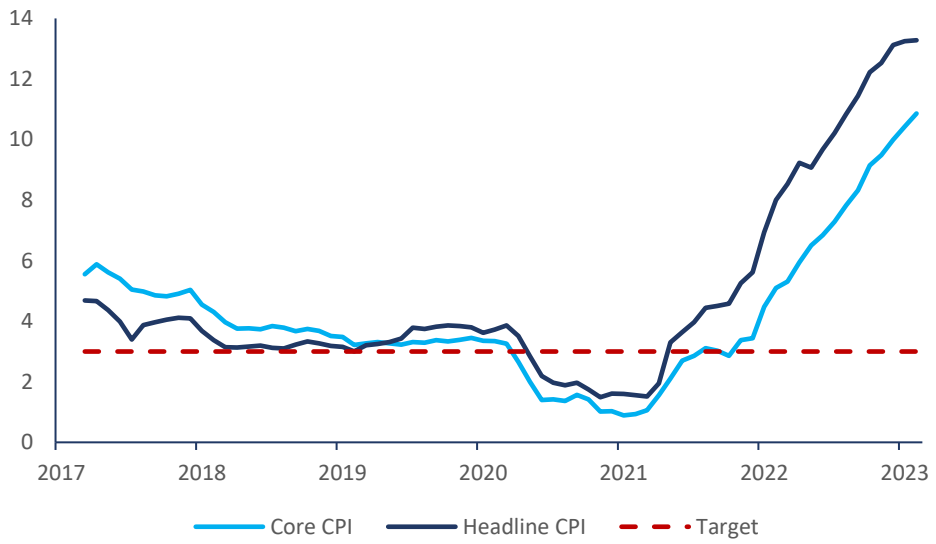
welcome sign for the central bank committee. Within the same survey, economists also expect the key rate to be raised by 25bps this month and see the rate falling to 11.00% by year-end.

Figure 1: Core CPI Continues Sharp Ascent



Will The Guidance Be Altered?

Previously, the BanRep statement has intimated that monetary policy is close to the position required to induce a convergence of inflation in the medium term towards its target of 3%. Several analysts believe this week's decision may mark the final hike of the cycle and so the statement will be carefully analysed to see if any guidance is provided for upcoming meetings. Even if the central bank believes the peak rate has been reached, they may still choose to reiterate that in the context of high uncertainty, decisions will remain data dependent, providing the central bank with flexibility going forward amid the highly uncertain domestic and global backdrop.

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	13.28	12.5	↑	10.8	↑					1.43
Core CPI	% y/y	10.86	9.5	↑	7.8	↑					1.33
Oil Price (WTI Active)	$	73.26	80.59	↓	84.26	↓					-0.78
Economic Activity		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
PMI Manufacturing	Index	49.8	47.3	↑	52.4	↓					-0.86
Manufacturing Prod.	% y/y	0.2	5.3	↓	5.2	↓					-1.31
Economic Activity NSA	% y/y	5.85	4.60	↑	6.41	↓					
Trade Data		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Trade Balance	$ M	-1479.3	-1475.1	↓	-494.2	↓					-0.51
Exports FOB	$ M	3694.9	4226.5	↓	5913.7	↓					
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	1.2	7.2	↓	17.2	↓					-0.86
Consumer Confidence	Index	-27.8	-24.8	↓	-2.4	↓					-1.00
National Unemployment Rate	%	13.7	9.7	↑	11.0	↑					2.19
Urban Unemployment Rate	%	14.5	9.9	↑	11.3	↑					2.14
Markets		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Bolsa de Valores	Index	9,550	7,780	↑	8,290	↑					-0.92
Local 10-Year IBR Swap Rate	%	8.75	10.14	↓	9.52	↓					0.47

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, 17/25 analysts within the Bloomberg survey are calling for a 25bp hike of the overnight lending rate to 13.00%. The remaining 8 forecasters are predicting a bolder 50bp increase to 13.25%.

Bank of America: Dovish Guidance Should Prompt Final 25BP Hike

- BofA expect BanRep to hike 25bp, to bring the monetary policy rate to 13%, at the March meeting, given recent dovish guidance from board members. It would be the last hike of the tightening cycle, in their view.

Citi: High Core Inflation Raises Risk Of A Bolder 50BP Move

- Citi Economics expects a 25bp hike but sees risk of a 50bp one, given persistently high core inflation.

Goldman Sachs: Do Not Anticipate BanRep To Explicitly Close The Door To Further Hikes

- Goldman Sachs expect the MPC to hike its policy rate by 25bp to 13.00%, with potential dissenting votes. They assign a 25% subjective probability to a bolder 50bp hike.
- Their view of a 25bp hike as the most likely scenario is grounded on the evolution of inflation expectations and the policy stance after the Jan meeting, when the MPC held that another hike was necessary to preserve the restrictive policy stance due to rising expectations.
- The MPC may complement this move with guidance suggesting that with such a hike the policy stance becomes significantly restrictive to lay the groundwork for eventually stopping the tightening cycle, although we do not anticipate that the MPC will explicitly close the door to further hikes.

- In their assessment, the case for a 50bp hike rests on a more conservative calibration of monetary policy to counter still challenging inflation pressures (e.g. inflation has not peaked yet) and heightened policy uncertainty given a heavy legislative agenda, including major reforms with macro and market impact (e.g. pension and labor reforms, national development plan). In doing so, the MPC would mitigate the risk of being perceived as dovish, which could potentially unsettle the COP.

Itaú: Forecasting 50BP Hike, Ending The Cycle

- In January, through a split decision, the Board delivered a 75bp rate hike to 12.75%, down from the 100bp hiking pace in the previous three meetings. The split vote saw five board members in favor of the majority decision, while two opted for a 25bp hike.
- The decision highlighted upside inflation surprises, a strong indexation process, the pass through from the weaker Colombian peso to prices, and still positive output gap.
- Itaú expect the Board will increase the policy rate by 50bps to 13.25%, ending the cycle. However, global financial market developments tilt the risks towards a rate hike of a smaller magnitude.

JPMorgan: Surprising The Market Does Not Appear Dominant Strategy

- A forward-looking stance would put to the fore the significant adjustment of domestic demand under way, evidenced by the plunge in imports as well as the performance of banking credit.
- On top of that, inflation expectations have not only plateaued, but started to decline. Finally, against the volatility triggered by banking and financial developments in core markets, JPM note the relatively good performance of the local currency compared to peers.
- In sum, the market is currently pricing more probability of a 25bp hike than of a 50bp one. Right now, with the market pricing in a probability of about 80% of a 25bp hike (and 20% of 50bp), any gain stemming from surprising the market, higher or lower, does not appear to be a dominant strategy.
- JPM's base case is thus revised for a 25bp hike this week, with the policy rate converging to 13.0%, with BanRep staying in data-dependency mode ahead.

Morgan Stanley: Expect Cycle Ending 50BP Hike

- Morgan Stanley expect a final 50bp hike in light of highflation and persistently de-anchored expectations.

Scotiabank: Final 25bps Hike To Ensure Inflation Expectations Converge In The Long Run

- If markets see Petro's announcements and reforms as initially expected, which incorporate the negative bias to market liquidity and some nonstructural rule changing, it should not further affect market pricing. On the contrary, if, for instance, the pension reform guarantees that liquidity and the TES market framework will continue, market participants (particularly offshore) can increase their appetite and help TES and the FX rate to reduce a bit the risk premium in the markets.
- Further to the political noise already priced in, we see that some domestic agents have started to add more TES risk to their portfolios. In fact, some trust and insurance companies are buying TES due to lower corporate (financial) debt issued at the margin, higher liquidity in the financial system on the back of TES UVR 2023 maturity that brought COP8tr to the banks, and a slower pace of expansion in consumer credit. In fact, during February offshore investors sold COP4.2tn in TES without a real hit to the market since they found demand from domestic agents.
- Turning to the traditional macro equation, economic activity continued showing a decent performance, however some signals are pointing to a deceleration in the formal sector, reaffirming Scotiabank's hypothesis of a gradual slowdown. Core inflation remains high, but headline seems to have peaked which has helped 1-yr and 2-yr inflation expectations stabilize—albeit, above target.
- Either way, the macro backdrop regarding inflation and growth is aligned with Scotiabank's call of a final 25bps hike from BanRep to 13% on March 30 to ensure inflation expectations converge in the long run.

- We also get CPI data for March on April 5, where Scotiabank expect inflation to continue hovering at the ceiling of around 13.3%. Food, gasoline, and some services prices will continue contributing to upside pressure in monthly inflation. Core inflation will accelerate further reflecting the cumulative effects of indexation but also still robust demand.

SocGen: BanRep May Remain Hawkish To Prevent Excessive Pressure On COP

- With inflation expected to subside only slowly, SocGen expect the BanRep to raise rates by 50bp this month, taking the policy rate to 13.25% and concluding its tightening cycle. Nevertheless, following the recent dovish Fed hike, the risk to their BanRep forecast is probably skewed in favour of only a 25bp hike.
- In recent months, consensus inflation expectations have come off their highest levels in over a decade. Nevertheless, with the economy overheating and currency depreciation effects yet to be felt in full, the inflation moderation could be sluggish to begin with and still faces an uncertain trajectory.
- Although the economy slowed in 4Q22, it remains surprisingly stronger than consensus and SocGen's expectations. With the current account balance at historical lows, the currency remains under significant pressure for both domestic and external reasons. Both factors continue to feed inflation pressure to some extent.
- In any event, at present, the real interest rate is still negative and will likely lead BanRep to implement another 50bp hike in March before it concludes its tightening cycle. The risk is probably tilted towards the downside (in favour of only 25bp hike in March) given the recent global financial market events that have raised the risks of financial market instability and led to a dovish Fed hike in March.
- Nevertheless, its immediate effect on Colombian financial assets might actually lead BanRep to remain hawkish (at least early on) in order to prevent excessive pressure on the currency.

TD: Expect BanRep To Hit Terminal Rate This Week With 25BP Hike

- In line with recent forward guidance and statements by board members, TD expect the central bank to hit its terminal rate with a final 25bp hike.
- While there is evidence suggesting that inflation has registered an inflection point, prices have been more stubborn than expected. TD expect BanRep to keep their options open and remain ready to act if necessary.

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