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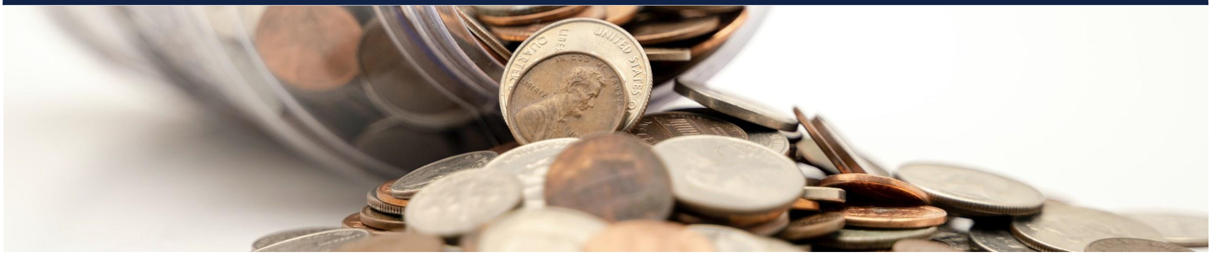

INTERNAL NOTE

Flash September BanRep Meeting

September 29, 2023
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Banco de la República maintained the monetary policy rate unchanged at 13.25% with a divided vote.

At its September meeting, Banco de la República left the monetary policy rate unchanged at 13.25% in a split decision with a balance of 5 to 2.

- **Decision:** The Board, in a 5 to 2 split vote, kept the monetary policy rate unchanged at 13.25%. Among the arguments for the decision, the majority group considered that the Economy is still facing high inflation, well above the target set by the Bank. At the same time, they warned that there are risks regarding inflation in the future. On the other hand, the minority group argued that inflation maintains a downward trend and that it could be lower if fuel prices were not being increased, while highlighting the importance of supporting economic reactivation with lower interest rates. This group voted for a 25bp reduction.

- **Inflation:** The statement highlights that inflation (11.4%) continues to moderate, although in August there was an upward surprise in monthly inflation (0.7% compared to the 0.5% expected by analysts and the Central Bank). They also highlight that core inflation showed a second consecutive month of moderation and stood at 9.9%. Despite the trend, the statement explicitly stated that inflation remains well above the inflation target for both this year and 2024. At the same time, the Governor mentioned that analysts' expectations increased in the last month. Additionally, inflation faces several risks in the coming months, partly due to pending fuel adjustments (both gasoline and diesel), and the effects of the El Niño phenomenon. In this regard, the Minister highlighted the concern with the increase in energy prices in recent weeks. Finally, the Minister highlighted that inflation in Colombia remains high due to the late adjustment of fuel prices, which differs from what has occurred in other countries. In this regard, he also highlighted that due to the increase in the price of crude oil at international level, there is an increased risk that the adjustment of fuel prices may be higher than anticipated.

- **Activity:** High-frequency indicators, as stated in the press release, have continued to show a slowdown in economic activity. However, the statement highlights that this moderation is from higher levels than implied by the trend of activity since the pre-pandemic. In other words, the economy is still operating at levels above its potential, arguing that there is still some demand pressure. On the other hand, the good performance of the labor market is highlighted, in particular, the Governor highlighted that employment in its most recent record published at the time of the meeting was close to 4.5% per annum, which is still very positive. This factor mitigates somewhat the concern about the slowdown in activity and fuels the concern about potential demand pressures.

- **External sector and exchange rate:** At the press conference, the Governor mentioned that the main central banks of developed economies continue to raise rates or announce that they could do so in the future, however he did not detail the particular impact of this scenario on the local environment or the decisions of the Issuer. On the other hand, he highlighted that the current account deficit has been significantly reduced so far this year, which is very welcome, especially because this imbalance reached high and unsustainable levels in the past.

- **Credit:** The Governor emphasized that the moderation of credit is welcomed and desired, especially because in the past it reached levels of expansion that the Issuer considered unsustainable. He emphasized that despite the credit slowdown, the financial system maintains robust solvency levels and the capacity to face this moderation in activity. On the other hand, the Minister emphasized that there are already reductions in the interest rates of credit capture and placement, supported by the decisions of the Financial Supervisor regarding the CFEN.

- ***Our vision:*** *The Board's split decision is in line with our expectation and marks the beginning of the discussion on the timing of the downward rate cycle. We believe that the labor market data, the recent surprise in inflation and increase in inflation expectations limit the decision to be made at both the current meeting and the October meeting, so we maintain our expectation that the downward rate cycle will begin in December of this year. It is possible that at the next meeting the split vote will be maintained with a tighter balance, but not enough to initiate the downward cycle.*

Decision	Banco de la República held its policy rate steady at 13.25%. The vote was split with a balance of 5 to 2 (the minority voting for a 25bp reduction).
Rationality	The surprise in inflation and its still high level relative to the target keeps most Board members cautious about the beginning of the cycle of rate cuts. At the same time, it should be noted that although the economy is slowing down, it is doing so from activity levels above potential and the labor market is still showing strong dynamics.
Our vision	The split decision marks the beginning of the discussion on the timing of the rate reduction cycle. We believe that due to the level of inflation and especially the increase in expectations, as well as the good performance of the labor market, the beginning of the downward cycle of the policy rate will be in December of this year.

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