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Policy Rate Held Steady at 9.25% in July, in a Split Decision

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Policy rate held steady in July, at 9.25% with a hawkish tone in the press release and Q&A

The monetary policy rate was held steady at 9.25% in July, in a split decision by the Board. The decision reflected a majority vote, with four members in favor of keeping the rate unchanged, while the remaining three members were split: two voted for a 50 basis point cut, and one for a 25 basis point cut—mirroring the voting configuration observed in the June meeting.

- **The statement highlighted that, despite the decline in headline inflation in June, both core inflation (excluding food and regulated items) and inflation expectations remained stable.** Headline inflation fell by 23 basis points, from 5.1% to 4.8%. However, core inflation held steady, interrupting the downward trend observed in previous months. Furthermore, inflation expectations remained anchored around 4.7% by year-end, despite the easing in headline inflation. The Central Bank Governor noted that analysts expect only marginal reductions in inflation for the remainder of the year—from the current 4.8% to 4.7%—a factor that was significant in the Board's deliberations.
- **On the economic activity front, the statement emphasized that the economy continues to gain traction.** Specifically, the Economic Monitoring Indicator (ISE) grew approximately 2.7%, driven primarily by tertiary-sector activities. Looking ahead, the technical staff projects second-quarter GDP growth to be around 2.7%, albeit with sectoral heterogeneity. Internal demand is expected to show particular strength, with a forecasted growth rate of about 4.1%. During the press conference, the Finance Minister reiterated his support for rate cuts, citing the need to further stimulate the economy, particularly the manufacturing sector. However, the Central Bank Governor emphasized that several sectors have exhibited strong momentum and that the Bank's technical analysis indicates clear signs of economic recovery.
- **Fiscal matters were notably absent from the official statement, standing out due to their omission.** Nonetheless, a significant number of questions during the press conference revolved around fiscal concerns. The Governor confirmed that fiscal issues

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were discussed by the Board and that the Finance Minister addressed all questions regarding the latest fiscal developments.

In response to criticisms regarding a lack of fiscal discipline—specifically, the use of financial space to support higher primary expenditures rather than fiscal consolidation—the Minister reaffirmed the government's commitment to its policy agenda and public spending plans. He emphasized that public spending is rigid and that this structural inflexibility justifies the observed increase in primary expenditure. Regarding the feasibility of raising additional revenues through a new tax reform, as envisioned in the budget proposal, the Minister argued that the proposed reform is structural and would provide sustainable funding for future administrations. He expressed confidence in reaching an agreement with Congress and made it clear that no alternative plan is currently being considered.

- **On the external front, the Board underscored heightened global uncertainty and its implications for the availability of external financing.** The statement noted that a confluence of factors—ongoing trade tensions, geopolitical conflicts in several regions, and the slow normalization of U.S. monetary policy—is increasing pressure on Colombia's external financing environment. The exchange rate was not addressed in the statement.
- During the Q&A session**, the Minister stressed the need to approve the national budget and tax reform in order to avoid a severe fiscal adjustment that could dampen economic growth.** This argument was used to justify the activation of the fiscal rule's escape clause and the uptick in primary expenditure. He made clear that no spending cuts are anticipated and asserted that the onus is on Congress to approve the necessary funding. This conveyed the government's limited appetite for austerity and highlighted potential upward pressure on domestic demand from fiscal policy, which in turn may constrain the space for monetary easing. Additionally, several journalists inquired about recent remarks made by the President, who criticized the Bank's decision, suggesting it was politically motivated. In response, **the Governor mounted a robust defense of the Central Bank's independence and the technical rigor underlying its monetary policy decisions.**

In our view, the press release was particularly brief and focused exclusively on traditional monetary policy topics: inflation, economic activity, and external context. Fiscal issues, which had been prominently discussed in prior communications, were deliberately omitted. Nevertheless, both the statement and the press conference conveyed a distinctly hawkish stance by the Central Bank: stable core inflation, limited scope for further disinflation, accelerating economic activity—particularly in domestic demand—robust consumption growth, and a resilient labor market.

Despite the lack of explicit references to fiscal matters in the statement, the Governor's comments confirmed that fiscal dynamics were central to the Board's internal discussions. The majority position on the Board was justified by these factors, underpinning a cautious approach to monetary policy that we do not expect to shift significantly in the near term. This supports our expectation of a more restrictive policy stance for the remainder of 2025 than previously anticipated.

Key elements likely to influence monetary policy in the coming months include: budget debates and funding negotiations in Congress, the trajectory of fiscal indicators, continued stickiness in core inflation, discussions on minimum wage increases, and ongoing strength in the labor market.

Global developments further complicate the policy outlook. On one hand, recent U.S. monetary policy signals and macroeconomic data suggest that the Federal Reserve may cut interest rates less than markets had initially priced in. On the other hand, pending tariff decisions pose a substantial risk to global trade and to Colombia in particular.

It is worth noting that the April 2 measures placed Colombia in a relatively favorable position, with the lowest tariffs applied among affected countries and approximately 50% of exports exempt from the measures. However, recent announcements and remarks from U.S. authorities suggest that tariff increases remain on the table, which could have a more pronounced negative impact on Colombia’s economy and potentially justify additional monetary policy accommodation.