

BanRep raises the policy rate by 75 bps at the June meeting

BBVA Research
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By majority vote, the Board of Directors of Banco de la República (BanRep) increased the monetary policy rate by 75 basis points, bringing it to 12.00% in June.

The June decision was split, returning to the voting pattern observed during the first meetings of the year. Four Board members voted in favor of a 75-basis-point increase in the policy rate, while two members supported a 50-basis-point reduction. One Board member voted to keep the policy rate unchanged. This decision marks the resumption of the tightening cycle following a one-meeting pause.

- **BanRep emphasized that inflation continues to exhibit an upward trend, broadly in line with the technical staff's projections, reaching 5.8% year-over-year in May.** Core inflation, excluding food and regulated items, increased to 6.0%, further reinforcing its upward trajectory. In both cases, the Board highlighted that inflation remains significantly above Colombia's inflation target. The Governor noted that the technical staff expects inflation to decline gradually throughout 2027 toward the upper bound of the target range and to converge to the 3.0% target in 2028, implying a cumulative seven-year period of inflation remaining above target. He stressed that monetary policy has sought to minimize the economic costs of disinflation through a gradual and cautious adjustment process. In the near term, the Governor indicated that inflation is likely to continue increasing, potentially ending the year above 6.0%, or even 6.5%. Accordingly, current monetary policy decisions are primarily intended to contain inflationary pressures in 2027 rather than materially affecting inflation outcomes during 2026.
- **The Governor also highlighted significant upside risks to the inflation outlook.** First, he referred to the potential development of an El Niño weather event, particularly regarding its possible intensity. A severe event could exert upward pressure on both food and energy prices. Second, he pointed out that the recent decline in international oil prices may provide some future relief to inflationary pressures, although the outlook remains highly uncertain and warrants close monitoring. Separately, the Minister of Finance confirmed that domestic fuel prices are expected to remain unchanged in July.
- **According to the Bank, inflation expectations have displayed considerable volatility, following a clear upward trend through May before declining somewhat in June,**

particularly those derived from government bond market instruments. Nevertheless, all measures of inflation expectations remain substantially above the 3.0% inflation target across all forecasting horizons, reflecting persistent concerns regarding the credibility of inflation convergence, consistent with the Governor's remarks regarding the prolonged deviation from target.

- **On the real activity front, Colombia's National Administrative Department of Statistics (DANE) reported 2.2% year-over-year GDP growth in the first quarter, slightly above the rate observed in the final quarter of 2025.** The Board highlighted that domestic demand continues to grow at a faster pace than overall GDP. This performance has been accompanied by a particularly robust labor market. The unemployment rate remained at historically low levels, reaching 8.0% in May, its lowest reading since 2001. This outcome has coincided with solid employment creation and sustained wage growth.
- **Regarding the external environment, the Board emphasized that economic and geopolitical uncertainty remains elevated,** particularly due to the conflict in the Middle East and its potential implications for international fuel and fertilizer prices. Additionally, members highlighted the recent volatility observed in global financial markets associated with monetary policy decisions in advanced economies.
- In response to questions from the press, **the Minister of Finance stated that the government will conduct the presidential transition in accordance with Colombian law. He noted that such a transition can be either cooperative or confrontational and argued that, based on recent actions by the incoming administration,** the latter appears more likely. He also reaffirmed that the current administration will remain fully in office until August 6, rejecting calls from the incoming government for an earlier transfer of responsibilities. The Minister also explained that he opposed the Board's policy decision, arguing that it is inconsistent with strengthening economic growth. He further stated that recent labor market outcomes challenge the view that increases in the minimum wage necessarily lead to employment destruction.
- **On fiscal matters, the Minister announced that the budget proposal to be submitted at the end of July will require the introduction of a new Financing Law.** He explained that Congress has not approved meaningful revenue-enhancing measures in recent years, increasing pressure on public finances. According to the Minister, restoring fiscal sustainability will require a combination of expenditure restraint and higher revenues. However, given the high degree of rigidity in public spending, he argued that a Financing Law will be necessary to address these structural fiscal challenges. The government expects to submit the proposal at the opening of the new congressional session.

Our opinion:

Following a brief pause, BanRep resumed its monetary tightening cycle in June, with a divided vote similar to those observed during the January and March meetings. The majority continues to support a more restrictive monetary policy stance aimed at containing inflationary pressures and

preventing further deterioration in inflation expectations. In this regard, the recent acceleration in inflation, together with expectations of additional price increases over the coming months, played an important role in the Board's decision.

Looking ahead, additional inflationary pressures are likely to emerge over the coming months. Some are expected to be temporary, such as the potential effects of an **El Niño** event, while others appear more structural, including demand-side pressures supported by the continued strength of the labor market. Against this backdrop, close monitoring of inflation developments—particularly core inflation—will be essential to assess the extent to which exchange rate appreciation can offset inflationary pressures arising from the prolonged expansion of both private and public spending and their implications for medium-term inflation.

Moreover, the current macroeconomic environment makes inflation more sensitive to temporary and persistent price shocks alike. Although an **El Niño** event would represent a transitory supply shock, there is a significant risk that part of the resulting increase in inflation could become embedded in price-setting behavior and inflation expectations, particularly given that expectations remain insufficiently anchored. Accordingly, we believe that BanRep is likely to continue the current tightening cycle with **at least one additional 25-basis-point rate increase** over the coming months, bringing the policy rate to **12.25%**, which remains our year-end forecast.

Finally, the Governor's assessment of recent developments in capital markets, interest rates, sovereign risk premiums, and the exchange rate reflects a cautious stance, which we believe will continue to influence future policy decisions. The Board will closely monitor whether the recent improvements in financial conditions prove durable—allowing the exchange rate, sovereign spreads, and domestic interest rates to stabilize at more favorable levels—or whether these gains reverse over the coming months. Exchange rate developments are likely to remain a key variable to monitor.

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