

BanRep raises the policy rate by 25 bps at the September meeting

BBVA Research
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BanRep raises its policy rate by 25bp to 12.25% in a split decision.

The September decision was once again split, although the voting pattern revealed a notable hawkish shift within the Board. Four members voted in favour of the 25bp increase. Unlike in previous meetings, however, one Board member favoured a larger 50bp hike. Overall, the number of members supporting a rate increase rose from three at the July meeting to five in September. The remaining two Board members voted to keep the policy rate unchanged.

- **BanRep highlighted that inflation increased again in August, reaching 6.2% YoY.** The Board noted that inflationary pressures were stemming from both food and regulated prices, while also highlighting that services inflation remained elevated at 7.2% YoY. Core inflation, excluding food and regulated items, reached its highest level in a year. Looking ahead, the Bank warned that the materialisation of El Niño could generate additional upside pressures on inflation through food and regulated prices. Inflation expectations for year-end have also increased, while two-year-ahead expectations declined, although they remain at the upper end of the target range, at 4.0%. During the press conference, the Finance Minister stressed that the Government and BanRep share the view that bringing inflation under control remains a priority, given its particularly adverse effects on lower-income households and its implications for key decisions such as the minimum wage, among others.
- **On economic activity, the statement highlighted the 3.4% QoQ seasonally adjusted growth recorded in 2Q.** However, the Board did not emphasise the composition or underlying drivers of this expansion. Regarding the latest available indicators, it pointed to the weak July Economic Activity Indicator (ISE), as well as subdued industrial production and retail trade data. A new element in the statement was the reference to the strong growth in imports. The labour market, meanwhile, received little attention.
- **On the external front, the Board highlighted a marked deterioration in global financial conditions, associated with expectations of tighter-for-longer monetary policy in advanced economies.** During the press conference, the Finance Minister also pointed to the renewed increase in fuel prices as one of the factors shaping the response

of global central banks and financial markets, adding pressure to the Colombian economy.

- The press conference largely avoided issues outside the scope of monetary policy. However, when asked about the fiscal outlook, **the Finance Minister reiterated the Government's commitment to fiscal adjustment and recalled its three-stage strategy: expenditure cuts in 2026, the budget process and the rescue bill.**

Our view:

The decision conveys several important, and somewhat conflicting, messages. On the one hand, the consensus among analysts, including BBVA Research, was for the policy rate to remain unchanged, making the 25bp increase a surprise. However, when assessing the domestic backdrop, the inflation picture has changed only marginally since the July meeting: headline inflation increased from 6.14% to 6.24%. The exchange rate, while somewhat weaker, has not moved materially and its recent depreciation remains limited relative to the cumulative appreciation observed previously. Developments on the real side of the economy, however, are becoming more significant. Industrial production contracted in July. Retail sales, while still growing at close to 5.0%, have slowed from double-digit rates. Moreover, although second-quarter GDP growth was strong—largely driven by public expenditure—the July ISE already pointed to a significant loss of momentum, expanding by just 1.1%. This has now been compounded by a very weak labour-market reading. Although part of this deterioration reflects the impact of the earthquake, the figures also reinforce signs of a more structural moderation in employment growth. These labour-market data were released today and therefore may not have been available early enough to materially influence the Board's assessment.

At the same time, the September statement remained broadly aligned with the July communication and, in our view, its wording appeared more consistent with a decision to keep rates unchanged than with an additional hike. The tone became somewhat more hawkish during the press conference, particularly through the emphasis placed on upside inflation risks and external pressures stemming from higher prices and interest rates. One argument that received only limited attention, but could become increasingly relevant at upcoming meetings, is the strong growth in imports and the extent to which it could contribute to a wider external imbalance and greater external financing requirements. Nevertheless, neither the statement nor the press conference placed significant emphasis on this risk.

At BBVA Research, we expect economic activity to remain weak over the coming months, partly reflecting the short-term effects of the earthquake but also due to trends that were already emerging before the event. Against this backdrop, BanRep may have viewed this meeting as one of its last opportunities to raise the policy rate and reinforce its commitment to bringing inflation under control. In our view, however, that commitment was already clearly reflected in the very high level of real interest rates prevailing over recent months and can continue to be signalled over the medium term without the need for additional rate increases.

Looking ahead, BanRep faces several important challenges. First, the fiscal position has been one of the key arguments supporting the monetary tightening cycle, given its implications for aggregate demand. The Government has launched a strategy aimed at moderating public

expenditure, reducing fiscal deficits and delivering a gradual fiscal consolidation. If implemented within the relevant monetary-policy horizon, this adjustment should help alleviate inflationary pressures stemming from domestic demand. Second, Colombia is expected to face a very strong El Niño episode, with potentially significant economic effects, particularly on prices. As is typically the case, however, part of the resulting inflationary pressure is likely to be transitory. The main risk is that, after several years of inflation remaining above target and amid persistently high inflation, these temporary shocks could have a stronger pass-through into price-setting behaviour and inflation expectations. Finally, the substantial cumulative appreciation of the Colombian peso has yet to become fully visible in consumer prices, partly because of the resilience of domestic demand. If the slowdown in activity expected by BanRep itself materialises over the coming year, softer demand should facilitate a greater pass-through from the stronger peso to final consumer prices, thereby contributing to the disinflation process.

Overall, we expect incoming economic data to provide BanRep with sufficient grounds to keep the policy rate unchanged over the next several meetings. We currently see the next move as potentially being a rate cut around September next year. However, if El Niño shocks become embedded in core inflation expectations and the expected fiscal adjustment fails to materialise, the economy could require a somewhat higher real policy rate. This could take the form of either additional rate increases or a delayed start to the monetary easing cycle.

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