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BanRep holds its policy rate at 12.25% in october in a split decision

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At its October meeting, Banco de la República (BanRep) decided by a majority vote to keep its monetary policy rate unchanged at 12.25%.

The October decision revealed a divided Board, with four members voting to hold the policy rate steady and three members favoring a 25 basis point (bp) increase. This voting outcome indicates that two Board members who had supported a rate hike at the previous meeting shifted their stance in favor of keeping rates unchanged.

- **BanRep highlighted that headline inflation edged up to 6.3% in September, although the reading came in below market expectations.** The Board also noted that core inflation (excluding food and regulated prices) declined marginally from 6.1% to 6.0%, broadly in line with the behavior of inflation excluding food. In this regard, the Board emphasized that El Niño represents a significant upside risk to the inflation trajectories of both food and regulated prices. This assessment is likely related to the fact that the latest acceleration in headline inflation was largely driven by higher prices for perishable food products, particularly those vulnerable to the adverse conditions associated with El Niño. Regarding inflation expectations, the Board highlighted an upward revision in year-end expectations to 6.9%, while noting that expectations at the two-year horizon remained relatively stable at around 4.0%. Market-based inflation expectations, derived from government bond trading, increased at shorter maturities and remained above the 3% target across all horizons. However, these measures may have been significantly distorted by the government's recent large-scale debt exchange operations.
- **On the economic activity front, the Board emphasized the weakening of key indicators for the third quarter.** Available data point to slower consumption growth, across both private and public expenditure components. Similarly, the August Economic Activity Indicator (ISE), along with manufacturing and retail trade surveys, suggest continued weakness across productive sectors. According to our estimates, the economic

slowdown in the third quarter is likely to be significant, reflecting not only the temporary impact of the earthquake but also a gradual moderation in underlying economic activity.

- **The external environment received no specific mention on this occasion.** Unlike in September, when the Fed's interest rate increase and less favorable external financial conditions were highlighted as relevant factors for the domestic economy, the latest statement made no reference to the Fed's decision to leave interest rates unchanged. Nevertheless, external monetary conditions may remain an important consideration going forward, particularly if additional Fed rate hikes materialize in December.
- **Fiscal developments once again featured prominently in both the monetary policy statement and, particularly, the press conference.** The statement emphasized that public finances are a key determinant of Colombia's current and prospective macroeconomic performance and directly influence the effectiveness of monetary policy in bringing inflation back to target. Regarding the proposed Economic Rescue Bill, the Board stressed the need for a thorough assessment given its potential implications for the Colombian economy. During the press conference, the Governor noted that measures involving an increase in the value-added tax (VAT) could exert upward pressure on inflation, although such effects are typically transitory. However, he refrained from providing further details, underscoring the need for a comprehensive evaluation of the proposed reform. He also called for a broad and substantive debate on the legislative proposal.

Our view:

The Board's decision, in line with our expectations, reflects increasing signs of weakness across several economic activity indicators, alongside a marginal decline in core inflation, providing policymakers with room to pause and assess incoming economic data.

The monetary policy statement highlights that El Niño is expected to exert upward pressure on both food and regulated-price inflation, effectively anticipating some of the inflationary pressures likely to materialize over the coming months. In our view, this acknowledgment suggests that the Board is already factoring in a degree of additional inflationary pressure and considers such developments compatible with its decision to hold rates steady. Nevertheless, uncertainty surrounding the intensity of El Niño and the magnitude of its inflationary impact remains elevated.

An additional factor entering the policy equation at this meeting was the submission of the proposed Economic Rescue Bill to Congress. Although the proposal was not necessarily a decisive factor behind the current policy decision, and Board members explicitly emphasized the need for a more thorough and rigorous assessment, it is likely to become a key consideration in upcoming monetary policy deliberations.

In this context, it is worth recalling that Banco de la República warned nearly two years ago about the risks that fiscal imbalances posed to monetary policy effectiveness and inflation dynamics. These imbalances have since widened, helping to explain, at least in part, the more restrictive monetary policy stance adopted by the central bank. Consequently, the bill's legislative

progress through Congress could play a significant role in shaping both the December policy decision and the subsequent interest rate trajectory.

Approval of the legislation, even with substantial amendments, could support an extended period of monetary policy stability, provided it delivers a meaningful reduction in the fiscal imbalance. Our baseline scenario assumes that the policy rate will remain unchanged until September 2027, when BanRep would begin a gradual monetary easing cycle.

However, the balance of risks remains tilted toward a more restrictive monetary policy stance. In particular, resilient domestic demand, the inflationary effects of El Niño, and additional supply-side shocks could push inflation above our projections, potentially requiring the central bank to maintain tighter monetary conditions or implement further policy rate increases.

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