

July's Central Bank Ordinary meeting - what to expect?

- We consider that BRep would decide to hold repo rate at 7.50%
- BRep past decisions, growth considerations and repo survey inaccuracy support our forecasts

Facts

1. BRep will hold its ordinary meeting. Market is expecting an additional (and probably last) 25bps hike
2. Last decision was not unanimous. A minority supported not to hike

Our take

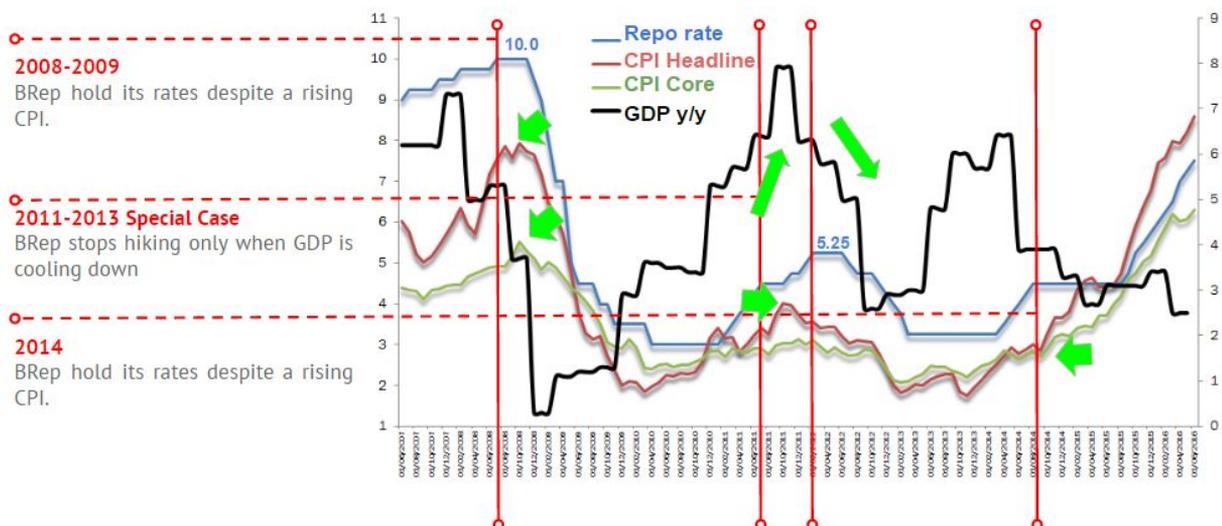
- **BRep would not hike this time.** We found that economic activity is not strong enough to support additional hikes. Additionally, Central Bank uses to stop hiking before CPI reaches its peak.

WHY BRep would decide NOT TO HIKE REPO RATES ?

Despite market consensus is highly biased towards a last 25bps hike, **we consider that BRep would decide to hold repo rates at 7.50%**. Our forecast is based on three considerations.

1. **BRep past decisions** (see graph below): Since 2007, BRep decided not to hike (in a restrictive monetary policy) in Aug/2008, Sept/2011, March /2012 and Sept/2014.
 - a. In 2008, 2011 and 2014, Central Bank decided to hold rates despite headline and core CPI showed additional pressure for some months after BRep's call.
 - b. We consider that 2011 and 2013 are special cases: In 2011, Central Bank decided to hold rates for only 3 months: in that occasion, CPI rose further after BRep's holding decision, similar to historical behaviour. The critical point was a strong GDP performance: BRep decided to hike again and reach a neutral level when GDP showed a downtrend movement.

To sum up, it seems that **Central Bank usually decides to suspend a restrictive monetary policy before CPI reaches its peak**. Additionally, **GDP influences BRep decisions when its trend depicts a cooling economy**.

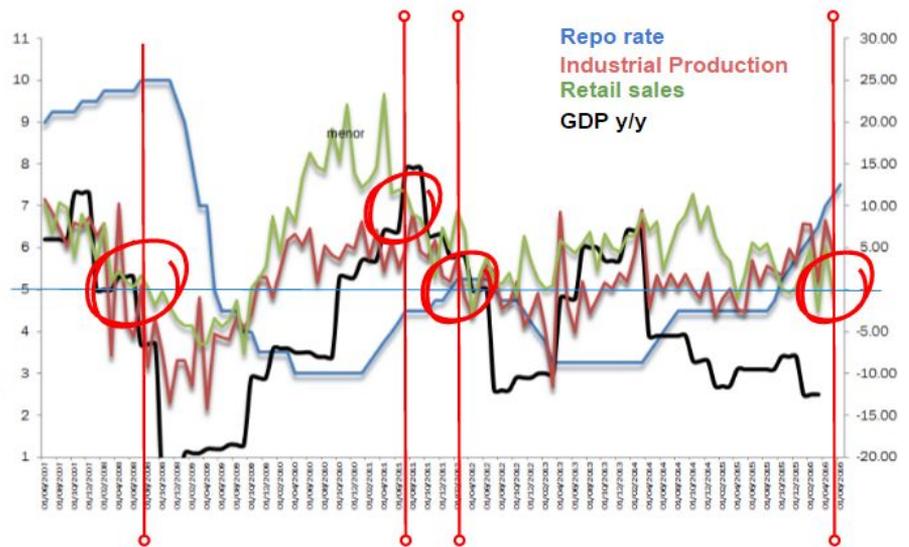


2. **Growth considerations** (see graphs below): During the last month, several indicators are evidencing a cooling economy. Some of those indicators are:
- a. 2.5% GDP y/y (IQ/16) VS 3.4% y/y (IVQ/15). An important reduction that should not undermined
 - b. Industrial production (IP) ex-Reficar: 0.57%
 - c. Retail sales (RS): -0.46%, the lowest level since March 2016
 - d. Energy consumption, -2.2% for the first time in several months
 - e. Business Confidence, 3.7% down from 5.9% two months ago
 - f. Economic Activity (DANE) at 0.6% the worst level since Feb 2009

Both IP and RS are accurate leading indicators that forecast economic growth. It seems that monetary policy usually prefers not to hike further when both indicators are crossing 0% in a downward trend. Currently, conditions are favourable to re-evaluate further hikes

Since 2007, retail sales and industrial production have been affecting BRep decisions.

When those indicators cross 0% in a downward trend, BRep might prefer to stop hiking.



In addition, Economic Activity Index (Dane) seems to accurately predicts GDP's. Conditions are not settled to a profundization of current restrictive monetary policy.



To sum up, it seems that **current economic conditions are weak enough to reconsider additional hikes.**

3. Repo surveys are never accurate when Central Bank changes its policy

In the graph below, it is evident that throughout recent years, market surveys have not been accurate forecasting BRep's trend change. In most cases (see difference between red and green lines) surveys prefer to continue with the latest movement. Hence, we can conclude that market consensus is not a good guideline when making predictions concerning interest rates.



Conclusions

- We consider that conditions are set to stop hiking monetary policy. We expect that BRep keeps its repo rates at 7.50% in coming months and a new expansive monetary policy before end of 2016.
- Currently, we consider that the focus should be growth, not prices.

What-to-watch

COL Leading activity indicators	:	Tuesday, August 2nd @ 14:00 COL
COL PPI report	:	Thursday, August 4th @ 14:00 COL
COL CPI report	:	Friday, August 5th @ 19:00 COL

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