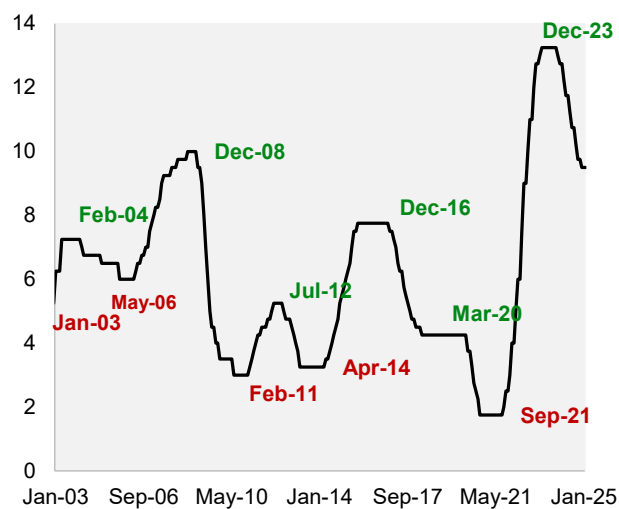


COLOMBIA – Interest rate cycles

- ▶ Following analysis on patterns in interest rate cycles in Brazil and Mexico, we now extend our investigation to Monetary Policy in Colombia.
- ▶ This descriptive study analyzes 11 interest rate cycles since January 2003 following the adoption of the inflation targeting regime in 1999.
- ▶ Interest rate cycles generally see adjustments of similar magnitude during periods of increases and decreases. In general, easing and tightening cycles mainly consist of 25-50bp adjustments, with the median pace being 25bps in both cycles. The Board usually starts and concludes hiking cycles with a 25bp increase. In contrast, easing cycles have begun with either a 25bp or 50bps cut and typically end with a 50bp adjustment. BanRep has only cut by more than 50bp during the start of the Global Financial Crisis.
- ▶ Similar to Banxico, when implementing changes to the policy rate, BanRep did so at a 25bps pace around 58.8% of the time, while movements of 50bps occurred 26.5% of the time. In our 23-year sample, BanRep adjusted rates by more than 50bps only 14.7% of the time. Unlike Brazil, where the Central Bank has always implemented cycles with a string of continuous adjustments, BanRep, like Mexico, has had some "on hold" meetings during cycles.
- ▶ In the current cycle, BanRep paused in January leaving the policy rate at 9.50%, following 375pb of consecutive cuts since December 2023. The vote was split, with 5 members voting to keep the rate unchanged, one member favoring a 25bp cut, and another member voting for a 50bp cut. The pause also took place after an unexpected smaller cut of 25pb in December. A larger than expected minimum wage adjustment, stressed fiscal accounts, and above-target inflation expectations were behind the decision to pause.
- ▶ Our base case sees BanRep resuming its easing cycle with a 25bp cut to 9.25% later this month and then continue at such a pace to 8.0% by YE25 and 6.50% by YE26. We cannot rule out additional pauses in the cycle amid still volatile inflation and fiscal noise.

This study analyzes 11 interest rate cycles since December 2002 to identify recurrences and patterns in monetary policy decisions.

11 interest rate cycles (5 tightening cycles and 6 easing cycles)



Source: Itaú, Banrep

Since January 2003, BanRep has announced 54 decisions to raise the policy rate and 48 decisions to lower it. Of note, BanRep held monthly meetings between 2003 and 2017, and then shifted to eight per year; most of the analyzed cycles refer to the period in which BanRep had monthly meetings, and hence, the Board might have been more inclined to more gradual adjustments per meeting.

Brief of easing and hiking cycles

		Start	End	Cycle (bps)	Length in months	Meetings on hold during the cycle	Meetings on hold after the cycle	Pace bps					
								First three meetings	Last 3 Meetings	Min	Max	Avg	Median
Interest rates easing cycle	Feb-04	7.25	6.00	1.25	20	16	7	25/25/0	0/0/50	-25	-50	-6.3	0
	Dec-08	10	3.00	700	19	9	9	50/0/50	0/0/50	-50	-100	-36.8	-50
	Jul-12	5.25	3.25	200	9	2	11	25/25/-	25/25/50	-25	-50	-22.2	-25
	Dec-16	7.5	4.25	350	17	3	22	25/0/25	0/0/25	-25	-50	-20.6	-25
	Mar-20	4.25	1.75	250	7	0	12	50/0/50	25/25/50	-25	-50	-35.7	-25
	Dec-23	13.25	9.5	525	14	1	-	25/25/50	50/25/-	-25	-50	-37.5	-25
Interest rates hiking cycle	Jan-03	5.25	7.25	200	4	2	10	100/-/-	0/-/100	100	100	50.0	50
	May-06	6.0	10.0	400	27	13	4	25/25/-	0/0/25	25	50	14.8	25
	Feb-11	3.0	5.25	225	13	4	4	25/25/25	0/25/25	25	25	17.3	25
	Apr-14	3.25	7.75	450	17	2	4	25/-/25	50/-/25	25	50	26.5	25
	Sep-21	1.75	13.25	1150	20	0	4	25/50/50	75/25/25	25	150	82.1	100

*Current cycle until Jan-25 meeting

*Banrep reduced the frequency of monetary policy decisions in January 2018 from 12 to 8 a year

The pace of policy rate adjustments has varied, ranging from 25bps to 150bps for hikes and from 25bps to 100bps for cuts (the average hike is 38bps and the average cut is 24bps). The median pace is 25bps for both hikes and cuts. The Board has typically started with moves of 25bps and 50bps, ending tightening cycles with 25bps, while easing cycles generally closed with a 50 bp cut.

When adjusting the policy rate, BanRep mostly did so at a 25bp pace (58.8% of the time), and less so at 50bps (26.5%). In the 23-year sample, the Central Bank decided on a policy rate move that was greater than 50bps 14.7% of the time.

Almost all cycles had at least one 50 bps change, but on a few occasions, Banrep adjusted the policy rate by more than 100 bps. In only two tightening cycles (September 2021 and January 2003) did BanRep's decisions exceed the 50bp threshold. In the 2021 cycle, when the interest rate was at historically low levels, BanRep implemented two unprecedented jumbo hikes of 150bps, six hikes of 100bps and one hike of 75bps. Regarding easing cycles, BanRep executed 100bps cuts only in the cycle that started in December 2008, during the Global Financial Crisis. In the last easing cycle, which started at the beginning of the pandemic (March 2020), BanRep was cautious and made consecutive cuts of 50bps and 25bps.

25bps is the most common central bank adjustment

Pace bps	Interest rates hiking cycle	Interest rates easing cycle	All Movements (abs)
#Movements	54	48	102
Min	25	0	25
Max	150	-300	150
Average	38	-24	32
Median	25	-25	25
%25bps	66.7%	50.0%	58.8%
%50bps	13.0%	41.7%	26.5%
%75bps	1.9%	0.0%	1.0%
%100bps	14.8%	8.3%	11.8%
%150bps	3.7%	-	2.0%

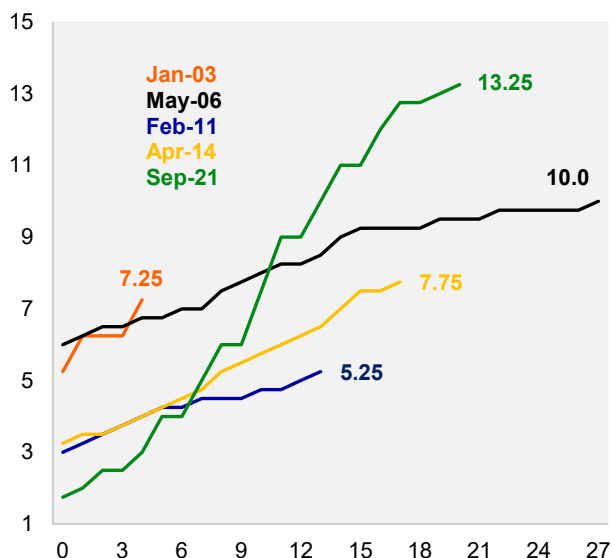
*Since January 2003, current cycle until Jan-25

Source: Banrep, Itaú

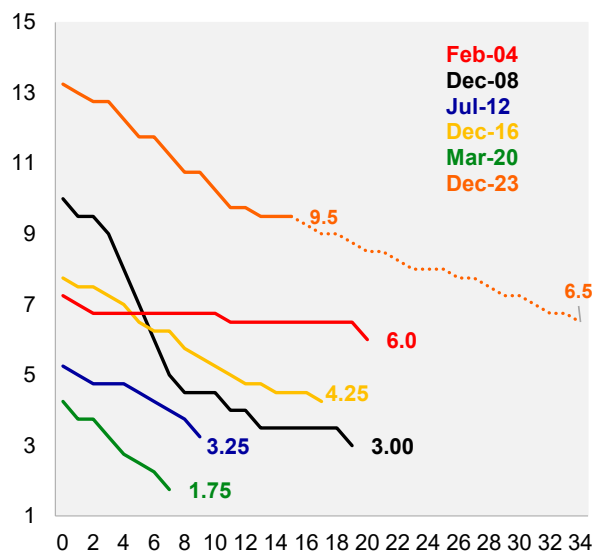
Easing cycles take place over 14 months, on average, slightly less than hiking cycles (16 months). The on-hold period following an easing cycle is, on average, one year, the Board has acted, on average months, after concluding a tightening cycle.

Current cycle is to be the longest since the adoption of the targeting regime

Hiking cycles



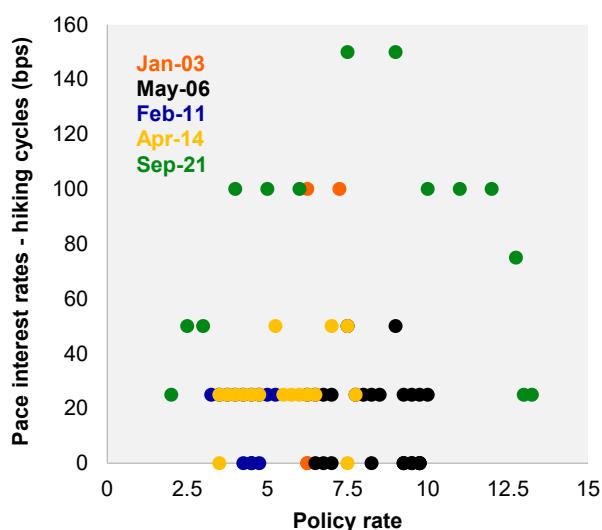
Easing cycles



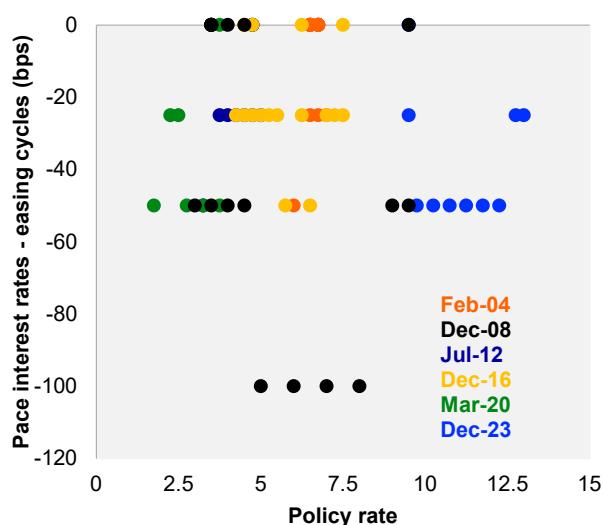
Source: BanRep, Itaú

Pauses in both tightening and easing cycles are common in Colombia. Unlike Brazil, where the Central Bank has cut continuously in cycles, BanRep, like Mexico, has had some "on hold" meetings within cycles. We refer to a pause as a hold decision that lasts one or more months. The average number of pauses within the cycle in a cycle is four but ranges from zero to thirteen in tightening cycles and up to sixteen in easing cycles. This stylized fact suggests that we cannot rule out additional pauses in the current cycle. Precisely, several hiking cycles in Colombia held an important number of pauses, for instance the cycles started in May 2006 and February 2011 accounted for 13 and 4 meetings on hold. Similarly, most easing cycles had few pauses (between zero or four holds) with exception of February 2004 that included 16 meetings on hold, and December 2008 that included 9 meetings on hold.

Rate hikes above 100bps only in September /21 and January /03 cycles



Rate cuts of 100bps only in July/08 cycle (change axis to intervals of 25bps)



Source: BanRep, Itaú

In terms of macroeconomic conditions, cycles have not had a steady threshold that triggered a policy adjustment. Average inflation at the start of an easing is 5.7% YoY and 4.3% YoY for a hiking cycle, both above the inflation target range of 3% (+/-1pp). Moreover, most cycles start with an unemployment rate close to 12% (versus NAIRU of 10.5%).

Historically, analysts' CPI expectations were above the 3% target. In 21 years of history of the BanRep survey, 12-month expectations averaged 4.11%, slightly above the upper limit of the target range. Additionally, two-year expectations averaged 3.4%, above the 3% target. One-year inflation expectations above the 3.5% level seem to trigger tightening cycles.

In terms of the output gap, a pre-pandemic output gap of 0.9% of GDP triggered a tightening cycle, while a level of -0.3% of GDP triggered an easing cycle.

Inflation and output gap

		CPI YoY	Deviation from the target	Expect 1Y	Expect 2Y	Unemployment sa	Output Gap	Neutral rate	Real rate at the start of the cycle	Real rate at end of the cycle
Interest rates easing cycle	Feb-04	6.3%	0.8%	5.75%		14.40%			1.50%	1.29%
	Dec-08	7.5%	3.5%	5.15%		11.70%	-1.70%	1.80%	4.85%	-0.73%
	Jul-12	3.0%	0.0%	3.32%		11.80%	0%	1.60%	1.93%	0.22%
	Dec-16	4.7%	1.7%	3.76%	3.22%	11.20%	-0.10%	1.30%	3.74%	0.62%
	Mar-20	3.9%	0.9%	3.54%	3.30%	13.80%	-0.20%	1.30%	0.72%	-1.05%
	Dec-23	9.3%	6.3%	5.70%	3.80%	10.60%	0.50%	2.20%	7.55%	3.20%
Interest rates hiking cycle	Jan-03	7.0%	1.0%			17.14%			5.25%	3.14%
	May-06	4.1%	-0.4%	4.30%		12.40%			1.70%	4.86%
	Feb-11	3.4%	0.4%	3.40%		12.50%	0.50%	1.70%	-0.40%	2.02%
	Apr-14	2.5%	-0.5%	2.97%		10.40%	1.30%	1.40%	0.28%	4.25%
	Sep-21	4.5%	1.5%	3.49%	3.10%	13.70%	-2.50%	1.50%	-1.74%	6.25%

*Banrep survey is executed since September 2003
 Long term since Jun 2022
 2 yr since Jan 2015

For the neutral rate, BanRep revised their estimate from 1.9% in 2019 to 2.7% in 2025 and 3% in 2026. We do not rule out further upward revisions, given tighter global financial conditions and a weakened fiscal scenario.

Regarding the current cycle, our base case remains for BanRep to resume its easing cycle with a 25bp cut to 9.25% this month and then continue at this pace to 8.0% by YE25 and end the cycle at 6.50% in YE26. However, risks are skewed toward a higher terminal rate. Unlike the previous easing cycle, the current one will likely end with a slower pace of cuts (25pbs vs. 50pbs) and we cannot rule out further pauses ahead.

Andrés Pérez M.
Vittorio Peretti
Carolina Monzón
Juan Robayo
Angela Gonzalez

Macro Research – Itaú

Mario Mesquita – Chief Economist

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