Weekly Colombian Peso (COP) Outlook

Acvaeconomia FX perspective

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Our take:

This week, the **US Dollar (USD)** has shown an aggressive hawkish rally, hampering the recovery of emerging markets. The market awaits the Federal Open Market Committee (FOMC) minutes, which we expect will send a dovish message to investors, increasing expectations of a pivot in the Federal Reserve's (FED) monetary policy, curbing the bullish momentum of the USD. This week's US economic calendar contains important data that will reflect the condition of the economy, through manufacturing activity (PMI and ISM manufacturing) and the labor market (unemployment rate, employment ADP change, and non-farm payrolls). Labor market data could potentially join last week's bullish US unemployment claims to reflect a slowdown in economic growth, limiting the strength of the USD. This context leads us to expect a USD with a trading range between 104.0 and 105.5 units.

The **EUR/USD** pair has reversed its gains, in response to the sudden recovery of the USD. The euro (EUR) loses strength as pessimism emerges in the market, induced by growing fears of recession in the eurozone. This fear has been catalyzed by contractionary manufacturing PMI results, and December's consumer prices in Germany, which have declined at a stronger pace than expected. Macroeconomic results reduce the need for a more aggressive European Central Bank (ECB) for a prolonged period of time. So far, it seems that neither the aggressive comments from ECB officials, nor improvements in the German labor market, have managed to offer support to the EUR bulls. This week, the market awaits inflation data in the European Union (EU), which will be decisive in setting expectations regarding the monetary rate spread between the FED and the BCE, defining the EUR/USD trend for the week. In this sense, we expect the euro to remain within a trading range between USD$1.051 and USD$1.073.

The **EUR/COP** pair showed a strong uptrend during last week, driven by the EUR's robust recovery. However, this week's USD rally and the emergence of pessimism in the eurozone, have led the EUR to overturn its gains. This week, traders should be mindful of inflation data in Colombia and the Eurozone. Expectations aim towards a still strong price hike in Colombia, against the prospect of a slowdown in the EU inflation. Additionally, while signs of recession in the eurozone permeate market sentiment, data shows a still robust aggregate demand in Colombia. This contrast leads us to expect a more aggressive Banco de la República (BanRep) compared to the ECB stance, leading to more competitive interest rates in Colombia that allow the COP to appreciate against the EUR. Given this context, we expect a weekly trading range between COP$5,040 (lower limit COP$5,020) and COP$5,190 (upper limit COP$5,210) per euro.

Last week, the **USD/COP** pair remained predominantly bullish, managing to reverse most of the COP's monthly gains. Demand for USD as a safe-haven asset remains strong, nourished by the International Monetary Fund (IMF) forecasts, which aim towards the possibility that one third of the world's economy will enter recession by 2023. The pessimistic mood in the market is reinforced by the release of Chinese data, showing a sharper-than-expected economic contraction through a downbeat manufacturing PMI. This enhances the importance of services and composite Chinese PMI on Tuesday, and trade balance on wednesday. We expect the Chinese economy contraction to catalyze fears of a slowdown in aggregate demand, leading to a decline in oil prices and limiting the strength of the COP. However, we expect crude oil price volatility to remain correlated with Russian decisions regarding the exporting restriction to countries that impose the European Commission's oil price cap.

This week, the market awaits for Colombian consumer price index (CPI) data, which, according to analyst consensus, is expected to be bullish (ACVA Expectations: 12.99% YoY and 1.13% MoM). An inflationary surprise would increase the need for a persistently contractive BanRep, leading to the imposition of more competitive interest rates in Colombia that attract foreign capital inflows, strengthening the COP. This would join last week's bearish November unemployment rates, which reflect a still robust Colombian labor market, highlighting the importance of a more restrictive monetary policy in order to soothe aggregate demand and control inflationary pressures. This leads us to expect a trading range for the week for the pair between COP$4,820 (lower limit COP$4,780) and COP$4,900 (upper limit COP$4,950).

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