Detailed Explanation of the Macroeconomic Situation
Contenidos relacionados
Banco de la Republica Raises the Benchmark Interest Rate 25 Basis Points

A regular meeting of the Board of Directors of Banco de la República was held in the city of Bogotá D.C. on May 30, 2014. In attendance were Mr. Mauricio Cárdenas Santamaría, Minister of Finance and Public Credit, Mr. José Darío Uribe Escobar, Governor and Managing Director of Banco de la República, and the Board Members Carlos Gustavo Cano Sanz, Ana Fernanda Maiguashca Olano, Adolfo Enrique Meisel Roca, César Vallejo Mejía and Juan Pablo Zárate Perdomo.

A synthesis is presented below of the view held by the Banco de la República's technical team with respect to the macroeconomic situation (section 1) and, afterwards, the main discussion points regarding policy considered by the Board of Directors are summed up (section 2)

A more detailed explanation of the macroeconomic situation written by the technical team at the Banco de la República is presented in the data section of the April 2014 Inflation Report and in the statistics appendix

1. MACROECONOMIC CONTEXT

With respect to the quarterly inflation report published in March 2014 and considering the information available on the date of the meeting, the technical team has found no significant changes in the macroeconomic context:

The following items, in particular, are emphasized:

i. The official growth in the United States for the first quarter was revised downward. This drop in economic activity, which was attributed to the effects of the severe winter, could mean a lower market forecast for the entire year. In spite of that, the downward revisions will probably not be significant since the more recent favorable performance suggests that the first quarter shock was transitory. The main emerging countries, in turn, have slowed down but continue to show moderate growth. In this context, the DPI estimates an average growth in 2014 for Colombia's trading partners that is similar to what was registered in 2013.

ii. The FED reduced their purchases of financial assets again. The foreign interest rates declined and the market is expecting that the first increase in the FED benchmark interest rate will occur in the second half of 2015. In the euro zone, the ECB is thinking of implementing new monetary stimulus measures.

iii. In May, the measurements of global risk aversion and the risk premiums for the main countries in the region decreased slightly and remain below the averages seen so far this year and in 2013.

iv. In the first three months of 2014, the prices for exports declined more than the ones for imports and, because of that, the terms of trade (TT) deteriorated. Between February and March, the TT recovered due to the better prices for coffee and nickel. It is estimated that the average TT for all of 2014 will be lower than the average seen in 2013, but their level will continue to be favorable.

v. The deterioration in the TT contributed to a foreign trade deficit being registered in the first quarter of 2014. So far this year and in annual terms, exports dropped due to the fall in foreign sales of mining and industrial products (agricultural sales increased). During the same period, imports rose because of the higher international purchases of raw materials. The value of the consumer imports was similar to what it was a year ago while the value of capital goods fell. With all of that, the probability rose that an increase in the current account deficit would be registered this year.

vi. The new figures for retail trade during the first quarter of the year and the Bank's economic expectations ratify the positive performance projected for household expenditures, especially in durable goods. With respect to supply, when corrected for working days, the industrial numbers indicate low growth for the sector which is similar to what was estimated.

vii. In April, consumer confidence remained at levels that are above their historical average. According to the Fedesarrollo survey, the confidence of industrial and commercial businesses continued its upward trend (seasonally adjusted series). In the same month, vehicle sales declined, but their trend component started to grow again. Nonetheless, it is necessary to be aware that the figures for the second quarter will be affected by the lower number of working days and, therefore, the performance of the economy during this period, may be lower than it was in the first.

viii. In April, bank loans again presented higher rates of growth as a consequence of the better performance of commercial loans (in pesos) and mortgages and due to a consumer loan portfolio that stopped dropping. The real interest rates for the different types of loans began to decline again due to the increase in inflation excluding food.

ix. With all of the above, the most probable projected growth for the first three months of 2014 (4.8%) did not change in comparison to the estimate in the last report. Thus, the estimates suggest that the output gap in 2014 will be negative but close to zero and that, in 2015, it will be above this value.

x. With respect to prices, inflation was 0.46% in April. This was higher than the average estimated by the market (0.32%) and the SGEE forecast. With that, annual inflation went to 2.72%. Likewise, the average for the four measurements of core inflation continued its growth trend and went to 2.75%. Just as it did the month before, the annual change in the non-tradables dipped slightly while the other groups registered higher rates of growth.

xi. In view of these results, the analysts' inflation expectations for a year from now climbed to 3.2%. The expectations that emerge from the public debt securities with 2, 3, and 5-year maturities have been volatile and are around 3%. Regarding costs, salaries in industry and commerce began to register higher rates of growth again in April with annual changes that are above the upper limit of the target range. This is in a context of an unemployment rate with a downward trend and that is at a level that is similar to the NAIRU estimate. The cost of raw materials has surged for industry judging by the increase in the IPP (intermediate consumption: 4.8%).

To summarize, for the technical team at the Banco de la Republica, the macroeconomic context is characterized by an output gap that is slightly negative, an inflation that is converging more rapidly towards the midpoint of the target range, analysts' inflation expectations that rose and surpassed 3%, a new decline in the real interest rates from levels that are low compared to the historical average, and a surge in the growth of loans.

2. DISCUSSION AND POLICY OPTIONS

The members of the Board of Directors agreed that inflation expectations are anchored to the Bank's medium term goal and, that even though the recent data on the observed inflation show a greater surge than expected, they are part of the process of convergence towards the goal. In addition, they mentioned that one part of this phenomenon was due to a correction in the reduction that the index for certain subbaskets had in 2013 and that, due to their nature, was transitory.

Regarding the product, the members of the Board of Directors agreed that the economy will grow at least 4.3% in 2014. This is the main forecast of the technical team. There are some differences within the group over what the potential GDP growth, the aggregate demand, and the velocity of the closing of the output gap will be. Specifically, some members expect that the growth of both the potential and the observed GDP will be higher than what has been projected by the Bank's technical team.

Within the analysis that was carried out to determine the monetary policy posture, follow up on the financial variables was also done. In this case, several directors mentioned that the growth of household and business indebtedness and the change in the financial burden indicators represent an accumulation of risk on the balance sheets of economic agents. Special note was made of the fact that, currently, an increase in the benchmark interest rate is consistent with goal of reducing the stimulus to accumulate said risks. This is even more true if the fact that the real interest rate for the economy has been low for a lengthy period of time is taken into account.

The members of the Board of Directors decided that, in the abovementioned context, it is desirable to continue the gradual rolling back of the monetary stimulus which implies an increase in the benchmark interest rate. This policy option encompasses the fact that both the output gap and inflation will be closing over the course of the year and counteracts the downward pressure that the rise in inflation will generate on the real interest rates. At the same time, it will contribute to moderating an excessive accumulation of risks in the balance sheets of the economy.

3. POLICY DECISION

The Board of Directors decided unanimously that it would be appropriate to raise the benchmark interest rate by 25 bp and set it at 3.75%.