Monetary Policy Report

A regular meeting of the Board of Directors of Banco de la República took place in the city of Bogotá D.C. on Friday, February 24, 2017. In attendance were Mauricio Cárdenas Santamaría, Minister of Finance and Public Credit; Juan José Echavarría, Governor of the Central Bank; and Board Members Ana Fernanda Maiguashca Olano, Adolfo Meisel Roca, Cesar Vallejo Mejia, and Juan Pablo Zárate Perdomo.

These minutes contain a summary of the outlook on the macroeconomic situation by the technical staff of the Central Bank (section 1), followed by a review of the main discussion regarding monetary policy by the Board of Directors (section 2).

Further detail on the macroeconomic situation prepared by the technical staff from the Central Bank will be presented in the monthly Monetary Policy Report for January 2017 and in the statistical annex (Only available in Spanish).

1. MACROECONOMIC CONTEXT

1. In 2016, the Colombian economy grew 2.0%, and 1.6% in the fourth quarter, somewhat better than in the third quarter. The branches of activity with the highest growth rates during the year were financial services, construction, and agriculture, while mining and transport exhibited contractions.
2. On demand side, the DANE will publish the figures on 1 March. The available information suggests that in the year, domestic demand would have stalled versus 2015 as a result of the slowdown in consumption (households and Government) and a fall in investment. Net exports would have contributed positively to growth. Foreign trade figures (in US dollars) show a decrease in the deficit of goods close to 25%.
3. So far in 2017, the information on economic activity is still very scarce. The negative outcome of the consumer confidence index stands out, standing in January at the lowest part of the series (since November 2001).
4. For 2017, GDP growth is still projected between 0.7% and 2.7%, with 2.0% as the most likely figure.
5. Regarding inflation, in January it posted at 5.47% annually, 28 bp less than in December 2016; however, the average of the four core inflation indicators monitored by the Central Bank stopped declining. The available information suggests that during January part of the observed increase in consumer prices was due to the impact of the tax reform (by the change in the VAT, the green tax and the Liquor Act).
6. Measures of inflation expectations by economic analysts to December 2017 and 2018 increased (10 bp and 6 bp, respectively), while those embedded in public debt bonds to 2, 3, and 5 years remained relatively stable.
7. As for the external context, the most recent indicators for the United States and Europe suggest that their economies maintain a dynamism similar to that of previous quarters. Regarding Latin America, low growth rates continued during the fourth quarter.
8. So far in 2017, the improvement of the international prices of major commodities exported by the region would contribute to the strengthening of the currencies and the lowering of the country risk indicators. In the first weeks of the year, there have been significant capital inflows to emerging economies.
9. For 2017, it is expected that the strong transitory shocks that diverted inflation from its target continue to fade, in an environment of a weak economic activity. On the other hand, the increase in value-added tax and other indirect taxes would pressure inflation upwards. The monetary policy actions undertaken so far, which consider these effects, should strengthen convergence of inflation to its target.

2. DISCUSSION AND POLICY OPTIONS

With information from the last month, the Board of Directors highlighted the continued reduction in the headline inflation indicator, the weak performance of the economy so far this year, and the favorable reduction in the current account deficit. All this confirms the Board’s conviction that there are conditions to change the contractionary monetary policy stance gradually towards its neutral level, at a pace that will depend on the information and the risks observed in each session. The sharp drop in consumer confidence raised particular concern, although in recent months this index has lost its correlation with domestic demand and household consumption.

A majoritarian group voted to reduce the rate by 25 bp. Among the arguments sustained by these Board Members, the following stand out: the low growth forecast by the technical staff for this year, the poor performance of the industry in recent months, the slight increase in the unemployment rate in the thirteen major cities, and the collapse of the consumer confidence index. Some members considered it is necessary to avoid the risk of falling into a negative spiral of a greater slowdown of the economy, and that greater attention should be given to recovering confidence, given the relatively favorable behavior expected for the external deficit. Finally, regarding inflation expectations and their slight increase in the last month, some Board Members within this group pointed out that, with a 25 bp reduction, the benchmark interest rate continues to be contractionary, and reaffirmed that the change should continue to be gradual in the future, depending on the observed data and, particularly, on the inertia and indexation of inflation.

The minority group, while acknowledging the importance of a gradual normalization of monetary policy, voted in favor of maintaining the reference rate unchanged. Among the arguments posed by the members of this group, the following stand out: the degree of persistence of inflation is still high; inflation expectations increased again slightly and continue above the long-term target in the policy horizon. One member of the Board stated that, although there are still external and internal factors for uncertainty, there are reasons to believe that the economy has bottomed out and, although slowly, it can begin to recover. Particularly, s/he mentioned the growth rate for the fourth quarter and throughout 2016, which were slightly better than expected, and the recent behavior of the country’s terms of trade and trade balance.

3. POLICY DECISION

The Board of Directors of Banco de la República, by majority, decided to reduce the benchmark interest rate by 25 bp to 7.25% at today’s meeting.

The decision to reduce the benchmark interest rate was approved by four members of the Board. The remaining two Board members voted to keep the benchmark interest rate unaltered.

Bogotá, D. C.