PUBLIC VERSION

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Monetary Policy Report

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Monetary Policy Report

Economic Studies Division

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I. External Context and Balance of Payments

1. The information available once more suggests that the recovery of global economy has been stronger than expected. This has been observed both in advanced and emerging economies. In the latter, the improvement continues to be based on China's better behavior and better prices of commodities.
2. Real GDP in the United States grew 2.6% in the fourth quarter, versus 3.0% expected by the market. This represents a slowdown from the third quarter, explained by a reduction in the growth of the accumulation of inventories. Thus, the GDP for 2017 grew 2.3%, in line with the high growth forecast scenario of the country's trading partners.
3. Inflation in the US registered 2.1% on a yearly basis in December, and the various core inflation indicators remained below 2.0%, including the PCE deflator (1.5% annually in November).
4. In the euro zone (EZ), growth for the third quarter accelerated, reaching 2.8% on a yearly basis. This would be supported by both domestic demand and exports.
5. Inflation in the EZ remains well below 2.0%, and stood at 1.4% annually in December. This situation is even more evident for core inflation, which posted at 0.9% in the same month.
6. Growth of the Chinese economy has been better than expected in the previous Report. Throughout 2017, it grew at an annual 6.9% rate, a figure well-above the growth target (6.5%). During the fourth quarter, the yearly expansion of this economy was 6.8%.
7. In Latin America, information on GDP growth in the third quarter continues to exhibit recovery in the economies monitored by the technical staff of the Central Bank. The only exception is Mexico, where growth in the third quarter was impacted significantly by supply shocks (explained by the hurricanes and earthquake).
8. Inflation in Latin America remained stable in December, except for Peru.
9. Colombia's terms of trade in October continued recovering, mainly explained by higher oil prices. The price of this product would be responding to a greater global demand and to a production figure that grew less than expected before. Additionally, prices would have been driven upwards by the successful implementation of the OPEC agreements.

Exports

10. In November, the value of total exports in US dollars registered a yearly 6.7% growth due to increases in mining goods and in the group of other exports. These were partially offset by the contraction of goods of agricultural origin (Table 1). The contribution of coal with significant increases in both the price and the quantities exported stands out.
11. External sales for the group of other exports[1] continue to exhibit good levels, with an annual 10.4% variation in November. Food, beverages, and tobacco excluding coffee once more exhibited the highest growth within the group.
12. On the other hand, the agricultural group contracted, led by bananas and coffee. In both cases, the fall is due both to a decrease in prices as in the quantities exported.

Table 1: Behavior of Exports in US dollars

	Annual Variation [Contribution]	Main contributing items to annual variation, in the same direction: Item	Annual variation of the item	Contribution to annual variation
November 2017				
Total Exports	6.7%			
Agricultural goods	-12.2%	Bananas	-42.3%	-1.4
	[-1.8]	Coffee	-10.1%	-0.8
Mining goods	9.6%	Coal	56.7%	6.9
	[5.4]	Oil	4.8%	1.4
Other exports*	10.4%	Foods, beverages, and tobacco, excluding coffee	23.7%	1.2
	[3.1]	Chemical products	13.4%	1.1
Accumulated value for January - November 2017				
Total Exports	19.6%			
Agricultural goods	11.1%	Coffee	16.2%	1.1
	[1.6]	Flowers	7.3%	0.3
Mining goods	29.4%	Coal	54.1%	7.7
	[15.9]	Oil	24.2%	6.7
Other exports	6.6%	Foods, beverages, and tobacco, excluding coffee	18.3%	1.1
	[2.1]	Non-metal minerals and basic metals	23.1%	0.5

13. The variation for the year to date shows a 19.6% expansion of exports, explained by the increase of external sales for the three groups, particularly mining goods, which contribute 15.9 pp to the total variation.
14. The group of other exports continued to accelerate, exhibiting a 6.6% increase for the year to date.
15. As for the accumulated value for the year, the value of exports increased as a result of improvements in prices, (with a 19.2% annual increase), while the figure for quantities contracted 0.5%.

[1] Excluding oil and its derivatives, coal, nickel, gold, coffee, bananas, and flowers. Includes other mining and agricultural goods. Exports of manufactured goods accounted for 96.6% of this group in October.

16. According to the foreign trade preview by DIAN, in December, exports excluding oil and its derivatives recorded an annual 7.9% increase.

Imports

17. In November, CIF imports in US dollars registered an annual 4.3% fall due to setbacks of external purchases in the three groups of goods. The most important fall was that of capital goods, where the transport equipment item fell 77.7%, and explained 5.1 pp of the annual contraction.
18. On the other hand, imports of consumer goods declined, led by consumer durable goods, particularly transport vehicles, which decreased 31.2%.

Table 2: Behavior of Imports in US dollars

	Annual Variation [Contribution]	Main contributing items to annual variation, in the same direction: Item	Annual variation of the item	Contribution to annual variation
November 2017				
Total Imports	-4.3%			
Capital Goods	-8.0%	Transport Equipment	-77.7%	-5.1
	[-2.6]	Fixed Equipment for Industry (others)	15.6%	1.0
Raw materials	-0.3%	Fuel	-21.3%	-1.7
	[-0.1]	Non-food products for agropecuarian industry	-4.7%	-0.2
Consumer Goods	-6.0%	**Non durable consumption goods**	**3.0%**	**0.4**
		Clothing and other textiles	19.6%	0.3
	[-1.5]	**Durable consumption goods**	**-15.9%**	**-1.9**
		Vehicles for Private Use	-31.2%	-2.2
Accumulated Value for January - August 2017				
Total Imports	3.9%			
Capital Goods	6.5%	Fixed Equipment for Industry (others)	14.2%	0.8
	[2.0]	Transport Equipment	10.2%	0.4
Raw materials	3.7%	Mining Products	9.7%	0.8
	[1.7]	Chemical and Pharmaceutical Products	4.2%	0.6
Consumer Goods	1.1%	**Non durable consumption goods**	**1.6%**	**0.2**
		Clothing and other textiles	18.0%	0.2
		Food Products	-3.9%	-0.2
	[0.3]	**Durable consumption goods**	**0.6%**	**0.1**
		Domestic Machines and Appliances	8.2%	0.2
		Vehicles for Private Use	-3.8%	-0.2

19. So far this year, total imports have increased 3.9% on a yearly basis, with increases in the three groups of goods, particularly capital goods.
20. According to the foreign trade preview by DIAN, CIF imports in December recorded a 9.0% yearly fall.

Balance of Trade for Goods

21. The accumulated value of the trade balance so far to November registered a deficit of USD $6.692 m FOB. This suggests a 37.5% reduction in the deficit *vis-à-vis* the same period last year, due to higher increase of exports (16.4%) versus imports (3.8%).

II. Projections of External Variables

a. External Growth Scenarios

Baseline or more likely scenario (Table 3)

22. This report revises growth forecasts for the country's main trading partners upwards (2.5%), compared to the information presented in the September quarterly report. Domestic demand would continue to drive growth in advanced economies. Emerging economies show signs of recovery, supported by greater demand of advanced economies and by better terms of trade. Thus, growth of trading partners is projected to accelerate in 2018, compared with 2017.
23. Growth in the United States in 2017 was slightly higher than expected, due to the fact that the expected negative effect of climate events was not observed in the third-quarter data.
24. For 2018, the growth forecast for this country was also revised upwards, due to the expectation that the recent tax reform represents a boost to investment. Consumption would continue stimulating the economy, supported by improvement in the labor market.
25. In the baseline scenario, three increases in the Fed's policy interest rate are expected during 2018. This implies a higher path than had been forecast in the previous Report. Thus, at the end of 2018, its upper limit would be at 2.25%. Added to this, the program for the reduction in the balance sheet would continue to be met as announced.
26. Growth in the euro zone (EZ) was also revised upwards for 2017 and 2018. This reflects the better performance of recent data compared to the estimations in the previous Report.
27. Monetary policy by the European Central Bank would continue to be expansive, although less than before, considering recent announcements regarding the reduction of the asset purchase program. Inflation is expected to remain at low levels.
28. As for China, its growth figure was revised slightly upwards for 2018, considering that its deceleration has taken a slower pace than expected in previous reports.

29. In Latin America, growth figures for 2017 were revised upwards in four of the countries monitored by the technical staff: Brazil, Ecuador, Mexico, and Chile. In contrast, they were reduced for Peru and Venezuela.
30. As for 2018, growth figures were revised upwards for Brazil and Ecuador; Chile remained stable, and those for Peru, Mexico, and Venezuela lowered.
31. Regarding oil, this report raises the forecast for its price in 2018 to 60 US dollars per barrel (on average) *vis-à-vis* the forecast of 53 dollars per barrel in the September report. This is due to the fact that an increasing global demand for oil is expected, and that supply shall be limited by the OPEC agreements. However, the forecast for the average of the year assumes that the price will decrease during the second half of 2018 from the high levels reached in recent weeks (close to USD 70 per barrel). The latter due to:
    - The high prices observed in the last few months would lead to an increase in production, particularly in the United States, which would be concentrated in the second half of the year.
    - Gradual erosion of the OPEC agreements is expected.
32. This time, the risk balance of global growth would be balanced. Among the downward risks, there could be a likely correction to the decline in financial markets, high levels of global indebtedness, and the possible implementation of policies in the United States affecting global economy. Within the upside risks is a stronger cyclical recovery than in earlier times.

Table 3: Economic Growth Forecasts for Colombia's Major Trading Partners

Country or region	2017			2018		
	Low	Baseline	High	Low	Baseline	High
US	2.1	2.2	2.3	1.6	2.6	3.4
	1.9	2.1	2.3	1.2	2.2	3.2
Euro Zone	2.1	2.3	2.5	1.5	2.3	2.9
	1.9	2.1	2.3	1.0	1.9	2.5
China	6.7	6.8	6.9	5.5	6.5	7.0
	6.6	6.8	6.9	5.4	6.4	6.8
Brazil	0.7	0.9	1.1	1.0	2.4	3.4
	0.2	0.6	1.0	0.6	2.2	3.2
Ecuador	1.8	2.1	2.4	0.0	1.5	2.5
	0.0	2.0	2.5	0.0	1.0	2.0
Venezuela	-12.0	-10.0	-8.0	-8.0	-5.0	-2.0
	-10.0	-8.0	-6.0	-5.0	-2.0	0.0
Perú	2.5	2.7	2.9	2.8	4.0	4.8
	2.3	2.8	3.3	3.0	4.2	5.0
Mexico	1.8	2.1	2.3	1.3	2.2	3.0
	1.5	2.0	2.5	1.3	2.3	3.0
Chile	1.2	1.5	1.8	1.4	2.7	3.4
	1.0	1.4	1.8	1.4	2.7	3.4
Trading Partners	1.8	2.0	2.2	1.5	2.5	3.2
	1.4	2.0	2.4	1.5	2.4	3.3
Trading Partners (excluding Venezuela)	2.3	2.5	2.6	1.8	2.8	3.4
	-	-	-	-	-	-

The current forecast is shown in black.
The forecast from the previous quarterly report is shown in red.

b. Projection of the Balance of Payments

33. With results to September 2017, the information available to date for the first quarter and the external context scenario presented in the previous section, the new estimate of the current account deficit for 2017 is 3.5% of GDP (USD 10,901 m) in the baseline scenario, within a range between 3.3% and 3.7%.

34. Regarding the forecast presented a quarter ago, the current account deficit for 2017 reduced in US dollars and as a proportion of GDP. This resulted from better exports of coal and oil, as well as from the expected contraction in imports in the last quarter of the year. This led to a reduction of the trade deficit greater than had been forecast in the previous Report. This offset the upward revision of the deficit of factor income and services. The estimate of income through remittances was also revised upwards.
35. The current account deficit projected for 2017 is lower than in 2016, when it reached 4.4% of GDP (USD 12,393 m). This correction is mostly explained by the lower deficit in the trade of goods (Table 4a), mainly as a result of the improvement expected in the terms of trade. In addition to this, higher income from current transfers would contribute positively to the narrowing of the external imbalance. On the contrary, a widening of the deficit of non-factor income services and factor income is expected, due to a great extent to the improvement in export prices.
36. Thus, the additional adjustment to the current account deficit for 2017 would be explained not by a reduction of expenditures (as happened in 2016), but by the increase in income, mainly due to exports of goods.
37. Particularly, an annual 15.1% growth is estimated for exports of goods in the baseline scenario, particularly due to increases in the international prices of the main products. For the rest of goods (other than mining and main agricultural products), yearly growth is expected to be 5.7%, contrasting with the fall observed in 2016 (-8.4%). As for imports in US dollars, an annual 2.4% increase is expected, driven by the dynamism observed in the first half of the year.
38. Additionally, in 2017, the services trade is expected to reach a higher deficit than observed a year ago. This is due to the increase of expenses, for which a greater expenditure by Colombians traveling abroad is anticipated, as well as an increase in payments for financial services. Higher payments for freight rates and increases in the imports of services related to the oil activity are also considered, although to a lesser extent. On the other hand, growth associated with tourism and other business services (advisory and consultancy services and *call centers*) are estimated to increase.
39. Compared to 2016, an increase in net outflows from factor income is forecast, associated with the increase in the profits of companies of the mining and energy sector and to the higher payments of interests on loans and bonds.

Table 4: Outlook for the current account of the balance of payments

	2016	2017 Baseline	Variation
CURRENT ACCOUNT (A+B+C+D)	**-12.393**	**-10.901**	**1.492**
Percentage of GDP	**-4.4**	**-3.5**	**0.9**
A. Goods	**-9.855**	**-5.858**	**3.997**
Exports	33.384	38.414	5.030
Main	22.498	26.355	3.857
Other Exports	10.886	12.059	1.173
Imports	43.239	44.272	1.033
B. Non-factor Services	**-3.244**	**-4.117**	**-873**
Exports	7.891	8.432	541
Imports	11.135	12.549	1.414
C. Factor Income	**-5.118**	**-7.562**	**-2.445**
D. Transfers	**5.823**	**6.636**	**813**

Memo Item:

Mining and oil sector (a-b)[1]	**14.858**	**17.029**	**2.171**
a. Exports	15.388	19.857	4.469
b. Factor Income Revenue	530	2.828	2.298

40. As for capital flows, in 2017, resources from direct investment are expected to have been the main source of financing, followed by portfolio investment. Net amortizations would be recorded in external loans and other credits (Table 5).
41. Foreign direct investment flows in Colombia would record an annual 4.0% fall as a result of the base effect from the sale of Isagen in 2016. Estimated FDI flows are similar to those expected a quarter ago, when the resources received from companies in the communication industry were foreseen. Higher inflows are also estimated for the mining and energy sector, given the favorable performance of international prices.
42. Additionally, net capital inflows of portfolio investment were observed, largely associated with the purchase of TES by foreigners and, to a lesser extent, with the issuance of Government bonds in external markets.
43. In contrast, due to loans and other external credits, the country would have recorded net capital outflows caused by the prepayment of credit, which would more than offset the debt contracted with multilateral organizations.

Table 5: Outlook for the current account of the balance of payments

	2016	2017 Baseline	Variation
FINANCIAL ACCOUNT (A+B+C+D+E)	**-12.584**	**-10.182**	**2.402**
Percentage of GDP	*-4.5%*	*-3.3%*	*1.2%*
A. Direct Investment (ii-i)	**-9.225**	**-9.442**	**-216**
i. Foreign Investment in Colombia	13.743	13.189	-553
ii. Colombian Investment abroad	4.517	3.748	-770
B. Portfolio Investment	**-3.718**	**-2.106**	**1.612**
C. Other investment (loans, credits, and other derivatives)	**194**	**837**	**643**
D. Reserve Assets	**165**	**529**	**363**
ERRORS AND OMISSIONS	**-191**	**719**	

44. For 2018, a current account deficit around 3.3% as a share of GDP is projected, which would bring an additional adjustment to the external imbalance. A reduction in the trade deficit of goods is forecast, due to the expected growth of exports (particularly oil and its derivatives), and industrial products, within a context of higher prices and better growth of the country's main trading partners. Moderate growth is expected regarding imports, although higher than observed in 2017, in line with the recovery of economic activity for 2018.
45. The services deficit is estimated for 2018 at levels higher than in the previous year. On the side of expenses, these would increase as a result of the increased traveling expenses by Colombians living abroad (due to the higher growth of the economy), the increase in outflows for freight, and growth of the technical services related to oil given the higher international prices of oil. Meanwhile, income would grow mainly due to higher revenues from tourism, favored by the improvement of global growth.
46. Higher net outflows of factor income are expected compared with 2017, mainly due to the increase of profit of foreign companies in the oil sector and to higher interest payments on the foreign debt. The profit of companies operating in different sectors of the mining and energy sectors are also expected to improve, consistent with the higher expected growth of the economy.
47. An additional factor that would contribute to a lower deficit in 2018 could be the increase in income from current transfers, as a result of the higher growth expected from countries where remittances are originated, particularly USA and some Latin American countries.
48. In terms of the financing of the current account, for 2018, direct investment is expected to continue to be the main item of inflows of foreign capital. Additionally, an increase in loans (net disbursements) is expected, in contrast to net amortizations in 2017. As for portfolio investment, the baseline scenario for 2018 assumes a lower placement of Government bonds and a less dynamic participation of foreigners in the TES market.
49. The forecast range for the current account deficit in 2018 would be between 2.8% and 3.8% of GDP, determined by the risks that exist on the cost and availability of external financing, as well as by global growth and improvement of the country’s terms of trade.

III. Growth, Domestic Demand, and Credit

50. The information available on real activity suggests that during the fourth quarter of 2017, annual GDP growth would have decreased slightly *vis-à-vis*

the previous quarter. This would be due, to a large extent, to a higher base of comparison in the same period of 2016 and to the adverse effect of the air transport strike. This forecast confirms that the macroeconomic adjustment would have bottomed out during the first part of the year, when the Colombian economy grew 1.2%, but that the recovery of output dynamics to its path of potential growth would be slow.

51. Indeed, the dynamics observed for the seasonally adjusted series in the monthly Economic Monitoring Indicator (ISE) by DANE confirms this. This indicator expanded 1.6% on a yearly basis in November, similar to the records in October (1.5%) and during the third quarter (1.6%).
52. The technical staff's forecast for the fourth quarter implies that domestic demand would have slowed down somewhat, both in investment and consumption. In the first case, construction of buildings and transport equipment would have recorded a mediocre performance that would not have been offset by the expansions of machinery and civil works. In the second, private consumption would have exhibited lower growth, particularly in semidurable and durable items. Public consumption would have also shown rapid deceleration, although of lesser magnitude. On the other hand, net exports would have contributed positively to GDP.
53. Several indicators support this scenario. According to the results of the Monthly Retail Survey (EMCM) by DANE, retail in November (excluding fuel) fell 1.9% on a yearly basis. The aggregate for October-November fell 1.3% on a yearly basis, which contrasted with 1.2% in the third quarter.
54. Excluding vehicle sales, the remaining aggregate grew 1.4% versus November 2016. However, a 0.04% annual fall was observed for the quarter (vs.+1.4% for the aggregate of the third quarter).
55. On the other hand, vehicle sales fell 17.1% on a yearly basis in November. This performance was due largely to a high basis for comparison in the same month last year. The aggregate for the two-month period contracted 8.0% on a yearly basis (vs. -0.02% in the third quarter).
56. Although the consumer confidence index (ICC) recovered marginally in December versus the levels recorded in previous months, it remains below the average calculated since November 2001. With data for this month, the average for the fourth quarter was somewhat higher than in the immediately preceding quarter.
57. With figures to November, the seasonally adjusted series of the balance of sales of the Monthly Survey of Economic Expectations (EMEE) of the Central Bank suggests a slow behavior of private consumption in that month.
58. Regarding the labor market, the seasonally adjusted to November exhibit increases in the unemployment rate nationwide (TD) and in the 13 areas. This is consistent with the dynamics of employment, which remained stagnant at

the national level and dropped in the 13 areas. The forecasts of the urban unemployment rate place it above the NAIRU estimates for 2018, which would be compatible with low inflationary pressures from the labor market for these years.

59. The latest data on wages show that wage adjustments of retail and industry (with figures to November) remained at rates above the inflation target. Something similar happened in the December figures for construction.
60. The gross fixed capital formation indicators suggest that investment (other than construction of buildings and civil works) would have grown at a slower pace than observed in the third quarter. This follows from the behavior of imports of capital goods (in constant pesos) to December. The balance of investment expectations of the EMEE to November does not suggest greater dynamism for this component of GDP during the fourth quarter of 2017.
61. Regarding external trade, when converting the figures published by DANE and in the bulletins by DIAN from US dollars to real pesos, growth of exports and contraction of real imports is expected. In the first case, such recovery would have been driven by sales of mining products, particularly coal and oil. As for imports, its poor performance would have explained by the contraction of the purchase of capital goods (transport equipment) and durable consumption, mainly.
62. On the supply side, the indicators available also point to a slight reduction in the rate of annual growth during the fourth quarter of 2017.
63. With data to November, total industrial production (IPI) grew 0.3%, a figure lower than the one expected by the technical staff of the Central Bank. Excluding oil refining, the rest of the industry exhibited a yearly 0.3% contraction. So far this year, total industrial production fell 0.7%, while industry excluding oil refining did so by 1.9%. The trend components of both total industry and industry excluding refined products show an upward slope.
64. Although industrial confidence improved in November compared to the previous month, expectations to three months continue suggesting weak performance in the sector. In line with this, in December, energy demand for the industry reported a 3.0% contraction, according to the latest publication of XM (ISA).
65. Regarding the agricultural activity, cattle slaughter showed a 1.3% contraction on a yearly basis, with information to November. In October-November, it fell at a slower pace than observed during the third quarter (-2.2% vs -3.2%). On the other hand, in December, coffee production stood at 1,550,000 60-kg sacks, which represented a 17.5% expansion. However, this did not offset the deterioration observed in the previous two months, for which in quarterly terms there was a contraction in the fourth quarter (-8.9%).

At the end of the year, production was 14,194,000 sacks, which represents a 0.3% yearly reduction.

66. Construction, cement production, and shipment increased in November 2.0% and 0.3%, respectively. In contrast, construction licenses exhibited an 8.0% contraction, mainly explained by the fall of housing construction (-14.1%).
67. As for mining, in December, oil production amounted to 870 thousand barrels per day (mbd), which represented an annual 4.0% expansion. With this, the fourth quarter showed a 1.9% growth. For the whole year, oil production dropped 3.7%, with a level close to 853 mbd, on average.
68. With this, the technical staff at the Central Bank forecasts that yearly GDP growth for the third quarter of 2017 would post between 1.3% and 2.3%, with 1.8% as the most likely figure. Considering this, this report maintains the projection of GDP growth at 1.6% for 2017, but the forecast range reduced somewhat (moving from 1.3% and 1.9% to 1.4% and 1.8%).
69. Regarding GDP growth projections for 2018, the technical staff's projection is 2.7% as the most likely figure, within 1.7% and 3.7%.

IV. Behavior of Inflation and Prices

70. Annual inflation in 2017 stood at 4.09%, exceeding the inflation target. Nevertheless, the result in December was lower than in the previous month, thus interrupting an upwards trend that accumulated four months **(Table 8).**
71. The monthly variation in December was 0.38%, lower than the one observed in December 2016 (0.42%), but higher than the forecast of the market (0.31%) and the expectations by the Central Bank's technical staff.
72. The fall of the annual inflation between November (4.12%) and December (4.09%) is explained exclusively by the fall in food. In contrast, annual CPI variation excluding food increased, with rises in its three main components (tradables, non tradables, and regulated items).
73. Core inflation (4.66%), measured as the average of the four indicators monitored by the Central Bank, increased 12 bp for the second consecutive month, which contrasts with the steady declines that took place between August 2016 and October 2017 (**Table 8**).
74. Three of the four core inflation indicators increased in December: Core 20 (from 4.69% to 4.87%), the CPI excluding food and regulated items (from 4.57% to 4.76%), and the CPI excluding food (from 4.80% to 5.01%). Only the CPI excluding primary food, fuel, and public utilities decreased from 4.09% in November to 4.02% in December.

Table 8

Headline and Core Inflation to December 2017

Description	Weight	Dec 2016	Sept 2017	Oct 2017	Nov 2017	Dec 2017	Participation percentage in monthly deceleration	Participation percentage in deceleration of the year to-date
Headline inflation	**100.00**	**5.75**	**3.97**	**4.05**	**4.12**	**4.09**	**100.00**	**100.00**
Non-food inflation	**71.79**	**5.14**	**4.71**	**4.70**	**4.80**	**5.01**	**(429.44)**	**6.79**
Tradables	26.00	5.31	3.41	3.38	3.64	3.79	(100.05)	21.72
Non-tradables	30.52	4.85	5.21	5.23	5.27	5.49	(196.79)	(11.12)
Regulated items	15.26	5.44	5.68	5.61	5.58	5.86	(132.59)	(3.81)
Food inflation	**28.21**	**7.22**	**2.22**	**2.51**	**2.52**	**1.92**	**529.44**	**93.21**
Perishables	3.88	(6.63)	(0.32)	3.20	5.89	5.84	11.26	(34.31)
Processed food	16.26	10.74	0.84	0.52	(0.15)	(0.91)	379.29	110.65
Eating out	8.07	8.54	6.01	5.78	5.75	5.21	138.88	16.87
Core inflation indicators								
Non-food inflation		5.14	4.71	4.70	4.80	5.01		
Core 20		6.18	4.87	4.73	4.69	4.87		
CPI excluding perishable foods, fuel and utilities		6.03	4.31	4.13	4.09	4.02		
CPI excluding food and regulated items		5.05	4.44	4.44	4.57	4.76		
Average of core inflation indicators		**5.60**	**4.58**	**4.50**	**4.54**	**4.66**		

Source: DANE. Calculations by *Banco de la República*.

75. Analyzing the CPI excluding food, is may be seen that all the sub-groups drove annual inflation upwards in December. Tradables excluding food and regulated items increased from 3.64% in November to 3.79% in December, this being their second month of consecutive increase. In line with a weak demand, the annual variation of this group had been falling since last March, with few pressures on the exchange rate, once the increase in the VAT and other indirect taxes passed-through to those prices. In the last month, the growth of this segment was led by airline tickets, whose monthly adjustment in December was 2.53%, as a likely consequence of the strike that hit the country's main airline between September and October 2017.
76. The annual CPI variation for non-tradables excluding food and regulated items also rose (from 5.27% in November to 5.49% in December). The bulk of this increase was concentrated in the sub-group of entertainment, culture, and recreation (specifically the item of “services related to entertainment," which increased 18.3% that month) and can be attributed to the behavior of soccer tickets, whose prices increased significantly in December due to the end of the Colombian tournament between the two largest teams in the capital.
77. The impact of the increase in the prices of soccer tickets this year (with teams from the capital in the final) on headline inflation can be estimated in two ways. One is by calculating headline inflation assuming a price adjustment in tickets equal to that observed in December 2016, when, at the end of the soccer tournament there was a team from outside Bogotá (Tolima vs Santa Fe). In that month, the monthly increase in the item related to entertainment services was only 1.3% and the resulting annual headline inflation for

December 2017 would have been 3.99%. Another method is to exclude this item from the CPI, in which case headline inflation would have been 3.98%.

78. The other major items of the CPI registered few hikes or some declines in prices. Thus, the annual variation of the set of items of the CPI mostly affected by the exchange rate fell from 6.57% in November to 5.72% in December; that for leases moved from 4.30% to 4.28%; and the one for indexed items remained at 6.96%.
79. Regarding the CPI for regulated items, its annual variation in December (5.86%) also increased *vis-à-vis* November (5.58%). This rise was concentrated particularly in the sub-group for fuels (from 8.28% in November to 9.94% in December). Since June 2017, the international price of oil has been increasing, which would be impacting on increases in the domestic price of gasoline, which in December was COP $139.
80. Also, the sub-group of transport moved from 4.32% in November to 4.92% in December. In December, transport fares for buses, vans and small buses ("SITP Provisional") in Bogotá increased COP $100. It should be noted that two new adjustments are expected for this subgroup at the beginning of 2018. The first one refers to the $100-peso increase in Transmilenio and SITP fares, decreed by the Mayor of Bogotá, starting on 1 February. The second is associated with the new technological platform for the taxi service in Bogotá, which is yet to be fully implemented.
81. Within the CPI for regulated items, public utilities was the only subgroup that fell (from 5.82% to 5.39%). In the coming months, a reduction in the rates of garbage collection in Bogotá is expected due to the change of operators. The reduction is estimated to be close to 10.0%, and would start to be reflected in April.
82. After four consecutive increases, annual food inflation fell in December (1.92%). This behavior is consistent with a large farming supply during the last few months. In December all the sub-groups decreased: processed food reduced from -0.15% in November to -0.91% in December; meals outside the home from 5.75% to 5.21%; and perishable foods from 5.89% to 5.84%.
83. Towards the end of 2017, it became clear that *La Niña*, phenomenon (weak and of short duration), would continue during the first quarter of this year, according to the latest reports by the main weather agencies of the world. As mentioned in the previous report, this higher rainfall favors, in general, greater agricultural productivity, with some exceptions such as coffee.
84. The adjustments in non-labor costs, estimated by the PPI, retook a moderate rising path, after a pause in November. Thus, yearly PPI inflation for domestic supply (domestically produced and consumed items plus imported goods) increased from 1.31% in November to 1.86% in December. This higher yearly inflation to producers can be explained both by the component

of imported goods (from -0.62% in November to 0.38% in December), as by the domestic component (from 2.16% to 2.50%).

85. Labor costs continued exhibiting mixed behaviors, but adjusting to rates above the inflation target. The annual variation of wages in the manufacturing industry decreased between October (8.0%) and November (7.1%). On the contrary, those for retail increased from 5.3% to 5.8%. On the other hand, with data to December, wage adjustments for housing construction (5.90%) and heavy construction (4.2%) remained stable. The slack in the labor market does not allow to forecast pressures on these wage indicators, and by this way on prices, at the beginning of 2018. However, the readjustment of the minimum wage for this year by about 6.0% may have an impact on price increases of some services, at relatively high rates versus the 3.0% target.
86. According to the latest monthly survey to financial analysts by the Central Bank (applied at the beginning of January), inflation expectations to December posted at 3.47%. Expectations to 12 months ahead moved (from 3.46% in December 2017 to 3.42% in January 2018), as did those to twenty-four months (from 3.27% to 3.25%). On the other hand, in the latest quarterly expectations survey (January 2018), the market expects annual inflation in December 2018 to reach 3.83%, and 3.80% to December 2019.
87. Inflation embedded in public debt bonds (Breakeven inflation, BEI) extracted from TES denominated in pesos and UVR to 24 January is at 3.56%, 3.55%, 3.52%, and 3.54% to 2, 3, 5, and 10 years, respectively. Compared to the average in December, BEI varied 11 bp, 9 bp, 4 bp, and -5 bp for these same horizons, respectively.
88. Using the forward curve (FBEI Break-Even Inflation), the estimation of yearly inflation for 2018 is 3.58%. For 2019, 2020 and 2021, it is 3.55%, 3.50% and 3.47%, respectively.