PUBLIC VERSION

Working Papers from the Board of Directors Banco de la República

Monetary Policy Report

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Board of Directors
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Monetary Policy Report

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I. External Context and Balance of Payments

1. During the last days of February and so far in March (with data to the 16th) Colombia's terms of trade would have exhibited some increases from the minimum values reached in January. This is mainly a result of the increase in the international price of oil. The price of Brent oil rose on average 15.6% so far this month compared to that observed in February, moving from USD $33.80 to USD $39.00 per barrel. This behavior is explained largely by the possibility of reaching a potential agreement among major countries to freeze their oil production at the levels of January. Additionally, the weakening of the US dollar and the lower extraction of oil in the United States would have also pushed prices upwards.

2. The prices of other commodities also showed increases compared to those observed in the previous month, partly as a response to the stimulus measures announced by Chinese authorities.

3. The records of global economic activity for January and February suggest that growth of Colombia's main trading partners for 2016 would continue weak and would be similar to that observed in 2015. This is due especially to the poor performance expected for Latin American economies with which the country has important trade relations.

4. In the United States, the figures of retail sales and consumer confidence to February remained favorable and suggest that private consumption continues to consolidate as the main growth engine. In contrast, industrial production and exports continued to decline on a yearly basis. As for the labor market, employment creation indicators for February were high, with which the unemployment rate remained at 4.9%. Regarding the annual variation of prices in the same month, there were some increases in the core inflation indicators (from 2.2% to 2.3%), while that for total inflation lowered (from 1.4% to 1.0%).

5. The press release and the projections by the Federal Open Market Committee (FOMC) of the Federal Reserve (Fed) in its meeting of March suggested that the potential adverse effects of the global financial and economic uncertainty and of the strength of the dollar on the economic activity of the US would cause the increases in its benchmark interest rate to be more gradual than expected by the end of 2015.

6. In the euro zone, the indicators of retail sales and industrial production available for January and those of industrial and consumer confidence for February suggest that the economy would have continued to expand at a modest pace. Regarding variation in prices, the indicators of yearly total inflation and core inflation in February exhibited reductions, posting at -0.2% and 0.7%, respectively. In this context, the European Central Bank (ECB) adopted several stimulus measures by reducing its reference and deposits rates, increasing the amount for its program of quantitative easing and offering new target long-term refinancing operations (TLTRO) to banks.

7. In China, the indicators to February of industrial production, retail trade and fixed asset investment to moderated once again their pace of expansion. On its part, annual inflation showed some increases moving from 1.8% to 2.3%. It is worth mentioning that the data from the first months of the year do not allow determining trends clearly, since they are affected by the celebrations of the Chinese New Year.

8. The Chinese government announced that its growth target for 2016 would lie between 6.5% and 7.0%, along with fiscal measures aimed at stimulating some sectors of the economy.

9. As for Latin America, the figures for economic activity to January exhibit a weak behavior. In Chile, the yearly rate of expansion was lower than the one observed by the end of the previous year, reaching levels below 1.0%. Meanwhile, the Brazilian economy would have deepened its contraction with rates close to -7.0%. Although there are no recent figures for Ecuador and Venezuela, the sharp deterioration of their terms of trade at the beginning of the year should deepen the recession they are going through. Peru is the exception, considering there was an acceleration in December and January to rates higher than 4.0%.

10. The records for annual inflation in Latin American economies to February exhibited an uneven behavior. Brazil, Chile and Peru exhibited some reductions *vis-à-vis* the figures for the previous month, although they remained above the target range set by their monetary authorities. Contrastingly, some increments took place in Mexico, but annual inflation remains below the Central Bank's target (3.0%).

11. During the last weeks of February and so far in March, there has been a reduction of the indicators of financial volatility from the high levels early in

2016. This is explained by a reduction of risk aversion in international financial markets mainly as a result of: i) the announcement of stimulus policies in China, ii) increases in the prices of commodities, iii) the greater provision of liquidity by the central banks of Japan and the euro zone; and (iv) the prospects that the increase in the benchmark interest rate by the Fed would be more gradual than had been expected by the end of the previous year. In this context, the US dollar weakened *vis-à-vis* most currencies in the world, and a recovery of the stock indexes took place.

12. As for Latin America, during the same period, risk premia reversed the increases that had taken place in January and February, when they reached their highest levels since 2009. The currencies of the region weakened further *vis-à-vis* the US dollar. The Colombian *peso* appreciated 4.7%, moving from an average value of COP $3,357 per dollar in February to COP $3,197 per dollar a month later (to March 16).

a. Exports and Imports

13. In January, exports registered an annual fall of 36.2%, due to setbacks in the external sales for all groups of goods. The strong decline in goods of agricultural origin, whose exports fell 39.3% annually (compared to the 8.8% decrease of the previous month) stands out. Table 1

14. In December 2015, CIF imports registered an annual fall of 24.2%, due to setbacks in the external purchases in all groups of goods. With this, CIF imports fell 15.6% in 2015. Meanwhile, in January 2016, they fell 28.0% on a yearly basis (Table 2).

Table 1: Behavior of Exports in US dollars

January 2016			
	Annual Variation	Main items that contributed	
		Item	Annual variation of the item
Total	-36.2%		
Agricultural goods	-39.3%	Coffee	-44.2%
		Flowers	-37.4%
Mining goods	-45.6%	Oil	-50.2%
		Coal	-43.0%
Other exports*	-13.4%	Chemical products	-22.5%
		Others	-23.1%

* By destinations, the falls toward Ecuador (36.7%) and to Asia (14.4%) stand out. Contrastingly, there was an increase in external sales towards Venezuela (3.4%).
Source: DANE

Table 2: Behavior of Imports in US dollars

	Annual Variation	Main items that contributed: Item	Annual variation of the item
December 2015			
Total	-24.2%		
Capital Goods	-32.7%	Transport equipment	-37.7%
		Capital goods for industry	-28.7%
Raw materials	-13.0%	Raw materials for industry	-17.6%
		Raw materials for agriculture	-25.9%
Consumer Goods	-28.4%	Durable Consumer Goods	-34.4%
		Non-Durable Consumer Goods	-22.3%
Accumulated Value for January-December 2015			
Total	-15.6%		
Capital Goods	-14.7%	Transport equipment	-16.0%
		Capital goods for industry	-14.5%
Raw materials	-16.6%	Fuels and Lubricants	-32.0%
		Raw materials for industry	-11.6%
Consumer Goods	-14.9%	Durable Consumer Goods	-20.8%
		Non-Durable Consumer Goods	-8.6%
January 2016			
	Annual Variation	**Main items that contributed: Item**	**Annual variation of the item**
Total	-28.0%		
Capital Goods	-39.9%	Transport equipment	-68.3%
		Capital goods for industry	-13.1%
Raw materials	-23.1%	Raw materials for industry	-19.2%
		Fuels and Lubricants	34.6%
Consumer Goods	-12.5%	Durable Consumer Goods	-16.4%
		Non-Durable Consumer Goods	-8.9%

Source: DANE

15. According to the figure for progress of foreign trade by DIAN, CIF imports fell 26.5% in February.

16. On their part, the figures for the balance of payments show that during 2015 the country's current account showed a deficit of USD $18,925m, USD $668m lower than the one registered in 2014. However, as a proportion of GDP, the current account deficit rose from 5.2% to 6.4%, which is explained by the reduction of nominal GDP in US dollars due to the 37.0% depreciation of the *peso* recorded in the average for 2015.

17. The behavior of the external balance in US dollars was characterized by a significant increase in the trade deficit during the year, moving from USD $4,630 m in 2014 to USD $14,026 m in 2015, offset by the lower deficit of factor income (USD $5,989 m, compared to USD $12,639 m a year before) and by the reduction of net outflows related to the service component, which

recorded a deficit of USD $3,981 m. Additionally, the net income from current transfers in 2015 increased USD $713 m, reaching a value of USD $5,071 m.

18. Records for 2015 include: net capital income of USD $19,201m; result of foreign capital inflows by USD $24,991m; outflows of Colombian capital due to purchase of assets abroad by USD $3,849m; transactions with financial derivative instruments for USD $1,526m; and accumulation of international reserves USD by $415m.

19. Forty-eight percent of the total income from foreign capital in the period analyzed came from FDI flows, while 21.0% came from resources obtained from the issuance of long-term external debt bonds, 18% from portfolio investments in the local market, and the remaining 12.0% from loans and other external credits. In 2015, foreign capital income was USD $12,276m lower (33.0%) than a year ago.

20. Colombian capital outflows for the constitution of assets abroad were USD $8,877m lower than those observed in 2014. These resources were destined mainly to direct investment abroad (US$4,218m), whereas USD $369m were liquidated under other investments, mostly by private enterprises.

II. Growth, Domestic and Credit

21. According to the most recent publication of quarterly national accounts by DANE, economic activity grew 3.3% during the fourth quarter last year, compared to the same period of 2014. This number was slightly higher than the central path forecast presented in the previous Inflation Report (between 2.6% and 3.6%, with 3.1% as the most likely figure). The increase between quarters was 0.6%, which corresponds to an annualized rate of 2.4%. The seasonally adjusted series of the economic activity index (ISE) is consistent with this observation, because it increased 3.2% in the fourth quarter compared to the same period last year.

22. Thus, GDP for all of 2015 increased 3.1% on a yearly basis, just above the forecast made by the technical staff a quarter ago (3.0%). For 2014, the GDP was revised downwards from 4.6% to 4.4%.

23. On the side of expenditure, in the fourth quarter, domestic demand slowed down compared to the third quarter (from 4.2% to 2.6%). The increase in

consumption (3.6%) was higher than had been estimated, both private (3.0%) and public (4.0%). Compared to the results of the third quarter, household consumption slowed down, but the Government exhibited a major recovery (**Table 3**).

Table 3

	2014	2015				2015
	Whole year	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	Whole year
Total consumption	**4.3%**	**4.1%**	**3.7%**	**4.4%**	**3.6%**	**3.9%**
Household consumption	4.2%	4.4%	3.8%	4.3%	3.0%	3.8%
Non-durable goods	3.2%	4.4%	4.1%	4.6%	3.4%	4.1%
Semi-durable goods	3.1%	5.7%	2.8%	5.6%	4.5%	4.6%
Durable goods	13.5%	5.1%	1.4%	-4.8%	-8.4%	-2.0%
Services	4.7%	4.4%	4.2%	4.5%	3.7%	4.2%
Final government consumption	4.7%	1.9%	2.2%	3.3%	4.0%	2.8%
Gross capital formation	**11.6%**	**6.5%**	**0.8%**	**3.4%**	**0.2%**	**2.6%**
Gross capital formation	9.8%	7.3%	3.6%	0.5%	0.0%	2.8%
Farming, forestry, hunting and fishing	1.5%	-5.4%	-3.0%	0.2%	2.7%	-1.5%
Machinery and equipment	7.1%	0.6%	-2.0%	-0.3%	-5.3%	-1.8%
Transportation equipment	10.0%	41.3%	6.0%	3.1%	-5.1%	9.4%
Construction and buildings	7.7%	2.3%	10.1%	-8.2%	8.0%	2.7%
Civil works	14.0%	3.7%	7.2%	7.6%	2.5%	5.2%
Services	11.0%	1.9%	4.6%	-3.3%	0.7%	0.9%
Domestic demand	**6.0%**	**4.4%**	**3.1%**	**4.2%**	**2.6%**	**3.6%**
Total exports	**-1.3%**	**4.1%**	**-0.2%**	**-5.2%**	**-1.0%**	**-0.7%**
Total imports	**7.8%**	**12.3%**	**-0.7%**	**7.4%**	**-2.9%**	**3.9%**
GDP	**4.4%**	**2.7%**	**3.1%**	**3.2%**	**3.3%**	**3.1%**

Source: DANE; calculations by *Banco de la República*

24. Regarding investment, results were better than expected, with an annual growth of 0.2% in the last quarter. Anyway, compared with data from the third quarter, a strong deceleration was evidenced (3.4%).

25. Regarding foreign trade in constant *pesos*, exports fell 1.0%, while imports fell 2.9%, exhibiting the greatest contraction of the year. These reductions were lower than those projected by the technical staff of the Central Bank.

26. For the whole year, domestic demand slowed down from 6.0% in 2014 to 3.6% in 2015, mainly due to a mediocre performance of investment. This reduced its growth rate from 11.6% to 2.6%, while consumption lowered from 4.2% to 3.8%. On the other hand, after increasing 7.8% in 2014, imports in constant *pesos* lowered to 3.9% in 2015, and exports moved from -1.3% to -0.7%.

27. On the supply side, during 2015 the sectors that showed a better performance were: financial services (4.3%), retail (4.1%), and construction (3.9%), particularly civil works (5.4%). Despite the fact that the industry reported recovery in the fourth quarter (4.0%), which is partly explained by the

reopening of Reficar, its expansion was moderate for the whole year (1.2%). Something similar happened with mining, which showed contractions in the second semester that caused the whole year to end up with a 0.6% increase (**Table 4**).

28. It is important to note that, within supply, the tradable production accelerated during the second semester of the year, moving from growing 0.9% in the first one to 2.0% in the second. Excluding mining, the remaining tradable GDP rose from 0.6% to 2.8%. On its part, the non-tradable GDP rose from an annual increase of 4.2% in the first semester to a 4.0% in the second.

Table 4

Real annual GDP growth per economic activity

Branch of activity	2014 Whole Year	2015 1st Quarter	2015 2nd Quarter	2015 3rd Quarter	2015 4th Quarter	2015 Whole Year
Farming, forestry, hunting and fishing	3.1	1.8	2.5	4.3	4.8	**3.3**
Mining and quarrying	-1.1	0.2	4.2	-0.3	-1.4	**0.6**
Manufacturing	0.7	-1.8	-0.2	3.2	4.0	**1.2**
Electricity, gas and water	3.4	2.2	1.5	4.0	4.0	**2.9**
Construction	10.5	3.1	8.2	0.4	4.3	**3.9**
Buildings	8.1	2.1	8.9	-8.2	6.8	**2.1**
Civil works	13.4	3.6	7.4	7.7	2.9	**5.4**
Retail, repairs, restaurants and hotels	5.1	4.9	3.6	4.6	3.6	**4.1**
Transportation, warehousing and communications	4.7	2.8	0.4	2.0	0.5	**1.4**
Financial, real estate and corporate services	5.7	4.9	3.8	4.2	4.2	**4.3**
Social, community and personal services	5.2	2.7	2.5	3.2	3.4	**2.9**
Subtotal value added	4.3	2.6	3.0	3.0	3.2	**3.0**
Taxes minus subsidies	5.6	4.1	4.0	4.5	3.5	**4.0**
GROSS DOMESTIC PRODUCT	**4.4**	**2.7**	**3.1**	**3.2**	**3.3**	**3.1**

Source: DANE, calculations by *Banco de la República*

29. The information available for the first quarter of 2016 is still very scarce; therefore, it is not appropriate to modify the forecast range for GDP. Additionally, some key factors such as the price of oil improved in the last few weeks, after the sharp deterioration in January and early February; however, other indicators send mixed signals. While the figures for industry and retail sales showed improvement beyond expectations (as explained below), others such as confidence and unemployment deteriorated.

30. According to the results of the monthly retail survey (EMCM) by DANE, retail sales in January excluding fuel expanded 3.4% compared to the same month in 2015. This figure, which represented an acceleration versus the aggregate of the fourth quarter last year (-0.4%), was above market expectations (-0.15%, median) and by the technical staff at *Banco de la República*.

31. Excluding vehicle sales, the remaining aggregate grew 5.5% annually during the same month. This figure represented an acceleration compared to the records from the end of last year (4.9% yearly in the fourth quarter). Removing the trend component from the series, stagnation in the levels can be observed.

32. According to the same survey, automobile and motorcycle sales fell 8.9% on a yearly basis in January. This figure contrasts the -24.2% from the fourth quarter of last year. The trend component of the series reveals a negative slope.

33. The figures for licenses reported by the Colombian Automotive Committee (CAC) to February do not seem to indicate that this trend will be reversed in the short term. In that month, the number of licenses issued reduced 11.3% on a yearly basis. According to these sources, the falls were concentrated in the item of vehicles for commercial use (investment in transportation equipment). Those for non-commercial use (durable consumption) also fell, although at a slower pace.

34. Other indicators having a historical correlation with household consumption and with investment different to construction suggest that during the first quarter of 2016 these items of GDP could register lower increases than those observed towards the end of last year.

35. This is the case of the Consumer Confidence Index (ICC), published by *Fedesarrollo* in February, which remained at historically low levels, comparable with those of January. The low levels persisted in both the index of expectations as in that of economic conditions of households.

36. On the other hand, the results of the monthly survey of economic expectations (EMEE) by *Banco de la República* anticipate lower dynamics for household consumption and gross formation of fixed capital (without construction) than three months ago. Both the balance of sales as well as that of investment expectations of enterprises fell somewhat compared to the levels recorded in previous months.

37. With information to January, a significant increase in the unemployment rate took place, being particularly strong in urban areas. This increase is due mainly to a fall in employment. Regarding the seasonally adjusted series, an upward trend in the unemployment rate continues to be observed.

38. According to the figures from the Financial Superintendence of Colombia, the conditions of the credit market seem to be adjusting. With figures to February, it may be noted that the pace of expansion of household credit was 11.41% in nominal terms, lower than the one of January (11.71%) and that of the fourth quarter of 2015 (12.04%). Additionally, interest rates to households (consumption and credit cards) increased compared to the records from the end of last year, as a response to changes in the monetary policy stance. Indeed, since September 2015, consumption and credit card rates have increased 157 and 92 bp, respectively.

39. On the supply side, the indicators available for the first quarter of the year show favorable trends in several branches such as industry, trade, and energy production, but unfavorable regarding mineral production.

40. According to DANE, industrial production grew 8.2% in January 2016, a figure higher than the one expected by the Central Bank and by the market (3.5%). Excluding oil refining, the industry expanded at a yearly 4.3% rate. The branches that contributed the most to this result were: coking, oil refining and mixture of fuels (26.6%); beverage production (15.7%); manufacture of non-metallic mineral products (11.4%); manufacture of motor vehicles and their engines (59.2%); and manufacture of pharmaceutical products and chemicals for medicinal purposes (14.0%). On the contrary, the following items subtracted from growth: production of iron and steel (-9.2%); spinning, weaving and finishing of textile products (-8.8%); manufacture of appliances and electrical equipment (-8.2%); and manufacturing of bodies for motor vehicles and trailers (-44.8%).

41. Regarding construction, in January, cement production and shipments increased 7.3% and 3.0%, respectively.

42. According to figures from Aerocivil, the number of passengers on domestic and international flights increased 7.1% and 5.9% in January 2016. The greater participation of international flights in the last year stands out.

43. According to the figures from the Federation of Coffee Growers, in February, production stood at 1,096,000 60-kg bags, which represents an annual 6.5% variation. In the two-month period of January-February, production has increased 5.5% on average.

44. In February, total energy demand increased 8.3% on a yearly basis. Regulated demand did so by 9.9%, and non-regulated by 4.9%. By regions, the greatest increases in energy demand were observed in the Atlantic Coast, Huila, Arauca, and Casanare.

45. Contrastingly, oil production fell 6.9% annually in February, with a level that remained below 1 million barrels per day (956 tbd) for the fifth consecutive month. *Vis-à-vis* the previous month, the fall was 2.6%. In the first two-month period of the year, oil production has been on average 969 mbd, which represents a 6.0% reduction.

46. It should be noted that the figures for the first quarter will be affected by a lower number of working days in March (given that Easter falls in that month). This should bring a negative effect on growth as measured by DANE in sectors such as industry.

47. Given all this, and since the information available does not allow to make a full-forecast exercise, the technical staff of the Central Bank considers it appropriate to maintain the growth forecast for all 2016 within a range of 1.5% and 3.2%, with 2.7% as the most likely figure.

III. Behavior of Inflation and Prices

48. In February, annual consumer inflation was 7.59%, 14 bp higher than that of the preceding month (**Table 5**). The figure for yearly inflation in February is the highest since December 2008. So far this year, CPI variation stood at 2.59%, higher than the record of 2015 (1.80%). As for monthly variations, the result was 1.28%, a figure lower than the forecasts by the market (1.30%) and the Central Bank.

49. Unlike the preceding seven months, in February the increase in annual consumer inflation was not explained by food or tradables. On this occasion the segments of regulated and non-tradable goods exerted upward pressures. The activation of indexing mechanisms and problems in supply associated with *El Niño* (in the CPI for regulated goods) explain this situation.

50. Core inflation, measured as the average of the four indicators monitored by the Central Bank also increased, reaching 6.07% in February, compared to 5.73% in January. The four indicators registered significant increases. The highest

record was that of the CPI excluding primary food items, fuels and public utilities (6.41%), and the lowest was that of the CPI excluding food (5.88%).

Table 5
Behavior of Inflation to February 2016

Description	Weight	dic-14	mar-15	jun-15	sep-15	dic-15	jan-16	feb-16	Participation percentage in monthly acceleration	Participation percentage in acceleration of the year to-date
Headline inflation	**100.00**	**3.66**	**4.56**	**4.42**	**5.35**	**6.77**	**7.45**	**7.59**	100.00	100.00
Non-food inflation	**71.79**	**3.26**	**3.46**	**3.72**	**4.58**	**5.17**	**5.54**	**5.88**	**168.13**	**59.18**
Tradables	26.00	2.03	3.46	4.17	5.90	7.09	7.39	6.97	**(70.46)**	(3.95)
Non-tradables	30.52	3.38	3.56	3.98	4.27	4.21	4.46	4.86	**91.66**	24.42
Regulated items	15.26	4.84	3.25	2.55	3.30	4.28	5.02	6.35	**146.92**	38.72
Food inflation	**28.21**	**4.69**	**7.37**	**6.20**	**7.30**	**10.85**	**12.26**	**11.86**	**(68.13)**	**40.82**
Perishables	3.88	16.74	21.57	10.73	14.95	26.03	31.31	27.42	(99.66)	13.96
Processed food	16.26	2.54	5.99	6.00	6.71	9.62	10.22	10.26	13.54	14.79
Eating out	8.07	3.51	3.59	4.45	4.73	5.95	6.78	7.09	17.99	12.07
Core inflation indicators										
Non-food inflation		3.26	3.46	3.72	4.58	5.17	5.54	5.88		
Core 20		3.42	3.70	4.24	4.73	5.22	5.56	6.25		
CPI excluding perishable foods, fuel and utilities		2.76	3.95	4.54	5.28	5.93	6.13	6.41		
CPI excluding food and regulated items		2.81	3.52	4.06	4.95	5.42	5.69	5.75		
Average of core inflation indicators		**3.06**	**3.65**	**4.14**	**4.89**	**5.43**	**5.73**	**6.07**		

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

51. Within the CPI excluding food, increases in regulated items and in several components of the non-tradable CPI excluding food and regulated items stand out. In the first case, its annual variation rose from 5.02% in January to 6.35% in February. As in previous months, upward pressures came mainly from the rates for household gas and electric power. In the case of gas, bottlenecks in the transport and a greater demand by thermal power generators have affected the rates. On its part, the CPI for energy is being affected by factors such as the lack of rainfall, depreciation, increase in producer inflation and recent damages at hydroelectric plants of Guatapé (in Antioquia), especially, and to a lesser extent at Termoflores (Barranquilla). The facility in Guatapé would begin to operate again in May (at 25.0% of its capacity) and only until September will it be in full operation. For this reason, the impact of this situation on the prices in the stock exchange could be felt along most of the year.

52. Increases in public transport fares in Bogotá (Transmilenio) and Cali were another factor that pressed the CPI for regulated goods upwards. On the other hand, annual CPI variation for fuels moved from -6.6% in January to -6.1% in February.

53. As for the CPI for non-tradable goods excluding food and regulated items, its annual variation in February posted at 4.86%, exhibiting an increase *vis-à-vis* the data from January (4.46%). During this month, increases in the prices of

some items related to entertainment (such as soccer tickets) and education services (tuition fees and monthly payments) stand out.

54. As expected, several components of the group of non-tradables are experiencing price increases that might be associated with the activation of indexation mechanisms and/or with increases in the minimum wage and other wages (as shown below). Such is the case of education, where price increases have trended to be linked with the previous year's inflation. In the first two months of the year, indexing on these items and on non-tradable items in general has not been full, given that the annual variation in prices for most of these items is below the inflation registered in December (6.77%). For leases, an item that has exhibited indexing in the past, CPI variation remained much lower (3.91%).

55. In February, for the first time since July 2014, annual variation of the tradable CPI without food or regulated items decreased *vis-á-vis* the previous month, rising from 7.39% in January to 6.97% this month. However, the monthly variation of this sub-group continued to be high (1.46%), for which it is possible to state that the depreciation of the *peso* continued passing through to the prices of these items.

56. The rising path observed since August last year for food inflation stopped, moving from 12.26% in January to 11.86% in February. Monthly variation was also high (1.44%), which suggests that climatic factors related to *El Niño* and depreciation of the *peso* have continued to generate increases. As has been pointed out in previous reports, the current event of *El Niño*, considered as one of the strongest in history, has been affecting the productivity of crops, stopping decisions concerning new plantings and driving the prices of perishable foodstuffs upwards, ending February with a 27,42% yearly variation. The strong accumulated depreciation of the *peso* has pushed the prices of processed food (imported food or with a high percentage of imported materials), whose yearly growth rate was 10.26% in February. Additionally, the yearly CPI for meals outside the home (7.09%) increased again in February, affected by higher food prices, rates of public utilities, and the increase in the minimum wage, among others.

57. Non-labor costs continued pressuring consumer prices upwards, as suggested by the behavior of the PPI. In February, yearly inflation to producers of domestic supply (produced and consumed plus imported items) reached 11.0% versus 10.0% in January. This behavior is explained by the pressures exerted by

locally produced and consumed items, whose yearly variation rose from 6.9% in January to 7.5% in February. Similarly, the item for imported goods contributed to a greater inflation of the PPI, increasing from 17.3% in January to 19.4% in February, which confirms that the inflationary pressures caused by exchange rate continue.

58. Regarding labor costs, with information to February, there were mixed results, while salary adjustments for construction increased slightly *vis-à-vis* the previous month (from 4.6% to 4.8%; those for housing moved from 4.7% to 4.4%. In contrast, with information to January, salary adjustments in the retail sector increased significantly from 2.9% to 5.6%.

59. Inflation expectations for December 2016, collected from the monthly survey to financial analysts at the beginning of March stood at 5.72%, a number higher than in February (5.49%); inflation expectations to twelve months fell slightly (from 4.54% to 4.51%), while that to twenty-four months increased (from 3.70% to 3.77%). On average, so far to March 15, with average data from February, break-even inflation, (BEI) embedded in sovereign bonds in *pesos* and RVU lowered for all terms. Thus, the average BEI so far in March to 2, 3, 5 and 10 years posted at 4.86%, 4.62%, 4.49%, and 4.72%, respectively.