PUBLIC VERSION

Working Papers from the Board of Directors Banco de la República

Monetary Policy Report

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OFFICE OF THE DEPUTY TECHNICAL GOVERNOR

DECEMBER 2018

I. External Context

The external context forecast for 2019 presents a slight deterioration vis-à-vis 2018 and the estimations presented in the previous report. The average growth of the country's trading partners projected for 2019 was revised slightly downward, taking into account a lower performance forecast for the euro zone and for some Latin American countries. Lower global demand and the strength of global oil production reduced the price that had been forecast for 2019. In this environment, the risks towards a more pronounced slowdown in global growth increased. This, together with the absence of inflationary pressures in advanced economies, suggests lower increases in external interest rates, particularly the Fed's. In Colombia, the lower price of oil and a somewhat weaker growth of the country's trading partners would contribute to a gradual increase in sovereign risk premia. The new estimates suggest that the external imbalance would have widened in 2018, and that, in an external scenario as described above, this trend would continue in 2019.

1. In the last month and a half, global economy continued to face significant downward risks that are still taking place in both advanced countries as well as in emerging economies, including China.

2. However, so far in January, there has been an improvement in international financial conditions after the deterioration observed in December last year, when both the perception of global risk and international financial volatility indicators increased. The signals sent by the Fed regarding minor increases in its policy interest rate have tended to reassure the markets, inasmuch as they suggest that the conditions of international liquidity will continue to be very wide given the deterioration in the pace of global growth. This has allowed for some reductions in risk premia and the recovery of other indicators, including stock indexes. As for some emerging economies such as Colombia, this has contributed to some appreciation of the peso, in the wake of the significant depreciation observed in the last quarter last year.

3. Despite the above, fears persist among analysts and international agencies regarding medium-term growth in the United States, given the weaker-than-expected corporate results by the market at the end of last year. There are also concerns about high levels of indebtedness reached in this country and other advanced and emerging economies. Added to this is the greatest uncertainty over the political situation in the United Kingdom on account of *Brexit* and the effect of the partial closure of the federal government of the United States.

4. As for China, growth slowed in the fourth quarter of 2018 (6.4 per cent per annum), this being the lowest since the first quarter of 2009. Recent data suggest that the protectionist measures adopted in 2018 could be affecting its exports. Added to the above, there would be further weakness in private consumption, according to recent indicators.

5. The price of oil, on the other hand, exhibited a rebound in recent weeks, although so far in 2019 (USD 59.7) it remains below the records from the last quarter of 2018 (USD 68.3). This recent development in prices has been largely the result of cuts by OPEC and its allies.

Baseline or more likely scenario (Table 1)

6. The forecast of the average growth of the country's trading partners for 2019 was revised downwards to 2.3% in this report (see table 1). However, the estimated growth rates for 2018 and 2019 are still above those observed in 2015 and 2016 (1.85% on average). These forecasts suggest a soft landing towards 2020 for the United States' economy, and that the shutdown of the federal government in that country, temporarily overcome on 25 January, would not be repeated and would have a soft impact on growth in the first quarter of 2019.

7. The Fed is expected to continue its path of rate increases, given the good conditions in the U.S. labor market and the presence of a positive output gap. However, recent announcements suggest that said increase would be lower than suggested in previous months due to the relatively low inflation and the few pressures anticipated on this front. Thus, for 2019, this report forecasts a 25-basis points (bp) increase (one less than in the December report). It is assumed that the balance sheet reduction program continues to be met as announced.

8. In the case of the European Central Bank, no changes in reference rates are expected before the first half of 2019, as envisaged in the previous report.

9. The forecast for the price of oil was reduced to USD 63 per barrel for the average of 2019, *vis-à-vis* the forecast presented in December (USD 66.5). This revision was made taking into account the low prices observed until the end of last year and the significant increase in production and inventories, recently revealed in the United States. The forecasts still assume that the agreement to cut production by OPEC countries and their allies is still being fulfilled.

10. Despite the decline in Colombia's sovereign risk premia in recent weeks, this report still expects a gradual increase during the rest of the year. However, in line with the reduction of the forecast of oil prices and growth of trading partners, at present, it is assumed that the increase would be somewhat faster than previously forecast.

11. The balance of risks facing the baseline scenario for the external context described above continues to be biased to the downside. Concerns over the duration of the current expansionary phase of global economy have increased recently, assigning a higher probability of an economic slowdown at the turn of a year or more. Added to this is the increasing concern about the high levels of debt recorded globally, particularly in the United States and China. These concerns could be added to the adoption of protectionist measures in several countries, a longer duration of the partial shutdown of the federal government of the United States, and an eventual traumatic outcome for *Brexit*, among others. In these circumstances, a further decline of the prices of oil and other commodities could be expected, on par with a greater increase in sovereign risk premia. This, however, does not rule out more favorable financial conditions during part of 2019, given the possibility that the international liquidity remains wide, should there be lower increases in the United States' policy interest rate.

Table 1: Growth projections for trading partners and prices of some *commodities*

Country or Region	2018			2019		
	Low	Baseline	High	Low	Baseline	High
USA	2.8	2.9	3.0	1.4	2.5	3.2
	2.7	2.9	3.1	1.4	2.5	3.6
Euro Zone	1.8	1.9	2.0	0.7	1.6	2.2
	1.8	1.9	2.0	0.7	1.7	2.5
China	6.5	6.6	6.7	5.4	6.2	6.7
	6.5	6.6	6.7	5.4	6.2	6.8
Brazil	1.2	1.3	1.4	1.3	2.3	3.4
	1.0	1.3	1.6	1.2	2.3	3.6
Ecuador	0.9	1.1	1.3	-0.7	0.6	2.3
	0.4	0.9	1.3	-0.3	0.8	2.6
Venezuela	-17.0	-14.0	-11.0	-11.0	-6.0	-1.0
	-17.0	-14.0	-11.0	-11.0	-6.0	-1.0
Peru	3.7	3.8	3.9	2.5	3.8	5.0
	3.6	3.9	4.2	2.5	3.8	5.0
Mexico	2.0	2.1	2.2	0.8	2.0	3.3
	1.8	2.2	2.4	1.0	2.2	3.5
Chile	3.9	4.0	4.1	2.4	3.4	4.4
	3.7	4.0	4.3	2.4	3.4	4.4
Total partners (excluding Venezuela)	2.4	2.5	2.6	1.4	2.3	3.2
Total partners (excluding Venezuela) (Dec-18)	2.3	2.5	2.7	1.5	2.4	3.4

COMMODITIES	2018	2019		
	Observed	Low	Baseline	High
Oil (Brent)	71.6	52	63	77
		55	66.5	80
Coal	85.8	67	81	91
		65	79	90
Coffee	1.37	1.20	1.40	1.60
		1.20	1.40	1.60
Gold	1,269	1,500	1,270	1,100
		1,500	1,270	1,100

The current forecast is shown in black.

The forecast from the December report is shown in red.

II. Foreign Trade and Balance of Payments

Exports of Goods

12. In November 2018, total exports in US dollars registered an annual 7.9% growth rate explained by increases in the group of mining goods. Oil refining and oil continued to exhibit good performance, contributing 12.4 percentage points (pp) to the variation of the month. Table 2

13. In terms of the variation from January to November, total exports grew 13.4% on a yearly basis, explained by the increase in foreign sales of mining goods (20.7%), followed by the rest of exports (7.2%). Exports of agricultural goods contracted 5.8% in annual terms.

14. So far this year, the value of exports grew mainly by improvements in prices, reflected in an annual 17.1% increase of the price index, which was partially offset by the 3.3% fall in the index for quantities. The improvement in prices in annual terms took place in the group of mining goods (28.5%), which offset the fall in those of agricultural origin and the rest of exports (-7.3% and -0.4% respectively).

Table 2: Behavior of Exports in US dollars

	Annual Variation [Contribution]	Item	Annual variation of the item	Contribution to annual variation
November 2018				
		Main contributing items to annual variation, in the same direction:		
Total Exports	7.9%			
Mining goods	15.5% [9.1]	Oil	28.7%	8.7
		Oil refining and others	68.3%	3.6
		Gold	-9.9%	-0.4
Agricultural goods	-3.2% [-0.4]	Flowers	-12.6%	-0.5
		Coffee (not roasted)	-3.2%	-0.2
Other exports*	-2.7% [-0.8]	Motor vehicle and other types of transportation	-25.2%	-0.5
		Food, beverages, and tobacco (excluding coffee)	-5.3%	-0.3
Accumulated value for January - November 2018				
Total Exports	13.4%			
Mining goods	20.7% [12.0]	Oil	28.9%	8.4
		Oil refining and others	48.7%	2.7
Agricultural goods	-5.8% [-0.8]	Coffee (not roasted)	-11.1%	-0.8
		Bananas	-6.6%	-0.2
Other exports	7.2% [2.0]	Chemical products	5.7%	0.4
		Food, beverages, and tobacco (excluding coffee)	6.9%	0.4

Source: DANE

Imports of Goods

15. The value of imports declared in November grew 12.3% compared to the same month of 2017, thanks to the good performance of the three large groups. The increase in external purchases of raw materials for industry stands out (12.7% in annual terms), and contributed 4.2 pp to total growth. Table 3

16. From January to November, total imports grew 10.9% in annual terms, supported by increases in the three groups of goods. The greatest growth was observed in foreign purchases of raw materials, which account for 5.1 pp of the total variation.

Balance of Trade for Goods

17. With these results, the trade balance in November exhibited a deficit of USD 920 million (FOB). This represents a USD 220 million increase in the deficit compared with the previous year.

18. As for the period from January to November, the deficit stood at USD 6,517 million FOB, which represents a reduction of USD 92 million compared with the same period in 2017 due to a higher increase in exports (13.4%) than imports (11.0%).

Table 3: Behavior of Imports in US dollars

IMPORTS				
November 2018				
	Annual Variation [Contribution]	**Main contributing items to annual variation, in the same direction:**		
		Item	**Annual variation of the item**	**Contribution to annual variation**
Total Imports	12.3%			
Capital Goods	11.2% [3.5]	Transport equipment	36.1%	2.2
		Capital goods for industry	4.6%	1.0
Raw materials	10.8% [4.7]	Raw materials for industry	12.7%	4.2
		Raw materials for agriculture	13.0%	0.5
Consumer Goods	16.2% [4.0]	**Durable consumption goods**	**29.8%**	**3.2**
		Private transport vehicles	56.0%	2.8
		Non-durable consumption goods	**6.1%**	**0.9**
		Pharmaceutic products and toiletries	8.1%	0.3
Accumulated value for January - November 2018				
Total Imports	10.9%			
Capital Goods	10.6% [3.3]	Capital goods for industry	11.1%	2.1
		Transport equipment	10.8%	0.9
Raw materials	11.1% [5.1]	Raw materials for industry	15.7%	5.2
		Raw materials for agriculture	10.0%	0.4
Consumer Goods	10.7% [2.5]	**Non-durable consumption goods**	**8.3%**	**1.0**
		Pharmaceutic products and toiletries	7.5%	0.3
		Durable consumption goods	**12.3%**	**1.5**
		Appliances and household devices	15.4%	0.4

Source: DANE

Balance of Payments

19. With results to date and the external context scenario presented hereinbefore, the new estimate of the current account deficit for 2018 is 3.7% of GDP (USD 12,390 m) in the baseline scenario. This would imply a current account deficit close to 3.9% of GDP for the fourth quarter of the year.

20. The larger current account deficit estimated for 2018 compared to the one observed a year ago (3.3% of GDP) would be explained mainly by the widening of factor income and, to a lesser extent, by the larger trade deficit of goods (Table 4). On the contrary, the greatest income from current transfers and lower net imports of services would continue to contribute positively to the closure of the external imbalance.

21. In terms of financing of the current account, for 2018, direct investment is expected to continue as the main item of foreign capital inflows (Table 4). An increase in the number of loans by the public sector is expected (net disbursements), contrasting the net amortizations in 2017. As for portfolio investment, the baseline scenario for 2018 includes a lower placement of bonds by the Government and public entities, as well as less purchases of TES by foreigners in the market *vis-à-vis* the previous year.

22. The momentum experienced by exports of the main products in 2018 is expected to fade in 2019, in line with the decline in the terms of trade (-7.7%). To a great extent, this is due to an average oil price of USD

63 per barrel (Brent), below the price per barrel in 2018 (USD 71.6). A lower export price for Colombian coal is also expected.

Table 4: Projection of the Balance of Payments

BALANCE OF PAYMENTS (Millions of US Dollars)	2017 (pr)	2018 Baseline	2019 Baseline
CURRENT ACCOUNT (A+B+C+D)	**-10,508**	**-12,390**	**-13,165**
Percentage of GDP	**-3.3**	**-3.7**	**-3.9**
A. Goods	**-4,571**	**-5,183**	**-8,659**
a. Exports	39,676	44,287	44,053
Main	27,433	30,792	29,644
Other Exports	12,243	13,495	14,409
b. Imports	44,247	49,470	52,712
B. Non-factor Services	**-4,144**	**-3,902**	**-3,013**
a. Exports	8,380	9,225	9,990
b. Imports	12,523	13,127	13,002
C. Factor Income	**-8,389**	**-10,870**	**-9,846**
D. Current Transfers	**6,596**	**7,565**	**8,353**
FINANCIAL ACCOUNT (A+B+C+D+E)	**-9,856**	**-12,170**	**-13,165**
A. Direct Investment (ii-i)	**-10,267**	**-7,847**	**-7,723**
B. Portfolio Investment	**-1,618**	**-1,484**	**-892**
C. Other investment (loans, credits, and other derivatives)	**1,484**	**-3,910**	**-6,129**
D. Reserve Assets	**545**	**1,070**	**1,579**
ERRORS AND OMISSIONS	**652**	**219**	**0**
Memo Item:			
Mining and oil sector (a-b)[1]	**17,777**	**20,322**	**19,528**
a. Exports	20,917	24,750	23,285
b. Factor Income Revenue	3,141	4,428	3,757

[1] Including oil and derivatives, coal, and ferronickel

23. Thus, traditional exports are expected to decrease by 3.4% in 2019. In addition, moderate growth is expected for external sales of industrial goods (5.0%), in the context of a slight slowdown in the growth of the main trading partners. The path of positive growth in imports is expected to continue, in line with a greater economic growth. All of the above would imply a significant increase in the trade deficit of goods as compared with the forecasts for 2018 (Table 4).

24. On the contrary, a lower deficit by non-factor services is expected, as well as by factor income, the latter as a result, to a great extent, of the lower income from exports for oil and mining firms with FDI. Also, the positive contribution of revenues from remittances in line with the economic growth in the countries where they originate would continue.

25. Regarding the financing, an increase of flows from other investment is estimated for 2019, originated in liquidations of external assets (especially by the public sector) and, to a lesser extent, by contracting new debt. A similar level of FDI flows is expected, driven by the resources allocated to sectors other than oil and mining. The purchase of TES by foreigners is also expected to continue, although at a slower pace.

26. With this, for 2019, a current account deficit around 3.9% as a share of GDP is projected, which would bring an additional widening of the external imbalance. The forecast range for said period would be between 3.5% and 4.3% of GDP, determined by the risks over the cost and availability of external financing, as well as by global growth and improvement of the country's terms of trade.

27. Presently, the Central Bank of Colombia maintains a program to accumulate international reserves through the *put* options auction mechanism, which does not pursue any type of exchange-rate objective. However, given that these auctions are contingent in nature, they are held on a monthly basis and their

amount is announced only at the time it is summoned, the current projection for the balance of payments only considers for the purchases already made, which amount to USD 400 million so far in 2019.

III. Growth, Domestic Demand, and Credit

The information available for the fourth quarter suggests that the economy would have grown 2.7%, a similar pace as in the third quarter (2.6%). However, a slightly more dynamic domestic demand than forecast in the previous report is estimated. This is due to the fact that household consumption would be performing somewhat better due to expenditures on durable goods and because the positive impact observed on public consumption at the beginning of the year would be reversing more slowly than expected. Although the forecast of total investment did not change for the fourth quarter, growth is expected to be more grounded in the purchase of machinery and construction equipment. The better performance of domestic demand is being offset by a net external demand that subtracts more from GDP, given a lower growth of exports and higher imports. Given the aforesaid, the forecast for 2018 remained at 2.6%. For 2019, GDP growth is forecast at around 3.4% within a range between 2.4% and 4.0%.

28. The information available for the fourth quarter of 2018 allows to anticipate an expansion of GDP (seasonally adjusted and corrected for calendar effects) that would have been slightly above the figures observed throughout the year.

29. This projection foresees an annual growth figure for domestic demand somewhat higher in the last quarter of the year with respect to the third quarter. However, the forecast exercise of the Central Bank's technical staff considers that positive shocks to domestic demand observed in previous quarters would have faded partially in that period.

30. Thus, public consumption would return to levels consistent with the trend exhibited since the beginning of 2016, taking into account that the positive effects of the electoral cycle and the population census on this sector of GDP would finish reversing in the latter part of the year, albeit at a slower pace than expected in the previous report. On the other hand, investment in construction would fall at the margin, as part of the acceleration of the construction of buildings observed in the past is expected to be transitory, given the extensive inventory levels in the housing market and of non-residential buildings, and the limited dynamism exhibited by the prices of these assets in the recent past.

31. Private consumption would have accelerated slightly at the margin, especially by the performance expected from the consumption of durable goods. Additionally, gross capital formation would have reported significant growth, greater than what had been observed over the previous quarters. Within this sector of GDP, the behavior of investment in machinery and equipment stands out, which more than offset the low growth recorded by investment in construction.

32. Also, the real accounts of foreign trade would have performed better, both in annual variations as on a quarterly basis. However, these would be higher for imports than for exports. This implies a widening of the trade deficit in constant pesos and, consequently, a negative contribution of net exports to GDP growth.

33. The recent behavior of the economic indicators supports the previsions described above (see Table 5). The figures on domestic retail sales of goods point at a satisfactory performance of household consumption during the fourth quarter, driven mainly by vehicle sales. This would have taken place despite the recent decline in household confidence, which would have been temporary in nature and showed signs of recovery in December.

34. The series of imports of capital goods (in constant pesos) and the seasonally adjusted series of the balance of investment expectations of the Monthly Economic Survey suggest that investment in capital goods would have grown at a significant rate during the fourth quarter.

35. On the supply side, the indicators suggest some disparities. Industry, retail sales, and oil production exhibit favorable growth figures. However, coffee production and some indicators related to construction show a weak performance (see Table 5).

36. Regarding the labor market, in November, the seasonally adjusted series exhibited increases in unemployment rates nationwide in rural areas and in the municipalities. In the thirteen areas, decreases were observed in the overall participation rate and in the occupancy rate, along with an increase in the unemployment rate. In addition, there were marginal falls in the number of occupied workers nationwide and in the thirteen areas, and deterioration in the quality of urban employment. However, this poor performance may be the result of the reversion of the positive impact that these indicators experienced at the beginning of the year, which would be associated mainly with the behavior of public consumption given the expense associated with the election days and the implementation of the census.

37. Finally, the seasonally adjusted series, corrected for calendar effects, from the Monthly Economic Monitoring Indicator by DANE recorded an annual 2.2% growth in November, lower than in October (2.6%). The aggregate for the two-month period recorded a 2.4% annual expansion (vs. 2.6% observed for the third quarter). The figures in the original Monthly Economic Monitoring Indicator (uncorrected) revealed an annual 2.2% expansion in November (2.3% for the October-November period, and 2.7% for 2018Q3).

38. Taking this into account together with the results of the forecasting models, the technical staff confirmed the projection for GDP growth in the fourth quarter of 2018 at 2.7%, with high and low growth scenarios at 3.2% and 2.2%, respectively. This figure implies a 2.6% expansion of GDP for 2018, similar to the figure presented a quarter ago. The forecast range containing this projection is between 2.5% and 2.7%.

39. Thus, in 2018, domestic demand would have expanded *vis-à-vis* 2017 with positive contributions of total consumption and investment. In the first case, the dynamics of public consumption stand out, which benefited from different positive shocks between the first and third quarters. The dynamics of the private component would also accelerate in 2018. Investment would record mixed behaviors. On the one hand, investment in capital goods would increase at a higher rate than the other items that make up the GDP, after having registered falls in 2017. In contrast, investment in construction, both of housing and non-residential buildings and civil works, would have exhibited a mediocre behavior for the aggregate of the year. Besides, in 2018, the trade deficit, in constant pesos, of 2018 would have expanded versus the records from 2017, due to a higher dynamism of imports than of exports.

Table 5: Main indicators of demand and supply

	Indicator	2018Q3		October		November		December		2018Q4		Year to date	
		Original	SACCE*	Original	SACCE*	Original	SACCE*	Original	SACCE*	Original	SACCE	Original	SACCE
Demand Indicators	Retail sales excluding fuel (annual variation, %)	5.6%	6.0%	6.8%	7.9%	12.3%	11.5%	N/Avail.	N/Avail.	N/Avail.	N/Avail.	6.8%	6.9%
	Retail sales excluding fuel and motor vehicles (annual variation, %)	4.8%	5.1%	5.5%	7.1%	6.7%	6.3%	N/Avail.	N/Avail.	N/Avail.	N/Avail.	5.5%	5.5%
	Retail vehicle sales (annual variation, %)	10.3%	10.5%	14.3%	11.0%	43.4%	43.1%	N/Avail.	N/Avail.	N/Avail.	N/Avail.	14.8%	14.2%
	Records of total enrollments (annual variation, %)	5.6%	5.9%	9.2%	10.2%	24.4%	22.5%	N/Avail.	N/Avail.	N/Avail.	N/Avail.	4.9%	4.5%
	Records of enrollment, private use (annual variation, %)	0.7%	0.9%	6.6%	7.4%	20.9%	19.7%	N/Avail.	N/Avail.	N/Avail.	N/Avail.	1.4%	1.1%
	Records of enrollment, commercial use (annual variation, %)	11.2%	11.4%	12.1%	13.2%	28.0%	26.5%	N/Avail.	N/Avail.	N/Avail.	N/Avail.	9.0%	8.5%
	Expectations survey - Sales (levels, balance)[\1]	1.76	2.72	6.35	5.42	N/Avail.	N/Avail.	N/Avail.	N/Avail.	N/Avail.	N/Avail.	-0.92%	0.89%
	Consumer Confidence Index (CCI, balance, levels)[\1]	4.60	N/Applic.	-1.30	N/Applic.	-19.64	N/Applic.	-8.31	N/Applic.	-9.75	N/Applic.	-0.5%	N/Applic.
	Expectations Survey - Investment (levels, balance)[\1]	-1.27	0.30	2.54	-0.48	N/Avail.	N/Avail.	N/Avail.	N/Avail.	N/Avail.	N/Avail.	-1.83%	-0.89%
	Imports in constant pesos: Capital goods (annual variation, %)	5.0%	5.2%	50.6%	44.7%	15.5%	22.8%	30.1%	31.6%	31.9%	33.2%	10.8%	10.6%
Supply Indicators	Industrial Production Index (annual variation, %)	3.5%	3.4%	5.4%	5.6%	4.7%	3.4%	N/Avail.	N/Avail.	N/Avail.	N/Avail.	3.3%	3.5%
	Coffee Production (annual variation, %)	-13.8%	-13.7%	1.2%	1.4%	-0.3%	-0.7%	-17.2%	-17.6%	-6.6%	-6.5%	-4.4%	-3.8%
	Oil production (annual variation, %)	1.1%	N/Applic.	1.7%	N/Applic.	3.8%	N/Applic.	2.2%	N/Applic.	2.6%	N/Applic.	1.4%	N/Applic.
	Energy demand (annual variation, %)	4.1%	4.1%	3.3%	3.3%	4.4%	4.3%	3.5%	3.5%	3.7%	3.7%	3.3%	3.3%
	Construction Licenses, total (annual variation, %)	-5.3%	N/Applic.	-3.6%	N/Applic.	-3.0%	N/Applic.	N/Avail.	N/Applic.	N/Avail.	N/Applic.	-5.0%	N/Applic.
	Construction Licenses, housing (annual variation, %)	-7.5%	N/Applic.	-13.0%	N/Applic.	-5.3%	N/Applic.	N/Avail.	N/Applic.	N/Avail.	N/Applic.	-6.1%	N/Applic.
	Cement Production (annual variation, %)	2.0%	N/Applic.	2.4%	N/Applic.	6.5%	N/Applic.	N/Avail.	N/Applic.	N/Avail.	N/Applic.	0.7%	N/Applic.
	Cement dispatches (annual variation, %)	-0.5%	N/Applic.	5.2%	N/Applic.	4.2%	N/Applic.	N/Avail.	N/Applic.	N/Avail.	N/Applic.	0.0%	N/Applic.

* SACCE = Seasonally adjusted and corrected for calendar effects
[\1] Average for the quarter and year to date.
N/Applic. = Not applicable
N/Avail. = Not available

40. For 2019, GDP growth is forecast at around 3.4% within a range between 2.4% and 4.0%. This forecast considers lower prospects for international commodity prices (particularly oil) and a slightly weaker global economy. Despite this, the Colombian economy would continue to enjoy access to international financing, although this would take place in a context of high uncertainty. Additionally, it is considered that the changes in the *Ley de Financiamiento* represent a positive impact on investment that would boost growth, partly offsetting the lower thrust from oil prices and external demand.

41. In this sense, in 2019, domestic demand would record a slight acceleration, driven mainly by a greater dynamism of investment. In addition, the construction of civil works would have yielded positive growth figures, product of the implementation by local administrations and, to some extent, of the deferred execution of 4G resources. As for consumption, the private component would exhibit a moderate growth, greater than in 2018, but below its historical average; on the other hand, public consumption would have slowed down, which would reflect the adjustment of the National Central Government's accounts to comply with the Fiscal Rule.

IV. Behavior of Inflation and Prices

Observed inflation in December surprisingly moved downward again, mainly due to a more favorable performance of the prices of tradable and non-tradable inflation (excluding food and regulated items). As a result, inflation excluding food and regulated items fell to 2.64%, and the average of core inflation indicators fell to 3.03%. Food prices continued adjusting to moderate rates, and regulated items maintained yearly increases well above 3.0%. The output gap continued in negative terrain, thus contributing to the reduction of inflation, added to a low pass-through of the depreciation in recent months to consumer inflation, particularly to tradable goods. Analysts' expectations to horizons greater than or equal to one year stand between 3.3% and 3.5%, and those embedded in public debt securities between 3.4% and 3.7%.

42. In December 2018, annual consumer inflation (3.18%) decreased 9 bp versus the results of the previous month. In the last 10 months, annual inflation remained relatively stable within a range between 3.1% and 3.3%, having declined significantly at the beginning of the year (Table 6).

43. The monthly result for December (0.30%) stood below market expectations (0.33%) and above the estimations of the technical staff.

44. The average of core inflation indicators ended 2018 at 3.03%, i.e., 163 bp below the figure for December 2017. In December, all core inflation indicators fell, the highest being non-food CPI (3.48%), and the lowest the one for inflation excluding food and regulated items (2.64%) (Table 6).

45. In December, except for food, all annual variations in the main groups of the CPI fell compared to November. This month, the fall in the annual variation of the CPI excluding food was led by the non-tradable segment (3.79%). This performance was explained particularly by the subgroup of entertainment, culture, and recreation, and within this, by the core spending of services including soccer tickets. In this sense, this reduction is largely transitory. On the other hand, the annual variation of the CPI for leases exhibited an increase between November and December (from 3.37% to 3.42%).

46. It should be noted that the item for soccer tickets is not part of the new basket for consumer goods that starts this year. Thus, this source of statistical noise will disappear from the measurements of inflation.

Table 6: Indicators of consumer prices and inflation

Headline and Core Inflation to December 2018

Description	Weight	Dec 2017	Sept 2018	Oct 2018	Nov 2018	Dec 2018	Participation percentage in monthly deceleration	Participation percentage in deceleration of the year to-date
Headline inflation	**100.00**	**4.09**	**3.23**	**3.33**	**3.27**	**3.18**	**100.00**	**100.00**
Non-food inflation	**71.79**	**5.01**	**3.71**	**3.78**	**3.70**	**3.48**	**168.76**	**115.24**
Tradables	26.00	3.79	1.57	1.52	1.29	1.09	51.93	69.53
Non-Tradables	30.52	5.49	4.13	4.13	4.05	3.79	91.47	56.46
Regulated items	15.26	5.86	6.03	6.41	6.53	6.37	25.36	(10.74)
Food inflation	**28.21**	**1.92**	**2.05**	**2.25**	**2.22**	**2.43**	**(68.76)**	**(15.24)**
Perishables	3.88	5.84	9.51	9.66	7.96	8.88	(42.01)	(14.92)
Processed food	16.26	(0.91)	(0.72)	(0.54)	(0.15)	(0.08)	(13.35)	(15.08)
Eating out	8.07	5.21	3.32	3.52	3.55	3.68	(13.40)	14.76
Core inflation indicators								
Non-food inflation		5.01	3.71	3.78	3.70	3.48		
Core 20		4.87	3.56	3.58	3.57	3.23		
CPI excluding perishable foods, fuel and utilities		4.02	2.81	2.89	2.90	2.76		
Inflation excluding food and regulated items		4.76	3.04	3.02	2.88	2.64		
Average of core inflation indicators		**4.66**	**3.28**	**3.32**	**3.26**	**3.03**		

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

47. The CPI for tradable goods (excluding food and regulated items) closed the year at a level well below 3.0% as well as of the level expected by the technical staff (1.09%). In the last two months, the falls in this indicator contrast with the stability observed in the previous six months, within a range between 1.5% and 1.8%. The recent declines have been concentrated in specific items such as telephone services and airfares. To December, there was no pass-through of the depreciation of the peso in recent months to the prices of this basket.

48. Regarding the annual variation of the CPI for regulated items, a decrease took place in December (6.37%), although somewhat lower than anticipated. The fall in the last month is explained by the subgroup of fuels (gasoline maintained its prices stable in December) and public transportation. As for public utilities (7.47%), an increase was observed in electricity, whose rates may be picking up the recent increase of the *spot* price in the stock market.

49. After a pause in November, annual food inflation increased again in December (from 2.22% to 2.43%), mainly due to increases in the prices of perishable foods (8.88% in December). Processed foods continued in negative terrain (-0.08%) and meals outside the home increased slightly (to 3.68%).

50. In December, non-labor costs were reduced, as may be judged from the annual inflation of the total PPI for domestic supply (3.09%). This figure is higher than the one observed 12 months ago (1.85%), but lower than the one in November (3.32%). In the last month, the local component led the fall in producer inflation, moving from 3.47% in November to 2.85% in December, while the imported component increased from 2.99% to 3.67%.

51. Regarding labor costs, with figures to November and December, there was no change in the pace of adjustment. Thus, to December, the wages for housing construction adjusted at a rate of 3.6% (heavy construction at 3.7%), while trade and industry did so by 6.3% and 5.2%, respectively, to November.

52. Inflation expectations exhibited a mixed performance. Analysts' expectations (collected monthly) to twelve months decreased from 3.50% in December to 3.41% in January. Those to twenty-four months increased from 3.26% to 3.28%, while those to December 2019 remained at 3.50%. Those embedded in public debt bonds (*Breakeven Inflation*, BEI) averaged, to 29 January, 3.47%, 3.52%, 3.61% and 3.81% to 2, 3, 5, and 10 year horizons, respectively. Measurements with respect to the last meeting of the Board of Directors of *Banco de la República* on 21 December varied -34 bp, -17 bp, 0 bp, and 6 bp, respectively.

53. Using the Forward Break-Even Inflation (FBEI) curve, the estimation of annual inflation for 2019 is 3.62% (obtained by adding the accumulated inflation observed for the remainder of the year to inflation expectations). For 2020, 2021, and 2022, it is 3.62%, 3.63% and 3.66%, respectively.