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
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Public Version

I. External Context

This report forecasts a somewhat weaker external demand for Colombia than in the previous report, which sets the growth rates of the country's trading partners at values similar to those in 2017. The latest information on growth for some emerging economies explains this change. Added to this, there is a greater uncertainty about the speed of the normalization of monetary policy in the United States. The terms of trade, driven by oil prices, remain at high levels and favor national income. Colombia's risk premia have not experienced significant changes, although the peso continues to receive depreciation pressures.

1. The stress in international financial markets continued to increase in the last month, while a greater risk aversion was observed. This took place amidst an intensification of trade tensions between the United States and China, the prospects of a faster increase in the Fed's interest rates, greater political uncertainty in Europe due to the fiscal situation in Italy, and from the perspective of a weaker global growth.
2. The good dynamics observed in the first half of the year in the United States and other advanced economies, together with the persistence of high prices for commodities (particularly oil), have increased the likelihood of inflationary pressures. Thus, the normalization of monetary policy in advanced economies is expected to continue taking place, with moderate impacts on the financing conditions for emerging economies. This has restricted the space for a more expansionary monetary policy in some economies in the region that are trying to prevent greater capital outflows and to control inflationary pressures arising from the depreciation of their currencies. Other emerging economies have suffered moderate effects on their risk perception and the depreciation of their currencies, despite the increase in the uncertainty on external financing conditions.
3. Regarding external demand, the information available shows that in recent months the economic growth of the country's trading partners for 2018 and 2019 would continue at levels similar to those observed in 2017. This implies a slight downward revision versus the previous month, but of a greater magnitude regarding the projections contained in the previous quarterly report (July).
4. The growth of the Chinese economy declined in the third quarter (6.5% annually), registering the lowest level since the first quarter of 2009. This data stood below the market's expectations and resulted from lower growth in the manufacturing sector. This result took place in the midst of an increase in the trade tension with the United States and increased concern by the authorities due to high levels of leverage.

a. External Growth Scenarios

Baseline or more likely scenario (Table 1)

5. This report revised the average growth forecast for trading partners downwards for 2018 and 2019 to 2.6% and 2.5%, respectively (see **Table 1**). These rates, however, remain above those observed in 2015 and 2016 (1.85%, on average).
6. In the United States, inflation has continued to gain ground slowly, although still at moderate levels. For this reason, the FED is expected to continue with its strategy to increase rates. This report considers an additional increase in the FED's interest rate in the remainder of 2018. Thus, it would move from the current range (2.0% to 2.25%) to (2.25% to 2.5%) by the end of the year. For 2019, three new 25-basis point increases are forecast. Added to this, the program for the reduction in the balance sheet would continue to be met as announced.
7. Given the persistence of oil prices at levels above USD $75 per barrel, this report increased the forecast for the remainder of 2018 and for 2019. It should be noted that to 23 October, the price of oil (Brent) has stood at USD $73.44 per barrel, on average. Thus, the average for this year is expected to be around USD $74.50 per barrel, and USD $73 for 2019. A decrease in the price of oil is still expected towards the end of this year and, above all, in 2019, explained by the gradual deterioration of the OPEC agreements, by increased production in the US, and by a lower growth of global demand.
8. In the last few months, the risks of a deterioration in the external outlook have increased, which in turn increases the uncertainty for the previous forecast baseline scenario. Some of the downside risks are: 1) Larger and/or faster increases in the Fed's benchmark interest rate, above what was considered for the baseline scenario; 2) a greater contagion in Colombia in the event of an increase in the financial stress experienced by some particularly vulnerable emerging economies (Turkey, Brazil, Argentina, among others); 3) a likely negative effect on global growth due to the recent adoption of protectionist measures in the United States and other countries; 4) a faster-than-expected cooling of the Chinese economy on account of the high levels of leverage observed, with adverse consequences on global growth and commodity prices. Additionally, the risks posed in Europe by the *Brexit* and the conflict regarding budget goal of the Italian Government, among others, have recently increased.
9. A favorable scenario for Colombia would be a higher oil price than expected in the baseline scenario. The high levels of the past two months have been linked to supply reductions due to the sanctions imposed on Iran and the fall in the production of Venezuela. These circumstances will tend to remain in the next quarters and could more than offset the downward factors.[1]

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

[1] In the last few days there have been news that suggest that Saudi Arabia would increase its oil production over the next few months to offset the fall in production in the face of economic sanctions imposed by the United States on Iran, which would add to the downward factors regarding the international price of oil.

Country or Region	2018			2019		
	Low	Baseline	High	Low	Baseline	High
USA	2.7	2.9	3.1	1.4	2.5	3.6
	2.1	2.8	3.2	1.4	2.4	3.4
Euro Zone	1.8	2.0	2.2	0.8	1.8	2.6
	2.0	2.2	2.5	1.0	2.0	2.6
China	6.4	6.6	6.8	5.4	6.2	6.8
	6.2	6.6	6.8	5.6	6.4	7.0
Brazil	1.0	1.3	1.6	1.2	2.3	3.4
	1.6	2.1	2.6	1.0	2.7	3.5
Ecuador	0.2	1.4	2.4	0.0	1.1	3.0
	0.5	1.8	3.0	0.0	1.5	3.0
Venezuela	-17.0	-14.0	-11.0	-8.0	-5.0	-2.0
	-10.0	-9.0	-6.0	-7.0	-4.0	-1.0
Peru	3.6	4.0	4.2	2.2	3.9	4.4
	2.7	3.5	4.0	2.0	3.8	4.3
Mexico	1.9	2.2	2.5	1.0	2.3	3.5
	1.5	2.2	3.0	1.0	2.3	3.5
Chile	3.6	3.9	4.2	2.4	3.4	4.4
	2.8	3.5	3.8	2.0	3.3	4.0
Total (excluding Venezuela)	2.2	2.6	2.9	1.5	2.5	3.4
Total (excluding Venezuela) June 2018 Report	2.4	2.9	3.1	1.7	2.8	3.5

COMMODITIES	2017	2018			2019		
	Observed	Low	Baseline	High	Low	Baseline	High
Oil (Brent)	54.79	72	74.5	76	65	73	81
		68	71	76	57	67	77
Coal	70.32	82	84	87	61	76	86
		75	79	86	60	75	85
Coffee	1.52	1.33	1.36	1.39	1.20	1.40	1.60
		1.30	1.40	1.50	1.20	1.45	1.80
Gold	1,258	1,320	1,280	1,240	1,500	1,280	1,100
		1,400	1,320	1,200	1,600	1,300	1,100

The current forecast is shown in black.

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

II. Foreign Trade and Balance of Payments

To August, the improvement in the country's terms of trade has contributed to reduce the trade deficit of goods. Particularly, to this month, exports in US dollars rose increased 14.8%, and imports did so by 8.4%. However, the projections for the full year suggest that there would no longer be a correction of the external balance in the current account as a share of GDP, and that it would remain *above the estimates for a sustainable current account.*

Exports of Goods

10. In August 2018, total exports in US dollars registered an annual 13.1% growth rate explained by increases in the groups of mining goods. In this sector, the external sales of oil and refining explained such increase, registering growth rates of 41% (**Table 2**).

Table 2: Behavior of Exports in US dollars

	Annual Variation [Contribution]	Item	Annual variation of the item	Contribution to annual variation
August 2018				
		Main contributing items to annual variation, in the same direction:		
Total Exports	13.1%			
Agricultural goods	0.6%	Bananas	34.4%	0.7
	[0.1]	Coffee (not roasted)	1.4%	0.1
Mining goods	21.3%	Oil	41.2%	11.5
	[12.2]	Oil refining and others	41.3%	2.4
Other exports*	2.8%	Machinery and Equipment	46.9%	0.5
	[0.8]	Others (mining sector)	85.0%	0.3
Accumulated value for January - August 2018				
Total Exports	14.8%			
Agricultural goods	-4.3%	Coffee (not roasted)	-10.0%	-0.7
	[-0.6]	Bananas	-5.5%	-0.2
Mining goods	21.3%	Oil	27.1%	7.9
	[12.4]	Coal, lignite, and peat	17.1%	3.0
Other exports	10.9%	Chemical products	9.0%	0.7
	[3.0]	Motor vehicles and other transport	28.8%	0.4

Source: DANE

11. In terms of the variation from January to August, total exports showed an annual 14.8% growth, explained by the increase in foreign sales of mining goods (21.3%), followed by other exports (10.9%). The group of agricultural items contracted 4.3% in annual terms.

12. So far this year, the value of exports increased, explained by improvements in prices, which were reflected in an annual 18.1% increase in the consumer price index, which was partially offset by the 2.9% fall for the index of quantities. The improvement in prices in annual terms took place in the group of mining goods (30.5%), which offset the fall in agricultural goods and other exports (-7.3% and -0.3%, respectively).

Imports of Goods

13. The value of imports declared in August grew 9.3% *vis-à-vis* the same month of 2017, explained by the increase in imports of all groups, particularly of intermediate goods, which contributed 6.0 percentage points to the total variation. The increase in external purchases of raw materials for industry stands out, which grew 22.1% in annual terms (**Table 3).**

14. From January to August, total imports grew 8.4% in annual terms, supported by increases in the three groups of goods. The greatest increase was observed in foreign purchases of raw materials, which explain 4.4 pp of the total variation.

15. The increase in total imports from January to August 2018 is explained by a 6.4% increase in the index of prices and 1.8% for quantities.

Table 3: Behavior of Imports in US dollars

IMPORTS				
August 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	9.3%			
Capital Goods	1.6% [0.5]	Capital goods for industry	9.7%	1.8
		Construction Materials	6.1%	0.2
Raw materials	13.5% [6.0]	Raw materials for industry	22.1%	7.2
		Fuel	-13.3%	-1.1
Consumer Goods	11.9% [2.8]	**Durable consumption goods**	**23.2%**	**2.3**
		Private transport vehicles	37.1%	1.7
		Non-durable consumption goods	**3.7%**	**0.5**
		Clothing and other Textiles	24.6%	0.4
Accumulated value for January - August 2018				
Total Imports	8.4%			
Capital Goods	6.5% [2.0]	Capital good for industry	9.8%	1.8
		Construction materials	8.6%	0.3
Raw materials	9.6% [4.4]	Raw materials for industry	15.4%	5.2
		Raw materials for agriculture	10.5%	0.4
Consumer Goods	8.5% [2.0]	**Non-durable consumption goods**	**8.9%**	**1.1**
		Pharmaceutic products and toiletries	7.3%	0.3
		Durable consumption goods	**8.1%**	**0.9**
		Appliances and household devices	17.5%	0.4

Source: DANE

Balance of Trade for Goods

16. With these results, the trade balance in August exhibited a deficit of USD $765 million FOB, similar to the same month of the previous year.

17. Regarding the period from January to August, the deficit stood at USD $4,139 m (FOB), which represents a 21% reduction compared to the same period of 2017, due to higher growth in exports (14.8%) than imports (8.4%).

Balance of Payments

18. With results to date and the external context scenario presented herein, the new estimate of the current account deficit for 2018 is 3.4% of GDP (USD $11,650 m) in the baseline scenario, within 3.2% and 3.6% for the low-growth scenario and high-growth scenarios, respectively.

19. Although the current account deficit as a share of GDP projected for 2018 is equal to the one observed in 2017 (3.4%), current projections would imply a USD $1,059 m increase (**Table 4**). The lower trade deficit in goods and services, as well as higher income due to current transfers would contribute to reducing the external deficit. On the contrary, a widening of factor income is expected.

Table 4

BALANCE OF PAYMENTS (Millions of US Dollars)	2017 (pr)	2018 Baseline	2019 Baseline
CURRENT ACCOUNT (A+B+C+D)	**-10,591**	**-11,650**	**-11,978**
Percentage of GDP	**-3.4**	**-3.4**	**-3.4**
A. Goods	**-4,651**	**-4,120**	**-5,974**
a. Exports	39,597	44,978	46,917
Main	27,433	31,344	31,777
Other Exports	12,163	13,634	15,141
b. Imports	44,247	49,098	52,891
B. Non-factor Services	**-4,142**	**-3,898**	**-3,461**
a. Exports	8,382	9,290	10,059
b. Imports	12,524	13,188	13,520
C. Factor Income	**-8,394**	**-11,015**	**-10,707**
D. Current Transfers	**6,596**	**7,383**	**8,163**

Memo Item:

Mining and oil sector (a-b)[1]	**17,777**	**20,437**	**20,922**
a. Exports	20,917	25,193	25,305
b. Factor Income Revenue	3,141	4,756	4,382

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

20. In terms of financing of the current account for 2018, direct investment is expected to continue to be the main item of foreign capital inflows (**Table 5**). Additionally, greater borrowing by the public sector (net disbursements) is expected, as opposed to the net amortizations of 2017. Regarding portfolio investments, the baseline scenario for 2018 assumes a lower placement of

bonds by the public sector and a lesser dynamism of foreigners in the TES market.

21. A slight fall in the prices of the main export products is forecast for 2019, while the growth of exports of goods would take place on account of the dynamism of external sales of industrial products. The positive path of growth in imports is expected to continue, in line with the greater expected economic growth. This would imply a larger trade deficit in goods *vis-à-vis* the forecasts for 2018 (**Table 4**). On the contrary, a lower deficit by non-factor services and factor income is expected, and that the positive contribution of revenues from remittances continues.

22. Thus, the current account deficit projected for 2019 in the baseline scenario is USD $11,978 m (3.4% of GDP).

Table 5

	2017 (pr)	2018 Baseline	2019 Baseline
FINANCIAL ACCOUNT (A+B+C+D+E)	**-9,807**	**-11,430**	**-11,978**
Percentage of GDP	***-3.1%***	***-3.3%***	***-3.4%***
A. Direct Investment (ii-i)	**-10,324**	**-8,648**	**-9,102**
i. Foreign Investment in Colombia (FDI)	14,013	12,174	12,892
ii. Colombian Investment abroad	3,690	3,525	3,790
B. Portfolio Investment	**-1,414**	**160**	**-87**
i. Public Sector (a-b)	**-7,250**	**-1,838**	**-2,246**
a) Assets	-555	2,909	-900
b) Liabilities	6,695	4,747	1,346
ii. Private Sector	**5,836**	**1,998**	**2,159**
C. Other investment (loans, credits, and other derivatives)	**1,387**	**-3,708**	**-3,947**
D. Reserve Assets	**545**	**767**	**1,158**
ERRORS AND OMISSIONS	**784**	**221**	**0**

23. As for funding, for 2019, an increase of FDI flows and other investments is forecast, inasmuch as the purchase of TES by foreigners continues, although at a slower pace. Additionally, a lower placement of bonds by the Government and public entities is expected, as well as higher portfolio outputs by the private sector.

III. Growth, Domestic Demand, and Credit

The GDP forecast for the third quarter of 2018 and for the whole year was slightly reduced in this report. The fall in the production of some raw materials for exports and the greater lag of the recovery of investment in construction explains this revision. Added to this are a) the recent deterioration in household confidence, which suggests a lower dynamism of private consumption and b) the estimates of a weaker global demand. GDP growth is expected to continue recovering in 2019, although uncertainty in this regard is high, particularly concerning external conditions and the behavior of the construction sector.

24. The information available for the third quarter suggests that the Colombian economy would

have expanded at a similar rate as in the first half of the year. Particularly, domestic demand would have slowed down slightly in the margin on account of lower growth in government consumption. Private consumption, on the other hand, would have registered no significant changes in its pace of expansion. Gross capital formation would have continued exhibiting a mediocre performance. In this sense, the better performance of investment in capital goods for industry and other sectors would not have completely offset the bad times for gross capital formation in construction.

25. Also, there would have been accelerations in foreign trade (in real terms) that were greater for exports than for imports. Despite this, net exports would continue to contribute negatively to GDP expansion.

26. The recent behavior of the economic indicators supports the scenario described above (see **Table 6**). While the domestic trade of goods, highly correlated with the behavior of household consumption, continues to show a good dynamism, the recent fall in consumer confidence generated a slight downward revision of the projections for household spending.

27. Regarding Gross Capital Formation, the series for imports of capital goods (in constant pesos) and the seasonally adjusted series of the balance of investment expectations of the EMEE suggest that investment in capital goods would continue reporting improvements in the third quarter.

28. On the supply side, the indicators suggest mixed signals. While the industry, trade, and oil production exhibit favorable growth, coffee and coal production, along with indicators related to construction show a weak performance (see **Table 6**).

29. In this context, the labor market showed little change. The seasonally adjusted series to August continue exhibiting stability in the national unemployment rate (UR) and begin to show a decreasing trend in the UR of the thirteen areas. On the other hand, the urban global participation rate and the employment rate (TO) have remained stable during the last semester, which reveals a change in the decreasing slope that took place in the last 2 years. With information to the mobile quarter ending in August, job creation at the national level has been driven mainly by urban employment and by the branch of community, social, and personal services. Regarding the quality of employment, semi-annual variations evidence a boost in the creation of non-salaried jobs.

30. The seasonally adjusted series corrected for calendar effects of the Economic Monitoring Indicator (ISE) of DANE recorded an annual 2.1% growth in August, similar to 2.0% in July. The aggregate for the third quarter reported an annual 2.1% expansion (vs. 2.2% observed in the second quarter). The figures in the original ISE (uncorrected) revealed an annual 2.3% expansion in August (2.1% for the two-month period of July-August, and 2.8% for 2018.Q2).

31. Considering this and the results of the forecasting models, GDP growth was revised downwards slightly in the third quarter of 2018 (moving from 2.7% to 2.6%), with low and high growth scenarios of 2.1% and 3.1%, respectively.

32. Despite the good behavior of the price of commodities and access to international financing,

Colombia's trading partners are expected to expand at a rate somewhat lower than the forecast in the previous report. Additionally, some downside risks referred to in past reports have materialized (e.g., the recent decline in household confidence). Similarly, the production of some raw materials contracted and the construction of civil works would have exhibited a greater slowdown than estimated in the previous report; the execution planned for the second half of 2018 is likely to be transferred to the coming next year.

33. In this way, the GDP estimate for 2018 also changed from 2.7% to 2.6%. The forecast range containing this projection is between 2.3% and 2.8%. For 2019, the technical staff considers a growth figure of 3.5% within a range between 2.5% and 4.0%.

Table 6: Main demand and supply indicators

	Indicator	2018Q2		July		August		September		2018Q3		Year to date	
		Original	SCA*	Original	SCA*	Original	SCA*	Original	SCA*	Original	SCA*	Original	SCA*
Demand Indicators	Retail sales excluding fuel (annual variation, %)	6.8%	6.0%	3.7%	4.5%	6.1%	6.1%	N/Avail.	N/Avail.	N/Avail.	N/Avail.	6.0%	6.0%
	Retail sales excluding fuel and motor vehicles (annual variation, %)	6.2%	5.9%	2.4%	3.9%	5.4%	5.4%	N/Avail.	N/Avail.	N/Avail.	N/Avail.	5.1%	5.1%
	Retail vehicle sales (annual variation, %)	10.3%	6.5%	11.5%	7.8%	10.5%	10.6%	N/Avail.	N/Avail.	N/Avail.	N/Avail.	11.4%	11.1%
	Records of total enrollments (annual variation, %)	3.8%	3.8%	3.8%	4.5%	2.4%	1.8%	10.7%	11.4%	5.6%	5.8%	2.0%	1.9%
	Records of enrollment, private use (annual variation, %)	2.1%	2.1%	-1.7%	-0.7%	-4.6%	-5.0%	9.0%	8.9%	0.7%	0.8%	-1.5%	-1.7%
	Records of enrollment, commercial use (annual variation, %)	5.8%	5.7%	10.4%	11.2%	10.7%	9.9%	12.6%	13.3%	11.2%	11.4%	6.1%	5.9%
	Expectations survey - Sales (levels, balance)\1	-3.45	0.01	-3.82	0.59	4.36	3.11	N/Avail.	N/Avail.	N/Avail.	N/Avail.	-2.54	0.05
	Consumer Confidence Index (CCI, balance, levels)\1	8.63	N/Applic.	9.80	N/Applic.	4.68	N/Applic.	-0.67	N/Applic.	4.60	N/Applic.	2.59	N/Applic.
	Expectations Survey - Investment (levels, balance)\1	-1.09	1.96	-7.27	-3.44	0.18	1.26	N/Avail.	N/Avail.	N/Avail.	N/Avail.	-3.02	-1.43
	Imports in constant pesos: Capital goods (annual variation, %)	4.2%	1.5%	5.8%	4.3%	4.6%	7.3%	14.4%	18.0%	8.0%	8.2%	4.6%	6.1%
Supply Indicators	Industrial Production Index (annual variation, %)	5.0%	4.8%	3.5%	1.4%	3.9%	4.5%	N/Avail.	N/Avail.	N/Avail.	N/Avail.	2.9%	3.2%
	Coffee Production (annual variation, %)	13.2%	12.8%	-23.5%	-22.4%	-2.8%	-3.5%	-14.5%	-15.1%	-13.8%	13.8%	-3.6%	-3.2%
	Oil production (annual variation, %)	1.2%	N/Applic.	0.5%	N/Applic.	0.9%	N/Applic.	1.9%	N/Applic.	1.1%	N/Applic.	1.0%	N/Applic.
	Energy demand (annual variation, %)	2.9%	2.9%	4.5%	4.6%	4.3%	4.2%	3.4%	3.4%	4.1%	4.1%	3.2%	3.2%
	Construction Licenses, total (annual variation, %)	5.7%	N/Applic.	8.8%	N/Applic.	-10.3%	N/Applic.	N/Avail.	N/Applic.	N/Avail.	N/Applic.	-4.4%	N/Applic.
	Construction Licenses, housing (annual variation, %)	6.1%	N/Applic.	-0.6%	N/Applic.	-11.6%	N/Applic.	N/Avail.	N/Applic.	N/Avail.	N/Applic.	-4.9%	N/Applic.

* SCA = Seasonally and calendar adjusted
\1 Average for the quarter and year to date.
NA = Not applicable
ND = Not available

34. The forecast for GDP growth in 2019 assumes a greater production of exportable raw materials (mainly coffee and coal), due partly to a low basis for comparison in 2018, and an acceleration of domestic demand. In this context, the price of oil would remain at relatively high levels in 2019, which is expected to generate a greater buoyancy of investment by the firms in the sector. On the other hand, the construction of civil works is expected to report positive growth, driven by the deferred execution of the funds for 4G. Added to this is a gradual recovery in private consumption.

IV. Behavior of Inflation and Prices

Although inflation rebounded in September due to food prices, it has remained relatively stable at figures close to the target for several months now. The average of core inflation indicators has fallen slowly and remains above 3.0%. Analysts' expectations and those embedded in public debt bonds to horizons greater than or equal to one year stand between 3.3% and 3.5%.

35. In September, headline inflation stood at 3.23%, 13 bp higher than in August. After descending at the beginning of the year, annual inflation has remained stable for the last seven months at levels slightly higher than the target (**Table 7**). Year-to-date inflation (2.63%) was lower than last year (3.49%), and the monthly figure (0.16%) confirmed the forecasts of the market (0.16%) and the technical staff.

36. The average of the four core inflation indicators stood at 3.28%, a very similar figure to that of the previous month (**Table 7**). This indicator has fluctuated around 3.3% since June. In the last month, the individual measures exhibited mixed behaviors, with the CPI excluding food being the one with the highest level (3.71%), and the CPI excluding primary food, fuel, and public utilities (2.81%) with the lowest level.

Table 7

Headline and Core Inflation to September 2018

Description	Weight	Dec 2017	May 2018	June 2018	July 2018	Aug 2018	Sept 2018	Participation percentage in monthly deceleration	Participation percentage in deceleration of the year to-date
Headline inflation	**100.00**	**4.09**	**3.16**	**3.20**	**3.12**	**3.10**	**3.23**	**100.00**	**100.00**
Non-food inflation	**71.79**	**5.01**	**3.85**	**3.81**	**3.91**	**3.83**	**3.71**	**(59.91)**	**103.46**
Tradables	26.00	3.79	1.58	1.83	1.57	1.67	1.57	(18.72)	60.27
Non-Tradables	30.52	5.49	4.57	4.27	4.31	4.16	4.13	(4.82)	47.66
Regulated items	15.26	5.86	5.79	5.82	6.60	6.36	6.03	(36.37)	(4.47)
Food inflation	**28.21**	**1.92**	**1.50**	**1.74**	**1.23**	**1.34**	**2.05**	**159.91**	**(3.46)**
Perishables	3.88	5.84	7.75	8.47	5.30	6.10	9.51	112.02	(18.71)
Processed food	16.26	(0.91)	(1.15)	(0.91)	(1.09)	(1.18)	(0.72)	57.19	(4.12)
Eating out	8.07	5.21	3.12	3.13	3.30	3.46	3.32	(9.30)	19.37
Core inflation indicators									
Non-food inflation		5.01	3.85	3.81	3.91	3.83	3.71		
Core 20		4.87	3.79	3.58	3.61	3.54	3.56		
CPI excluding perishable foods, fuel and utilities		4.02	2.80	2.71	2.72	2.76	2.81		
Inflation excluding food and regulated items		4.76	3.29	3.23	3.14	3.10	3.04		
Average of core inflation indicators		**4.66**	**3.43**	**3.33**	**3.35**	**3.31**	**3.28**		

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

37. In September, all CPI components excluding food decreased. The annual adjustment of the group of regulated items was the one that fell the most (from 6.36% to 6.03%). Similarly, tradables and non-tradables fell (from 1.67% to 1.57%, and from 4.16% to 4.13%, respectively).

38. As for regulated items, the downward behavior of the yearly variation for public utilities stands out (from 7.18% to 6.57%) and fuels (7.33% to 6.66%). In both cases, a favorable statistical basis for comparison explains these behaviors; no atypical negative monthly variations were registered in these services. It is worth noting that, in the remainder of the year, rebounds are

expected in fuels and energy services due to the depreciation of the peso and the increase in the price of oil, among other reasons.

39. As has been happening along 2018, the annual variation of non-tradables (excluding food and regulated items) decreased again, reflecting the weakness of demand and a slower pace of indexation in several prices. Within this group, several items exhibited decreases, with leases as perhaps the most important one (3.45%).

40. On the other hand, the CPI for tradable goods (excluding food and regulated items) still doesn't show signs of a significant pass-through of the depreciation of the peso in recent months (from COP $2,800 per US dollar in April, rebounding to nearly $3,100 recently). As a matter of fact, tradable inflation has been very stable since last April (between 1.5% and 1.8%). Although some upward adjustments are expected in this subgroup, given the lag with which the pass-through operates, this is likely to be postponed until the beginning of the coming year due to the bearish effect of the price cuts in vehicles that usually accompanies the biannual automobile fair in November. It should be noted that the weight of this item is relatively high (4.35%).

41. During September, the only upward pressures on consumer inflation originated in food, particularly by perishable goods. This took place despite the fact that the food supply has remained favorable, as suggested by the supply indicators of the main collection centers in the country. However, the frequent closures of the Bogotá-Villavicencio road generated temporary reductions in the supply to the city, which impacted inflation due to the weight of the city in the national index.

42. In September, an increase was noted in the pace of adjustment of non-labor costs, which stems from the pick-up observed in the annual inflation of the total PPI for domestic supply (produced and consumed domestically plus imported goods) from 2.45% in August to 3.77% in September. Both the imported component (affected by depreciation) as well as the local one (for food and mining) increased. In contrast, there were no pressures on labor costs (wages for industry, trade, and construction). Given the current slack with which the labor market is operating, no pressures are expected on this front in the coming months.

43. In general, inflation expectations exhibited an upward trend. Those by analysts, collected monthly, increased slightly for December this year (from 3.23% to 3.28%), and to a twelve-month horizon remained stable (3.37%). Inflation expectations to December 2019 increased slightly, (from 3.30% to 3.34%), as did those to twenty-four months (from 3.18% to 3.20%). On the other hand, those embedded in public debt bonds (*Breakeven Inflation*) averaged to 23 October, 3.48%, 3.48%, and 3.54% to 2, 3, and 5-year horizons, respectively. *Vis-à-vis* the last meeting of the Board of Directors on 28 September, the measures increased 9 bp, 7 bp, and 5 bp, respectively.

44. Using the Forward Break-Even Inflation (FBEI) curve, the estimation of annual inflation for 2018 is 3.50% (obtained by adding the accumulated inflation observed for the remainder of the year to inflation expectations). For 2019, 2020 and 2021, it is 3.43%, 3.51% and 3.63%, respectively.