Inflation Report - June 2012

Report Keep in mind
The Monetary Policy Report presents the Bank's technical staff's analysis of the economy and the inflationary situation and its medium and long-term outlook. Based on it, it makes a recommendation to the Board of Directors on the monetary policy stance. This report is published on the second business day following the Board of Directors' meetings in January, April, July, and October.

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In June 2012 annual inflation stood at 3.2%, down by 20 basis points (bp) from the figure of March, resuming its downtrend after remaining relatively stable in April and May.

From March to June, year-on-year change in the consumer price index (CPI) for food fell from 4.6% to 4.2%, accounting for nearly half the drop in second quarter inflation. The supply of perishable food products, which had been affected in 2011 by La Niña weather conditions, returned to normal, leading to a downtrend in food prices in the first half of 2012.

Non-food CPI also decreased year on year, from 2.95% in March to 2.8% in June, accounting for the other half of the drop in inflation. In March and in June the average of the four core inflation measures calculated by the Bank remained at 3%.

The regulated group of non-food CPI made the biggest contribution to the drop in inflation, by falling year on year from 4.9% in March to 3.9% in June. All components of this group decreased year on year, with fuel contributing the most by decreasing from 4.4% to 1.8% over the same period. In June non-tradable CPI was up by 3.6% year on year, 10bp lower than in March, though it continued to be subject to upward pressure from rising housing rents.

Tradable CPI excluding food and regulated items was the only group registering a higher year-on-year change: from 0.7% to 1%, driven mostly by vehicle prices, air fares, and charges for telephone services.

Monetary policy actions and lower-than-expected inflation helped to keep expectations of consumer-price rises on a downward trend. At June, breakeven inflation derived from two-, three- and five-year TES securities stood below 3%, while monthly surveys pointed to expectations of inflation running at 3.1% in December 2012 and 3.3% in July 2013.

Colombia’s year-on-year GDP growth in the first quarter of 2012 was 4.7%, standing in the lower half of the range forecast by the Bank’s technical staff. This was the second consecutive quarter with loss of pace in GDP growth: from 7.5% in the third quarter of 2011 and 6.1% in the fourth.

By type of expenditure, the biggest slowdown in GDP growth occurred in investment, which declined from a year-on-year expansion of 14.2% in the last quarter of 2011 to 8.3% in the following quarter. The fall in civil works (8.1%), resulting from lower investment in the oil and mining sector, accounted for most of this behavior. Investments in machinery and transport equipment also slowed but still grew at high rates, above their averages since 2000. The only component of investment that accelerated was building construction.

Household consumption, too, grew at a slower pace but continued to be the spending item contributing most to GDP performance. Its growth rate of 5.9% in the first quarter of 2012 was 20bp lower than in the previous quarter but still higher than the average rate since 2000. Household consumption was mostly driven by nondurable goods and by services. Spending on semi-durable goods decelerated but continued to grow apace. Annual growth in consumption of durable goods was below its average since 2000 for the second consecutive quarter. Government consumption remained moderate, becoming the slowest growing component of demand.

Accordingly, the first quarter of 2012 saw domestic demand growing year on year by 6.1%, compared with 10.5% in the third quarter of 2011 and 8.0% in the fourth.

Imports and exports also lost pace. The first quarter of 2012 saw external sales growing year on year by 6.3%, down from 16.2% in the previous quarter. Over the same period year-on-year growth in imports fell from 21.3% to 13%.

On the side of supply, the biggest contributors to year-on-year GDP growth in the first quarter were financial and leasing services, mining, and commerce, restaurants and hotels, in that order. Supply problems prevented mining from expanding at its potential. Growth in industrial GDP dropped from 3.9% in the last quarter of 2011 to 0.6% in the first quarter of 2012. Farming and construction also fell year on year, farming because of lower coffee production, and construction because of the behavior of civil works.

Regarding economic activity in the second quarter, much of the available information points to a slowdown. Consumption indicators, including retail sales, vehicle sales, imports for consumption, the household confidence index and consumer loans, suggest that family spending in the second quarter of 2012 grew more slowly than in the first.

With respect to investment, capital goods imports grew at a faster annual pace in April-May than in the first quarter. But, the situation is less certain for overall investment, since it will depend on the speed of recovery in civil works.

On the side of supply, available indicators suggest a year-on-year contraction in industrial GDP over the second quarter. From April to May the industrial production index, excluding coffee threshing, contracted on average by 1.3%, continuing on a declining trend. At May, Fedesarrollo’s orders and inventory indices showed downturns, while still remaining above their averages for the past twenty years. The business confidence index also fell, though to a slighter extent than growth in industrial production.

Available construction indicators do not suggest much strength either. From April to May, cement production fell on average by 0.8% year on year. Over the same period building licenses contracted at an average rate of 33% year on year, owing to atypically high levels in 2011.

In the farming sector, recovery in coffee production and increasing cattle slaughter in April and May are reasons for expecting the sector to reverse the negative growth shown in the preceding two quarters.

Figures on financial intermediation services indicate that this sector will be driving GDP growth in the second quarter. Although bank credit has lost pace, owing mainly to moderation in consumer lending, its rate of expansion to June was still high: 17% year on year.

In the external context, global economic activity became weaker than expected, largely because of high uncertainty created by the sovereign debt crisis in Europe.

It is therefore more likely that the slowdown projected for 2012 will be deeper than expected. For 2013, the latest forecasts by the major international organizations still project a recovery, albeit at a slower pace than estimated in previous months Indicators of real activity in the Euro area point to the likelihood that this economy will contract in the second quarter of 2012 by more than expected. Recession in the different peripheral economies has significantly affected business and consumer confidence across the area and has begun to sap Germany's momentum.

Economic growth in Germany might not therefore be sufficient to offset lower Weak global demand has lowered some international commodity prices, except for a number of farm products affected by climate phenomena. Nevertheless, commodity prices continue to be higher than their averages in recent years.

Global spare capacity and reduced inflationary pressure resulting from lower commodity prices (except for some farm goods) have led to the adoption of expansionary monetary policies in a great number of countries. In emerging economies, for example, the central banks of Brazil, China and South Korea have reduced their interest rates in an effort to counteract the impact of the slowdown in demand.

Lower global demand and the decline in the prices for Colombia's main exports were reflected in export behavior. In May export sales in dollars grew by 1.2% year on year, down from the average rate for January-April (17.6%). Mining and farm exports fell year on year by 1% and 12.4%, respectively. External sales of all 12 other goods, mostly industrial products (22% of total exports), rose by 14.6% year on year. Among this group, exports of chemicals, basic metals, electric appliances, and food and beverages were notably stronger.

This external context of lower global demand and lower commodity prices is likely to affect the Colombian economy. For this reason, and given the domestic developments mentioned earlier, second-quarter GDP growth in 2012 is expected to be in the range of 3.3% to 4.8%.

For the full year of 2012, the Bank's technical staff has revised down the GDP forecast range by one percentage point, to 3%-5%. The width of the range is due to uncertainty about the size of the global slowdown and its impact on Colombia's economy, and due also to uncertainty about recovery in civil works and overcoming a number of negative supply shocks that are affecting the industrial and mining sectors. Growth for 2013 is projected to be much the same as in 2012.

In conclusion, relative to the March Report actual inflation was less than expected, and inflation expectations at different horizons are around 3% or less. The external context deteriorated even more, and forecasts of Colombia's economic growth for 2012 have been revised down. Estimates for 2012 point to a narrower output gap and a less "tight" labor market; both of these trends might intensify in 2013.

In the setting described above, the Bank's Board of Directors analyzed the different risk scenarios for inflation and growth, and based thereon decided to leave the benchmark rate unchanged at 5.25% at the monthly meetings in April, May and June, and to lower the rate to 5% at the July meeting.

The Board has stated that the international situation, inflation behavior and projections, growth, and asset markets will continue to be monitored carefully, and reiterated that monetary policy will depend on new information as it becomes available.

Fuente: https://www.banrep.gov.co/en/news-and-publications/inflation-report-june-2012