Minutes of a Meeting of the Board of Directors of Banco de la República Held on January 28, 2013

Detailed Explanation of the Macroeconomic Situation (only in Spanish) Must reads Banco de la República Lowers the Benchmark Interest Rate by 25 Basis Points and Expands its Daily Reserve... Last modified Monday the 29th of April, 2024

A regular meeting of the Board of Directors of Banco de la República was held in the city of Bogotá D.C. on January 28, 2013. In attendance were Mr. Mauricio Cárdenas Santamaría, Minister of Finance and Public Credit, Mr. José Darío Uribe, Governor and Managing Director of Banco de la República, and the full-time co-directors Messrs. Fernando Tenjo Galarza, Carlos Gustavo Cano Sanz, Juan José Echavarría Soto, Juan Pablo Zárate Perdomo and César Vallejo Mejía. Inflation and the economic situation were discussed with respect to growth and prospects for the future, and monetary-policy decisions were reached.

1. BACKGROUNDa. Recent Developments in Inflation

Annual consumer inflation dropped sharply in December, far more than anticipated by the market and the technical team. The outcome by that month was 2.43%, which is 34 basis points (bp) less than the rate in November, a month that also witnessed a major decline. As a result, consumer inflation was below the target for 2012 and the long-term target (3%), but within the range of 2% to 4%. As occurred throughout the year, the slowdown in inflation can be explained, once again, by less of an increase in the CPI for food and regulated items.

The annual variation in the food CPI at December (2.52%) showed a considerable drop (49 bp), adding to the one of the previous month and those of other months throughout the year. The decline in prices for a good many unprocessed foods accentuated in December; however, quite moderate and even negative changes in the prices of various processed and semi-processed foods continued to be observed as well. In the case of unprocessed foods, the drop in prices can be attributed to acceptable supply conditions and lower input costs. As for processed foods, the downward trend in prices is explained by the drop in international prices for corn and other cereals, oilseeds, oils and coffee, among others, as well as peso appreciation, and an important supply of imports. The annual variation in eating was down again, although slightly, reaching 4.9%

Within the non-food CPI, the regulated sub-basket posted an annual variation of 1.9% (88 bp less than in November). This is the lowest rate on record since the end of 2008. The annual change in this item had declined as of the fourth quarter of 2010, but accentuated in the past two months. December saw reductions in the annual variations for all items. However, the sharpest was in public utilities and was led by the CPI for electrical power, which showed negative annual and monthly changes. In this case, the reduced risk posed by El Niño weather, coupled with the drop in producer inflation, which is part of the regulatory formulas, contributed to this behavior. Less of a change in the CPI for fuel also was important (only 1.3% at year’s end) and is associated with the gasoline price cuts.

The annual difference in the other two components of the non-food CPI; that is, tradables and non-tradables, also showed reductions at December. In the first case, the annual change was 0.77%. This figure is 17 basis points less than the one in November. The annual adjustment in this basket had been around 1% since June 2012. This outcome may be associated partly with appreciation of the exchange rate.

As for the non-tradable CPI excluding food and regulated items, the annual variation at December was 3.92%, which is 5 bp less than the figure on record in November. This can be attributed to aggregate demand, which has experienced a slowdown since mid-year that could have contained more pronounced price adjustments. The change in rentals fees, which exhibited an upward trend over the past two years, declined slightly on this occasion (5 bp) and stood at 3.9%.

The annual variation in core inflation also dropped sharply in December. The average of the four indicators monitored by Banco de la República came to 2.80%, which is 16 basis points less than the November figure.

The annual change in the IPP remained in negative terrain and continued to decline, reaching -2.9% in December. There were sharp reductions in both the imported PPI and the PPI for goods produced and consumed in the country. In fact, the annual variations in both these baskets were in negative terrain (-4.8% and -2.6% respectively). Annual appreciation, the stability or decline in international prices, and a good agricultural supply explain this behavior.

Inflation expectations continued to fall in December and early January. Banco de la República's latest monthly survey indicates financial market analysts expect 2.9% inflation twelve months out (vs. 3.1% a month ago). In the case of the quarterly business survey, expected inflation twelve months out is 3.1% (it was previously 3.4%), while the estimates derived from TES show expected inflation near 2.6% for horizons at two, three and five years.

b. Growth

The information at hand for the fourth quarter suggests the annual increase in output would accelerate slightly during this period with respect to the previous quarter, but less so than during the first half of 2012. In the case of private consumption, the latest retail sales figures (with and without vehicles), the slowdown in annual growth in consumer lending (18.4% on average for the fourth quarter vs. 20.5% on average for the third), and stability in the consumer confidence indicator reported by Fedesarrollo indicate the rate of growth in this sector during the fourth quarter would be less than the one observed in the first three quarters.

As for investment, there is a great deal of uncertainty about how this item will behave, especially spending on civil works, construction and buildings. In the other components of this expenditure, such as investment in transport equipment, the November increase in CIF imports of capital goods in the form of transport equipment (4.6% per year) would indicate a possible improvement with respect to what was observed during the third quarter of the year. Also noteworthy is the increase by November in imports of capital goods for agriculture (20.5% annually) and imports of construction materials (19%).

With regard to exports, the totals in dollars fell by 7.7% in November compared to the same month in 2011 (-8.2% if re-exports of aircraft are considered). The performance in November is due to the combined drop in exports of mining and agricultural commodities (-11.9% and -18.9%, respectively). The most notable reductions in these groups concerned exports of petroleum and petroleum derivatives (-13.8%), coal (-12.4%) and coffee (-42%). The group comprised of industrial exports and others posted a positive annual variation of 12.7% in November 2012, with the rise in exports of vehicles (246%), chemicals (5.2%) and electrical machinery and equipment (43%) being the high points.

On the supply side, the indicators at hand for the industrial sector show deterioration. The annual variation in the IPI excluding coffee threshing was -4.0% by November. The tendential component of the indicator shows a negative slope since May 2012. Moreover, according to Fedesarrollo, industrial confidence continued to deteriorate in November. There were no further reductions in the indicator for orders, while the inventory indicator (counter-cyclical to production) saw a slight increase. However, this did not affect the negative trends in both these indicators. Something similar happened with expectations for production three months out. Accordingly, the demand for unregulated industrial energy, which is highly correlated to the IPI, declined in

December at an annual rate of 0.8%. However, it is important to note this effect could be due to fewer working days with respect to the same month last year.

In contrast, in the case of trade, according to the Fedesarrollo survey for November, the economic situation of merchants has rebounded in recent months. Likewise, expectations six months out suggest improvements in the coming months. Something similar can be detected from the Fenalco survey for current sales.

Several figures associated with mining, particularly oil, improved during the final quarter of 2012. The National Hydrocarbons Agency (ANH) reports oil production in December came to 984,000 barrels per day. On average, 972 MBD were produced in the fourth quarter, which is more than during the previous three months (934 MBD). This is due to the improvement in transport conditions and stabilization of production at the various fields, coupled with a reduction in the problems with law and order that affected production between the second and third quarters.

All of the foregoing allows for a fourth-quarter annual GDP growth forecast between 2.0% to 3.5%. This contemplates a partial recovery in investment and performance in public and private consumption that would raise rates to near their historic averages. Exports and imports increased slightly less than the rates posted during the third quarter of 2012. On the supply side, the most dynamic sectors in the fourth quarter would have been transportation, social, community and personal services and, finally, mining. In contrast, construction and industry would be the sectors that detracted from growth. It is important to mention that uncertainty about how investment in civil works will perform has increased significantly, but without a definite bias, given the high volatility the series has shown in recent quarters. This explains why the forecast range is broad.

Consequently, the forecast range estimated for annual GDP growth in all of 2012 is between 3.3% and 3.9%.

The technical team predicts between 2.5% and 4.5% economic growth for 2013. The major uncertainty with respect to this forecast is rooted in the possible persistence of the negative shock witnesses in investment in civil works and buildings. Some of the factors that have slowed this type of spending are expected to turn around, thereby bolstering domestic demand. The conditions that supported the momentum observed in consumption and investment in machinery and equipment are expected to continue during 2013. Among others, these include stable levels of employment and consumer confidence, and the accumulated reduction in policy interest rates. The latter is being passed through to interest rates on loans, coupled with lending that has slowed but continues to grow at a good pace. All of this is accompanied by an international context of broad liquidity and low interest rates.

c. Financial Variables

In December, the annual increase in bank lending (D/C and F/C) came to 15.19%, which is 6 bp less than the rate in November. Compared to September and June, the decline came to 58 bp and 231 bp, respectively.

As to the different types of lending, the commercial loan portfolio rebounded, with 13.8% annual growth in December, which is 46 bp higher than the rate observed the month before (13.3%). This momentum is explained by loans in foreign currency, which went from 5.8% growth to 14.5% between November and December, thereby consolidating the recovery that began in July. For its part, the component in domestic currency continued to slow, posting a decrease of 13.7% in December, down from 14.3% the month before. Annual growth in consumer lending came to 17.8% in December, which is 112 basis points less than the rate in November. Mortgage loans slowed somewhat, with an annual variation of 15.2% in December as opposed to 15.4% the month before.

Nominal interest rates on all types of loans mark a downward trend compared to their levels at the end of July, when the policy interest rate began to be reduced. However, the effect on real rates (discounting the non-food CPI) has been less, since inflation has declined as well. In this context, the real interest rate on December

disbursements was 15.5% for consumer loans, 10.2% for mortgages and 9.1% for regular commercial loans. These rates are below their historic averages calculated since 2000. On the other hand, the real interest rate on preferential commercial loans was 6.0% as opposed to 27.4% on credit card lending and 5.8% on treasury loans. These rates are higher than their averages calculated since 2000.

d. The External Context

In the Euro Zone, the measures adopted by economic policymakers in recent months brought calm to the financial markets, allowing for a reversal of the outflow of capital from peripheral countries of the region that had begun in the first half of 2012. Accordingly, the tensions on government bond markets for Spanish and Italian debt have very much subsided. Therefore, the probability of a major financial crisis that would deepen the recession in the Euro Zone has declined significantly. Nevertheless, this improvement in financial conditions has yet to pass through to the real sector. So, most analysts expect the recession in the region to continue during at least the first half of 2013. In fact, the latest figures for the Euro Zone show industrial production, retail sales and lending to the private sector contracted in November, while business and consumer confidence was still down. In December, the unemployment rate in several of the peripheral economies remained at record highs. Moreover, the region's weak situation continued to affect countries such as Germany and France, economies that experienced a setback in industrial production during the final months of 2012.

As for the United States, the indicators of real activity in the fourth quarter show the economy would have expanded at a moderate pace during that period. The figures at December show retail sales and industrial production continued to grow in both annual and monthly terms, while the housing market continues to recover, but still from a very low level. Performance in the external sector also remained depressed, evidencing the increased pass through of weak global demand. In addition, the levels of consumer confidence are still being affected by fiscal uncertainty. Regarding negotiations on the fiscal issue, the United States Congress reached a partial agreement to prevent the country from going over the so-called "fiscal cliff" for a few months. However, decisions on spending cuts in social security and defense, as well as the definition of certain federal budget items, were postponed until March. This being the case, fiscal uncertainty would continue to affect confidence in the early months of 2013. For the current year, the United States economy is expected to grow at a moderate rate, somewhat less than what was estimated for 2012.

In China, economic growth accelerated in the fourth quarter to 7.9% annually (previously 7.4%). This would be fueling growth in other emerging countries of the region. Although the figures at December show an added increase in exports, industry and retail sales, the main force driving the economy has been investment in fixed assets. In 2013, China's economy is expected to increase at a rate similar to the growth observed in 2012.

With respect to the Latin American economies, the information at hand for the fourth quarter shows Chile and Peru would have grown at a rate close to their potential, while the Mexican economy has begun to slow, although its growth rate remains favorable. In Brazil, real activity has continued to recover in response to the stimulus measures implemented recently. The prospects for the coming year point to growth in Peru and Chile that is again favorable and near its potential, acceleration in Brazil, although at moderate rates, and a slowdown in Venezuela.

In terms of oil prices, Brent crude benchmark prices behaved during the fourth quarter as anticipated in the September edition of the Inflation Report. On the other hand, although coal, nickel and coffee prices contracted in 2012, they did increase slightly during the final months of the year. Food prices were on a downward trend in the final months of 2012, since the weather conditions that affected prices at midyear returned to normal.

The slowdown in international food prices and the stability in crude oil prices helped to keep inflation low in the major developed economies. This fact, coupled with the weak momentum in these countries, made it possible to continue a monetary stimulus policy backed by low interest rates and ample injections of liquidity. For most of

the Latin American economies, inflation adopted a downward trend during the final months of 2012. This would be explained by lower food prices and by generalized appreciation of the currencies of the region.

In short, average economic growth in 2012 with respect to Colombia's trading partners was consistent with expectations. As for 2013, the measures adopted by the European authorities and the improvement in financial conditions have reduced the likelihood of a sharp recession in the Euro Zone. In the United States, the latest information suggests its economy could grow at a somewhat slower pace than was estimated for 2012. China's growth would stay at around 8%. This being the case, the expectation for the current year is that external demand will remain weak and expand at a pace similar to the rate in 2012. Moreover, broad liquidity and low interest rates are expected to continue.

The rising trend witnessed in terms of trade up to 2011 was interrupted in 2012, the year when terms of trade remained stable. Given the weakness of the global economy, terms of trade in 2013 could be somewhat less than the average observed in 2012.

2. POLICY DISCUSSION AND OPTIONS

The Board of Directors considered the following factors in its deliberations:

(i) In the external context, average economic growth during 2012 with respect to Colombia's trading partners was in line with expectations. As for 2013, the measures adopted by the European authorities and the improvement in financial conditions have reduced the likelihood of a sharp recession in the Euro Zone. In the United States, the latest information suggests its economy could grow at a somewhat slower pace than was forecast for 2012. China's growth remains at around 8%. This being the case, the expectation for the current year is that external demand will continue to be weak and increase at a pace similar to the rate in 2012.

(ii) The rising trend witnessed in terms of trade up to 2011 was interrupted in 2012, the year when terms of trade remained stable. Given the weakness of the global economy, terms of trade in 2013 could be somewhat below the average observed in 2012.

(iii) As to the fourth quarter of 2012, the new figures on consumer lending, retail trade and consumer confidence suggest household spending would grow slightly less than the rate observed in the third quarter. There is a great deal of uncertainty about how investment will behave, especially investment spent on civil works, construction and buildings. The figures for exports in dollars show more of a slowdown than for imports.

(iv) On the supply side, the industrial production indicator posted an annual drop in November and expectations in the sector deteriorated yet again. Retail sales, both with and without vehicles, rose at a good pace.

(v) For 2013, the technical team forecasts between 2.5% and 4.5% economic growth, with 4% being the most likely figure. The major uncertainty with respect to this forecast is rooted in the possible persistence of the negative shock witnesses in investment in civil works and buildings. Some of the factors that have slowed this type of spending are expected to be reversed, thereby bolstering domestic demand. The conditions that supported the momentum observed in consumption and investment in machinery and equipment are expected to continue during 2013. Among others, they include stable levels of employment and consumer confidence, and the accumulated reduction in policy interest rates. The latter is being passed through to interest rates on loans, coupled with lending that has slowed but continues to grow at a good pace. All of this is accompanied by an international context of broad liquidity and low interest rates.

(vi) Annual consumer inflation in December (2.4%) declined more than anticipated by the market and by the Bank's technical team. As occurred throughout the year, the slowdown in inflation was explained, yet again, by less of an increase in the CPI for regulated items and food. Average core inflation and inflation expectations declined again and are now below the long-term target (3%).

(vii) In short, the Colombian economy is growing below its potential. Moreover, observed and projected inflation are under the 3% target, and there are no signs of upward pressure on inflation in the near future. Given these conditions, an assessment of the risk balance indicates the advisability of lowering the intervention interest rate to 4%. The monetary policy action that has been taken is designed to situate output in 2013 near the economy's productive capacity, without jeopardizing the inflation target or the country's macroeconomic stability.

The majority of the Board members considered it appropriate to lower the intervention interest rate by 25 bp, primarily in view of the following:

(i) Inflation forecasts and expectations are below the long-term target of 3%, as are total inflation and core inflation.

(ii) Weakening economic growth and the reduced growth forecasts for this year.

(iii) The significant and unexpected slowdown in domestic demand, mainly due to a negative shock to investment. The duration of this shock is uncertain and depends largely on the performance of public spending and investment in the mining sector during 2013.

(iv) Private consumption grew at a rate close to its historic average, and it is feasible to expect it will slow somewhat this year, but not significantly. Given these conditions, the risk that a reduction of this size in the intervention interest rate would exacerbate the risk of financial imbalances and jeopardize growth in employment and output is considered limited.

Moreover, the feeling is that although a more expansionary monetary policy is needed, uncertainty as to how domestic demand will evolve in the future and the possibilities of aggravating previous imbalances accumulated by the economy, especially in an environment of ample international liquidity, suggest the advisability of being prudent in terms of policy measures.

One member of the majority group emphasized that, in addition to the problems affecting the construction sector in the third quarter of 2012, the weak growth in aggregate demand observed since the second quarter of 2012 has led to less growth in various sectors of the economy, so much so that there is now surplus installed capacity. However, the abundance of international liquidity and the latest data on the supply of non-tradable goods and services indicate the momentum in domestic demand could increase by the end of 2013.

Other members felt a 50 basis point reduction in the Bank's intervention rate would be appropriate for a number of reasons. The information at hand confirms there is every indication at the beginning of 2013 that the recession in Europe would be more prolonged. The recovery in the United States has yet to be anything but mediocre. In the region, there is the good performance exhibited by Chile and Peru, and the fact that the downward trend in Brazil is being halted. Venezuela, the most important market for Colombian industrial exports, surely will experience serious devaluation this year due to its fiscal and exchange imbalances, and a drop in growth from 5.5% in 2012 to 2.5% in 2013. In Colombia, with an average real rate of exchange for 2012 at 8% below the equilibrium rate, the momentum in exports drops. In fact, between January and November, compared to the same period in 2011, exports rose by only by 6%, as opposed to 43% between 2010 and 2011. Mining and oil exports during the same interval went from an increase of 56% in 2011 to just 8% in 2012. Agricultural exports went from 26% to a drop of 14%, while the increase in industrial exports went from 15% to 7%. For industry, the problems associated with weakening domestic demand are bringing increasing weight to bear. Unemployment has ceased to decline, because total employment is growing less and less, to the point where the NAIRU in 2013 will remain below that rate. Industrial employment began to drop for the first time in two years. It is in the domestic market where industry is losing ground to imports of consumer goods. This is consistent with the growth in trade, in contrast to the contraction in industry. The technical team expects growth for this year to be

within a range of 2.5% to 4.5%, with 4% being the most likely figure, but with a risk balance tilted towards the downside. This indicates the growth achieved in 2012 (about 3.6%) and the amount projected for 2013 are both below potential growth. In other words, the gaps in output and labor are in increasingly negative terrain.

In short, weakening domestic demand, coupled with the continued fragility of the international context, has been evident since last year. Moreover, inflation in December was 56 basis points below the middle of the target range, while average core inflation was 2.8% and non-food inflation, 2.4%. All inflation expectations were below target as well. In keeping with an inflation targeting scheme, monetary policy should cause inflation to return to the 3% target. Consequently, they proposed lowering the Bank's intervention interest rate by 50 basis points. From a monetary standpoint, this should be done to allow GDP to approach its potential yet again by the end of 2013 and in 2014, without jeopardizing compliance with the inflation target.

3. POLICY DECISION

Based on its assessment of the current risk balance, the Board agreed to reduce the intervention interest rate by 25 bp.

The Board reiterated that Banco de la República has sufficient tools and resources to satisfy the economy's regular liquidity needs with respect to both local and foreign currency, as well as any needs that could arise in an environment of international financial turmoil.

The Board will continue its careful monitoring of performance and projections with respect to economic activity and inflation in Colombia, asset markets and the international situation. Finally, it reiterated that monetary policy will depend on new information as it becomes available.

Fuente: https://www.banrep.gov.co/en/news/board-directors/minutes-january-2013