Minutes of the Banco de la República Board of Director's meeting on October 25, 2013

Detailed Explanation of the Macroeconomic Situation (only in Spanish) Must reads Banco de la Republica Maintains the Benchmark Interest Rate 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 October 25, 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 Board Members Carlos Gustavo Cano Sanz, Ana Fernanda Maiguashca Olano, Adolfo Enrique Meisel Roca, César Vallejo Mejía and Juan Pablo Zárate Perdomo. These minutes contain a summary of inflation, economic growth and their prospects for the future, which was prepared by the Bank's technical staff (Section 1), in addition to a review of the key deliberations and policy options considered by the Board of Directors (Section 2).

1. INFLATION AND ECONOMIC GROWTHa. Recent Developments in Inflation
In September, annual consumer inflation was 2.27%, which is the same as what was registered the month before. In the first nine months of the year, the accumulated change in the CPI came to 2.16%, which is lower than the accumulated change for the same period in 2012 (2.32%). The stability of the indicator for the latest month was the result of a surge in the annual variation of the CPI for food that was offset by reductions in the annual changes of the CPI for the other three large components (regulated and tradables and non-tradables excluding food and regulated prices).

The annual variation of the CPI for food in September was 2.1%, 28 basis points (bp) higher with respect to August. The rising trend in this indicator has been continuous since the middle of the second quarter. The prices for perishables are the reason for a large part of this performance (they rose 40 bp in comparison to the month before and were at 5.9%). There was very moderate upward pressure on processed foods (0.18% annual change). In this sub-basket, the depreciation of the last few months has not been transmitted to the domestic prices which could be due to the fact that the international prices for grain, oleaginous products, and oil have fallen significantly. Finally, the annual change in the CPI for eating away from home rose to 3.7% from 3.6% in August.

The annual change in the CPI excluding food was at 2.4% this month, 10 bp less than the information from August. After the increases seen between January and June, this variable has shown a slightly downward trend. The largest drop occurred in the annual change in the CPI for regulated prices (1.2% in September compared to 1.5% in August) and is mainly due to the stability of the fuel prices in comparison to the upswings registered during the same month last year. The annual change in the CPI for regulated items has remained below annual inflation since mid-2012 thanks to the lower increases in the international prices for petroleum, the reductions in the fees for sewage and garbage collection services, and other decreases associated with the tax reforms at the beginning of this year.

In the case of the CPI for non-tradables excluding food and regulated items, the annual change was 3.7% or 8 bp less than what was seen in August. This indicator shows, with a few interruptions, a slight downward trend which has been ongoing for three quarters and which the performance of rentals, its most important component, has made possible. The annual variation for rent was at 3.6% last month compared to 3.7% in August and lower than those registered in June and March. In the rest of the subgroups for the non-tradables basket, there were adjustments of close to 3.0% except for education which was at 4.9%.

With respect to tradables excluding food and regulated items, the datum for September was 1.3%, 5 bp below that registered for August. Although the depreciation from previous months has been transmitted to said prices, this has occurred slowly and intermittently.

The average for the four core inflation indicators that are monitored by the Banco de la Republica was at 2.51% in September, 3 bp less than the month before. This indicator has stabilized around 2.5% since February of this year.

The annual variation of the PPI declined to -1.3% in September from -0.5% in August. The local component decreased with respect to the month before (122 bp), due to the lower adjustments to the prices for agricultural and manufactured products. The import component rose 1.6% annually in September as a result of the recent depreciation of the peso.

Regarding inflation expectations, according to the Bank's monthly survey of financial market analysts, expected inflation for December of this year is 2.6% while that for the coming 12 months is 3.0%. These are the same as those registered last month. The inflation expectations derived from the yield curve of the TES at horizons of 2, 3, and 5 years, in turn, are between 2.6% and 2.7%. This represented a slight rise from what was seen a month ago.

b. Growth

The indicators of demand that are available for the third quarter suggest a greater expansion of the GDP than what was registered in the first half of the year. This surge is largely the result of the performance of domestic demand, a category that could have been driven mainly by the positive performance of investment. Household consumption would have grown at a rate similar to what was seen in the first half of the year.

The expected surge in investment during the third quarter would have been mainly due to the favorable performance that is expected for building construction. The greater expected expansion in this item is associated to a large degree with the low base of comparison from the same period last year and the effect of the government's policy on priority housing and the generally positive outlook for the housing market which was reflected in the increase in the number of building licenses approved during the third quarter. The investment in public works is expected to grow at rates that are slightly higher than those registered in the second quarter. Note that the uncertainty surrounding the performance of investment in public works projects is very high.

Investments other than building construction and public works are expected to have a slightly better performance than what was registered in the second quarter. This is based on the balance of the investment expectations reported by businessmen in the Banco de la Republica's Monthly Survey of Economic Expectations (EMEE in Spanish) and the results (in terms of real pesos) of imports of capital goods and machinery for industry.

In the third quarter, the performance of household consumption is expected to be similar to what was seen in the first half of the year. According to the information from the monthly retail-trade surveys (MMCM in Spanish) published by DANE, retail sales grew 6.9% in annual terms during August. This figure is higher than the 5.8% registered for the second quarter and the 2.8% for the first half of the year. When the segment of vehicle sales was discounted, they grew 8.6% annually in the same period. This shows an upsurge in comparison to 5.2% for the second quarter and 4.3% for the first semester. The growth rates for the July-August 2-month period confirmed the outlook of a positive performance for private consumption in the third quarter (6.2% in the growth of total sales, 5.9% when vehicles are discounted). In line with the above, the EMEE balance of sales suggests that, in July and August, merchants saw a slightly stronger demand than what had been seen in the second quarter.

Nevertheless, there are indications that the strength of consumption in the third quarter could be lower than what has been drawn from the previously described indicators. On the one hand, the Fedesarrollo consumer

confidence index for September was at levels similar to those registered in August, which had fallen significantly with respect to what had been seen in the second quarter of the year. On the other, the consumer loan portfolio registered new slowdowns (in real terms) when it expanded 10.0% in annual terms during the July-September quarter in comparison to 11.7% for the second quarter and 12.9% for the first half of the year.

With respect to the country's foreign sales, the total value exported in dollars in August presented an annual increase of 8.9%. This increase is the result of the 19.3% growth in the exports of mining products (the higher foreign sales of petroleum and its derivatives and coal). This month, agricultural exports registered a dip of 0.8% associated with the negative change in exports of bananas and coffee. The exports of industrial goods and others fell 16.4% primarily because of the lower sales of chemical products, other agricultural products, rubber, plastics, and vehicles. For the third quarter, exports are expected to have grown at a modest rate mainly due to the effect that the various strikes that occurred in the coal sector could have had.

In the month of August, total imports in dollars dropped 5% with respect to the same month last year. This performance was due to the combined fall in the imports of capital goods (-6.1%), raw materials (-3.9%), and consumer goods (-5.4%). The prediction is that this sector will grow at a higher rate than exports in the third quarter although below the rate registered in 2012.

With respect to supply, the indicators available suggest that the construction sector will have been the main source of output growth followed by agriculture, mining, and commerce. The performance of industry will continue to be low.

The GDP for industry will have shown no or slightly positive annual growth in the third quarter. Even if an additional drop can be expected in the industrial production index excluding coffee threshing, the performance of the coffee sector will have offset falls in some branches of industry since the threshing will have been growing well above the average for the entire economy. This was the case when the industrial production index excluding coffee threshing fell 3.9% annually in August (in July, it had grown 0.2%) while there was significant growth in coffee threshing (it rose 12.7% annually in August and 15.1% in July). Although other industry indicators showed slight deteriorations with respect to the previous month, when an analysis of the trends is done, one sees that its long term components could be stabilizing. This is the case for the orders indicator, the inventory indicator, and the industrial outlook for six months from the Fedesarrollo survey.

In regards to mining, in spite of the drop that could be seen in the production of coal due to the strike at the Drummond, better growth is expected for this quarter because of the increase that has been seen in petroleum production. In this latter sector, the annual growth for the July-September quarter was 8.7%.

In the construction sector, the available indicators suggest that the positive performance seen in the first half of the year will continue over the coming three months. Construction licenses grew 18.7% in August primarily due to a 33.1% upswing in the area approved for housing.

With respect to other sectors, the lower performance of the transportation sector together with the strike in August could have had negative effects. Nonetheless, it is expected that the growth rate for the third quarter will be maintained at a level that is only slightly lower than that for the second. In the case of commerce, the information from Fedesarrollo and Fenalco shows a weakening in the outlook the merchants have of the future. However, as was mentioned above, retail sales showed a strong performance in August. Last of all, agriculture will have had a favorable performance mainly supported by the strength of coffee production. According to the Federation of Coffee Growers, this is growing at more than 40% in the third quarter.

All of the above makes it possible to predict that the growth of the Colombian economy will have been between 3.8% and 5.2% in the third quarter of 2013. Note that the width of this range is determined to a large degree by the uncertainty surrounding the performance of the investment in public works and public consumption.

The forecast range for all of 2013 is between 3.5% and 4.5%. This forecast assumes that household consumption in the second half of the year will grow at rates close to those seen in the first half of the year while investment in construction will surge significantly. By branches of activity, the strongest sectors will be construction and agriculture while the lowest performance will be seen in industry.

The estimated growth of the Colombian economy in 2014 will be between 3.0% and 5.0%.

c. Financial Variables

Bank loans (N/C and F/C) in September registered an annual growth rate of 13.94% which is close to the average seen since April (13.97%). The loan portfolio in national currency climbed from 12.90% in August to 13.18% in September and that in foreign currency went from 30.91% to 27.25% during the same period.

Broken down by market, the portfolio of loans granted to households registered an annual growth in September of 12.80%, which is lower than the growth in the previous month (13.19%). This was the result of the performance of consumer loans which went from 12.90% to 12.37% while mortgages maintained an annual growth of 14.0% in September.

The growth rate of the commercial loan portfolio rose 36 bp in September (14.41%) with respect to the same month last year due to the upswing in the national currency component (from 12.33% in August to 13.13% in September).

The interest rates for the loans disbursed by credit institutions since the beginning of the cuts in the benchmark rate in July 2012 have accumulated reductions of: -223 bp for mortgages, -206 bp for consumer loans, and -185 bp for building loans.

The size of the decline in the real interest rates has been lower due to the effect of the lower rate of inflation. There have been reductions during the same period of: -189 bp in mortgages, -170 bp in consumer loans, and -141 bp in loans for construction.

The levels of the real interest rates for consumer loans, mortgages, preferential loans, ordinary commercial ones and commercial lines of credit, and loans for construction in September were below their historical averages as calculated since 2000. In contrast, the credit card loans are above their average.

d. The External Environment

The information available for the third quarter indicates that the world economy has continued to recover. This is due to the positive growth indicators that are beginning to be registered in the euro zone after a prolonged period of contraction as well as moderate growth in the United States and Japan. The large emerging economies in Asia and Latin America, in turn, are growing heterogeneously although the majority are showing rates of expansion that are lower than those seen the year before.

In the case of the euro zone, the business and consumer confidence indicators together with the activity indicators in the manufacturing and service sectors continued to show an encouraging performance based on data as of September. Likewise, based on the figures as of August, retail sales completed several months of monthly growth and are slowing down their annual decline. Nevertheless, it is important to note that the economy of this region remains vulnerable. The unemployment rate, especially in the economies on the periphery, is still at high levels. Credit continues to contract and financial fragmentation is still affecting the most vulnerable economies in the region.

In the case of Japan, the strong stimulus provided by the monetary policy is beginning to manifest itself in the positive indicators of economic activity in that country. These show that exports have continued to expand just as industrial activity has. In this context, business confidence has risen in the last few months in contrast to

consumer confidence which has been deteriorating for several months.

With respect to the United States, retail sales and industry grew in both monthly and annual terms based on the figures for August. Likewise, in September, the activity indicators in the manufacturing and service sectors remained in expansionary territory. This information indicates that productive activity expanded at a moderate rate in the third quarter. Note that in the first few days of October, the US Congress did not succeed in reaching an agreement on the budget for the fiscal year as a result of which, a government shutdown was declared. The discussions about the budget coincided with the negotiations on the debt limit. On October 16, Congress reached an agreement that prevented a suspension of economy payments (the debt was approved until February 2014) and allowed the government to reopen until January 2014. During this period, negotiations should be carried out to agree on new fiscal adjustments.

In the emerging economies, the economic growth of China rose slightly in the third quarter of the year. The better growth was reflected in the recovery of domestic demand and industrial activity. During this period, the government implemented some stimulus measures that contributed to the growth of investment.

In the case of Latin America, based on preliminary information for the third quarter, the performance of productive activity continues to be heterogenous. Thus, while in Peru the monthly indicators show a limited upswing, the growth in Chile seems to be stabilizing at 4.5%, a rate that is below its potential. The economy in Brazil, in turn, seems to be losing strength.

Regarding the international prices of commodities, the increase in geopolitical tensions raised the foreign prices of petroleum above what had been estimated by the technical team in the June Inflation Report in the third quarter. For other goods exported by Colombia, the falling prices for coal and nickel were interrupted and, in the last few weeks, they have shown some stability. However, the foreign prices for coffee continued to fall though at a slower rate. There were also drops in the international prices of some beans and grains (except for wheat).

Inflation in the main developed economies has stayed relatively stable in the last few months. The panorama is more heterogenous for inflation in the emerging economies. Thus, there are countries such as Brazil, India, and Indonesia with relatively high inflation and in some cases, inflation that is above the targets fixed by their central banks. In contrast, there are economies like Chile, Colombia, and Peru with inflation that is low but rising. Other Asian economies show low and even declining inflation (Taiwan and Korea).

In regards to global financial markets, the latest events in the United States have led to the market reducing the probability that the FED will begin to lower the amount of monthly asset purchases this year. This has partially reversed the increases in the long term interest rates that were registered as of May. It also produced a decline in the country risk indicators in Latin America and a slight appreciation of their currencies.

Taking this international environment into account, the technical team continues to predict a growth in the foreign demand for Colombian products for this year that is below what was seen the year before. It is to be hoped that for the rest of the year and in the coming one, the terms of trade remain at relatively high levels even if they are lower than those registered at the beginning of 2012.

The external risks for global economic activity rose with respect to the previous quarterly report. On one hand, the uncertainty about the fiscal agreements in the United States could have a negative effect on consumer and financial market confidence and this would have an impact on the economic growth of this country both in 2013 and 2014. On the other hand, the changes in financial flows that would result from the beginning of a phase out of the monetary stimulus in the United States could cause a sharper slowdown in 2014, even including risks to financial stability, in the most vulnerable emerging economies.

2. DISCUSSION AND POLICY OPTIONS

The Board of Directors considered the following relative aspects.

(i) The global economy is expanding at a moderate rate and its short term strength has changed a little with respect to what has been seen in previous quarters. According to indicators for the third quarter, there is an incipient recovery in the euro zone. However, the growth of the United States could have been weakened as a consequence of the partial shutdown of the federal government and the greater uncertainty. The emerging economies as a whole are expanding at a slower pace although the growth of the GDP in China was higher than the market expected.

(ii) Furthermore, the probability that the FED will begin to reduce the amount of monthly asset purchases this year has dropped. This is what partially reversed the increases in the long term interest rates that were registered as of May. It also produced a decline in the country risk indicators in Latin America and a slight appreciation of their currencies

(iii) The international price of petroleum and of some raw materials imported by Colombia, in turn, dropped.

(iv) In Colombia, the data available for the third quarter suggest that, driven by investment, economic activity is expanding at a faster rate than it did in the first half of the year. Consumption will have grown at a rate similar to that of the first half of the year. In the area of supply, the construction sector will have been the main source of growth, followed by agriculture, mining and commerce. The technical team forecasts a rate of growth that is between 3.5% and 4.5% for all of 2013.

(v) Bank loans are growing at stable rates that were above the nominal GDP. In real terms, the interest rates for the different types of loans are below their historical averages (except for credit card interest rates) and are driving economic growth.

(vi) Annual inflation (2.27%) in September remained stable with respect to the month before and the same was true of the average of the core inflation measurements. The analysts' inflation expectations for the coming 12 months and those calculated on the basis of public debt securities at longer horizons are consistent with the long term inflation target.

Some members thought that the GDP gap was slightly negative and judging by the performance of the core inflation indicators and the prices for non-tradables, it seems to have been at a stable level for quite a few months. Additionally, the 3.25% benchmark interest rate is below any reasonable estimate of the "natural" level of the nominal interest rate. This indicates an expansionary monetary posture. This posture is justified by the negative effects of external productive and financial shocks on aggregate demand and somewhat by the precarious recovery in some of the confidence and expectation indicators. There is a lot of uncertainty about the future of these variables and, therefore, maintaining the current level of the benchmark interest rate is considered appropriate.

Another group of directors thought it was possible that the output gap could be more negative than previously stated if the fact that both core inflation and the mid-point of the inflation projections are remaining at around 2.5%, which is below the long term target, is considered. Likewise, the evolution of various sector indicators and of demand has been erratic and has not shown any convincing signs with respect to the magnitude and sustainability of the process for closing this gap. Finally, in spite of the fact that there has been some improvement in the projections for the global context, there is no indication that foreign demand could be a source for fostering better growth of output. Under these circumstances, it is appropriate to continue the stimulus that monetary policy is giving to the aggregate demand by maintaining the current expansionary posture.

3. POLICY DECISION

Based on the evaluation of the balance of risks, the Board of Directors agreed unanimously that it would be appropriate to keep the benchmark interest rate at 3.25%.

The Board will continue to monitor the performance and projections for economic activity and inflation in the country, the asset markets, and international situation carefully. Finally, they reiterate that the monetary policy will depend on the new information available.

Bogotá, D. C.

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