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Must reads

[Banco de la Republica Holding the Benchmark Interest Rate at 3.25%](#)

A regular meeting of the Board of Directors of Banco de la República was held in the city of Bogotá D.C. on December 30, 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 GROWTH**

### **a. Recent Developments in Inflation**

In November, annual consumer inflation was 1.76%, which is 8 basis points (bp) lower than in October. So far this year, the datum comes to 1.67%, which is lower than the accumulated rise for the same period last year (2.34%). The decline in inflation in November is primarily due to the component of regulated items.

The annual variation in the basket for food ended the month at 0.62%, 4 bp lower than the month before. The annual change in the prices for meals away from home and in the change for processed foods showed drops of 23 bp and 15 bp respectively. Within this second group, the prices of imported products or of other products that are produced in the country but are highly tradable have remained unchanged or have continued to fall. This reflects the lower international prices and the limited pressure from the exchange rate. The prices of perishables, in turn, fell 2.1%, which is a smaller drop than the one seen in October (-2.8%).

The annual change in the CPI excluding food in November was at 2.21%, 10 bp lower than the month before. The fact that the annual change in the CPI for regulated items (0.5% annually) was a drop of 62 bp is noteworthy. This is again attributable to public utilities (fees for electricity service) and to the decline in the prices of fuel which was -3.95% annually last month. The accumulated depreciation of the peso over the course of the year and slight upticks in the prices of some imported goods have kept the

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annual change in the prices for tradable goods excluding food at 1.4%. The non-tradables excluding food, in turn, showed an annual change of 3.7%, which is 6 bp higher than the previous record. The annual variation in rent, the main component of the group, remained at 3.6%.

The average of the four indicators of core inflation monitored by the Banco de la República was 2.46% in November, 2 bp higher than the previous month. This indicator has been stable at around 2.5% since February of this year.

The PPI dropped 1.3% in November in comparison to the same month last year. This decline was less than the one in October (1.9%). The local component rose with respect to the month before (57 bp). The import component rose 1.2% annually, a figure that is higher than the one registered the previous month (0.95%).

In November, inflation expectations continued to stay below the long term target although within the range established by the Board of Directors. The monthly survey of financial market analysts shows an expected inflation of 2.89% 12 months from now. This is 3 bp lower than the expectation a month earlier. For December of this year, the market expects a figure of 1.86%. At the same time, inflation expectations derived from the TES for 2- and 3-year maturities remained relatively stable between 2.3% and 2.6%. Those with 5-year maturities rose a little and were at 2.8%.

## **b. Growth**

According to the information published by DANE, the Colombian economy expanded 5.1% in annual terms during the third quarter of 2013. This figure, which indicated a significant surge with respect to what had been registered in the first half of the year, was in the upper part of the forecast range presented in the previous Inflation Report (between 3.8% and 5.2%). From the beginning of the year to September, the growth of the GDP (3.9% annually) was similar to the key projection made by the technical team at the Banco de la República.

During the July - September quarter, domestic demand grew at a positive rate (6.0% annually). This was due to a very good performance on the part of building construction (26.7% annually), of public works (18.2% annually), a sharp expansion in public consumption (5.7% annually), and a growth in household consumption (4.0% annually) that was close to its historical average. With respect to the international trading accounts, exports slowed down in annual terms in comparison to the second quarter (1.9% vs. 7.8%) due to several supply shocks in mining production that substantially affected foreign sales. In the case of imports, higher annual growth rates were reported in comparison to the second quarter of 2013 (2.9% vs. 1.3%).

On the supply side, the sectors that registered the highest annual growth in the third quarter were construction (21.3%), agriculture (6.6%), and mining and quarrying (6.1%). Industry continued to be the sector with the worse performance (-1.0%). Other sectors such as commerce and finance maintained a favorable rate of expansion as they grew at annual rates of 4.3% and 4.9% respectively.

In the fourth quarter of 2013, household consumption could remain strong. This comes from the indicators such as retail sales published by DANE that show that it grew at an annual rate of 6.6% in October and at 4.5% excluding vehicle sales. Part of this growth is explained by the low base of

comparison from last year. The Banco de la República's Monthly Survey of Economic Expectations (EMEE in Spanish) also reveals that based on data up to October, sales expectations are higher than the average registered for the third quarter of the year. Furthermore, the consumer confidence index (CCI) published by Fedesarrollo in November shows records similar to those seen in the month of October and slight improvements in the indicators of expectations. Likewise, the growth in imports of consumer goods (8.4% real) as well as the stability of the annual growth of the consumer loan portfolio (12.7%) indicates that consumption will maintain the strength seen in the last few quarters.

With respect to investment, the Banco de la República's Monthly Survey of Economic Expectations (EMEE in Spanish) with data up to October suggests a positive performance of investment other than building construction and public works in the last quarter of the year. The information on imports of capital goods shows that, in October, purchases of these types of goods remained at elevated levels as they grew 5.3% in real pesos (according to the technical team's estimates).

For total exports in dollars, the annual change in October was -11%. This drop was due to the combined decline in foreign sales of mining (-14.4%), agricultural (-7.4%), and industrial products and others (-0.4%). Total imports, in turn, in dollars grew 2.7% compared to the same period last year.

With respect to supply, the few indicators available show that sectors such as mining, commerce, and construction should continue to show high growth in the fourth quarter of the year. The Ministry of Mining and Energy reported that mining and hydrocarbons production grew 15.4% and 19.9% respectively. In turn, the production and delivery of cement saw an annual growth of 8.4% and 19.9% respectively. In the production and delivery of steel, the figures published by DANE for October reported an annual growth that was weaker, its recent strength suggests that industry is recovering going into the fourth quarter. In turn, likewise, the imports of raw materials in October suggest that productive activity will expand at the high growth rate of 10.2% in real pesos (according to the technical team's estimates). With the above results, the technical team did not modify the estimated range of growth for 2013 as a forecast, its rising construction, and public consumption is a source of high uncertainty for business.

### c. Financial Variables

Bank loans (N/G and E/C) in November registered an annual growth rate of 13.20%, a level which is 10.11% higher in October to 3.13% in November and, in turn, a foreign currency also which is 1.55% higher than the portfolio of loans granted to households registered an annual growth of 13.40% in November and 10.11% in October. The interest rates for loans disbursed by credit institutions since the beginning of the year in the consumer loans, and 1.64% for building loans. The rate of reduction of 2.24% to the beginning of the year in the consumer loans, and 0.24% for construction loans. The rate of the decline in the real interest rates has been lower due to the effect of the lower rate for consumer loans, and 0.24% for construction loans. The levels of the real interest rates for consumer loans, mortgages, preferential loans, and ordinary average real averages are maintained since 2000. In contrast, the credit and loans are above the low average real averages.

### d. Foreign Context

In the last few months, global activity has continued to improve mainly in the developed economies and in the emerging and developing economies. In the United States, the most recent figures on economic growth show that the economy expanded in the third quarter of 2012, and the growth rate was 2.1% in the third quarter of 2012, and 2.1% in the third quarter of 2012. In the euro zone based on November figures, the indicators of business confidence and the activity of internal and external stocks, showing any favorable signs. Thus, the region remains vulnerable to both the rise of the emerging economies, and the activity in China continued to expand at a favorable rate. In November, the performance of total sales, exports, and production was better than expected in Latin

## 2. DISCUSSION AND POLICY OPTIONS

(i) The latest information on prospects that household consumption is recovering slowly and better than expected and the large energy price increases in Asia and Latin America are growing the economy again;  
 (ii) In the United States, the Federal Reserve announced that it will purchase a down amount in financial  
 (iii) The terms of trade declined in October but they still remain at high levels. A minor rise in the terms of trade is expected in the near future supply is low  
 (iv) In Colombia the economic growth in the third quarter was higher than what had been estimated for the quarter. GDP growth (0.9%) was similar to that projected by the technical team of the Banco de la República. GDP growth (0.9%) was similar to that projected by the technical team of the  
 (v) For the fourth quarter of 2012, the indication of consumer confidence and economic expectations, retail sales, the manufacturing sector and non-financial services processing are again in growth (0.7%), although a  
 (vi) Due to these good results, the technical team did not change their estimated growth range for 2012 as  
 (vii) In November, the overall growth of has slowed down a little, but it continued to be higher than the  
 (viii) Average core consumer inflation was at 1.76% in November, a figure that was lower than expected. This  
 (ix) The public inflation expectations of economists have years ago, as well as those derived from  
 To summarize, economic growth in 2013 is expected to be similar to what was seen in the year before.  
 The monetary interest rate unchanged. Board of Directors decided that it would be appropriate to keep the  
 The members of the Board agreed that it would be an appropriate to keep the benchmark rate with  
 Another director stated that the information contained in the report indicates a positive performance of  
 current monetary policy posture, and the public inflation gap was gradually closing. In that, with the  
 Furthermore, another member thought that the fact that the growth rate of the GDP is increasing while  
 the target and the output gap is closing, the monetary policy will be more inflationary in the long run.  
 Finally, other members added that in consideration of the fact that the current level of inflation has been

### 3. POLICY DECISION

