Minutes of the Banco de la Republica Board of Director’s meeting on December 20, 2013

Must reads Banco de la Republica Holding the Benchmark Interest Rate at 3.25% 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 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 GROWTHa. 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 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 petroleum production in November came to a million twelve-thousand barrels per day (1.012 MBD) which indicates a growth of 2.63% in comparison to October and of 4.3% compared to the same month in 2012. In the case of commerce, in addition to the results from the DANE monthly manufacturing survey mentioned above, the FENALCO survey as of November showed that the businessmen's perception of the situation with current sales and expectations for sales in 6 months continued its rising trend. Based on

October figures for construction, the production and delivery of cement saw an annual growth of 18.4% and 13.9% respectively.

The figures published by DANE for industry in the month of October reported an annual growth that was negative but close to zero (-0.1%). Over the course of the year it fell 2.4%. Weakening of industry continues but at a slower pace in comparison to previous months (in August and September it fell 3.9% and 1.8% respectively). In November, industrial demand for energy grew 3.1% annually and the trend began to show a positive slope. This has a high correlation with industrial production as a result of which, its recent strength suggests that industry is recovering going into the fourth quarter.

Likewise, the imports of raw materials in October suggest that productive activity will expand at the beginning of the fourth quarter at a good pace. For that month, the level of these imports remained high with a 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 whole (between 3.5% and 4.5%). This indicates that the economic growth in the second half of the year could be considerably higher than what was seen in the first. Note that the performance of investment in public works, housing construction, and public consumption is a source of high uncertainty for these forecasts.

c. Financial Variables

Bank loans (N/C and F/C) in November registered an annual growth rate of 13.30%, a level which is lower than the one seen the previous month (14.03%). The loan portfolio in national currency dropped from 13.74% in October to 13.48% in November and the one in foreign currency also went from 19.35% to 11.10%.

Broken down by market, the portfolio of loans granted to households registered an annual growth of 13.51% in November, which is slightly higher than the growth in the previous month (13.28%). This was due to the performance of mortgage loans which rose between October and November and went from 14.37% to 14.8%. Consumer loans, in turn, slowed down slightly as they went from growing at an annual rate of 12.66% to one of 12.45% during the same period. Regarding the commercial loan portfolio, its annual growth rate in November (13.32%) was lower than the rate for the month before (14.45%). This was due to the moderation in the national currency component (from 13.99% in October to 13.65% in November) and to the slowdown in the foreign currency component (from 18.85% to 10.16%).

The interest rates for loans disbursed by credit institutions since the beginning of the cuts in the policy interest rate in July 2012 have accumulated reductions of: -224 bp for mortgages, -206 bp for consumer loans, and -184 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 this same period of: -163 bp for mortgages, -141 bp for consumer loans, and -124 bp for construction loans.

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. Foreign Context

In the last few months, global activity has continued recovering mainly in the developed economies and to a lesser degree in some emerging countries in Asia. In general, the global activity indicators in the sectors of manufacturing and services remain in expansionary territory and global trade is showing signs of recovery.

In the United States, the most recent figures on economic growth show that the economy expanded in the third quarter of the year at a rate that was better than that predicted by the analysts. Based on information as of November, retail sales and industrial production caught everyone by surprise on an upward trend and showed that the economy would continue expanding at a modest rate in the last quarter of the year. At the same time, the employment figures for the same month were encouraging and presented a favorable rate of hiring. Note that the US Congress also recently approved a plan that would avoid the implementation of certain automatic cuts in 2014 and 2015 and that would somewhat alleviate the fiscal discussions over the next few years. Thus in the coming quarters, the economy will face less fiscal debilitation and perhaps a little less uncertainty coming from this area.

In the euro zone based on November figures, the indicators of business confidence and the activity indicators in the manufacturing and service sectors show signs of an economy expanding at a modest rate. There was also evidence of some divergence in the productive activity figures for the countries in the region. Specifically, while Germany is expanding at a favorable rate, some weakening of productive activity can be seen in France. In spite of the improvement in the confidence indicators, retail sales remain depressed, the labor market shows high unemployment rates, financial fragmentation is continuing, and credit is not showing any favorable signs. Thus, the region remains vulnerable to both internal and external shocks.

In the case of the emerging economies, productive activity in China continued to expand at a favorable rate although one that is lower than what has been seen in the last 5 years. Based on information as of November, the performance of retail sales, exports, and production was better than expected. In Latin America, in turn, productive activity has continued to slow down in Chile while, in Brazil, it is expanding at a moderate pace.

Regarding the international prices for petroleum, these have remained at relatively high levels in comparison to what was seen in the first half of year. This was a little above what was expected. In the case of foreign prices for coal and nickel, there has been some stability. The prices of coffee have continued to fall. Foreign prices for food, in turn, remained at relatively low levels with some minor upticks.

Due to all of the above, inflation in the main developed economies is staying at low levels.This, together with an economic activity that is growing at a level below its potential, explains the monetary posture of their central banks. In the case of the emerging economies, the situation is more heterogenous. While some countries such as Colombia, Taiwan, and Korea have low declining inflation, others such as Brazil, India, and Indonesia are showing higher upswings in their price levels.

The terms of trade declined in October but remain at high levels. No rise in these terms of trade is expected in a scenario of dilatory recovery of the global economy and better conditions expected in the global supply of petroleum.

Finally, in their December 17-18 meeting, the Federal Reserve of the United States (FED) decided to reduce their purchases of financial assets by 10 billion USD beginning in January 2014. Thus, the FED would buy 40 billion in Treasury bonds and 35 billion in MBS. The favorable change in the labor market and in other economic and financial variables was the reason for this decision. Forward guidance on the conditions under which the rate for federal funds will rise was modified. It was stated that this rate will continue at low levels until after the unemployment rate drops below 6.5%, especially if the inflation projections remain below the long term target (2%). The FED insisted that the monetary policy posture will continue to depend on the evolution of the economy, especially the labor market and inflation. With respect to the predictions for growth and the unemployment rate, some improvements were presented for 2013 and 2014.

So far, the reaction of some market indicators has not been very strong in view of the announcement. The interest rates of the United States public debt securities, the VIX, and the dollar price with respect to the main currencies have shown no significant changes in their levels. A similar conclusion can be derived from the

financial indicators in the emerging markets: the risk premiums, the price of the dollar in the local currency, and the interest rates for public debt securities have not changed substantially.

2. DISCUSSION AND POLICY OPTIONS

The board of directors took the following relevant aspects into consideration:

(i) The new information suggests that the world economy is recovering slowly and better than expected. In the United States, the GDP growth in the third quarter was revised upwards and the figures as of November were still showing a recovery but at a modest rate. The euro zone is probably growing again and the large emerging economies in Asia and Latin America are growing unevenly.

(ii) In the United States, the Federal Reserve announced that it will purchase a lower amount in financial assets in January and reaffirmed its commitment to maintaining the current level of interest rates for an extended period.

(iii) The terms of trade declined in October, but they still remain at high levels. An increase in the terms of trade is not expected in a scenario of both a slow recovery in the global economy and better conditions expected for the worldwide supply of oil.

(iv) In Colombia, the economic growth in the third quarter was higher than what had been estimated mainly due to growth in the construction sector. Public spending surged and household consumption grew steadily. The growth of exports was low and below the one for imports. From the beginning of the year to September, the GDP growth (3.9%) was similar to that projected by the technical team at the Banco de la República.

(v) For the fourth quarter of 2013, the indicators of consumer confidence, economic expectations, retail commerce, and auto sales suggest that household consumption has been growing consistently. The upswing in mortgage lending also reflects a favorable dynamic for the investment in buildings. On the supply side, the industrial sector excluding coffee processing fell again in October (-0.1%) although at a slower rate than that recorded a month before.

(vi) Due to the above results, the technical team did not change the estimated growth range for 2013 as a whole (between 3.5% and 4.5%) of which 4.1% was the most likely figure. This means that economic growth in the second half of the year will be considerably higher than that registered in the first half.

(vii) In November, the overall growth of loans slowed down although it continued to be higher than the rise in the nominal GDP. The majority of the nominal interest rates for loans declined over the month. In real terms, they are staying below their historical averages (except for credit cards) and are driving economic growth.

(viii) Annual consumer inflation was at 1.76% in November, a figure that was lower than expected. This fact was mainly due to a slowdown in the annual change in the prices of regulated items and food. The average for core inflation remained stable at 2.46%.

(ix) The inflation expectations economic analysts have for a year from now as well as those derived from the public debt paper with maturities of less than five years remained relatively stable and were below 3%.

To summarize, economic growth in 2013 is expected to be similar to what was seen the year before. Interest rates are staying at levels that stimulate the economy’s aggregate expenditures. Having evaluated the balance of risks, the Board of Directors decided that it would be appropriate to keep the benchmark interest rate unchanged.

The members of the Board agreed that it would be appropriate to keep the benchmark interest rate unchanged. Some emphasized the recent information on the strength of domestic demand, the growth of output, and the fact

that the current monetary posture is expansionary, and that the inflation expectations for 12 months from now indicate they are anchored to levels that are close to the target. In addition, the low level of inflation is basically due to supply shocks with some transitory components.

Another director stated that the information contained in the report indicates a positive performance of both the supply and the aggregate demand. Regarding the supply, the performance of production, prices, employment, and wages shows positive growth of the potential GDP. This is very likely to stay within the scope of the policy due to the high rates of investment and the effects of the reductions in payroll taxes on the labor market. From the point of view of the aggregate demand, recent information shows an upswing in both public and private growth. This will increase the probability that, with the current monetary policy posture, the output and inflation gaps will gradually close.

Furthermore, another member thought that the fact that the growth rate of the GDP is increasing while the inflation rate is below the target and falling is a sign that the potential GDP could be higher than estimated, the NAIRU lower, and the output gap more negative than has been indicated by the indices that have been calculated up to now. Therefore, it would be appropriate to assume the responsibility and communicate their commitment to keeping the interest rate unchanged for an extended period – at least until the middle of next year or even longer – until there is evidence that inflation is converging towards the target and the output gap is closing.

Finally, other members added that in consideration of the fact that the current level of inflation has been below the target for several months, it is necessary to evaluate the coherence of the monetary policy rate in view of the indications that the potential GDP could be higher than estimated. Because of this, it could be necessary to make adjustments in order to hasten the convergence of inflation with the target and the closing of the output gap.

3. POLICY DECISION

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 information available.

Bogota, D. C. January 3, 2014

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