[Detailed Explanation of the Macroeconomic Situation]

Must reads

[The Board of Directors of the Central Bank of Colombia maintains the benchmark interest rate at 4.5%]

A regular meeting of the Board of Directors of Banco de la República took place in the city of Bogotá, D.C., on January 30, 2015. In attendance were Mauricio Cárdenas Santamaría, Minister of Finance and Public Credit, José Darío Uribe Escobar, Governor of the Central Bank, and Board Members Carlos Gustavo Cano Sanz, Ana Fernanda Maiguashca Olano, Adolfo Meisel Roca, César Vallejo Mejía, and Juan Pablo Zárate Perdomo.

These minutes contain a summary of the outlook of Banco de la República's technical staff on the macroeconomic situation (section 1), followed by a review of the main discussion regarding policy alternatives considered by the Board of Directors (section 2).

A more [detailed description of the macroeconomic situation] prepared by the technical staff from the Central Bank is provided in the data section of the December 2014 edition of the Inflation Report, as well as in the statistical appendix.

1. MACROECONOMIC CONTEXT

1. In the present report, oil prices continued to decrease and registered levels unobserved since 2009. [illegible] produced a quarter before. Other products exported by Colombia such as coal and nickel also posted falls in their international prices.
2. The risk premia of several emerging countries have increased, their currencies have depreciated, and the price of some financial assets has deteriorated. This behavior has been much more accentuated in oil-producing countries such as Colombia.
3. This has taken place within a context of weak global economic activity, driven mainly by [illegible] partners for 2015, a fact that reflects a weaker recovery than had been estimated in the previous quarterly report.
4. In the USA, the long-term interest rates fell again, and it is likely that the first increase in [illegible] continues gradually. Regarding the euro zone, the European Central Bank began a [illegible] purchasing program of financial bonds, which will extend at least until September 2016.
5. The fall in the prices of oil, which surpassed the reductions in the international prices of [illegible] deterioration in the country's terms of trade. Should these levels continue, the national income in 2015 would fall.
6. The fall in the price of oil continues to affect the value of the country's exports. In November 2014, external sales fell, [illegible] exported. Sales of the main agricultural products continued showing high increases, while exports of other sectors fell, although not as much as those of the mining sector.
7. Given the aforesaid, for all of 2014 the most probable forecast of the current account [illegible] financing be lower, partly as a result of an expected reduction in direct foreign investment (especially in oil), and by a less dynamic portfolio investment.

8. As for the domestic context, the new data for the fourth quarter of 2014 suggest that [illegible] expects that economic growth for 2014 may be posting between 4.5% and 5.0%, with 4.8% as the most probable outcome.
9. As for the labor market, with seasonally adjusted data, the unemployment rate to December continues to be low, with the highest occupation rate of the last 14 years, driven mainly by salaried employment.
10. In December, annual growth of corporate credit has slowed down, a fact that is explained [illegible] credit rates, which during the second semester of 2014 have only partially reflected the increase registered in the benchmark interest rate.
11. For 2015, the technical staff reduced the range for the economic growth forecast to an [illegible] generate a moderation in expenditure, especially due to a lower level of private investment.
12. Nevertheless, it is important to mention that uncertainty regarding the aforementioned [illegible] forecasts take place, the output gap could be positive in 2014 and may become slightly negative in the present year (which had previously been estimated as positive).
13. Regarding prices, inflation posted at 3.66% in December 2014, a number similar to the [illegible] in the same period, the average of the four core inflation indicators increased [illegible] and posted at 3.06% in December.
14. Inflation expectations of market analysts on a one year horizon as well as those derived from public debt bonds for longer terms increased and are above 3.0%.
15. It is expected that the greater level of the exchange rate be passed through to domestic [illegible] 2015, there is a risk that consumer inflation continues to increase this year. A high pass-through could affect expectations and have more persistent effects on inflation.

In all, domestic demand continues to be dynamic in a context close to the full use of the productive capacity. At the same time, inflation and its expectations are above 3.0%. This takes place in an environment of strong deterioration of the terms of trade, with high uncertainty regarding its future behavior. Global economic activity is recovering more slowly than was expected, and the evolution of the cost of financing is also uncertain. All these factors can impact the future behavior of aggregate demand.

2. DISCUSSION AND POLICY OPTIONS

The Board Members agree that Colombian economy will adjust to the fall in the terms of trade, growing less in 2015 and 2016 than in 2013 and 2014.

The dynamics of inflation in 2015 will mainly be affected by a lower economic growth and by the possible short-term effects of the depreciation of the peso on consumer inflation. Some Board Members consider that the effect of depreciation can initially take precedence over the low growth and transitorily deviate inflation from the target. As long as the expectations continue to be anchored to the mid-term target (3.0%), this effect on inflation would fade within the monetary policy horizon.

In turn, one of the members of the Board expects GDP to grow between 3.0% and 3.5%, with which the negative output gap would be greater than is expected by the technical staff and would have an even stronger mitigating effect over prices. In this context, it is appropriate for the monetary authority to continue keeping the benchmark interest rate unaltered.

With a countercyclical criterion, another Board Member considered necessary to contemplate scenarios with lower benchmark interest rates.

3. POLICY DECISION

The Board of Directors unanimously decided to keep the benchmark interest rate at 4.5%.

Bogotá, D. C.