Minutes of the Meeting of the Board of Directors of Banco de la República on Friday, December 18, 2015

Monetary Policy Report Last modified Monday the 29th of April, 2024
A regular meeting of the Board of Directors of *Banco de la República* took place in the city of *Bogotá D. C.* on Friday, December 18, 2015. In attendance were Mauricio Cárdenas Santamaría, Minister of Finance and Public Credit; José Darío Uribe Escobar, Governor of the Central Bank; and co-directors Carlos Gustavo Cano Sanz, Ana Fernanda Maiguashca Olano, Adolfo Meisel Roca, Cesar Vallejo Mejia, and Juan Pablo Zárate Perdomo.

The following is a summary of the vision of the technical staff at *Banco de la República* on the macroeconomic situation (section 1) and an overview of the main policy discussions considered by the Board of Directors (section 2).

Further detail on the macroeconomic situation prepared by the technical staff from the Central Bank will be presented in the Inflation Report for November 2015 and in the statistical annex.

1. MACROECONOMIC CONTEXT
a. The Federal Reserve of the United States decided to increase its benchmark interest rate by 25 bp in its meeting of 16 December, as had been anticipated by the market and the technical staff at *Banco de la República*. In its statement, the FOMC highlighted the improvements exhibited by the labor market, and suggested gradual increases in the reference rate during 2016. The information available for the fourth quarter indicates that the U.S. economy could maintain its dynamism, driven by the strength of domestic demand, particularly by consumption.

b. Despite the good performance of the U.S. economy, global demand remains weak. In the euro zone, economic activity continues with a very slow recovery. In China, the information available suggests that its economy may have ceased to slow down, but might have low dynamism. As for Latin America, GDP in the third quarter showed a deepening of the recession in Brazil and mediocre performance in Chile and Peru.

c. In recent weeks, the price of oil dropped significantly again, and to December 15 posted 9.9% below the observations from November. It is not unlikely that there may be additional reductions in the international price of oil in the future. The risk premia of Latin American countries also increased, and for Brazil and Colombia reached their highest levels since 2009.

d. In addition to oil, international prices of other commodities exported by the region, particularly by Colombia, continue being low. With this, the country’s terms of trade could register further deterioration.

e. The drop in the price of oil, the increase in the risk premia, and the expectations of increases in the Federal Reserve's reference rate, explain much of the strong depreciation of the Colombian peso, which has led the exchange rate to historically high records. The currencies of the region also depreciated, but to a lesser extent.

f. For Colombia, foreign trade figures to October show that exports in US dollars are still falling, mainly due to the impact of lower prices.

g. GDP in the third quarter grew 3.2% on a yearly basis, more than expected by the technical staff. Domestic demand grew by 2.8%, similar to the records for the second quarter. Total consumption accelerated vis-à-vis the

previous quarter, while the growth of gross capital formation was the same. Net exports contributed negatively to growth. On the supply side, all sectors exhibited growth, except for mining and construction of buildings. The figures available for the fourth quarter are still scarce, but indicate that the dynamism observed between July and September will continue.

h. Total credit has slowed down, but it continues to expand at rates higher than the nominal GDP. The commercial portfolio continued with its growth rates, while the pace of increase of the household portfolio has decreased. Real credit interest rates have slowed their decline and register below the average calculated since 2000.

i. As for the labor market with data to October, the seasonally adjusted series show an increase in the unemployment rate in recent months due to a slowdown in employment.

j. Considering all this, the technical staff reduced the width of the growth forecast range for the whole year. Expansion of the economy would lie somewhere between 2.8% and 3.2%, with 3.0% as the most likely figure.

k. Regarding the annual consumer inflation, in November it stood at 6.39%, above the projections by analysts and the technical staff at *Banco de la República*. So far this year, it has accumulated 6.11%, as against 3.38% in the same period in 2014. All core inflation indicators are above 5.0%.

l. Including this month and in the year to date, acceleration of inflation is explained by the behavior of the prices of food (9.81%) and of tradable goods excluding food and regulated items (6.92%).

m. The measures of inflation expectations obtained from the survey applied to financial analysts increased in the last month and were located at 6.67%, 4.63% and 3.83%, for the end of 2015, 2016 and 2017, respectively. To December 15, inflation expectations embedded in 2-year term TES remained stable, and declined slightly in those with terms to 3 and 5 years. The latter posted at levels similar to or higher than 4.5%.

n. Looking ahead, the adverse effects of *El Niño*, the pass-through of the depreciation of the peso towards domestic prices, and the activation of some indexation mechanisms, could maintain inflation at high levels during the first semester of 2016. It is expected that in the second semester next year these transitory shocks will diminish. This, together with monetary policy actions, should lead inflation to the target in a two-year horizon.

In synthesis, higher-than-expected increases in food prices and further increases in the exchange rate related largely to the fall in the price of oil have generated new inflationary pressures. At the same time, inflation expectations remain high and the risk of a slowdown in domestic demand, beyond that which is consistent with the decline exhibited in national income, has moderated.

2. DISCUSSION AND POLICY OPTIONS

The members of the Board highlighted the rise in all of the inflation indicators (total and core), the strength of domestic demand in spite of the negative effect of the drop in oil prices on national revenue, and the recent upward revision of the growth projection for 2015 done by the technical team at the Bank. Likewise, both the surveys and the Bank models suggest that medium term inflation expectations have deviated from the target fixed by the Board. With respect to the current account deficit in the balance of payments, the available data does not show any signs of correction thus raising the perception of macroeconomic risk for the Colombian economy.

Considering the strength of domestic demand, inflation factors, and the deficit level in the current account, the majority of the members of the Board consider a 25 bp increase in the interest rate to be necessary and reiterate the message that we are on course for a hardening of monetary policy. A course of incremental rises similar to the one announced is advisable since it reinforces the message of the Board's commitment to the inflation

targets, makes it possible to better calibrate the optimal response to new external shocks, and makes the Board's decisions more predictable for the market thus improving the transmission of monetary policy. The length of this path will be whatever is necessary for inflation to converge to its target in 2017.

The rest of the members of the Board believe that strong indexing mechanisms would be enabled in the Colombian economy and that the probability of additional effects of supply shocks on inflation have risen. Specifically, the effect of the pass through of devaluation to consumer prices and the impact of the *El Niño* phenomenon on food and energy prices. These shocks will probably bring additional upswings in inflation during the first half of 2016 which will affect expectations and reduce the real interest rate. In a context where there is a high current account deficit in the balance of payments which reflects an excess of expenditure over revenue, the additional effects of the supply shocks reinforce the need to act now with a 50 bp increase in the interest rate. Lower increases could be insufficient to anchor inflation expectations to the target and strengthen the credibility of monetary policy. This would make the convergence of inflation to the target slower and more difficult and require increases in the interest rate in the future that could coincide with a pronounced slowdown in expenditure and output.

3. POLICY DECISION

The Board of Directors of *Banco de la República*, by majority, decided to increase the benchmark interest rate by 25 bp to 5.75%.

Fuente: https://www.banrep.gov.co/en/news/board-directors/minutes-december-2015