A regular meeting of the Board of Directors of Banco de la República took place in the city of Bogotá D.C. on Friday, January 29, 2016. 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.

These minutes contain a summary of the outlook of the technical staff of the Central Bank on the macroeconomic situation (section 1), followed by a review of the main discussion regarding monetary policy by the Board of Directors (section 2).

Further detail on the macroeconomic situation prepared by the technical staff from Banco de la República will be presented in the Monetary Policy Report of December 2015 and in the statistical annex.

1. MACROECONOMIC CONTEXT

a. In the course of January (to Jan 26), the international price of oil fell again significantly (17.6% compared to the average in December) reaching the lowest level since 2003. The prices of other commodities (among them coffee and coal) also decreased in the last few weeks. With this, the country's terms of trade continue with a downward trend.

b. Additionally, there were falls in stock exchange and increases in the volatility of financial markets, mainly due to the prospects of a further weakening of emerging economies, particularly China. In Latin America, risk premia increased and currencies depreciated. The US dollar strengthened vis-à-vis most currencies in the world.

c. The information available on economic activity confirms the low growth of Colombia's main trading partners in 2015, and forecasts lower paces of expansion than those projected in the September Inflation Report, both for 2015 and for 2016, mainly for the countries of the region. Such countries, including Colombia, are being affected by the fall in the international prices of commodities and by the weakening of global demand. Additionally, confidence indicators have deteriorated considerably in several cases.

d. China would continue to slow down in 2016. The slowdown in this economy would continue to have negative effects on the performance of global activity, on trade, and on international prices of commodities.

e. As for developed economies, the United States would maintain a similar growth to that of 2015, driven by domestic demand, while Europe would continue its slow recovery. The Federal Reserve is expected to increase its reference rate gradually, and the European Central Bank to continue with a highly expansive policy.

f. In a context of low dynamism in global demand and the sharp fall in the prices of oil and commodities in general observed in 2015, exports in US dollars fell 35.3% in the accumulated value to November. While the adjustment in imports has recently accelerated with annual falls above 20.0% since September, so far this year there has been a trade deficit.

g. For all of 2015, a deficit in the current account between 6.3% and 6.7% of GDP is estimated. Part of the detriment in this indicator is due to the reduction of GDP in US dollars resulting from the effect of the depreciation of the peso versus the US dollar. For 2016, an external deficit between 5.4% and 6.5% of GDP is expected, which assumes in the baseline scenario that deterioration in exports and the adjustment of imports continues within an environment in which external financing would be lower than observed in previous years, and possibly more costly.

h. In the domestic context, for all 2015 the technical staff maintained its annual growth forecast at 3.0%, within a range between 2.8% and 3.2% (narrower than the previous report). In the fourth quarter of 2015, domestic demand would have slowed down, except for investment in civil works, while net exports would have contributed positively to growth due to the greater fall in imports than in exports. Although real interest rates of credits remained below their historical averages, they ceased falling over the past few months (except the mortgage rate). As for the labor market, a slight increase in the unemployment rate and flattening of the occupation rate (according to the seasonally adjusted series) have been observed since the middle of the year.

i. For 2016, the forecast for yearly growth of GDP was reduced: it is expected to register between 1.5% and 3.2%, with 2.7% as the most likely figure. Domestic demand is expected to continue slowing down, especially investment, as part of the adjustment to the new external conditions required by the economy.

j. Annual consumer inflation stood at 6.77% at the end of 2015, surpassing market projections and those of the technical staff. In December, core inflation indicators reduced their pace of increase and their average stood at 5.43% (3 bp above the value registered in November). Along the year, the increase in inflation is basically explained by the behavior of the food (10.85%) and of tradables excluding food and regulated items (7.09%). These groups represent 54.2% of the consumer basket.

k. According to the survey applied to financial analysts, inflation expectations are at 4.50% to twelve months and 3.68% to twenty-four months, figures slightly lower than the data from the previous month (4.63% and 3.83%, respectively). For December 2016, analysts expect a 4.83% inflation rate. The quarterly survey of economic expectations suggests an inflation expectation of 5.35% and 4.85% to December 2016 and 2017, respectively. Expectations arising from public debt bonds are above 4.5%, and they increased compared to those calculated in December.

l. The effects of El Niño, pass-through of depreciation of the peso to prices, and the activation of indexation mechanisms on prices and salaries could keep inflation high during the first semester of the year. Shocks in food prices and depreciation are expected to begin fading in the second semester, which, together with actions in monetary policy should lead inflation towards its target during 2017.

In all, higher-than-expected increases in food prices and further increases in the exchange rate related largely to the fall in the price of oil continue exerting inflationary pressures. At the same time, inflation expectations remain high and the risk of a slowdown in domestic demand, exceeding that which is consistent with the decline in national income, continues to be moderated.

2. DISCUSSION AND POLICY OPTIONS

The members of the Board emphasized that the main shocks that are currently affecting the Colombian economy (deterioration of the terms of trade and climatic factors) have been more intense and persistent than initially foreseen. The economy continues adjusting to these shocks with a moderate deceleration in economic activity, which is expected to continue throughout 2016 mainly due to an increase in domestic demand lower than the one observed in 2015. This slowdown would continue to contribute to the reduction of the current account deficit. For the closing of 2015, a slight decline in this deficit is expected (in millions of US dollars), and a further contraction of US $3 billion is expected in 2016.

The devaluation of the peso, which occurred as a result of the deterioration in the terms of trade and the strong climatic shocks, pushed inflation upwards during 2015. The estimations by the technical staff suggest that they will continue doing so during the first semester of 2016. In this period, inflation may also be affected by the indexation mechanisms of the Colombian economy, which would respond to the increase in inflation that took place in 2015.

In this context, the members of the Board agree that it is appropriate to continue with the adjustment of the monetary policy by increasing the types of interests necessary for the convergence of inflation expectations and projections to the target in the policy horizon, in line with a reduction of the current account deficit.

The majority of the Board Members considered that it is appropriate to continue with the path of 25 bp increases. These members ratified the advantages that this path offers in terms of market predictability and efficiency in the incorporation of marginal information within an environment of high volatility. Additionally, they stressed that the mechanisms for pass-through of the monetary policy would have strengthened since the last quarter of 2015 as a result of the change in the structure of the balance of the financial system. Finally, these members of the Board mentioned that there are specific factors related to the decline of investment in the oil sector which will contribute to the reduction of the external deficit.

The other Board members considered that it is necessary to increase 50 bp because they believe that the increase in inflation expectations above the upper limit of the target range as well as the indexation mechanisms of the economy pose a growing risk of persistence of high inflation. In a context of high deficit in the current account of the balance of payments, which reflects an excess of expenditure over income, additional effects of supply shocks on expectations and pricing decisions reinforce the need to accelerate the increases in the benchmark interest rate, with the purpose of anchoring expectations to the target and preserving the credibility of the monetary policy.

Finally, the Board reiterated that stronger increases in the present may avoid the need for future increases in the benchmark interest rate which could coincide with a sharp 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 6.0%.

Bogotá, D. C.