# Minutes of the Meeting of the Board of Directors of Banco de la República on Wednesday, 31 August 2016

Monetary Policy Report Last modified Sunday the 28th 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 Wednesday, August 31, 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 by 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 July and in the statistical annex.

1. MACROECONOMIC CONTEXT

- The Colombian economy grew 2.0% on a yearly basis during the second quarter of the year, a figure lower than the most likely forecast (2.6%), estimated by the technical staff of the Central Bank. The most dynamic sectors were industry and financial services, while mining, agriculture and electricity, gas and water utilities reported declines. Consequently, the annual increase in GDP for the first half of the year was 2.3%.
- The information available for the third quarter is still scarce. With data to July, energy demand and production of coffee and oil exhibited annual falls. Variables related to household spending such as consumer confidence and the indicators for the perception of the retail sector suggest a slowdown. On the other hand, the indicators for industrial perception remained favorable.
- This, together with the data observed for GDP in the second quarter, suggests that it is very likely that growth of the economy for the entire year will be below the midpoint of the forecast range (between 1.5% and 3.0%) published in the June Inflation Report.
- In July, annual inflation stood at 8.97%, above Banco de la República's forecasts and the market average. The average of core inflation indicators monitored by the Central Bank increased from 6.52% to 6.61%.
- The acceleration of inflation in the last month is explained by the behavior of food (processed and perishable goods), to a large extent, associated with the trucking strike. The CPI for regulated items, on the other hand, exerted downward pressures, while the variation of the prices of tradables and non-tradables (excluding food and regulated items) was similar to June's.
- The most recent information from Sipsa (DANE) suggests that food prices would be falling in August compared to the levels observed in July.
- Annual PPI variation, particularly of the group of imported goods, suggests that cost pressures related to pass-through of the accumulated depreciation of the peso to domestic prices would be moderating.
- Inflation expectations from the monthly survey to economic analysts to twelve and twenty-four months remained relatively stable (4.55% and 3.72%, respectively). To 26 August, expectations from TES to two, three and five years, on average, exhibited reductions compared to data from July (9, 13 and 17 bp, respectively). For two and three years' terms, they remain somewhat above 4.0%.

- Regarding the external context for the second quarter, growth in the US was below expectations, and in the euro zone it was lower than in the first quarter. China continues slowing down moderately; as for Latin America, GDP growth in Chile, Mexico and Peru was low and similar to that observed in recent quarters. In Brazil, economic activity index suggests lower falls of its output. This suggests that the average growth of Colombia's trading partners could be somewhat lower than estimated in the last quarterly report.
- International financial markets maintained a relatively low volatility, and risk premia for Latin America fell slightly compared to the previous month. Implicit rates for futures in the United States suggest it is likely that the next increment in the benchmark interest rate by the Fed will take place towards the end of the year.
- The recent behavior of the price of oil, increases in the prices of other export goods, and decreases in some of the prices imported food suggest that the country's terms of trade continued to recover in August. However, their levels remain low and lower than those in 2015.
- To June, Colombia's total exports have fallen 25.8% and imports 20.9%. This suggests that deficits in the trade balance and in the current account continue to adjust.

In all, output deceleration has been stronger than forecast, and inflation and inflation expectations remain high, exceeding the target. The recent behavior of the prices of tradable goods suggests that pass-through of the strong recent depreciation of the peso to domestic prices is fading. Prices of food, especially perishable goods, are expected to fall during the rest of the year. This, together with monetary policy actions, should lead inflation to its target range in 2017.

## 2. DISCUSSION AND POLICY OPTIONS

The members of the Board of Directors highlighted the decline in GDP growth in the second quarter of 2016 to 2.0%, a figure lower than expected by the technical staff at the Central Bank (2.6%). The causes and consequences of this result were considered by the members of the Board to determine their position regarding the monetary policy stance.

The majority of Co-Directors voted in favor of maintaining the benchmark interest rate unaltered at 7.75%. This group noted that inflation expectations remained stable and that the adjustment process of the economy to the fall in the terms of trade continues in an orderly manner. They also mentioned that monetary policy is in a contractionary stage. Likewise, they pointed out that, inasmuch as inflation continues lowering in the coming months, expectations can also be expected to reduce, given their adaptive component.

Within the majoritarian group, several issues were mentioned. Some referred to the fact that the current account deficit remains high, and that the probability of an increase in the benchmark intervention rate by the FED this year is high. This may lead to a greater devaluation of the peso and an additional pass-through to the prices of tradable goods and services. One of them pointed out that the adjustment of the economy to the new external conditions faced by the country is not neutral at the time of submitting the draft of the tax reform to Congress.

Finally, another member of the majoritarian group expressed his/her perception that there is a risk of a faster-than-expected slowdown in the economy. S/he added that if this takes place, a reduction to the benchmark interest rate should be considered eventually. However, this will also depend on what happens with inflation expectations.

One Co-Director noted that: (a) Yearly inflation continued to increase and reached 9.0% in July, the highest in 16 years, having remained for a year and a half above the upper limit of the target range, exceeding it by 125%. (b) Among the major economies of the region (excluding Venezuela) inflation in Colombia is the highest, and among those which have implemented the inflation target strategy, it exhibits the greatest deviation from the target. (c) The average of core inflation indicators also continued increasing. (d) According to the quarterly survey of economic expectations applied in July, the credibility in the fulfillment of the inflation target in December next year, which is the deadline to return to the target according to the announcement made by the

Board in November 2015, is merely 21.5%. Moreover, the Central Bank's latest quarterly survey shows that, although inflation expectations would begin to lower, they would not reach the target range in December 2017. If so, the probability that 2017 will become the third consecutive year failing to achieve the target is high, and this would seriously endanger credibility in the monetary authority. (e) The main challenge for the monetary policy at the present time is to break the persistence of deanchoring inflation expectations with regard to the target, along with complying with the commitment assumed by the Board to ensure that inflation returns to the target in 2017. Although the foreseeable reduction in the growth rate of food prices in the coming months must contribute to attenuate the increase of total inflation, it is very unlikely that with the current monetary policy stance the speed of its reduction be enough to face this challenge successfully. For these reasons, s/he proposed to increase the benchmark interest rate by 25 basis points.

3. POLICY DECISION

The Board of Directors, by majority, decided to maintain the benchmark interest rate unaltered at 7.75%.

The decision was approved by six members of the Board; one member voted for a 25-basis point increase.

Fuente: https://www.banrep.gov.co/en/news/board-directors/minutes-august-2016