[Monetary Policy Report](#)

A regular meeting of the Board of Directors of Banco de la República took place in the city of Bogotá D.C. on Friday, September 30, 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 on the macroeconomic situation by the technical staff of the Central Bank (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 August and in the statistical annex.

1. MACROECONOMIC CONTEXT

1. In August, annual consumer inflation stood at 8.10%, a figure lower than the one recorded in July (8.97%) and below the forecast of the Central Bank and the market. The slowdown of inflation was explained largely by the behavior of food prices, among them the group of perishable items. Tradables (excluding food and regulated) and regulated items also contributed to the reduction of inflation.
2. The average of the four core inflation indicators monitored by the Central Bank decreased slightly, moving from 6.61% in July to 6.56% in August.
3. The data from Sipsa (DANE) suggest that food prices would continue falling in September. According to the same source, food supply in the central markets remains high.
4. The annual variation of the PPI exhibited a significant reduction (from 8.38% in July to 4.89% in August). This suggests that the pressures of non-labor costs continue to decline.
5. In September, inflation expectations declined, but remain above the target. These reductions were mild as per the monthly survey to economic analysts by the Central Bank to one and two years (20 bp and 11 bp, reaching 4.35% and 3.61%, respectively). Those calculated on the basis of the public debt bonds (TES) to 2, 3 and 5 years (3.57%, 3.45% and 3.37%) recorded more significant declines (78, 62, and 43 bp) during the month (to 28 September).
6. The available data on economic activity for the third quarter are scarce and are affected significantly by the trucking strike registered between June and July. In general, the figures for retail sales, industrial production, and cement production exhibited setbacks in July. Similarly, the labor market showed some deterioration.
7. Some economic indicators suggest improvements in August such as energy demand (unregulated), the perception of the industry and trade, and the consumer confidence index. By contrast, coffee and oil production continued to fall.
8. Thus, given the slowdown that the Colombian economy has been experiencing and the negative effects of the trucking strike (which would not be fully offset in some sectors in the following months), economic growth in the third quarter is likely to be lower than in the second.
9. On the other hand, according to the figures of the balance of payments for the first half of the year, the current account deficit relative to GDP was 4.8%, i.e., 1.5 percentage points less than the one observed in the same period of 2015. The reduction of the external deficit was explained by the lower net outflows by factor revenue and services, and to a lesser extent, by the lower deficit in the balance of goods and the higher income from transfers. This is consistent with the slowdown in domestic demand, the more expensive imports on account of the cumulative effect of the depreciation of the peso, and the lower profits of firms with FDI, particularly for the mining-energy sector. To July, the information from DANE on foreign trade suggests that the trade deficit would continue to adjust.
10. In July, the terms of trade (foreign trade methodology) were close to the average of 2015. The recent behavior of international oil prices and those of the main basic goods imported by Colombia suggest that the recovery trend continues.
11. As for the external context, in the United States, the FED left the benchmark interest rate unaltered in an environment of relatively good labor market performance, but with low growth of retail sales and industrial production.
12. In the euro zone, improvement in the performance of some real indicators was observed, while in China the data suggest that its economy continues to gradually slow down. In Latin America, the figures available for GDP in the second quarter are lower than those reported for the first quarter, except for Mexico and Brazil; the economies of Argentina and Brazil exhibit contractions. In Ecuador, the figure for the first quarters suggests a deepening of the recession.
13. In recent weeks, the international financial markets maintained a low volatility. The risk premia and the currencies of most Latin American countries remained relatively stable. This takes place in a context in which the market deems it is more probable for the FED to increase its benchmark interest rate in December, and that there would be at least another adjustment in 2017.

In all, the Colombian economy continues to adjust to the strong shocks recorded since 2014, and the current account deficit is narrowing gradually. The effects of the transitory supply shocks that have affected inflation and inflation expectations have begun to reverse, and this trend is expected to continue. This, together with the monetary policy actions taken so far, should lead inflation to its target range in 2017.

2. DISCUSSION AND POLICY OPTIONS

After analyzing the most recent information on the Colombian economy and its prospects, the Board opted to maintain the benchmark interest rate unaltered. The data on growth, inflation, current account deficit, and confidence of consumers and entrepreneurs show that the adjustment of the economy to the cycle of prices of commodities continues in an orderly manner. This adjustment is consistent with the transmission of the monetary policy measures adopted by the Board in the past year.

The growth forecasts for 2016 and 2017 are compatible with the reduction that national income has experienced in the last two years, and reveal a noticeable resilience of the Colombian economy to external shocks, vis-à-vis other emerging economies that are exporters of commodities. One of the members of the board pointed out that potential GDP could possibly be lower than the estimations used to calculate the output gap, as has happened in other countries.

Annual inflation started to decline in August, which shows that the monetary policy measures have been effective. The fall in the prices of food, tradables, and (to a lesser extent) of core inflation indicators, plus the decrease in prices of imported foodstuffs, the moderate revaluation of the exchange rate, and the end of the negative effect of the trucking strike on product supply also contributed to reduce inflation.

The current account deficit has shown a faster adjustment than initially forecast largely associated with a reduction of imports and to lesser outflows by factor revenue. This adjustment must continue aided by the slowdown in domestic demand, the bullish behavior of oil prices, and the effects of the accumulated real devaluation.

Inflation and core inflation indicators remain high exceeding the target range, as do some measures of inflation expectations. This generates uncertainty about the compliance of the target in 2017, and makes it advisable and prudent to maintain the current monetary policy stance.

One of the board members pointed out that the data from last month show that the risk balance is more inclined to the slowdown of growth than to inflation, and stated that, should this situation accentuate, a reduction of the benchmark interest rate should be considered.

3. POLICY DECISION

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

The decision to maintain the benchmark interest rate unaltered was reached unanimously.

Bogotá, D. C.