Monetary Policy Report
Contenidos relacionados
Banco de la República reduces the benchmark interest rate 25 bp to 5.25%

A regular meeting of the Board of Directors of *Banco de la República* took place in the city of Bogotá D.C. on Thursday, August 31, 2017. In attendance were Mauricio Cárdenas Santamaría, Minister of Finance and Public Credit; Juan José Echavarría, Governor of the Central Bank; and Board Members Gerardo Hernández Correa, Ana Fernanda Maiguashca Olano, Adolfo Meisel Roca, José Antonio Ocampo Gaviria, 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 the Central Bank will be presented in the monthly Monetary Policy Report for July 2017 and in the statistical annex. (Only available in Spanish).

1. MACROECONOMIC CONTEXT

a. GDP growth in the second quarter of the year was 1.3% on a yearly basis, similar to the forecasts by the technical staff at the Central Bank. This result meant a 0.7% increase between quarters, which corresponds to an annualized 3.0% increase. Domestic demand grew 1.9% *vis-à-vis* the same period of 2016, slightly above the record for the first quarter (1.5%).

b. Per branch of activity, the sectors that grew most in that quarter were agriculture and financial services. In contrast, mining and industry exhibited significant contractions.

c. The information available for the third quarter is still scarce, and does not allow determining a forecast for GDP growth with certainty. However, some indicators suggest that performance of the economic activity during this period would be better than the one registered a year ago.

d. Regarding the labor market, data to June show a slight correction of the unemployment rate nationwide, but an increasing trend since over a year for that of the thirteen areas.

e. In real terms, household credit during the second quarter of 2017 grew 8.8%, while commercial indebtedness continued to stagnate. The interest rates on commercial loans (exception for construction) have registered falls that are higher than the one for the policy rate. Transmission towards interest rates on household loans has been lower. In the past two months, the reduction of the rate for home purchase stands out.

f. In the external context, the economies of the United States and the European Union continue to show signs of moderate recovery. However, Colombia’s trading partners in the region continue to exhibit low performance of their economic activity. With this information, the technical staff kept its growth forecast for Colombia’s trading partners unchanged.

g. Regarding the price of oil, in recent weeks, the news about lower inventories in the United States and on commitments for lower production by some members of OPEC appear to have contributed to stabilize prices close to the forecast of the technical staff (USD $51/barrel Brent reference).

h. With this, the technical staff at the Central Bank maintained its growth forecast for 2017 at 1.6%, within a range between 1.0% and 2.0%.

i. Inflation stood at 3.4% on a yearly basis in June, registering a 59 bp drop *vis-à-vis* June. All major groups contributed to this fall, particularly tradables and regulated in the sub-group of non-food inflation. In the group of food inflation, perishable and processed foods stand out. It is worth noting that, due to the basis of statistical comparison and to the normal agricultural cycle, the downward trend in annual food inflation could revert in the following months.

j. Inflation expectations to December 2017 obtained from the monthly survey to financial analysts lowered, posting at 4.16%. Analysts’ expectations and those derived from public debt bonds to horizons greater than or equal to a year increased slightly, standing between 3.5% and 3.8%.

k. In all, for 2017, the strong transitory shocks that diverted inflation from its target are expected to continue fading in an environment of a weaker-than-expected economic activity. Monetary policy actions undertaken so far, which consider these effects, should strengthen convergence of inflation to its target.

2. DISCUSSION AND POLICY OPTIONS

The Board Members highlighted the latest data on inflation, which have been better than expected. In July, the four core inflation indicators continued to fall, and the prospects for the yearly CPI variation to the end of 2017 have improved with the recent declines in this indicator. They all stressed that they expect the slowdown in economic activity to have bottomed out, and that in the second half of the year its recovery begins to show.

Six members voted for a reduction in the benchmark intervention rate, four of whom voted for a 25 bp cut, while two of them voted for a 50 bp cut. The members of the majoritarian group felt that there is space for a 25 bp cut, given the weak dynamics of the economic activity despite the recovery expected for the second half of the year, and an inflationary inertia that has caused the fall in core inflation to be slower than that for headline inflation. With this reduction, they mentioned, the rate could already be on neutral ground, according to some calculations.

The remaining two members considered that the weakness of economic activity deserves a stronger counter-cyclical response, since the output gap is very wide and the results in terms of inflation have been good. They consider inflation will continue converging to its target, as it has done up to now, and what is relevant at this time is to provide a greater stimulus to the recovery of growth.

One member of the Board voted in favor of maintaining the intervention rate unchanged. S/he highlighted the risks that still persist in terms of inflationary inertia. However, s/he also expressed concern over the low levels of growth expected for 2017 and 2018, despite the recovery in the second half of the year.

3. POLICY DECISION

The Board of Directors of *Banco de la República* decided to reduce the benchmark interest rate by 25 bp, placing it at 5.25%. This decision was approved by four (4) members of the Board. Two other Board Members voted in favor of reducing the benchmark interest rate by 50 bp, and the remaining one voted not to modify it.

Bogotá, D. C.