The purpose of monetary policy in Colombia is to keep inflation low and stable and to achieve the highest sustainable level of output and employment. In doing so, monetary policy fulfills the constitutional mandate to maintain the purchasing power of the Colombian peso and to help improve the well-being of the population.

Banco de la República pursues an inflation targeting strategy as part of a flexible exchange-rate system that is intended to achieve these objectives. Therefore, action with respect to monetary policy is meant to bring future inflation in line with the target defined for the policy horizon. In Colombia, the inflation target has been set at 3% by the Bank’s Board of Directors (BDBR) (with a permissible deviation of ±1 percentage point). This target refers to consumer price inflation, which is measured statistically as the annual variation in the Consumer Price Index (CPI).

To meet the inflation target, Banco de la República sets the benchmark interest rate, which is also known as the policy rate or intervention rate. The Bank adjusts the money supply to ensure the overnight interbank rate (IBR) is near the benchmark interest rate. Changes in the benchmark interest rate affect inflation and short-term growth through various transmission mechanisms.

The exchange rate flexibility that accompanies the inflation targeting strategy has two objectives. First, it allows Banco de la República to have an independent monetary policy that takes into account the state of the Colombian economy and allows it to fulfill its constitutional duties. Secondly, a flexible exchange rate softens the effect that external shocks, such as variations in the international price of oil, could have on the country’s economy.