Minutes of the Meeting of the Board of Directors of Banco de la República on 22 March 2019

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A regular meeting of the Board of Directors of Banco de la República took place in the city of Bogotá D.C. on Friday, March 22, 2019. In attendance were Alberto Carrasquilla Barrera, Minister of Finance and Public Credit; Juan José Echavarría, Governor of the Central Bank; and Board Members Gerardo Hernández Correa, Ana Fernanda Maiguashca Olano, José Antonio Ocampo Gaviria, Carolina Soto Losada, 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 quarterly Monetary Policy Report for March 2019 and in the statistical annex (Only Available in Spanish).

1. MACROECONOMIC CONTEXT

- The external context anticipated for 2019 suggests an average growth of the country's trading partners that is expected to be somewhat lower this year than in 2018, and which is estimated to be around 2.3%, with international financial conditions that would be more favorable for emerging economies than those considered in the previous report. Particularly, the information suggests a weaker-than-expected economic performance in the US at the beginning of the year. This, together with the absence of inflationary pressures, would be postponing the increase in the Fed's benchmark interest rate.
- On the other hand, sovereign risk premia in the region have declined in recent months. This, added with better financial conditions that those referred to in the previous report, would contribute to a slower-than-expected increase in the country's risk premia.
- The conditions for global supply and demand for oil do not suggest changes in the oil price forecast for 2019. Thus, the forecast of the average price for this year (USD 63 per barrel, Brent) has remained unchanged.
- The observed data suggest that the country's external imbalance increased somewhat more than expected in 2018, and that, in the external scenario described above, this trend would continue in 2019. Thus, the current account deficit for 2018 stood at 3.8% of GDP, and for 2019 it is estimated to stand between 3.9% and 4.7% of GDP, with 4.3% as the most likely scenario. This would take place in a scenario with a lower external income, in line with the expected setback in the terms of trade, a stable dynamism of imports consistent with the forecasts for domestic demand, and a less restrictive access to external financing than in the previous report.
- For the fourth quarter, growth figures were somewhat higher than had been forecast, with a more dynamic than expected domestic demand. This, above all, due to the good performance of public consumption and investment, which grew at a historically high rate for the second consecutive quarter. Contrary to expectations, this was due mainly to a strong accumulation of inventories and an unanticipated acceleration of construction spending, rather than to the performance of investment in machinery and equipment. The better behavior of domestic demand was offset by a net external demand that subtracted from GDP growth, consistent with a higher-than-expected widening of the trade deficit.
- The technical staff at the Central Bank projects an annual GDP growth that would increase again in the first quarter of 2019, and that would stand around 3.2% as the most likely figure. This would be consistent with a domestic demand that would maintain a good performance and an external demand that would subtract less from

GDP. The figure estimated for the first quarter of the year would be closer to the estimation of the rate of potential growth of the Colombian economy.

- For 2019, the growth forecast was revised upwards slightly to 3.5%. Vis-à-vis the previous report, the forecast suggests a more dynamic domestic demand with a faster closing of the output gap. This behavior would be explained, mainly, by a greater thrust from investment, which would offset the deterioration anticipated in the terms of trade and external demand, within a context in which the Colombian economy would continue to have favorable conditions to access international financing.
- In Colombia, inflation continued to surprise downwards in the first months of the year, standing at 3.01% in February. The results have been lower than expected in all the subgroups analyzed (tradables, non-tradables, food, and regulated items). As a result, inflation excluding food and regulated items fell to 2.41%, and the average of core inflation indicators fell to 2.81%.
- The different measures of inflation expectations remain slightly above the target (3.0%). Analysts' expectations stand between 3.2% and 3.3% to different horizons not over 24 months, and those embedded in public debt bonds stand around 3.3%.

In all, observed inflation has been lower than expected, and stood at the target. However, some upward pressures on inflation in the second half of 2019 are not ruled out. The economic activity continues to recover at a better pace from levels that have been lower than the natural output of the economy. Monetary policy actions taken so far should consolidate the convergence of inflation to the target and maintain a favorable path for GDP expansion. Uncertainty on global growth remains high.

2. DISCUSSION AND POLICY OPTIONS

The Board Members emphasized the excellent performance of inflation so far in 2019, particularly of core inflation indicators. The risks that had been advised regarding inflation this year due to El Niño and the impact of the increase in the minimum wage have not yet materialized. The conditions of international liquidity have relaxed, pushing away devaluation pressures, and, in any event, consumer prices of tradable products do not seem to be picking up the depreciation from the end of 2018. Thus, the outlook of inflation for 2019 is more favorable than had been considered at the end of last year. It is expected to continue at levels close to the target and has led to a reduction in inflation expectations in the market.

As for the productive activity, the Board considered that the reactivation is still in progress, and GDP is expected to grow 3.5% in 2019. Notwithstanding, some of the Board Members expressed their concern over the pace at which such recovery has taken place, which is lower than they expected. Several members expressed their concern over the weakness of the labor market, whose causes are still uncertain. Also, the improvement in the risk indicators of the financial system was also noted.

The members of the Board highlighted the consolidation of a broader environment of international liquidity, with which the Colombian economy is not expected to face external funding restrictions, nor increases in risk premia. In general, they expressed their concern about the outcome of the current account deficit in 2018 and its widening this year, which would be driven by the recovery of domestic demand and the low growth figures for the country's trading partners. Some Board Members stressed that the composition of the current account and its financing somehow mitigates the external vulnerability. The fact that imports of capital goods and raw materials for productive processes are a dominant factor in the widening of the trade deficit as well as that financing comes mainly from foreign direct investment stood out as positive elements.

In the context of an inflation figure very close to the target, with a reactivation process in progress (albeit slow) and an international environment with better liquidity conditions, the Board unanimously decided to maintain the benchmark interest rate at 4.25%, a level they considered moderately expansionist.

3. POLICY DECISION

The Board of Directors unanimously decided to maintain the benchmark interest rate unaltered at 4.25%.

Fuente: https://www.banrep.gov.co/en/minutes-03-2019