Minutes for Banco de la República's Board of Directors Meeting on June 30, 2022

Attachments
Determinantes de las Dinámicas de los Mercados de Capitales (Only Available in Spanish)
Anexo estadístico (Only Available in Spanish)

This decision took into account the following considerations:

- Annual headline inflation rate remained high due to higher external pressures and to a more-dynamic-than-expected behavior of demand. Headline inflation stood at 9.23% in April and at 9.07% in May; inflation excluding food and regulated items surprised to the upside, reaching 5.26% in April and 5.87% in May. Market inflation expectations increased, and, according to the June survey to economic analysts, they stand at a median of 8.6% and 7.1% for headline and non-food inflation, respectively, for the end of 2022. In the policy horizon, they are significantly above the 3.0% target.
- GDP growth figures for the first quarter of 2022 were higher than expected, exhibiting an annual 8.2% change compared to the 7.2% figure expected by the technical staff. This dynamism responds to the strengthening of domestic demand driven by household consumption, which expanded by 12.0% annually for that period. The consumer portfolio grew 22.1% annually in mid-June. The economic tracking indicator (ISE) exhibited an annual 11.8% change in April, which was higher than expected (8.6%). On this basis, the technical staff revised its 2022 growth forecast upward from 5.0% to 6.3%.
- The sustained recovery in GDP continues to favor the momentum in the labor market. In May, the figure for employed population registered an annual growth of 11.0% in the national total, and of 10.5% in the 13 main cities, which was reflected in significant annual reductions of the unemployment rate. Nationwide, it is already below its pre-pandemic level, as suggested by the seasonally adjusted series (10.6% in May 2022 vs. 11.1% in February 2020). The increase in employment and the reduction of unemployment, together with the observed increase in vacancy rates (which show a significant recovery in demand for new jobs), point to a tighter labor market.
- In an environment of a robust domestic demand and despite the improvement in the terms of trade, the current account registered a 6.4% deficit as a share of the quarterly GDP in the first quarter of the year, increasing from the 4.1% deficit as a share of GDP for the same period of last year. This excess demand occurs when external financing has become more expensive due to tightening global financial conditions.

By unanimously endorsing a 150 bp increase in the benchmark interest rate, the Board reaffirmed its full commitment to achieving convergence of inflation to its 3.0% target in the medium term, aware of the persistence of the shocks that have driven upwards both food prices and those in the basic basket excluding food and regulated items. The Board Members stressed that this decision was taken in the context of a vigorously expanding economy with favorable effects on job creation, while simultaneously exhausting the spare capacity that subsided after the pandemic.

In their individual reflections, the members of the Board agreed to point out several factors that call for a greater adjustment of the benchmark interest rate. Beyond highlighting the high levels of inflation, the Board stressed that inflation expectations from various surveys have risen significantly, thus increasing the risk of de-anchoring them. In addition, the increase in expectations has reduced the real interest rate, thus relaxing the monetary policy stance. They noted that the dynamism of consumer credit suggests that moderation in household spending could be delayed, which would contribute to prolong the economy’s excessive demand. They also cautioned against the inflationary effects that could arise from the recent peso depreciation vis-a-vis the US dollar, primarily due to the adjustment observed in the United States’ monetary policy and the one announced in the European Union. This has already been reflected in significant increases of term interest rates in global financial markets.

Some Board Members highlighted that the inflationary outlook takes place in the context of a fuel price policy that has contributed to restrain inflation at a high fiscal cost. In the short term, inflation dynamics may be altered by the degree in the reduction of these subsidies.

One member of the Board highlighted the limitations of analysis and forecasting tools in a post-pandemic economy, where many relationships seem to have changed. In this regard, s/he highlighted supply chains, the food price crisis, and the expectation-building process, all of which are global factors. The first two seem to reflect a change in relative prices more than inflation alone. The case of food is particularly acute in Colombia. The constraints of the tools have led other countries to restrictive monetary policies, which have resulted in slowing economies with high inflation. Additionally, the usual assumptions regarding the formation of expectations must consider that the impact of price increases is greater on ordinary people than on financial and monetary market agents.

Another Board Member expressed concern about the increasing gap between the inflation target and most forecasts for both 2022 and the two following years. This suggests that the conceptual basis of the models usually employed by analysts and by the Board itself, usually assuming a process of convergence towards the 3.0% target, could be evolving adversely and could threaten the nature of the target as a nominal anchor as it has been over the years. For this reason, s/he considered that in future discussions over the next few months, it would be important to give greater weight to the possibility of a wider de-anchoring than has been assumed and, therefore, to a stronger adjustment in monetary policy.

In the opinion of the majority, the interest rate adjustment made by the Board will allow bringing monetary policy more quickly to a path that reduces inflation and ensures its convergence to the target in the medium term. However, this adjustment does not suggest that subsequent increments will be of the same magnitude. In this regard, the Board agreed that in such an uncertain environment there are no grounds to anticipate the magnitude of future monetary policy adjustments. Therefore, they ratify that decisions will depend on the information available at a given moment in time.

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