Minutes for the meeting of the Board of Directors of Banco de la República on 27 January 2023

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Five Board Members voted in favor of this decision, and two voted for a 25 bp increase.

In their policy discussion, the Board of Directors considered the following elements:

- In December, both headline inflation (13.1%) and core inflation (excluding food and regulated items, 9.5%) continued their upward trend as a result of a monthly inflation of 1.3% that was higher than the technical staff (0.5%) and the market (median of 0.8%) expected. The surge in inflation was due to upward pressure on food prices, indexation at high inflation rates, and the cumulative effects of the depreciation of the peso along several other factors. In line with this result, inflation expectations were revised upwards, both for 2023 and for 2- and 5-year horizons.
- Economic activity began to show signs of a slowdown as of the fourth quarter of 2022, as deduced from leading indicators such as demand for energy, transaction figures, and consumer credit disbursements. The Economic Monitoring Indicator (ISE) registered an annual change of 2.9% in November, which was lower than October's (4.4%), and what was expected by the technical staff (4.0%). Nevertheless, GDP levels remain high, for which reason by 2022 it is estimated that the economy would have achieved growth of 8.0%. The slowdown in economic activity is expected to deepen. The technical staff is forecasting a 0.2% GDP growth figure for 2023.
- Inflation in the United States and Europe has shown a faster-than-expected decline as a result of the monetary policy tightening process and the mitigation of supply shocks. This will possibly allow for a less restrictive monetary policy path in these regions. Moreover, the relaxation of sanitary restrictions in China could translate into higher growth in that country and in an increased demand for basic goods, including oil. The improvement in the foreign environment and confidence in Colombia's fiscal outlook have been reflected in an appreciation of the COP/USD exchange rate.
- In line with the transmission of increases in monetary policy interest rates to market rates, total credit growth and, particularly pronounced, consumer credit growth, have been slackening since the fourth quarter of last year. Over the last month the growth of all portfolios has declined (with seasonally adjusted figures). This favors a moderation in domestic demand and inflationary pressures in 2023.

In the context described, the seven members of the Board of Directors agreed on the need for a new increase in the policy interest rate as to get inflation back to its 3.0% target in the medium term. They stressed the fact that the latest news on the inflationary front was not encouraging. The actual inflation in December for all baskets was higher than the technical staff and analysts had expected, while inflation expectations for most maturities continued to rise. This is in a context in which the slowdown in global economic activity has been slower than projected and in which there is renewed optimism among foreign investors regarding emerging economies. In the case of Colombia, this optimism was reflected in the successful placements of sovereign and Ecopetrol bonds in international markets and in reductions in the risk premia that were more pronounced than those of its regional peers. However, due to different emphases regarding the trends of the main macroeconomic variables, there was divergence with respect to the amount of the required adjustment. Five Board Members voted for a 75 bp increase, and two voted for an increase of 25 bp.

Among the arguments of the majority group, the multiple inflationary risks that still exist were highlighted

including the indexation of prices to either the minimum wage or the latest inflation data. This with the aggravating factor that much of the inflation is caused at the beginning of the year. They also warned that the ongoing high inflation expectations make it necessary to adjust the real interest rate to preserve the contractionary monetary policy stance. It was also noted that, despite the appreciation of the peso seen in recent weeks, the inflationary trend has been reinforced by the accumulated depreciation of the peso, which has been close to 15% in the last 12 months. For this group of Board Directors, reaffirming Banco de la República's commitment to the inflation target through a 75 bp increase will contribute to the peso's recovery process with beneficial effects on inflation. Finally, from a different perspective, a member of this group highlighted the decline in the indicators of the main monetary aggregates as a percentage of GDP and warned about the possibility that this may reflect a decrease in the demand for money. This leads economic agents to prefer foreign assets, durable consumer goods, or consumption, which could be an additional factor of upward pressure on price levels. The weakness in the demand for monetary assets seems to reflect the structure of deposit interest rates.

Board Members who voted for a 25 bp increase emphasized that the signs of a slowing economic growth justify a more moderate increase in the policy rate. They emphasized that the demand in the economy entered contractionary territory in November and December, as can be deduced from various indicators such as retail sales, fuel consumption, automobile sales, and the behavior of imports. The latter have registered consecutive drops for several months and fell in December, according to the information from the DIAN. They insisted that if the objective of monetary policy was to reduce demand in the economy, this has already been achieved, and forecasts indicate that its effects on economic growth in the coming year will be significant. They expressed the need to preserve the recovery of employment and noted that recent labor market indicators are highly sensitive to the slowdown in economic activity. They added that monetary and credit indicators confirm a decline in economic activity as evidenced by the lower growth rates of monetary aggregates and the loss of strength in the loan portfolio. They stressed that the persistence of inflation, despite historically high increases in the policy interest rate, demonstrates that the origin of the inflationary phenomenon has been essentially supply-side and mainly associated with food supply. This has been compounded by exchange rate pressure, which, together with the increase in international prices, has increased the cost of imported inputs, but they emphasized that this pressure has been decreasing since November. Price indexation has been another supply factor that has accentuated the inflationary trend.

Finally, the Board of Directors agreed that after the trajectory of interest rate increases in 2022 and with the decision adopted on this occasion, monetary policy is close to the stance required to induce a convergence of inflation towards its 3.0% target in the medium term. They reiterated that in the context of high uncertainty, further decisions will critically depend on the new information available.

Fuente: https://www.banrep.gov.co/en/minutes-meeting-board-directors-banco-republica-27-january-2023