Minutes: the Board of Directors of Banco de la República elected by majority vote to maintain the monetary policy interest rate unchanged at 13.25%

Attachments

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

- In August, headline inflation stood at 0.7%, above that expected by the technical staff and the market analysts (0.5%). Annual headline inflation came in at 11.4% and core inflation (excluding food and regulated items) at 9.9%. Although both inflation measures continued on a downward trajectory, they did so at a slower pace than anticipated and remain well above the target. The slower inflationary easing was explained by the behavior of food prices, mainly a rebound in the perishables segment, as well as by the price indexation mechanisms that led to the persistence of high inflation. However, most of the drop in inflation since April is reflected in the overall decrease in food inflation.
- Inflation expectations had mixed reactions. The survey of economic analysts for September showed a slight increase in their inflation expectations for year-end 2024, with the sample median moving from 4.9% to 5%. However, these fell over the two-year horizon from 4% to 3.9%. Expectations drawn from the financial markets for 1, 5, and 8 years forward, adjusted for the inflation risk premium, were revised upward and stood at 5.2%, 4.6%, and 4.2% respectively. These revisions occurred against a backdrop of lower-paced inflationary decreases and expected inflation risks primarily associated with the El Niño phenomenon, fuel price adjustments, and continued indexation processes.
- Economic activity continued to decelerate, consistent with the technical staff's projections. This is confirmed by high-frequency indicators whose demand components register a steep drop in investment, while supply-side activities presenting the greatest adjustment include manufacturing and construction. However, in the aggregate, economic activity continues at higher levels than those that would have been observed had the pre-pandemic growth trend continued. This is reflected in a dynamic job market that continues to register employment growth, with unemployment rates below those of the past five years, according to the August information published by DANE.
- In response to the adjustments of domestic demand, the country's external imbalance narrowed to 3% of GDP in the second quarter, from 4.2% in the previous quarter and 6.2% in 2022. This correction largely reflects a decrease in imports from the high levels recorded in 2022, lower profits remitted abroad by companies with foreign direct investment (FDI), and a rebound in

tourism-related service exports. The decrease in the current account deficit improves the country's external position and decreases the vulnerability of the economy to significant global deterioration.

The Board underscores that high inflation increases economic costs in terms of growth and equity, making long-term financing for both the public and private sectors more difficult. In addition, it introduces distortions in the allocation of resources and generates redistributions that are detrimental to the lower-income strata of the population. To this effect, the Constitutional Court in its 1999 ruling stated that the obligation of Banco de la República to preserve the purchasing power of the currency must consider the other economic objectives of the Government's intervention, such as economic growth and employment. The fulfillment of this mandate requires achieving sustainable growth with price stability. This long-term objective of monetary policy requires that inflationary shocks, such as the current ones, must be addressed in a timely manner.

Under the conditions of a largely anticipated slowdown in economic activity, the Directors shared the overall objective of finding the best opportunity to initiate an interest rate reduction process. In this context, five Directors voted to leave the policy rate unchanged at its current level of 13.25%, and two Directors voted to reduce it by 25 basis points.

Those Directors who opted to leave the interest rate unchanged acknowledged that the monetary tightening carried out so far has substantially moderated the excess demand that prevailed in 2022; normalized credit growth, particularly consumer credit; and brought about a significant reduction in the current account balance deficit. All of this represents significant progress in the requisite economic adjustment and has considerably reduced the macroeconomic stability risks. However, they warn that both headline and core inflation figures continue at excessively high levels, in contrast with what has been occurring in the main advanced countries as well as in comparable Latin American economies, which have been able to begin lowering their interest rates. They add that inflation expectations continue far removed from the 3% target, which encourages price indexation mechanisms reflected, for instance, in the CPI services basket, whose annual inflation remains above 9% and refuses to fall. They warn there are significant risks that may affect inflation in Colombia during the coming months, such as the materialization of a strong El Niño phenomenon that may push up food and energy prices; the possibility of higher interest rates in the main developed economies (the United States and the eurozone) that may drive investment capital out of the country and encourage exchange rate depreciation trends; and rises in oil prices, such as those recently experienced, which may accentuate the need to continue increasing fuel prices. Given these circumstances, these Directors considered the conditions were not suitable for an interest rate decrease, and a premature decision would risk a future reversal at great cost to the credibility of monetary policy and to the process of bringing inflation toward the established target. These Directors also noted that monetary policy foresees a longer horizon within its objectives and implementation, thus implying it must steadfastly maintain its objective of returning to the 3% target in order to provide Colombia with greater macroeconomic stability.

Those Directors who voted for a 25 bp policy rate reduction did not deviate substantially from the abovementioned majority group's concerns regarding the persistence of inflation, its unrelenting elevated level and expectations, and the inflationary pressures contingencies. However, their reading of the indicators and their outlook inclines them towards initiating the cycle of interest rate cuts. In this respect, they argue that the monetary policy adjustment introduced and continued since September 2021 has achieved its purpose of reducing excess demand in the economy and will continue to work throughout the remainder of the year. This is revealed by the significant weakening of domestic demand, especially investment, reflected in the significant current account deficit correction, which would decrease to 3.4% of GDP by the end of 2023, as forecast by the technical staff, after an imbalance of 6.2% of GDP in the previous year. They add that there was also a significant correction in the fiscal imbalance, which stands out as one of the largest adjustments made by the countries in the region in the last year, given the projected decrease in the general government deficit from -6.5% to -3.3% of GDP between 2022 and 2023, according to the medium-term fiscal framework published in June. They note that these adjustments bring the economy closer to a more sustainable future growth path and thus improve Colombia's international financial conditions. However, they expressed concern that an amplification of the economic slowdown could threaten household income and undermine the progress in reducing poverty achieved in 2022. On this matter, they noted that financial closings of road and housing construction projects currently headed by the private sector have been hampered by the high interest rates in force, which in turn weakens the pace of economic activity.

The Directors agreed that the Board's decision was in line with the objective of bringing inflation down toward its 3% target, and reiterated that future decisions by the Board will be determined according to new information available.

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