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- Annual headline inflation continued its downward trend during February, standing at 7.7% and exhibiting a cumulative drop of 1.5 percentage points (pp) during the first two months of the year. Likewise, annual inflation, excluding food and regulated items, had a 1.2 pp drop which, coupled with a substantial rise in food supply and lesser hikes in certain utilities and transportation services, played a role in moderating prices across most components of the consumer basket. However, inflation within the services sector maintained a relatively rigid downward trend, declining from 9% to 8.5% from December to February. This trend persists because essential items like rents, education, and personal services, among others, tend to adjust in line with observed inflation and wage increments.
- The different metrics used to gauge inflation expectations continued to drop, indicating an overall downward trajectory for inflation. The monthly survey of economic analyst expectations conducted by Banco de la República showed that, from December to March, median inflation expectations fell from 5.7% to 4.7% in the one-year horizon and from 3.8% to 3.5% in the two-year horizon. Similarly, adjusted expectations drawn from the public debt markets continued to present downward adjustments for all maturities.
- The technical staff revised their inflation forecast down for yearend 2024 from 5.9% to 5.4%. This adjustment is made within an environment where cumulative monetary policy measures will continue, bringing inflation close to 3% +/- 1 pp by mid-2025. Factors such as a low exchange rate, reduced international price and cost pressures, moderate adjustments in food prices, and indexing to a lower inflation rate versus that of 2023 will all play a role in achieving this projected outcome.
- The 3.8% contraction in domestic demand in 2023 rectified the overspending relative to income seen in previous years. This adjustment not only helped alleviate inflationary pressures but also led to a substantial reduction in the current account deficit, from 6.2% of GDP in 2022 to 2.7% in 2023. This correction of the external imbalance has contributed to reducing the country's vulnerability to potential deteriorations in the global economic landscape.

The Board members reached a consensus that the favorable trends in inflation and its expectations, coupled with a more sustainable external balance, create an advantageous environment for accelerating the pace of policy rate cuts. However, they cautioned that significant risks persist. The current level of observed inflation and its expectations continue far from the target. They highlighted uncertainties surrounding the extent of service price indexation and the lingering effects of the El Niño phenomenon, although both continue to fade. Moreover, they acknowledged the possibility of future challenges in international financial conditions. Given these considerations, they stressed the importance of caution in the magnitude of the monetary policy rate cut. Consequently, five directors voted in favor of a 50 basis-point reduction, one director supported a 75 basis-point cut, and one director advocated for a 100 basis-point decrease.

The majority of directors advocating for a 50 basis-point cut highlighted several reasons supporting a faster

reduction in the policy rate, alongside arguments for exercising caution during this process. They emphasized the positive trajectory of inflation in the first two months of the year, accentuating its continued decline as of 2023, in line with the expected convergence towards the target by mid-2025. Additionally, they pointed to the recent decrease in inflation, excluding food and regulated items, driven by favorable trends in goods prices. They also noted the stable exchange rate's role in lowering import prices, thus reducing producer costs and providing relief for consumers. Moreover, these directors highlighted that the significant drop in domestic demand, part of the broader macroeconomic adjustment, has disproportionately affected sectors like manufacturing, commerce, and construction. They maintained that these sectors would benefit from an interest rate cut, facilitating their recovery. Conversely, they underscored reasons for caution in the speed of monetary policy easing. They cautioned against sudden and unexpected interest rate cuts, which could fuel inflation expectations and currency depreciation, potentially jeopardizing the approximation to the inflation target and necessitating reversals with significant credibility costs. They also mentioned concerns about the anticipated deterioration in the fiscal position, citing warnings from the Autonomous Committee of the Fiscal Rule about compliance risks. Additionally, they pointed to market uncertainties stemming from high-level government announcements concerning political, economic, and social matters. They emphasized Colombia's fragile international standing, noting that events undermining fiscal sustainability or institutional stability could rapidly deteriorate the country’s risk and exchange rate, undermining confidence.

The member advocating for a 75 basis-point reduction aligned with the Board's consensus in highlighting the ongoing decrease in both headline and core inflation, indicating the success of the contractionary policies initiated in September 2021. Diminishing inflation expectations across various time horizons sourced from surveys and debt markets in their view, instills a degree of confidence in achieving the target by mid-2025. Furthermore, the expected negative impact of the El Niño phenomenon on price appears to be waning. This confluence of lower inflation, favorable external conditions, reduced risk premiums for Colombia, a falling exchange rate, and the government's commitment to fiscal rule compliance presents a unique opportunity for a more substantial monetary policy rate cut. This would provide crucial stimulus to counteract the nearly 25% contraction in fixed investment witnessed in 2023. Failing to attain this aim could limit the potential for future economic growth and result in adverse effects on employment and income levels.

Finally, the director supporting a 100 basis-point reduction in the policy rate emphasizes that the most substantial decrease in inflation has already occurred and that its rate of decline is expected to slow down moving forward. For this member, the risks associated with the El Niño phenomenon have diminished, and there is an expectation of a healthy agricultural supply in the upcoming months. Additionally, a crisis in power generation is not foreseen, given adequate water reserves backed by thermal generation, providing a buffer until rainfall patterns normalize. According to the director, the high energy tariffs in certain regions are mostly a result of market imperfections rather than energy shortages, suggesting that revising regulations could be a solution. The need to reach an agreement with transporters to determine an adjustment mechanism for diesel prices is also outstanding. In this context, the member does not foresee an immediate risk of inflationary pressures. On the contrary, concerns about the risks associated with low economic growth such as that forecast for 2024. Addressing these concerns would require a significant reduction in the real interest rate. However, the real (ex-post) intervention rate has increased this year due to a more significant decline in inflation compared to the cuts in the monetary policy rate and thereforethe director identifies an ample margin to implement a 100 basis-point cut in the interest rate to begin reducing the real interest rate effectively and stimulate economic growth recovery.

The Board of Directors agrees that today’s decision accelerates the pace of interest rate cuts while asserting a policy stance in line with the objective of driving inflation to its target by mid-2025. The Board reiterates that future decisions will be taken considering new information.

Fuente: https://www.banrep.gov.co/en/news/board-directors-minutes-march-2024