



**BANCO DE LA REPÚBLICA  
DIVISION OF ECONOMIC STUDIES**

**Description of the external circumstances facing the Colombian economy, the  
developments in foreign trade, the performance of domestic demand, output and  
lending, and the behavior of inflation and inflation expectations  
Data from the Inflation report of November, 2014**

## **I. The External Context, Exports and Imports**

1. In the last few weeks, the fall in the international prices of oil that began this year in July has continued, reaching levels that had not been observed for five years. The acceleration of this downward trend appears to be related to: the market reduction of the prospect of global oil demand; a wide supply; and the fact that there are no signs that the main producing countries may adjust their production volumes. It is expected that at least during 2015 the prices will not recover substantially, and some analysts even forecast additional deterioration.
2. The effects of this trend on global economy have been diverse. On the one hand, economies depending importantly on oil have seen an increase of their risk premia, a strong depreciation of the exchange rate, and a fall in the expectations of economic activity for next year. On the other hand, it is expected that the drop in oil prices gives an additional boost to growth in fuel-importing economies, although there is uncertainty about its magnitude. The fall in the prices of fuels is a source of global disinflation.
3. In this context, the figures of real activity in the United States to November indicate that this economy has maintained a favorable behavior during the fourth quarter. Added to this, confidence indicators for households and the corporate sector continue improving, and they suggest that dynamism of the domestic demand would be sustained in the following months. As for the labor market, the figures for November continue showing recovery: employment generation was greater than had been expected, the unemployment rate remained low, and improvements in the alternative indicators monitored by the Federal Reserve such as the rate of underemployment and the long-term unemployment rate continue to take place.
4. Inflation in the United States in November reduced to 1.3% on an annual basis (the indicator of core inflation posted at 1.7%) and remains below the Federal Reserve's 2.0% goal. Despite this, the press release and the interest rate projections by the members of the Federal Open Market Operations Committee (FOMC) from the most recent meeting suggest that the first increase of its benchmark rate would occur at the beginning of the second semester next year and would continue gradually.
5. Regarding the euro zone, the real activity and confidence indicators show that the growth of its economy would continue being weak during the fourth

quarter, and suggest an unlikely favorable outlook for next year. The growth forecasts for 2015 for official companies has been revised downward. Additionally, the extemporaneous elections in Greece have increased uncertainty in the financial markets of the region.

6. The annual inflation of the euro zone posted at 0.3% in November; together with the economic weakness and the fall of the prices of fuels, this suggests latent risks of deflation.
7. As for emerging economies, the figures of real activity in China to November indicate that its economy would have continued slowing down during the last quarter of the year. In Latin America, the results of the GDP for the third quarter display a mediocre growth, while the indexes of real activity in Brazil, Chile and Peru to October show that growth in these countries would have continued being low.
8. Inflation in emerging economies continues showing a heterogeneous outlook. In the majority of Asian countries, especially in China, a reduction has been observed in recent months. In contrast, Latin America maintains a growing trend that, nevertheless, has moderated.
9. As for the international prices of commodities, the price of nickel increased facing the prospect of a lower global supply. In turn, although the international price of coffee showed some reduction, it remained in the high levels observed since the beginning of the year.
10. The prices of some imported food items increased as a result of: less favorable climatic factors in North America which affected the quality of the crops; fear of possible restrictions to exports of cereals from Russia; and increases in the global demand of these items.
11. Regarding financial markets, the volatility indexes increased during the last month, and significant falls of the stock market were observed, especially in those of emerging economies. Meanwhile, the rates of long-term bonds of the United States and of the euro zone reduced during the last month.
12. As for financial markets in Latin America, a significant increase was observed in the risk premia, while weakening of their currencies continued to take place. The Colombian case stands out, considering that its currency has

depreciated the most in December so far; also, the strongest increases of the *Credit Default Swaps* (CDS) have been observed in Colombia.

13. In this context, the total exports in dollars fell 12.6% in October as compared to the same month one year before, a reduction associated chiefly with lower prices. The groups of the main commodities of mining origin (-18.1%) and those of other exports (-7.8%) contributed to this fall. The main commodities of agricultural origin had a growth of 30.7% on an annual basis.

14. In the case of mining commodities, those that contributed the most to the fall were oil (-21.2%) and oil derivatives (-48.5%). Among the group of other exports, the decline in sales of chemical products (-11.8% ), food and beverages (-12.2 % ), and meat (82.5% ) stand out; per destination, the largest decreases in this group corresponded to Venezuela (-28.8%) and Brazil (-24.8 %). As for commodities of agricultural origin, coffee (67.3%) and flowers (19.4%) grew.

15. So far this year to October, total exports in dollars fell 3.0% due to the fact that the reduction in the prices could not be compensated by greater quantities. Per groups, the annual diminution results from the lower exports of mining commodities (-4.3%) as well as of other exports (-5.1%). External sales of commodities of agricultural origin recorded a growth of 18.2% in the accumulated value of the year to October. As for commodities of mining origin, lower values in refined products (-28.8%) and gold (-32.4%) stand out; among the remaining exports, those registered in car sales (-37.8%), other agricultural commodities (-40.5%), and meat (-63.8%) are highlighted. The main commodities of agricultural origin showed an increase of 29% in coffee, 20.5% in banana, and 2.7% in flowers.

16. DANE has not yet published data of imports for October.

## **II. Domestic Demand, Growth and Credit**

17. According to the most recent information published by DANE, the Colombian economy grew 4.2% in annual terms during the third quarter of 2014. This figure, which marked a significant slowdown versus the records of the first semester, posted at the lower part of the forecast interval presented in the previous Inflation Report for the period of July-September (4.0% and 5.2%, with its mid-point at 4.6%). The increase between quarters was 0.6%.

18. On the side of supply, (**Chart 1**), the sectors which registered a greater increase were those of construction (12.7%), retail (4.8%), and that of personal, communal, and social services (4.7%). Mining and manufacturing recorded annual setbacks of 1.0% and 0.3%, respectively. Although they slowed down, financial services maintained a favorable growth (4.4%).

**Chart 1**

**Real annual GDP growth per economic activity**

Branch of activity	2013				2013	2014		
	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter		1st Quarter	2nd Quarter	3rd Quarter
Farming, forestry, hunting and fishing	3.1	7.6	5.3	5.9	5.5	6.1	1.5	3.4
Mining and quarrying	0.8	4.5	6.7	7.8	4.9	5.7	-2.2	-1.0
Manufacturing	-4.7	1.1	-0.4	0.1	-1.0	3.2	-1.4	-0.3
Electricity, gas and water	4.2	5.8	4.1	5.6	4.9	4.7	3.7	3.9
Construction	12.6	4.9	21.3	10.5	12.0	18.2	10.2	12.7
Buildings	10.3	9.8	30.0	-0.4	11.4	7.7	1.6	14.1
Civil works	12.8	2.2	17.4	20.0	12.7	26.0	17.6	11.1
Retail, repairs, restaurants and hotels	2.9	4.3	4.6	5.5	4.3	5.5	4.9	4.8
Transportation, warehousing and communications	2.2	3.3	3.4	3.4	3.1	4.6	4.4	4.3
Financial, real estate and corporate services	3.8	4.5	6.1	5.8	5.0	6.1	6.1	4.4
Social, community and personal services	4.9	5.1	5.0	6.2	5.3	6.8	5.8	4.7
<b>Subtotal value added</b>	2.8	4.2	5.5	5.4	4.5	6.4	3.9	4.0
<b>Taxes minus subsidies</b>	3.7	4.6	5.8	4.5	4.7	7.5	7.7	6.1
<b>GROSS DOMESTIC PRODUCT</b>	3.0	4.5	5.7	5.5	4.7	6.5	4.3	4.2

Source: DANE, calculations by *Banco de la República*

19. The few available indicators for the fourth quarter show mixed results. In the first place, the behavior of sales and confidence suggest a solid performance of household consumption. In contrast, the expansion of oil production is mediocre, and the industry would not be expanding at the expected pace.

20. According to the results of the *Monthly Survey of Retail Trade* (EMCM) by DANE to October, performance of retail sales indicates a significant dynamism of private consumption. In that month, the index excepting fuels recorded an annual expansion of 13.4%, greater than the 7.7% of the third

quarter. Discounting car sales, the increments were of 12.2% and 6.5% for October and the third quarter, respectively. It is worth mentioning that the effect of a low base for comparison during the same month of 2013 would have contributed to the high increase in this indicator.

21. According to the same survey, in October vehicle sales increased 18.7% on an annual basis, a figure similar to that of September. Against the previous quarter, this result represents an acceleration (13.4%). Together with this, a good behavior of the consumption of durables during the last quarter of the year is foreseen. Related to the aforesaid, the report of retail car sales published by *ANDI-Fenalco-Econometría* records an annual growth of 16.5% in November.
22. In turn, the consumer confidence index (CCI) by *Fedesarrollo* again showed an inter-monthly increase in November. With this performance, the indicator posted higher than the average for the third quarter of the year, and for the series since 2001. Both the household index of economic conditions (ICE) and that of medium and long-term consumer expectations (IEC) showed again increases in their rates with respect to the previous months.
23. Other indicators of the evolution of private consumption are those related to labor market and credit. Upon considering mobile quarters, the figures to October indicate that the unemployment rate has continued falling in all geographical regions. Nevertheless, the non-seasonal series indicate stability. It is worth mentioning that non-salaried employment has grown again in recent months, although slightly.
24. Finally, accelerations of household consumption credit were recorded during November. In this month, this portfolio expanded 13.3% on an annual basis, a rate somewhat higher than that of October (12.5%) and that of the third quarter (11.8%). Additionally, the nominal interest rates for households have not presented significant changes. However, in real terms they continue showing a decreasing trend.
25. On the side of supply, uneven results were observed. The trade GDP would continue showing a good dynamism, as suggested by the retail sales already analyzed.

26. In the case of oil, although production remains at one million barrels and reports an acceleration against the previous quarter (1,002,000 daily barrels on average for the two-month period of October-November, against 984,000 daily barrels in average for the third quarter), expansion is weak in annual terms (0.3% on an annual basis for the last two-month period, and -0.9% for November).
27. In turn, industry expands at lower rates than those expected. Particularly, the figures published by DANE for the month of October report an annual increase of 0.3% and a year-to-date growth of 1.5%. Weakening of the industry continues, not only due to the shocks associated to Reficar, but also because other sectors such as sugar mills, confection and knitting and weaving have contributed negatively to the results of the sector (its annual variances were -11.1%, -7.5%, and -12.4%, respectively).
28. In turn, in November the total demand of energy increased 3.1% on an annual basis, after having registered an increase of 4.0% in the previous month and of 5.1% during the third quarter. The regulated component increased 5.6%, and the non-regulated component 0.9%.

### **III. Behavior of Inflation and prices**

29. In November, annual consumer inflation accelerated by 36 basic points (bp), posting at 3.65% (**Chart 2**). In monthly terms, the variance amounted to 0.13%, a figure greater than the one expected by the market (0.05%). In the same month of the previous year, a strong downturn of the CPI had been registered (0.22%) due to the falls in the prices of food and regulated items, a situation that did not repeat in this opportunity, for which annual inflation increased. So far this year to November, the increase in consumer prices has been 3.38%.
30. Core inflation increased for a second consecutive month in November. According to the average of the four indicators estimated by the Bank, it posted at 2.85%, i.e., 9 bp higher than the one registered in October (**Chart 2**). All the indicators increased, except for the CPI for non-food and non-regulated items, which remained stable at 2.6%. The greater acceleration took place in the CPI without food, which reached 3.2% for this month, the

maximum level among the four indexes, surpassing Core 20 for the first time (3.1%).

31. Within the non-food CPI, bull pressures stemmed from the CPI of regulated items, which had been foreseen to a great extent by the SGEE. In the case of the other two sub-baskets (tradables and non-tradables except food and regulated items) annual variance remained very similar to that of the two previous months.

Chart 2

Inflation to November 2014

Description	Dec-13	June-14	July-14	Aug-14	Sept-14	Oct-14	Nov-14	Participation percentage in monthly acceleration	Participation percentage in acceleration of the year to-date
<b>Headline inflation</b>	<b>1.94</b>	<b>2.79</b>	<b>2.89</b>	<b>3.02</b>	<b>2.86</b>	<b>3.29</b>	<b>3.65</b>	<b>100.00</b>	<b>100.00</b>
<b>Non-food inflation</b>	<b>2.36</b>	<b>2.66</b>	<b>2.75</b>	<b>2.84</b>	<b>2.70</b>	<b>2.91</b>	<b>3.18</b>	<b>53.81</b>	<b>34.66</b>
Tradables	1.40	1.94	1.60	1.57	1.59	1.66	1.68	1.45	3.86
Non-tradables	3.76	3.45	3.17	3.29	3.26	3.26	3.23	(1.19)	(8.72)
Regulated items	1.05	2.14	3.60	3.83	3.25	4.07	5.32	53.55	39.52
<b>Food inflation</b>	<b>0.86</b>	<b>3.11</b>	<b>3.26</b>	<b>3.47</b>	<b>3.25</b>	<b>4.27</b>	<b>4.88</b>	<b>46.19</b>	<b>65.34</b>
Perishables	(0.16)	8.92	9.18	8.91	7.61	15.14	17.61	21.18	37.65
Processed food	(0.24)	1.44	1.66	2.09	2.14	2.13	2.65	21.89	26.04
Eating out	3.26	3.52	3.45	3.47	3.23	3.43	3.55	3.12	1.64
<b>Core inflation indicators</b>									
Non-food inflation	2.36	2.66	2.75	2.84	2.70	2.91	3.18		
Core 20	2.72	3.04	2.73	2.98	2.89	3.02	3.09		
CPI excluding perishable foods, fuel and utilities	2.19	2.53	2.33	2.42	2.39	2.53	2.57		
CPI excluding food and regulated items	2.74	2.81	2.51	2.56	2.55	2.58	2.57		
<b>Average of core inflation indicators</b>	<b>2.51</b>	<b>2.76</b>	<b>2.58</b>	<b>2.70</b>	<b>2.63</b>	<b>2.76</b>	<b>2.85</b>		

Source: DANE. Calculations by *Banco de la República*.

32. Until November, a pass-through of the depreciation of the peso to the prices of tradables except food and regulated items was not perceived. The annual variance of this sub-basket in the latest month (1.7%) was only 10 bp greater than the one by the end of the third quarter and even lower than that of June, when the peso posted at one of its highest levels (**Chart 2**). In November,



some prices such as those of vehicles and television services started to increase, but this has been compensated by downturns in other areas, such as purchase of cell phones and accessories. Likewise, falls in the CPI of the majority of electrical appliances and electronic devices continued to take place. To the end of November, the peso had depreciated close to 15% in annual terms, and 20% against its highest level in July.

33. The CPI of non-tradables except food and regulated items (**Chart 2**), in turn, descended slightly to 3.2% in the latest month. Since July, this indicator has fluctuated between this level and 3.3%, suggesting that demand pressures are scarce. The main item, leases, continues showing an annual variance of 3.1%.
34. In the last month, annual variance of the CPI for regulated items increased 125 bp, reaching 5.3%. As mentioned, this is partly due to a low base for comparison with November last year, but also to considerable increases in sectors such as public urban transport, natural gas, and, to a shorter extent, electric power. In the first case, the CPI in November collected part of the readjustment in public transportation rates as ruled by the government of Bogotá since mid-October. As for gas, the readjustment of the month was of 2.1%, which adds to a similar one in the previous month as part of a series of readjustments that would occur in the following months as a response to the increases of the price of natural gas in the Colombian Caribbean coast.
35. Regarding food, its annual variance in November amounted to 4.9%, i.e., 61 bp higher than the figures for October. The three main components of this basket (processed, perishable and, to a shorter extent, eating out) accelerated. In the case of processed food, part of the increase concentrated on beef, which could be related to the retention phase of livestock breeding in Colombia. However, increases were also recorded in the prices of products such as eggs, which could obey to the increase in the exchange rate, given that the production of these commodities is intensive in imported raw materials. In any case, the pass-through of the depreciation to the prices of food has also been scarce until now.
36. In the aforementioned environment, inflation expectations have increased. According to the monthly survey applied by *Banco de la República* to market analysts, inflation expected for December this year is 3.59%, and 3.22% to twelve months. A month ago, these values were 3.46% and 3.14%, respectively. In the case of expectations derived from the profitability of TES

to 2, 3, and 5 year periods, these posted between 3.1% and 3.6%, i.e., 24 bp more than a month ago, on average.

37. In November, annual variance of the PPI increased again, showing a figure of 5.1% against 4.9% in the previous month. Bull pressures were originated fundamentally by the PPI for imports (3.9%), which is increasing as a result of the depreciation of the peso. Nevertheless, the local PPI did not increase, partly attenuating these rises thanks to the discounts observed in the local PPI for mining due to reductions in the prices of fuels.

38. Regarding salary costs for industry and construction with figures to October, these continued adjusting to rates near or lower than 4.0%, compatible with the inflation goal. As for trade, the adjustment pace is greater (6.1%), but it descended against the one registered a month ago. Besides, the data may be affected by recent methodological changes applied to the trade survey.