



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

**Monetary Policy Report of January 2015**

## **I. International Context and Balance of Payments**

1. The international prices of oil recovered partially in the past weeks, after the strong fall observed since July 2014. This could indicate that a slowdown in global production growth is expected, especially in the United States, and that due to changes in the price expectations financial market agents have reduced their short positions in the futures market (contract sales).
2. On the other hand, the international prices of other commodities continue relatively stable after the falls during December and beginnings of January. In this context, the prices of the main exported commodities and those of some food imported by Colombia did not present significant changes, and remained at relatively low levels.
3. During the fourth quarter, GDP growth in the United States, despite being lower than the one observed three months before, shows that domestic demand remained dynamic and suggests that expansion of the economy continues to be strong. With this, the increase of its GDP for 2014 was 2.4%. Likewise, business and household confidence indicators, with data to January and February respectively, suggest a good performance of the real activity during the first part of 2015.
4. The data for January shows that the labor market continued its recovery. Employment creation was higher than expected; the unemployment rate remained at low levels (5.7%), and alternative indicators of this market monitored by the Federal Reserve (underemployment rate and long-term unemployment) continued to improve.
5. In the euro zone, GDP for the fourth quarter of 2014 grew 0.3% in quarterly terms, bringing growth for the whole year to 0.9%. These results, which were slightly better than those expected by the technical staff and by the market consensus, were favored by the good performance of Germany and peripheral countries (Spain, Ireland and Portugal). However, France grew 0.1% in quarterly terms, and Italy contracted -0.02%.
6. On the other hand, indicators for real activity and confidence for this year in Europe show a positive trend. Nevertheless, in recent weeks discussions about the extension of the financing plan for Greece have increased uncertainty in the financial markets of the region, which could have negative effects on household and investors' confidence.

7. The euro zone continued displaying a deflationary trend in January, since annual inflation registered -0.6%, mainly as a consequence of the fall in fuel prices. In turn, core inflation indicators in the region continued to slow down. Annual change of the Consumer Price Index (CPI), excluding food and energy, fell from 0.7% in December to 0.6% in January. As for the United States, although there are no new data, it has been forecast that in January inflation continued falling.
8. In China, GDP annual growth during 2014 (7.4%) was below the governments' target (7.5%), and lower than growth in the previous year (7.8%). The figures for January show that the slowdown of this economy would have continued. On the one hand, the survey on manufacturing activity registered below the neutral level, suggesting that this sector would continue to moderate. On the other, foreign trade records show a strong fall of imports in annual terms (-19.9%) and, to a lesser extent, of exports (-3.6%). Nevertheless, it is worth mentioning that the data at the beginning of the year for this country are usually affected by seasonal factors, given the irregularity of the Chinese New Year.
9. In Latin America, real activity indexes for December in Brazil, Chile and Peru show that these economies would have stopped deteriorating, although their growth would remain low.
10. On the other hand, inflation in some emerging economies continued with a heterogeneous outlook. In the majority of Asian countries, a reduction has been observed in recent months. The case of China stands out, where annual inflation fell from 1.5% in December to 0.8% in the following month, as a result of the lower prices of fuels and food, as well as of some seasonal factors. In turn, in Latin America, reductions have been observed in Chile, Peru and Mexico, while Brazil and Colombia present a growing trend.
11. In the financial markets, the volatility indexes have remained at relatively high levels, as a result of the uncertainty generated by the situation in Greece. Despite this, the long-term bonds rates for the euro zone (except Greece) continued falling in the last few weeks, thanks to the announcements in January by the European Central Bank of increasing their assets purchase program. By contrast, the long-term bonds rates in the United States showed some correction from the minimum levels that were observed by the end of January. In this context, the US dollar did not present significant changes compared to the major currencies of the world.

12. As for financial markets in Latin America, in the last few weeks the risk premia fell for most economies, while the currencies showed a heterogeneous behavior: those of Chile, Colombia and Mexico slowed the depreciation rate, while that of the Brazilian real was accentuated.

**a. Exports and imports**

13. In December 2014, total exports in dollars fell 28.5% as compared to the same month last year. As per the CIIU rating (Rev. 3), the main reduction was registered in the mining sector (-39.4%) and in the industrial sector (-12.5%). Within the former, the reduction in oil and natural gas (-43.8%) and in coal (-25.7%) stand out. In the case of industrial goods, the main falls were registered in coking and oil refining (-59.7%), paper production (-32.1%), metal products (-24.9%) and vehicles (-14.8%).

14. For the whole year, the fall in total exports was of 6.8%, explained by those of the industrial sector (-10.2%) and of the mining sector (-5.3%). The most significant falls in the group of industrial goods took place in coking and oil refining (-32.9%), production of basic metallurgical products (-23.5%) and vehicle production (-36.8%). Finally, the value for crude oil and natural gas (-7.2%) was the only one that was reduced within the mining commodities.

15. In November, the value in US dollars for total imports (CIF) recorded an annual growth of 6.4%, as a result of the increases in capital goods (17.1%) and consumer goods (9.8%). In turn, imports of raw materials and intermediate goods fell 4.0%. The growth of capital goods imports was due mainly to increases in those destined to industry (15.6%) and transportation equipment (21%); while the main growth among consumer goods was that of durables (16.6%). Within intermediate goods, the increased imports of raw materials for agriculture (16.9%) did not compensate the falls that took place in fuels and lubricants (-12.3%) and raw materials for the industry (-2.2%).

16. In the accumulated value from January to November, total CIF imports increased 7.5% annual due to higher purchases of raw materials (8.2%), capital goods (6.0%) and consumer goods (8.5%). In the first case, the main increases were those in the purchases of fuels and lubricants (16.8%) and those of raw materials for the industry (5.7%). As for capital goods, the largest contribution to growth came from the imports of industrial goods (7.0%), followed by those of transportation equipment (5.9%). Finally, growth in consumer goods was due

to the joint increase in the imports of durable (11.6%) and non-durable (5.3%) consumer goods.

17. According to the latest information published by DANE, the total imports CIF grew 11.2% in December, thanks to the joint increase recorded in intermediate goods (18.2%), capital goods (6.1%) and consumer goods (9.5%).
18. During 2014, total imports CIF increased 7.8%. In the accumulated value for the year, imports of raw materials grew 8.9%, those of capital goods 6.0%, and the purchases of consumer goods 8.6%.

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

19. The latest information for the fourth quarter of 2014 suggests that economic activity, especially domestic demand, maintained a satisfactory dynamics.
20. According to the figures of the Monthly Retail Sales Survey (*Encuesta mensual de comercio al por menor-EMCM*) by DANE, retail sales without fuels expanded in December at an annual rate of 10.6%. With this result, the increase was 11.0% annually for the fourth quarter, a figure which is higher than that of the third (7.6%). Excluding vehicle sales, annual growth was 8.2%, 9.4% and 6.7% in December and the fourth and third quarters, respectively. These results are consistent with the forecast on the good performance of private consumption during the last quarter of 2014 presented in the previous report.
21. On the other hand, according to the same survey, vehicle sales recorded an expansion of 25.8% yearly during December and of 18.8% for the fourth quarter, accelerating from the third quarter (13.4%). It is worth mentioning that the organization of the 14th *Salón del Automóvil* towards the end of November implied greater vehicle sales, with which 2014 marked new records.
22. In turn, the sales balance of the Monthly Survey for Economic Expectations (EMME) by Banco de la República corroborates the good prospect of private consumption growth in the fourth quarter of 2014. The average of this indicator for the period was significantly higher than the one registered in the third quarter.
23. Other indicators that confirm the forecast of household consumption are related to the performance of the labor market. With information to December, the

unemployment rate continued falling, although at a slower pace than in previous occasions. Besides, although job creation slowed down, salaried employment continued to grow over the same period of 2013, and relative to past months.

24. As for gross fixed capital formation, different from construction of buildings and civil works, it is expected that during the last three months of 2014 it may have expanded to an annual rate higher than the one observed for the third quarter, according to the balance of investment expectations obtained from the EMME.
25. On the supply side, the indicators available suggest a good performance in sectors such as retail (according to the EMCM already analyzed), coffee production, and industrial production. Particularly, the Industrial Production Index (IPI) without coffee threshing grew 2.1% yearly in December. During the period of October-December 2014, annual expansion of the IPI without coffee threshing was 0.4%. As a result, the industry reached a yearly growth of 1.3% for 2014, after the falls observed in 2012 and 2013.
26. Finally, with information to November, the *Índice de Seguimiento a la Economía* - ISE published by DANE indicates a lower growth rate of the Colombian economy during the fourth quarter of 2014, recording an annual expansion of 3.4%. For the two-month period of October-November, growth was 3.5%, which represents a slowdown compared to the one observed for the third quarter (3.9%). It is worth mentioning that this indicator does not exactly match the variances observed for the quarterly GDP.
27. This allows keeping the forecast range for GDP growth in the fourth quarter between 3.3% and 4.7%. With this, the expansion of the Colombian economy for all of 2014 would be 4.8%.
28. The data for the first quarter of 2015 is still limited, and suggests mixed results; however, some indicators show that the economy would have reduced its dynamism. With this, GDP expansion would be lower to the one registered in the fourth quarter and the estimate for last year. Additionally, a negative base effect will lower that of the first quarter of 2015.
29. In January 2015, car sales reported by ANDI, Fenalco and Econometría contracted annually 6.4%. In levels, sale records are significantly lower than those at the end of last year.

30. In turn, in the same month, the Consumer Confidence Index (CCI) showed an inter-monthly decline, reaching levels slightly above the average of the series since 2001. According to information by Fedesarrollo, the index of economic conditions (IEC) of households and of medium and long-term consumer expectations (ICE) showed lower levels compared to the previous month.
31. The first month of the year registered a slight slowdown in the consumer credit growth rate (13.1% annually versus 13.4% in December). Additionally, the consumption rate in real terms recently showed an increase, although it continues to be historically low.
32. On the supply side, the indicators available with information to January show mixed results.
33. According to the *Federación Nacional de Cafeteros*, coffee production registered 1,088,000 sacks in January 2015, which implied an annual growth of 7.6% (versus -2.6% in December 2014). Meanwhile, crude oil production during the same month was of 1,034,500 barrels per day, the second highest value in the history of the country. This implied an annual growth of 2.0%, as was informed by the Ministry of Mining and Energy.
34. Finally, the total energy demand slowed down, moving from a 4.2% growth in December to 2.8% in January 2015. The trend component flattened.
35. As compared to the previous report, the forecast range for GDP expansion in 2015 was not revised: between 2.0% and 4.0%, with 3.6% as the most likely figure.

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

36. In January, annual consumer inflation accelerated for fourth consecutive month, registering 3.82% and surpassing the print for December 2014 by 16 bp (**Chart 1**). In monthly terms, the variation was 0.64%, a number higher than the one observed twelve months before (0.49%) and the one expected by the market (0.54%). The acceleration of inflation was mainly explained by the increases in food prices, and by increases in the prices of tradable goods.
37. As with total inflation, in January, core inflation had its fourth consecutive month rise. According to the average of the four indicators estimated by the

Bank, it registered 3.22% in January, i.e., 16 bp higher than the registers for December (**Chart 1**). Except for the CPI without food (3.2%), which reduced its annual growth by 6 bp, all other indicators increased. The greater acceleration took place in the CPI without perishable foods, fuels, and public utilities, which for this month was 3.1%. The Core 20 indicator (3.6%) continues to show the maximum level among the four indexes, while CPI without food and regulated goods (3.0%) is the lowest.

**Chart 1**

| <b>Inflation to January 2015</b> |                    |                    |                    |                     |                     |                    |                    |                     |                     |                    |                    |
|----------------------------------|--------------------|--------------------|--------------------|---------------------|---------------------|--------------------|--------------------|---------------------|---------------------|--------------------|--------------------|
|                                  | <b>Wei<br/>ght</b> |                    |                    |                     |                     |                    |                    |                     |                     |                    |                    |
| <b>Description</b>               |                    | <b>Dec<br/>-12</b> | <b>Ma<br/>r-13</b> | <b>Jun<br/>e-13</b> | <b>Sep<br/>t-13</b> | <b>Dec<br/>-13</b> | <b>Ma<br/>r-14</b> | <b>Jun<br/>e-14</b> | <b>Sep<br/>t-14</b> | <b>Dec<br/>-14</b> | <b>Jan<br/>-15</b> |
| <b>Total</b>                     | <b>100.00</b>      | <b>2.44</b>        | <b>1.91</b>        | <b>2.16</b>         | <b>2.27</b>         | <b>1.94</b>        | <b>2.51</b>        | <b>2.79</b>         | <b>2.86</b>         | <b>3.66</b>        | <b>3.82</b>        |
| <b>Non-food inflation</b>        | <b>71.79</b>       | <b>2.40</b>        | <b>2.11</b>        | <b>2.48</b>         | <b>2.36</b>         | <b>2.36</b>        | <b>2.62</b>        | <b>2.66</b>         | <b>2.70</b>         | <b>3.26</b>        | <b>3.20</b>        |
| Tradables                        | 26.00              | 0.77               | 1.13               | 1.10                | 1.34                | 1.40               | 1.65               | 1.94                | 1.59                | 2.03               | 2.28               |
| Non-tradables                    | 30.52              | 3.92               | 3.85               | 3.78                | 3.70                | 3.76               | 3.55               | 3.45                | 3.26                | 3.38               | 3.47               |
| Regulated items                  | 15.26              | 1.91               | 0.20               | 1.98                | 1.24                | 1.05               | 2.21               | 2.14                | 3.25                | 4.84               | 4.01               |
| <b>Food inflation</b>            | <b>28.21</b>       | <b>2.52</b>        | <b>1.41</b>        | <b>1.34</b>         | <b>2.05</b>         | <b>0.86</b>        | <b>2.23</b>        | <b>3.11</b>         | <b>3.25</b>         | <b>4.69</b>        | <b>5.41</b>        |
| Perishables                      | 3.88               | (3.90)             | (1.86)             | 2.44                | 5.94                | (0.16)             | 3.17               | 8.92                | 7.61                | 16.74              | 16.78              |
| Processed food                   | 16.26              | 2.83               | 1.25               | (0.11)              | 0.18                | (0.24)             | 0.92               | 1.44                | 2.14                | 2.54               | 3.70               |
| Eating Out                       | 8.07               | 4.90               | 3.22               | 3.51                | 3.74                | 3.26               | 4.13               | 3.52                | 3.23                | 3.51               | 3.60               |
| <b>Core Inflation Indicators</b> |                    |                    |                    |                     |                     |                    |                    |                     |                     |                    |                    |
| Non-food inflation               |                    | 2.40               | 2.11               | 2.48                | 2.36                | 2.36               | 2.62               | 2.66                | 2.70                | 3.26               | 3.20               |
| Core 20                          |                    | 3.23               | 2.78               | 2.83                | 2.79                | 2.72               | 2.86               | 3.04                | 2.89                | 3.42               | 3.58               |



|  |  |             |             |             |             |             |             |             |             |             |             |
|--|--|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| CPI excluding perishable foods, fuel and utilities |  | 3.02        | 2.51        | 2.14        | 2.19        | 2.19        | 2.53        | 2.53        | 2.39        | 2.76        | 3.12        |
| CPI excluding food and regulated items             |  | 2.55        | 2.67        | 2.63        | 2.69        | 2.74        | 2.74        | 2.81        | 2.55        | 2.81        | 2.97        |
| <b>Average of Core Inflation Indicators</b>        |  | <b>2.80</b> | <b>2.52</b> | <b>2.52</b> | <b>2.51</b> | <b>2.51</b> | <b>2.69</b> | <b>2.76</b> | <b>2.63</b> | <b>3.06</b> | <b>3.22</b> |

Source DANE. Calculations by BANCO DE LA REPÚBLICA

38. Upward pressures within the CPI without food came from the group of tradable and non tradable goods. On the contrary, the sub-basket of regulated goods exerted downward pressures.

39. The annual variation in the prices of tradable goods accelerated from 2.0% in December to 2.3% in January, reflecting the effect of accumulated depreciation of exchange rate. Between July 2014 and January 2015 the peso depreciated 29.8% against the US dollar. Until November last year, the effect of the increase of the US dollar on the prices of tradables (without food and regulated goods) had not been evident, but from December this transmission began to be observed, and it should continue for several more months (**Chart 1**). In January, significant increases were observed in the prices of several items in this group, highlighting those of air tickets (1.5%) and vehicles (1.8%).

40. Nevertheless, the results in January for the prices of tradables were lower than expected by the SGEE, which suggests that the transmission of the exchange rate to consumer prices would be lower, or perhaps operating more slowly than in previous episodes. It is recommended to wait for results of February and March in order to have a clearer idea on the matter, since these are months in which firms usually adjust a wide range of prices.

41. In January, annual variation of the CPI of non tradable goods without food and regulated goods increased for second consecutive month, registering 3.5% versus 3.4% in December (**Chart 1**). As was the case a month ago, this increase is explained by the item of culture and entertainment, particularly by

the item comprising soccer-match tickets (since the finals for the Superliga took place with participation of a team from Bogotá, which did not happen a year ago). Given this, it is estimated that the increase (as that of December) would be mostly transitory, and it is expected that it be reverted in the next two months.

42. Aside from this noise, the CPI of non-tradable without food and regulated goods showed again low adjustments, as has been the case in the past, suggesting that demand pressures are scarce. The main item from the basket, i.e., leases, remained stable, recording an annual variation of 3.0%.
43. Offsetting the increases of tradables and non tradables, annual variation of the CPI of regulated goods decreased from 4.8% in December to 4.0% in January. This behavior is related to the reduction in the price of gasoline by \$93 pesos decreed by the Government for the month of January. The reduction of \$138 pesos ordered for February should also help to reduce the annual variation of this component of the basket. Between December and January, this variation changed from 1.8% to -0.6%.
44. The lower annual variation of the prices for regulated goods in January was also possible thanks to the reduction of electric power rates in the same month. By contrast, the rates for gas utilities increased.
45. As for the food basket, its annual variation stood at 5.4% versus 4.7% in December (**Chart 1**), constituting the main source of increase. In January, processed and semi-processed foods (3.7%) continued to increase as they have done since May, propelled this time by the strong increase in the price of rice and secondly, by the effect of the depreciation on internal prices of products from imported origin (vegetable oil and cereals). In turn, perishable foods maintained a high-adjustment annual pace (16.8%), attributable mainly to potato (with a monthly rise of 11.0% and an annual rate of 65.2%). There would be a limited supply of rice as well as of potato in response to the low prices observed in the two previous years and to other localized climatic and phytosanitary problems. Finally, eating out prices adjusted to an annual rate of 3.6% in January, i.e., 10 bp more than a month before.
46. According the monthly survey by Banco of the República to market analysts at the beginning of February, inflation expectations to twelve months decreased slightly and stood at 3.2%. Between April and December last year, its value fluctuated between 3.1% and 3.3%. The expected inflation by the analysts for December 2015 is 3.35%. At the same time, the average inflation expectations

for 2, 5 and 10 years, as inferred from the Break-Even Inflation in February, presented variations of +2 bp., -6 bp., and -6 bp. versus the average of January, registering 3.84%, 3.47%, and 3.70%, respectively.

47. Regarding non-labor costs, PPI annual variation continues to increase constantly since August last year, registering 6.4% in January versus 6.3% in December. Again, upward pressures came from the imported PPI, whose annual adjustment in January (8.3%) surpassed that of December (7.9%), which denotes the impact of the depreciations of the peso. On the contrary, the local PPI fell slightly from 6.0% to 5.9%, which is basically attributable to the smaller annual adjustments in the mining industry PPI.
48. As for labor costs, annual wage adjustments for the sector of heavy construction and housing (4.0% with data to January) and for industry (2.6% with data to December) do not suggest inflationary pressures. Nevertheless, greater increases in recent months have been observed in retail wages (7.1% in December). As was explained in the previous report, methodological changes could explain part of this result, which nevertheless deserves a close monitoring to rule out possible inflationary pressures from this front.