Monetary Policy Report
Contenidos relacionados
The Board of Directors of Banco de la República at today's meeting confirmed the inflation target at 3.0% and decided to maintain the benchmark interest rate at 7.75%

A regular meeting of the Board of Directors of Banco de la República took place in the city of Bogotá D.C. on Friday, November 25, 2016. In attendance were Mauricio Cárdenas Santamaría, Minister of Finance and Public Credit; José Darío Uribe Escobar, Governor of the Central Bank; and co-directors Carlos Gustavo Cano Sanz, Ana Fernanda Maiguashca Olano, Adolfo Meisel Roca, Cesar Vallejo Mejia, and Juan Pablo Zárate Perdomo.

These minutes contain a summary of the outlook on the macroeconomic situation by the technical staff of the Central Bank (section 1), followed by a review of the main discussion regarding monetary policy by the Board of Directors (section 2).

Further detail on the macroeconomic situation prepared by the technical staff from the Central Bank will be presented in the monthly Monetary Policy Report for October 2016 and in the statistical annex.

1. MACROECONOMIC CONTEXT

1. In this report, the growth forecast for the country's main trading partners as well as for the terms of trade did not change versus those presented last month. However, there is an increase in global uncertainty that could be transmitted to these projections.
2. The risk premia in Latin America increased after the results of the elections in the United States. The CDS for Colombia exhibited a significant increase. This took place within a context in which financial markets assign a high probability for the Federal Reserve to increase the policy rate by 25 basis points in December and to another increase in the second half of 2017.
3. Growth forecasts of the Colombian economic activity for the third quarter and for 2016 were not modified from the last report: growth for the third quarter is forecast between 1.0% and 2.2% with 1.6% as the most likely figure, and for the whole year between 1.5% and 2.5% with 2.0% as central forecast. However, the latest information available shows poor results below expectations. Thus, the likelihood that growth for the entire year will be somewhat lower than the central forecast increased.
4. As for the financial market, the dynamics of indebtedness continues to moderate from high levels relative to output. Commercial debt continued to decelerate (5.7%), and the rate of increase for households stabilized at 13.1%.
5. In October, annual consumer inflation completed three months falling, reaching 6.48%. In the last month, the decrease was mainly explained by the lower pace of annual adjustment for food prices, and, to a lesser extent, by the favorable behavior of the CPI for tradable goods excluding food and regulated items.
6. Core inflation, measured by the average of the four indicators monitored by the Central Bank, lowered from 6.29% in September to 6.03% in October.
7. In November, inflation expectations obtained from the monthly survey to economic analysts, decreased slightly in all horizons: they stood at 4.18% and 3.57% to one and two years, respectively. In contrast, those derived from public debt bonds increased for 2, 3, and 5 year terms, ranging between 3.88% and 4.15%.

In all, the Colombian economy continues to adjust to the strong shocks received since 2014, and the current account deficit is narrowing gradually. The dynamics of output have been weaker than had been forecast, and inflation continues to decline, although the core inflation indicators and inflation expectations to a year still exceed the target. The effects of several of the transitory supply shocks that affected inflation and inflation expectations continue to reverse, and this trend is expected to continue. The recent changes in the international context have led to a depreciation of the peso. The monetary policy actions undertaken so far strengthen the convergence of inflation to its target.

2. DISCUSSION AND POLICY OPTIONS

The members of the Board agreed that the process of adjustment of the economy to the shock on income suffered since 2014 is taking place more quickly than expected, as well as the decline in the figures for headline inflation. However, there are still risks that inflation may not converge to its 3.0% target.

Facing this scenario, five members of the Board voted to maintain the benchmark interest rate unchanged. They concluded that it was important to have more information on the possible risks on the convergence of inflation and inflation expectations to the target before starting to reduce the benchmark interest rates. One of the risks mentioned was the increased uncertainty in international markets, which could lead to inflationary pressures.

Some of the members of the majoritarian group stressed the risks of maintaining a high level of indexation in the economy, which others complemented with the need for more evidence on the convergence of inflation expectations and the measures of core inflation to the target. Finally, one of them mentioned that with shocks such as those suffered by the Colombian economy, it is difficult to assess the excess of installed capacity, with the risk of changing the monetary policy stance prematurely.

Two members of the Board voted for a 25 bp reduction of the benchmark interest rate. One of them highlighted that, while it is important for the trend in core inflation to consolidate before reducing the benchmark interest rate, it is also important to acknowledge that a change in the risk balance is starting to take place: i) there are clear signals of a higher-than-expected deceleration in domestic demand; ii) there is a marked slowdown of loan portfolio (particularly commercial loans); iii) as a result of the fall of inflation expectations, real benchmark interest rates have increased, and, in general terms, real loan interest rates of the financial system have also increased.

Finally, another Board Member pointed out that the growth figure for the third quarter and the forecasts for 2016 and 2017 are not encouraging, and there are no sources in sight to generate growth of domestic demand higher than potential GDP growth. On the other hand, inflation forecasts for 2016 and 2017 exhibit a faster convergence to the target. S/he acknowledges that there are risks associated with the uncertainty generated by the new trade policies that may be adopted in the United States and the change in the Fed's monetary policy stance. This could create a currency depreciation scenario whose magnitude is difficult to measure, but which would be tempered by the tax reform (which consolidates the credit rating), and by the evidence that despite the recent increase of global risk the country has not experienced capital outflows.

3. POLICY DECISION

The Board of Directors, by majority, decided to maintain the benchmark interest rate unaltered at 7.75%.

The decision to maintain the benchmark interest rate unchanged was approved by five members of the Board. The remaining two members of the Board voted for a 25 bp reduction of the benchmark interest rate.

Bogotá D.C.