Monetary Policy Report
Contenidos relacionados
The Board of Directors of Banco de la República at today's meeting decided to reduce the benchmark interest rate by 25 bp to 7.5%

A regular meeting of the Board of Directors of Banco de la República took place in the city of Bogotá D.C. on Friday, December 16, 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 November 2016 and in the statistical annex.

1. MACROECONOMIC CONTEXT

1. In the third quarter, the Colombian economy expanded 1.2% annually, a figure lower than expected by the technical staff at Banco de la República and by the market. Total consumption, particularly for households, reduced its growth rate, while investment deepened its fall. With this, domestic demand exhibited a negative annual variation (-1.1%), the first since 2009. On the other hand, net exports contributed positively to economic growth.
2. The information available for the fourth quarter is still scarce, but it allows anticipating that economic activity is expanding at a slightly faster pace than in the third quarter. This is partly due to the fact that some supply shocks that took place in the third quarter would have been overcome. Should this be the case, GDP growth for 2016 would post in the lower part of the forecast range presented in the previous quarterly Inflation Report (1.5% to 2.5%, with 2.0% as the most likely figure).
3. In the last month, commercial indebtedness (that of foreign currency adjusted to correct for the fluctuations of the exchange rate) registered a 5.7% annual increase, as in October, but lower than in previous months. The dynamics of household credit continues, with an annual growth rate close to 13%.
4. In November, annual consumer inflation continued decreasing, reaching 5.96% thanks to the reduction in food prices, tradable goods, and regulated items. The average of the four core inflation indicators (5.74%) also continues to fall. Inflation expectations by financial analysts to one and two years and those embedded in public debt bonds to 2 and 3 years exhibited some increases versus the previous month, and remain above 3.0%.
5. As for the external context, the Fed raised its benchmark reference rate by 25 bp in its December meeting, as expected, and suggested that there would be three more increases in 2017, more than had been expected before. The ECB modified the size, duration, and composition of its asset-purchase program. Long-term interest rates in several developed economies have remained above the levels observed between July and October this year, while headline inflation continues to increase.
6. Regarding oil price, it has rebound in recent weeks following the agreement reached by the OPEC, which other oil-producing countries have also joined, to reduce oil production in the first half of 2017. Thus, the country's terms of trade would have continued to improve.
7. The emerging markets' risk premia and currencies (including Colombia) have corrected, following the strong changes observed after the US presidential elections.
8. The figures for global economic activity suggest that the US, Europe, and China would continue the path of moderate growth held in recent quarters.
9. In the mid-term, uncertainty about the external context has increased due to the fact that the policies to be implemented by the new government in the US and the effects of Brexit, among others, are still unknown. Similarly, risks over China persist.

In all, the Colombian economy continues to adjust to the strong shocks recorded since 2014, and the current account deficit is narrowing gradually. Inflation continues to decline faster than expected, although core inflation indicators and inflation expectations to one year still exceed the target. The effects of several of the transitory supply shocks that have affected inflation and inflation expectations continue to reverse, and this trend is expected to continue.

2. DISCUSSION AND POLICY OPTIONS

The members of the Board agreed in that the process of convergence of inflation to its long-term target has strengthened in the last months. The reversion of climatic shocks and the stabilization of the exchange rate have produced an accelerated reduction of the increase in the prices of food and goods linked to international trade. In this direction, the weak growth of domestic demand and output widens the excess of installed capacity, which will induce additional reductions of inflation in the policy horizon. The weakness of domestic demand also contributes to moderate the current account deficit and thus to reduce the vulnerability of the economy.

The majority of the Board Members considered that the conditions to reduce the degree of contraction of the monetary policy stance were being met. Therefore, they voted for a 25 bp reduction of the benchmark interest rate. These members of the Board stated that the benchmark interest rate is high versus its historical average and neutral rate calculations. In this context, the recent slowdown of aggregate demand and the better prospects for inflation allow for a reduction of the benchmark interest rate. They highlighted the good response of financial markets to the Fed's increase in its benchmark rate, which reduces the risk of strong devaluations that may act against the convergence of inflation to the target. Another factor that reduces this risk is the agreement to reduce oil production reached by the OPEC, which would stabilize oil prices in 2017. They also noted the importance of pursuing an anticipatory monetary policy, given the lags between policy actions and their effects on domestic demand and inflation.

Other Board Members considered that, despite the fact that inflation is converging to its target, there are still no strong enough signals that the pace of convergence is adequate. In this regard, the most significant risks derive from the existence of several indexation mechanisms for prices and salaries, and the probable effects of the changes in the US and Europe's monetary policy on the exchange rate and the conditions for external financing of the economy. They held that it would be prudent to keep the benchmark rates stable, considering there would be relevant information on the aforementioned risks next month. This information would allow for a more precise idea of a proper, future monetary policy, which would enhance communication with the public and improve its effectiveness. They also stated that they do not consider the adjustment of domestic demand and growth to be excessive, considering that the current account deficit is still high, for which they believe the behavior of theses variables is part of the adjustment process. Some members from this group highlighted that Core inflation is still above the target, and that inflation expectations increased slightly in the last month. In this context, a reduction of the interest rates would bring about the risk of reinforcing the change in the behavior of inflation expectations, which could generate instability of the monetary policy and costs in terms of well-being.

3. POLICY DECISION

The Board of Directors of Banco de la República at today's meeting decided to reduce the benchmark interest rate by 25 bp to 7.5%.

The decision to reduce the benchmark interest rate was approved by four members of the Board. The three remaining Board Members voted to keep it unaltered.

Bogotá D.C.,