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## [Detailed Explanation of the Macroeconomic Situation](#)

### Must reads

#### [Banco de la República keeps the Benchmark Interest Rate at 4.5 %](#)

A regular meeting of the Board of Directors of Banco de la República was held in the city of Bogotá D.C. on September 26, 2014. In attendance were Mr. Mauricio Cárdenas Santamaría, Minister of Finance and Public Credit, Mr. José Darío Uribe Escobar, Governor and Managing Director of Banco de la República, and Board Members Carlos Gustavo Cano Sanz, Ana Fernanda Maiguashca Olano, Adolfo Meisel Roca, César Vallejo Mejía and Juan Pablo Zárate Perdomo.

These minutes contain a summary of how Banco de la República's technical team views the macroeconomic situation (Section 1), followed by a review of the key policy discussion points considered by the Board of Directors (Section 2).

A more [detailed description of the macroeconomic situation](#), prepared by Banco de la República's technical team, is provided in the data section of the June 2014 edition of the Inflation Report and in the statistical appendix.

## 1. THE MACROECONOMIC CONTEXT

The technical team underscores the following aspects with respect to the macroeconomic context:

1. The new figures on global economic activity suggest Colombia's trading partners could average demand for Colombian products is likely to be slower during the second half of the year than was predicted in previous reports.
2. The Federal Reserve (Fed) is expected to end its financial asset buying program in October 15, which could lead to a rise in the US dollar interest rate. State interest rates ceased to decline in recent weeks and were situated above the average observed in 2013.
3. A number of countries in the region have seen their risk premium increase in the last few years, making the deterioration in terms of trade could be higher than was estimated in the last quarterly report.
4. The value of exports in dollars recovered during July and exceeded the average for the first half of the year (it was -4.5% in the first six months). The value of total exports was still accumulated a reduction of 2.6% in the first seven months of the year.

5. Imports in dollars registered in July at the highest monthly value on record. The ratio of imports to GDP rose to 14.2% between February and July, and 3.2 percentage points more than during the first half of the year.
6. The upward trend in foreign trade increased the likelihood of a negative trade balance, temporary closure of the Cartagena refinery explains part of the increase in this deficit.
7. In the domestic context, economic growth during the second quarter of 2014 (4.2%) was in line with the domestic demand, which was the main driver of growth. The increase in demand was mainly because of temporary closure of the Cartagena refinery.
8. For the third quarter, the new figures on economic activity suggest growth during this period of 4.2%, mainly due to the mining and energy demand up to August. However, production continued to require less energy and energy demand up to August. However, production continued to require less energy and energy demand up to August.
9. The increase in bank loans in domestic currency continued to trend downwards in August and growth in credit to the private sector increased in all types of lending. The increase in credit to the private sector was estimated for the current year.
10. The pass-through of benchmark interest rate hikes to interest rates on loans deteriorated in rates on loans (except credit cards) are below the average calculated since 2000.
11. Given all of the above, the technical team continues to forecast growth between 4.2% and 5.8% in GDP during the second half of the year than in the first six months.
12. Annual inflation rate in August was 3.02%, which is consistent with the technical team's forecast. The inflation rate in August was 3.02%, which is consistent with the technical team's forecast. The inflation rate in August was 3.02%, which is consistent with the technical team's forecast.
13. Analysts' expectations for inflation one year ahead and the expectations derived from target (3%).

In short, aggregate demand continues to exhibit strong growth in a context of nearly full use of productive capacity. At the same time, inflation expectations remain at around 3%. This is occurring in an environment where terms of trade are deteriorating and there is added uncertainty about the recovery in global economic activity and the cost of external financing. These factors can influence aggregate demand, as well as the exchange rate.

## 2. DISCUSSION AND POLICY OPTIONS

The Board of Directors decided, by a majority vote, to keep the benchmark interest rate at 4.5%.

Some members of the Board agree with the main elements of the short- and medium-term diagnosis outlined in the document prepared by the technical team. The relevant considerations in the traditional horizon for inflation targeting (one to two years) include the existence of a slightly positive output gap, domestic demand that is growing at high rates and more than expected, inflation that will be slightly above 3% in the coming months, but inflation expectations that so far show signs of being anchored to the 3% target, and a policy interest rate that implies a slightly expansionary monetary stance. However, insofar as monetary policy acts with a lag, it is important to consider the risks that could affect confidence and the future performance of the real economy, particularly those inherent in the international environment and in fiscal policy. To that extent, they considered it prudent to leave the benchmark rate at 4.5% for now and emphasized the importance of further evaluating the performance of the economy at the next meeting in order to define the future of monetary policy.

Other members of the Board argued that the latest information on second-quarter GDP growth on the domestic-demand side indicates a slowdown, despite its continued momentum, mainly due to civil works. However, given the lag between movement in the policy interest rate and its full effect on demand, the greatest impact will not be felt before the second half of 2015 and first half of 2016. On the other hand, the boost from performance in the mining-energy sector has slowed, as has the downward trend in terms of trade. Added to this is the weakness in the external sector, particularly with respect to Colombia's neighbors in the region. Lastly, total inflation and inflation expectations are anchored to the target, which is the main objective of monetary policy, while the average of the core indicators, such as

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non-food inflation, is still below the midpoint of the target range. According, they believe the benchmark rate should be kept at 4.5%.

Another member of the Board felt that, given a positive output gap and inflation that continues to rise in terms of its expectations, it makes sense to raise the benchmark interest rate by 25 bps to 4.75%, considering the data on growth in domestic demand during the second quarter, the relevant job market figures, and the business and consumer confidence indicators.

### **3. POLICY DECISION**

The Board of Directors decided, by a majority vote, to keep the benchmark interest rate at 4.5%.

Bogotá, D. C.