[Monetary Policy Report](#)

A regular meeting of the Board of Directors of Banco de la República took place in the city of Bogota, D.C., on July 31, 2015. 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 Mejía, and Juan Pablo Zárate Perdomo.

The following is a summary of the vision of the technical staff at Banco de la República on the macroeconomic situation (section 1) and an overview of the main policy discussions considered by the Board of Directors (section 2).

Further [details on the macroeconomic situation](#) prepared by the technical staff will be presented in the Inflation Report for the second quarter of 2015 and in the statistical annex.

1. MACROECONOMIC CONTEXT

1. According to the present report, growth projections for the majority of Colombia's major [illegible] weaker external demand with a lower dynamics than the one recorded in 2014 is, a [illegible] expected for 2015.
2. In the United States, GDP for the first and second quarters of 2015 exhibits moderation in [illegible] partners of Colombia in Latin America continue to register low growths and some falls in their economic activity.
3. As for international financial markets, the agreement between Greece and its creditors [illegible] Reserve augmented, and with this market interest rates have risen and the US dollar continues strengthening.
4. The prospects of lower global growth, high levels of oil production, and the growing [illegible] commodities exported by Colombia. Thus, this year the fall in the terms of trade will continue to have a significant negative effect on national income.
5. The lower prices of basic goods and the weakness in external demand have affected the [illegible] those of external mining sales, followed by the fall in exports of agricultural goods and other sectors.
6. In April-May the yearly decline in the value of imports in US dollars was also important, [illegible] purchases of capital goods, followed by the decline in imports of raw materials and foreign consumption.
7. With the new data, the technical staff has revised the projection for 2015 of the current [illegible] trade of non-factor services, partially offset by a lower deficit in net exports and smaller net outflows of capital revenue.
8. As for the domestic context, the indicators of retail trade, consumer and commerce [illegible] the absorption would have slowed down again. The trade deficit measured in constant pesos would have reduced.
9. Regarding the labor market, the downward trend in unemployment rates (seasonally adjusted) shows signs of interruption. In recent months, the global participation rate has remained relatively stable, while the occupation rate has decreased.
10. Real interest rates have lowered, and are below their historical averages calculated since 2000 (except for credit cards). Total credit has slowed down, but is growing at rates higher than the one for nominal GDP.
11. Considering this, the technical staff believes that the growth of the economy for the [illegible] of 2015, the most likely figure was revised from 3.2% to 2.8%, within a range of 1.8% and 3.4%.

12. Annual inflation in June remained relatively stable, standing at 4.42%, somewhat lower [illegible] in other groups. The average of the four measures of core inflation rose again, reaching 4.14%.
13. Inflation expectations to one and two years by financial analysts remained relatively stable. Those embedded in public debt bonds to more than two years were reduced. All of them are around 3.0%.

In all, inflation remains above the upper limit of the target range, inflation expectations are around 3.0%, and domestic expenditure of the economy continues adjusting to the lower dynamics of national income. In the monetary policy horizon, it is expected that the temporary price shocks be reversed in an environment of inflation expectations anchored to the target.

2. DISCUSSION AND POLICY OPTIONS

The members of the Board highlighted the gradual adjustment of domestic expenditure of the economy to the lower dynamics of the national income and a level of inflation above the upper limit of the target range. In the monetary policy horizon, it is expected that the temporary price shocks be reversed in an environment of inflation expectations anchored to the target.

Some Board Members consider there are factors that increase the risk that inflation expectations diverge from the target in the future, which could be an argument for a preventive increase of the benchmark interest rate. However, considering the magnitude of the shock in the terms of trade, there are also high risks that economy grows below the forecasts by the technical staff. Therefore, they deem appropriate not to increase the benchmark interest rate pro-cyclically, unless the probability of compromising the credibility of the monetary policy increases, or that the adjustment in expenditure is still insufficient to guide the inflation to its long-term target.

Other Board-members felt that, given that inflation has remained relatively stable at 4.42% and its expectations continue within the target range, and that domestic demand is expected to suffer a significant shock, it is prudent to wait and gather more information related to the behavior of prices, particularly the impact of pass through. An increase in the benchmark interest rate at this moment would be inappropriate because inflation is still caused by temporary phenomena, and a change in the policy signals could affect expectations within a context in which these are anchored.

A third group expressed their concern about the persistent rise in the average of the core inflation indicators over nine consecutive months (which also already exceeded the upper limit of the target range, 4.0%), and the ensuing likelihood that expectations become unanchored from the target. Additionally, they opined that, at the present juncture, the risk of higher inflation seems more likely than that of an excessive slowdown, and stressed that the key to a good monetary policy lies in the authorities' ability to anticipate. A lower monetary stimulus of 25 bp should not have an excessive additional impact on the slowdown of the economy and employment. Rather, it would have the advantage of strengthening the anchoring of inflation expectations to the target, reducing the devaluation pressure, and helping to correct the current account deficit. Additionally, it would be a signal of the commitment of the Central Bank to controlling inflation, and it would increase the credibility of the monetary authority.

3. POLICY DECISION

The Board of Directors, by majority, considered maintaining the benchmark interest rate at 4.5%.