
Monetary Policy Report

A regular meeting of the Board of Directors of Banco de la República took place in the city of Bogotá D.C. on Friday, September 25, 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 Mejia, and Juan Pablo Zarate 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 [detail on the macroeconomic situation](#) prepared by the technical staff from the Central Bank will be presented in the Inflation Report for the third quarter of 2015 and in the statistical annex.

1. MACROECONOMIC CONTEXT

1. Figures for global economic activity continue to reflect a weak recovery of external demand, with the economies of Latin America recording low increases and, in some cases, setbacks.
2. In its meeting of September, the Federal Reserve of the United States decided not to raise the interest rate for the year, and that it will continue increasing gradually in the future.
3. So far this month, volatility indicators of financial markets fell from the high levels reached at levels higher than those in 2014, and the prices of the currencies of a wide range of dollar remain highly volatile.
4. In the last few weeks, the international price of oil recovered slightly but is still lower than a year ago. The price of oil remains volatile and is still lower than a year ago. The price of oil remains volatile and is still lower than a year ago.
5. The figures for the second quarter of 2015 show that the adjustment of the external deficit is slower than had been foreseen (-12.1% accumulated to July).
6. As for the domestic context, GDP results for the second quarter released by DANFA show that the economy grew by 2.8% in real terms, but their net contribution to GDP growth was positive.
7. On the supply side, the estimate that growth was 2.8% in real terms, but their net contribution to GDP growth was positive.
8. As for the labor market, the unemployment rate fell in July, which is explained by a lower and formal employment have slowed down in recent months.
9. Real interest rates continued to be below their historical averages calculated since 2000.
10. In August, annual consumer inflation in Bogotá reached 4.74%. So far this year, a notable increase in the price of most goods and services, more than 80% of the items in the CPI basket exhibited increases in their prices.

11. Inflation expectations of financial analysts and those embedded in public debt bonds, on average, above the ceiling of the target range to September 22.

In all, the new information available exhibits a continuous and higher-than-expected increase in inflation and core inflation indicators, as well as the appearance of signals of a potential “unanchoring” of inflation expectations. The sharp increases in the prices of goods that are mostly affected by the depreciation of the peso have continued pressing inflation upwards. Prices of other goods and services also show increasing variations, which may reflect indexation, expectations of higher inflation in the future, or pressures in costs in these sectors. El Niño has intensified, increasing the risk of further increases in food and energy prices. Recent data on growth and economic activity confirm a slowdown in production and expenditure in line with the projections of the Central Bank’s technical staff, compatible with the correction of the country’s external deficit. Thus, the risk of a lasting increase in inflation and unanchoring of inflation expectations has augmented, while the risk of an excessive slowdown in economic activity has not exhibited a noticeable change.

2. DISCUSSION AND POLICY OPTIONS

In September 2015, the Board decided to increase the benchmark interest rate by 25 basis points, after keeping it stable for 13 months, sensing a shift in the risk balance faced by the economy.

All members of the Board agree that the Colombian economy is adjusting to the strong impact on income derived from the fall in the international price of oil that has generated a substantial depreciation of the peso, which is necessary to achieve a sectoral re-orientation of spending and production, leading to the adjustment of the country’s external accounts.

Due to its magnitude, this devaluation has raised inflation of consumer prices, and this increase has been reinforced by other supply pressures, especially on food. However, the Board considers that this shock is temporary, given that an additional, strong and continuous depreciation is not expected; also, they expect the phenomena affecting food prices to disappear in the policy horizon.

Although there have been different perceptions concerning the risks of a fall in the rate of growth that could lead to the possibility that a larger-than-necessary adjustment may take place (particularly in a context of weak external demand), such perceptions have diminished.

On the contrary, the risks of inflation expectations becoming “unanchored” in the presence of a continuous and higher-than-expected increase of inflation and core inflation indicators have augmented. Inflation expectation indicators increased, and those embedded in short and long term public debt bonds are above 4.0%.

Considering this change in the risk balance faced by the economy, with greater risks of a lasting increase of inflation and unanchoring of inflation expectations, the Board decided to raise the Central Bank’s benchmark interest rate by 25 bp. With the current information, the Board believes that this increase is consistent with the convergence of inflation to the 3.0% target.

3. POLICY DECISION

The Board of Directors of Banco de la República unanimously decided to increase the benchmark

interest rate by 25 bp to 4.75%.

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