
[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, April 29, 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 by the technical staff of the Central Bank on the macroeconomic situation (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 Banco de la República will be presented in the Monetary Policy Report for March and in the statistical annex.

1. MACROECONOMIC CONTEXT

1. The average growth projection of Colombia's main trading partners was revised downward in this report. Global activity indicators for the first quarter suggest expansions at low rates for the advanced economies and, in the case of the United States, lower than expected in the Inflation Report of December 2015. As for the region, the information available suggests that the trends observed in 2015 continue, with low growth in Mexico and Chile, and contractions in Brazil, Ecuador and Venezuela. On the contrary, the indicator of economic activity for Peru suggests recovery.

2. Since the end of February, volatility in international financial markets has declined, the currencies of emerging countries have strengthened, and risk premia have reduced. The international price of oil increased, and during the course of April to the 26, they posted on average at USD \$42.7 per barrel (Brent). The prices of other commodities exported by Colombia and Latin America have also increased recently. Should these levels of international prices persist for the remainder of the year, deterioration in the terms of trade would moderate. However, some of the factors that have generated oversupply of oil continue, and inventories remain high. Therefore, the technical staff maintained an average estimate of oil in USD \$35 per barrel (Brent) for all 2016.

3. The Federal Reserve of the United States, in its press release following the April meeting of the FOMC, suggested that normalization of the monetary policy would be more gradual than what was

announced at the end of last year. Other central banks of developed countries also maintain a highly expansive monetary policy stance.

4. In the first two months of the year, the figures for foreign trade by DANE show a 31.2% fall in the value in US dollars for exports and 26.3% for imports. The deterioration in exports is expected to continue for the remainder of 2016 on account of the poor growth of trading partners, the prices of goods exported being lower than those observed in 2015, and the reduction in the volumes of some products such as oil. Imports are also expected to continue falling, in line with a lower growth of domestic demand. With this, the external deficit for 2016 would be somewhere between 5.3% and 6.4% as a percentage of GDP.

5. In Colombia, domestic demand would have slowed down in the first quarter, particularly due to a fall in investment other than the construction of buildings. The figures available for retail indicate that private consumption continued as dynamic as in the end of last year, despite the marked deterioration in confidence indicators and the upward trend of the unemployment rate (seasonally adjusted series). Regarding public expenditure, growth is expected to have been lower than what was observed in the last quarter of last year. On the supply side, indicators of industry, retail trade, and coffee production suggest a favorable behavior, while mining reported deterioration. With this information, the technical staff is projecting a growth rate between 1.8% and 3.2% for the first quarter, with 2.5% as the most likely figure.

6. The forecast range for the full year is maintained between 1.5% and 3.2%, but the most likely figure was revised downward to 2.5% (compared to 2.7% of the December 2015 Inflation Report). Regarding the previous quarterly report, the new estimates consider a weaker external demand and a greater decrease in investment.

7. In March, annual consumer inflation reached 7.98%. The increase is explained by the behavior of regulated items, tradable goods excluding food and regulated items, and processed foods. The average of core inflation indicators monitored by the Central Bank increased again, standing at 6.29%.

8. Inflation expectations to twelve months are above 4.5% (for the different measures monitored by the Bank) and to December 2017 at 4.08% (according to the survey to economic analysts). Two-year expectations are at 5.30% according to the quarterly survey of economic expectations, and at 3.81% according to the survey to analysts. Those embedded in public debt bonds exceed 4.4% for all maturities.

9. The effects of El Niño, pass-through of the accumulated depreciation of the peso to prices, and the activation of indexation mechanisms on prices and salaries would keep inflation high during the first semester of the year. Shocks in food prices and depreciation are expected to begin fading in the second semester, which, together with monetary policy decisions, should lead inflation towards its target during 2017.

In all, high increases in food prices and partial pass-through of depreciation to domestic prices continue to exert inflationary pressures. Inflation expectations remain high. This takes place within a context of excessive expenditure over national income, in which the risk of an excessive deceleration of domestic demand continues to be moderated.

2. DISCUSSION AND POLICY OPTIONS

The members of the Board agree that it is still necessary to continue increasing the benchmark interest rate. The latest figure for inflation confirms the persistence of the shocks that affect this variable, although their effect on inflation expectations to different maturities has reduced marginally. Data for the external balance show progress in the adjustment of the current account deficit, but, due to the magnitude it has reached, it is necessary to continue driving this adjustment from the fiscal front in coordination with the monetary policy.

The majority of the Board Members proposed a 50 bp increase in the benchmark interest rate. Some of them consider that convergence of inflation to the target is compromised, even after the effects of the transitory shocks to prices have subsided. Supply shocks on prices have been more intense and persistent than originally foreseen; core inflation indicators show a growing annual variation, above the target; inflation expectations exceed or are close to the upper limit of the target range, and domestic demand has exhibited a dynamics higher than had been expected at the beginning of this year. Under these circumstances, expectations and indexation mechanisms are reinforcing inflation, and threaten the credibility of the monetary authority.

They also considered that the excess of expenditure over income, reflected in a wide deficit in the current account, is a risk to macroeconomic stability in the future. A 50 bp increase in the benchmark interest rate underpins the credibility in the monetary authority, fosters convergence of inflation to the target range in 2017, and contributes to an orderly correction of the deficit in the current account, all this without increased risk of an excessive deceleration of the economy and employment creation.

One of the members of the majoritarian group considers that the impacts of the supply shocks continue to exhibit greater intensity and persistence than had been initially foreseen. Also, that in the course of the year, domestic demand has been more dynamic than had been expected at the beginning of the year. Although this does not imply that there are demand pressures, confluence of these factors slows down convergence of inflation to the target. Thus, there is space to increase the benchmark rate by 50 bp, continuing with the path of increases that began in September of 2015.

Other members expressed that, despite the fact that they agree in that the reasons to continue increasing the benchmark interest rate persist, they prefer to continue with the 25 bp increase path. They stated that the path of gradual increases has generated credibility in the process of tightening monetary conditions and, consequently, increases in the interest rates of the financial system in amounts equal to or greater than those displayed by the benchmark rate. The proper operation of the policy's transmission channels was a result of its consistency, credibility and predictability, as was reflected by the behavior of the financial markets.

They also noted that one of the greatest strengths of a gradual path of increases is the possibility to effectively incorporate new information to policy decisions. This strength becomes even more important considering that uncertainty about the future behavior of exogenous variables (which are relevant to the Colombian economy) has increased, such as the international price of oil or international financial conditions. In the last month, these variables have exhibited significant changes, with high uncertainty about their nature and duration, which would reaffirm the desirability of maintaining the path of gradual increases to the benchmark interest rate.

3. POLICY DECISION

The Board of Directors of Banco de la República, by majority, decided to increase the benchmark interest rate by 50 bp to 7.0%.

Bogotá, D. C.