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, 28 September 2018. In attendance were Alberto Carrasquilla Barrera, Minister of Finance and Public Credit; Juan José Echavarría, Governor of the Central Bank; and Board Members Gerardo Hernández Correa, Ana Fernanda Maiguashca Olano, José Antonio Ocampo Gaviria, Carolina Soto Losada, 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 September 2018 and in the statistical annex (Only Available in Spanish) .

1. MACROECONOMIC CONTEXT

1. The growth forecast of the country's trading partners (excluding Venezuela) for 2018 was maintained in this report (2.8%), which confirms the recovery of external demand for Colombia *vis-à-vis* the previous year. This is explained mainly by the performance of consumption and investment in advanced economies. Also, a slight acceleration is still expected for 2019.
2. However, the macroeconomic imbalances in some emerging economies, together with higher expectations of an increase in the interest rates of developed countries and the consequences of trade disputes, have generated greater uncertainty in the international context.
3. This report revised the forecast for some raw materials upwards, particularly oil for the remainder of 2018 and for 2019. Thus, the average price per barrel (Brent) is estimated at US $72 for 2018, and at US $68 per barrel for 2019.
4. The forecasts suggest that external deficit as a share of the country's GDP would continue correcting in 2018, but at a slower pace than observed in previous years. In this manner, the current account deficit is estimated as close to 3.3% of GDP in 2018, and slightly higher for 2019.
5. The technical staff estimates that the Colombian economy would expand at a rate of

2.7% in 2018 in the baseline scenario, considering that the international financing conditions, the prices of commodities, and the demand from trading partners continue to be favorable to GDP expansion. Additionally, domestic factors such as lower inflation, an expansive interest rate, and a relatively stable labor market would enhance a scenario of recovery in growth.

6. In the last few months, inflation has remained at levels close to the target. Particularly in August, headline inflation stood at 3.10%, slightly lower than in the previous month. The decreases in the annual variation in the group of non-tradable and regulated items stands out, although the latter continue at a very high level of annual adjustment.
7. In August, the average of the four core inflation indicators showed a slight decline compared with the previous month, reaching 3.35%. Inflation expectations to December 2018 obtained from the monthly survey to financial analysts posted at 3.23%. Analysts' expectations and those embedded in public debt bonds to horizons greater than or equal to a year stand between 3.2% and 3.4%.

In all, a slight increase in inflation due to supply factors is expected for the end of 2018, within a more dynamic economic growth environment than in the previous year, and which would continue in 2019. The monetary policy actions carried out so far should consolidate the convergence of inflation to the target and maintain a favorable path for the expansion of GDP. Uncertainty about external financing conditions and the performance of some emerging economies remains high.

2. DISCUSSION AND POLICY OPTIONS

The Members of the Board continue to highlight a good outlook in terms of inflation. The reading of the latest data is positive, particularly observing the evolution of the different core inflation indicators, which have stood around 3.0%. However, they emphasized that the inflation level of the groups of regulated and non-tradable items remains high, despite a fall in the latter throughout the year.

As in the previous meeting, there were several mentions of the transmission mechanisms of monetary policy. Several Board Members emphasized that the commercial loan portfolio does not yet exhibit recovery.

The members of the Board agreed that the external environment continues to be highly uncertain, and stressed that Colombia has not been negatively impacted and that sovereign risk premia have not recorded significant changes. In this scenario, it is essential for the monetary authority to continue monitoring the external conditions and the effects of possible shocks on the local economy.

The Board noted that, with the information available and from the meetings held with business representatives in several regions of the country, economic activity exhibits symptoms of recovery, although there is still a negative output gap which is expected to widen between 2017 and 2018, according to the forecast of the technical staff. The current levels of oil prices and greater confidence in the future growth of the economy should contribute to consolidate these dynamics in the remainder of the year and in the next year, although there is uncertainty about the pace of recovery.

The Board also discussed the possible effect of less-favorable international financial conditions and the impact that this would have on the future monetary policy stance.

In this context of economic recovery, although still with a negative output gap, with stable inflation albeit slightly higher than the target, and a more uncertain external environment, the members of the Board deemed prudent to maintain the current level of the benchmark interest rate.

3. POLICY DECISION

The Board of Directors unanimously decided to maintain the benchmark interest rate unaltered at 4.25%.