Monetary Policy Report

Must reads

Banco de la República maintains the benchmark interest rate at 4.25%

A regular meeting of the Board of Directors of *Banco de la República* took place in the city of Bogotá D.C. on Friday, October 26, 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 October 2018 and in the statistical annex (Only Available in Spanish).

1. MACROECONOMIC CONTEXT

1. The average growth forecast for Colombia's main trading partners for 2018 was revised downwards in this report (2.6%). For 2019, an expansion of the country's trading partners similar to the one projected for 2018 is estimated. This suggests that the recovery in external demand for Colombia would be stabilizing around the growth figure observed in 2017.
2. The prices of oil and other raw materials were revised upwards, which implies slightly more favorable terms of trade than those considered in the previous quarter and which stimulate national income. Particularly, this report increased the forecast of the average price of oil, which stood at USD 74.5 per barrel for 2018. For 2019, this figure was also was revised upwards. An average price of USD 73 per barrel is expected.

3. The expectations of a more rapid normalization of monetary policy in the United States, lower global growth prospects and political uncertainty in Europe have exacerbated the volatility in the financial markets in the last month. A greater risk perception towards emerging economies has affected the risk premia for the region, although this behavior has moderated in recent months.
4. Forecasts suggest that the external deficit as a share of the country's GDP would have finished adjusting and would remain stable *vis-à-vis* the previous year. Thus, the current account deficit is estimated at 3.4% of GDP in 2018 and somewhat similar in 2019.
5. The technical staff slightly reduced the growth estimate for the Colombian economy, which would expand at a 2.6% rate in 2018 in the baseline scenario, considering the persisting uncertainty associated with the execution of investment in civil works that may affect GDP dynamics. However, the conditions of international financing and the prices of commodities remain favorable to the expansion of output.
6. For 2019, GDP growth is expected to continue recovering, although uncertainty in this regard is high, particularly concerning the behavior of consumer confidence, civil works, and external conditions. Thus, for 2019, GDP growth is projected at 3.5% within a range between 2.5% and 4.0%.
7. In line with the technical staff's and the market's expectations, inflation increased in September, standing at 3.23% on a yearly basis. This acceleration is explained by the behavior of food, particularly perishable goods. In contrast, the other groups pressured the annual inflation downwards. In September, the average of the four core inflation indicators showed a slight decline compared with the previous month, reaching 3.28%.
8. Inflation expectations to December 2018 obtained from the monthly survey to financial analysts posted at 3.28%. Analysts' expectations and those embedded in public debt bonds to horizons greater than or equal to one year stand between 3.3% and 3.5%.

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 emphasized the stability of inflation. According to the latest records available, inflation remains slightly above the target. Core inflation indicators remain, on average, about 3.0%, with a downward trend. The Board mentioned that the level of inflation of regulated items remains high.

They also highlighted the increased uncertainty and the risk perception arising from the external context, which has begun to have an impact on Colombia, although moderate in the TES market. In this scenario, it is essential for the monetary authority to continue monitoring the external conditions and the domestic effects of likely shocks.

From the perspective of domestic demand, there was consensus in that uncertainty about the pace of economic recovery increased. Part of this uncertainty is linked to the low dynamics of commercial loans, which reflects a slow recovery of investment. In the opposite direction, the sales and industry indicators are positive.

In this context of a greater international uncertainty albeit with a weaker domestic demand and stable inflation, although slightly above the target, the members of the Board deemed prudent to maintain the current level of the benchmark interest rate.

Some Board Members mentioned that the recent devaluation of the Colombian peso has deviated from other emerging markets. Others argued that the recent adjustment responds to a correction of the revaluation observed in the first half of the year.

Another issue pointed out by some members of the group was the recent decline in the Consumer Confidence Index, which could add uncertainty to the process of economic recovery.

3. POLICY DECISION

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