Minutes for Banco de la República’s Board of Directors Meeting on September 29, 2022

Attachments

Determinantes de las Dinámicas de los Mercados de Capitales (Only Available in Spanish)

Anexo estadístico (Only Available in Spanish)

This policy decisión was based on the following considerations.

- Headline inflation in August was 10.8%, a figure above the 9.9% annual rate forecast by the technical staff. Core inflation (excluding food and regulated items) kept on an upward trend, reaching an annualized rate of 6.9% in that month. The percentage of items equal to or above the target in August 2022 stood at 89%, surpassing the rate observed a year earlier (61.7%) and confirming a significant difussion in price increases.
- Inflation expectations at different horizons mantained an upward trend, showing considerable sensitivity to recent inflation. In the case of economic analysts, Banco de la República's survey showed inflation expectations for the end of 2023 increased from 5.5% to 6.3% between August and September, according to the median of the sample. Inflation expectations derived from the debt markets also rose significantly, especially for shorter terms.
- The pace of economic activity so far this year has consistently exceeded the technical staff´s forecasts and those of the market. The momentum has been due to a build-up in domestic demand, driven largely by high growth in household consumption. On this basis, the technical staff increased the forecast for real GDP growth in 2022 from 6.9% to 7.8%.
- The economic tracking indicator (ISE), as well as several indicators for the third quarter, are beginning to show signs of a slowdown in productive activity. This trend could strengthen in the coming months as a result of exhaustion of the effects of post-pandemic pent-up demand, the impact of higher inflation on real income, less fiscal stimulus and the restrictive monetary policy stance. Taking all these factors into account, plus the risks associated with an adverse international context, the technical staff revised its forecast for growth in 2023 from 1.1% to 0.7%.

The Board of Directors agreed to continue the monetary policy adjustment that has been underway for the past year, which they believe is necessary in an economy where inflation and its expectations remain significantly above target, causing a high degree of indexation. Hikes in external interest rates, higher risk premia and the volatility in international financial markets also influenced this decision. The Board knows an adjustment of this magnitude requires weighing the prospect of a slowdown in economic activity against that of inflation, which is still far from the target, driving expectations that feed back into it. In this context, six members voted in favor of a 100 bp increase and one Board member supported a 50 bp increase.

In their individual interventions, the members of the majority group noted several reasons for their vote. Recent economic forces at work may have led to an increase in the output gap. While credit growth has stabilized, it has done so at fairly high rates, particularly for the consumer portfolio which is growing at an annual rate of nearly 23%. Core inflation has shown a strong upward trend. Inflation expectations respond mostly to increases in actual inflation, creating a mechanism that reinforces further price hikes. The current account deficit in the balance of payments, which is close to 6.0% of GDP, could see its future financing compromised in an environment of high global interest rates and growing risk aversion in international financial markets. Projected economic growth for 2022 improved by almost one percentage point, but the outlook for growth in 2023 was reduced by slightly less than half a percentage point. In these circumstances, six members felt a 100 bp increase to be appropriate, while giving a clear signal of the Board's commitment to fighting inflation.

The Board Member who voted for a 50 bp increase noted the greatest risk at this point in time is a sharp slowdown in productive activity and, therefore, in employment. S/he also pointed out that the benchmark interest rate hikes during the past year have yet to contain the rise in inflation or its expectations, as current inflation is due primarily to supply shocks. Surplus demand is manifest more in upturns in imports than in higher prices . This being the case, further interest rate hikes would affect economic growth far more than inflation. The trend increase in external interest rates entails similar adjustments in domestic interest rates. On this point, the member pointed out that such high interest rates imply considerable risks for the consumer portfolio, the productive sector and government financing.

The Board of Directors reiterated its commitment to seeing that inflation converges towards the 3.0% annual target, as a fundamental requirement to ensure the momentum and sustainability of economic growth in the medium and long term. In this regard, they noted that additional increases in the policy rate may be necessary in the months ahead, depending on data availability at any given time on the domestic and external economic situation and its outlook.

Publication Date:

Tuesday, October 4, 2022 - 12:00

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