[Monetary Policy Report](#)
Contenidos relacionados
[Banco de la República maintains the Benchmark Interest Rate at 7.5%](#)

A regular meeting of the Board of Directors of Banco de la República took place in the city of Bogotá D.C. on Friday, January 27, 2017. In attendance were Mauricio Cárdenas Santamaría, Minister of Finance and Public Credit; Juan José Echavarría, Governor of the Central Bank; and Board Members Carlos Gustavo Cano Sanz, Ana Fernanda Maiguashca Olano, Adolfo Meisel Roca, César Vallejo Mejía, and Juan Pablo Zárate Perdomo.

These minutes contain a summary of the outlook of 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 quarterly [Monetary Policy Report of December 2017](#) and in the [statistical annex](#) (Only available in Spanish).

1. MACROECONOMIC CONTEXT

1. For the fourth quarter of 2016, several of the indicators of activity and perception suggest that the economy maintains a low dynamism. Therefore, this report revised the growth projection for 2016 downwards to 1.8% as the most likely figure, within a range between 1.6% and 2.0% (compared to 2.0%, within a range between 1.5% and 2.5% in the previous report). The current account deficit would have posted for the whole year at 4.5% of GDP (within a range between 4.3% and 4.7% of GDP).
2. For 2017, GDP growth is projected between 0.7% and 2.7%, with 2.0% as the most likely figure. This forecast, which takes into account the effects of the Tax Reform, suggests an adjustment of expenditure consistent with the deterioration of the dynamics of national income due to the strong shocks registered since mid 2014. It also incorporates a recovery of the terms of trade for the country on account of the higher international prices of oil and of the main export products. External demand would exhibit a slight recovery resulting from growth of the main trading partners, somewhat better than in 2016.
3. The current account deficit for 2017 would stand between 3.0% and 4.4% of GDP, with 3.7% in the baseline scenario. This forecast considers an increase in the cost of external financing, mainly explained by possible increases in the Fed's benchmark interest rate. International markets could register a higher volatility, for example due to the measures that can be taken by the new government in the United States and decisions regarding Brexit, among others.
4. In Colombia, at the end of 2016, inflation stood at 5.75%, 322 bp less than the maximum reached in July and 102 bp below the figure for December 2015. The behavior of the food groups and of tradables (excluding food and regulated items) explained the reduction in inflation during the month and at the end of the previous year. Core inflation indicators also lowered, and their average stood at 5.60%. The different measures of inflation expectations remain above the target (3.0%). Analysts' expectations for December of 2017 have continued to rise, from 4.1% in November to 4.5% in January. All those derived from public debt bonds also increased: for 2 years, to 4.8%; for 3 years, to 4.3%; and for 5 years, to 3.8%.
5. For 2017, it is expected that the strong transitory shocks that diverted inflation from its target continue to fade, in an environment of a weak economic activity. On the other hand, the increase in value-added tax and other indirect taxes would pressure inflation upwards. The monetary policy actions undertaken so far, which consider these effects, should strengthen convergence of inflation to its target.

In all, the Colombian economy continues to adjust to the strong shocks recorded since 2014, and the current account deficit continues to adjust. The dynamics of output have been weaker than forecast, and inflation continues to decline, although the core inflation indicators and inflation expectations exceed the 3.0% target. The effects of several of the transitory supply shocks that have affected inflation and inflation expectations continue to reverse, and this trend is likely to continue. The tax reform adopted by the Congress favors productive investment and enables the achievement of higher levels of income in the long term, besides consolidating the country's fiscal and external sustainability.

2. DISCUSSION AND POLICY OPTIONS

The members of the Board of Directors highlighted the following changes in the information available since their last meeting. In the first place, an increase in global uncertainty arising from expectations regarding changes in the United States' fiscal and trade policies and their possible impact on the Fed's benchmark interest rates, and consequently on the global financial markets; secondly, an increase in all the measures of inflation expectations; finally, worse-than-expected output growth and domestic demand. The Board agrees that, if no negative, significant inflationary shocks arise, the benchmark interest rate will decrease in the coming quarters. The pace at which this takes place will only depend on the new data available.

The majority of Board Members voted in favor of maintaining the benchmark interest rate unaltered.

Among this group, some members of the Board emphasized that the new most outstanding fact —and at the same time, worrisome— since the last meeting of the Board on 16 December is the increase in inflation expectations, including those for December 2018. Also, according to the Fan Chart, the probability of achieving the target in December 2017 lowered to 40%, exhibiting a slower convergence. They stated that under the current circumstances, a rate cut is not advisable on two considerations: on the one hand, domestically, due to the possible impact that new inflationary shocks may produce on inflation expectations, indexation mechanisms, and the greater persistence of the price increase of non-tradable goods; on the other, externally, because of the uncertainty associated with political and economic events in the US and Europe, mainly, which may affect capital flows, the exchange rate, and inflation. Future movements of the benchmark interest rate must be subject to the evolution of expectations and to the speed of the convergence of expectations and observed inflation towards the target.

Other members highlighted that, despite the fact that the economy has been adjusting quickly, risks persist that indexation mechanisms generate inefficiencies in the convergence of inflation to its target. Consequently, they considered desirable a path of a gradual reduction of the benchmark interest rate in order to incorporate progressively the information that affects the forecasts for inflation and output gap in the policy horizon.

A group of Board Members proposed a 25-bp reduction of the benchmark interest rate. They stressed that the risk of an excessive deceleration of domestic demand has increased. Additionally, they pointed out that the monetary policy stance continues to be contractionary.

3. POLICY DECISION

The Board of Directors, by majority, decided to maintain the benchmark interest rate unaltered at 7.5%.

This decision was approved by four members of the Board. The remaining three Board Members voted for a 25 bp reduction of the benchmark interest rate.

Bogotá, D. C.