Report
Boxes 1 Food inflation: a comparison with other countries
Principales variables del pronóstico macroeconómico (Only Available in Spanish)

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Starting in October 2019, the quarterly Inflation Report produced by the technical staff of the Central Bank will be known as the Monetary Policy Report. The document, which is used for the technical staff´s monetary policy recommendation, will be published on the working day after the meeting of the BDBR in January, April, July, and October, simultaneously with the Board minutes.

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1.1 Macroeconomic summary

In September, headline inflation (11.4% annually) and the average of core inflation indicators (8.6% annually) continued on a rising trend, and higher increases than expected were recorded. Forecasts increased again, and inflation expectations remained above 3%. Inflationary surprises in the third quarter were significant and widespread, and they are the result of several shocks. On the one hand, international cost and price shocks, which have mainly affected goods and foods, continue to exert upwards pressure on national inflation. In addition to these external supply shocks, domestic supply shocks have also affected foods. On the other hand, the strong recovery of aggregate demand, especially for private consumption and for machinery and equipment, as well as a higher accumulated depreciation of the Colombian peso and its pass-through to domestic prices also explain the rise in inflation. Indexation also contributes, both through the Consumer Price Index (CPI) and through the Producer Price Index (PPI), which continues to have a significant impact on electricity prices and, to a lesser degree, on other public utilities and rent. In comparison with July's report, the new forecast trajectory for headline and core inflation (excluding food and regulated items) is higher in the forecast horizon, mainly due to exchange rate pressures, higher excess demand, and indexation at higher inflation rates, but it maintains a trend of convergence towards the target. In the case of food, a good domestic supply of perishable foods and some moderation in international processed food prices are still expected. However, the technical staff estimates higher pressures on this group's prices from labor costs, raw material prices, and exchange rates. In terms of the CPI for regulated items, the new forecast supposes reductions in electricity prices at the end of the year, but the effects of indexation at higher inflation rates and the expected rises in fuel prices would continue to push this CPI group. Therefore, the new projection suggests that, in December, inflation would reach 11.3% and would decrease throughout 2023 and 2024, closing the year at 7.1% and 3.5%, respectively. These forecasts have a high level of uncertainty, due especially to the future behavior of international financial conditions, external price and cost shocks, the persistence of depreciation of the Colombian peso, the pace of adjustment of domestic demand, the indexation degree of nominal contracts, and the decisions that would be made regarding domestic fuel and electricity prices.

Economic activity continues to surprise on the upside, and the projection of growth for 2022 rose from 6.9% to 7.9% but lowered for 2023 from 1.1% to 0.5%. Thus, excess demand is higher than estimated in the previous report, and it would diminish in 2023. Economic growth in the second quarterwas higher than estimated in July due to stronger domestic demand, mainly because of private consumption. Economic activity indicators for the third quarter suggest that the GDP would stay at a high level, above its potential, with an annual change of 6.4%, and 0.6% higher than observed in the second quarter. Nevertheless, these numbers reflect deceleration in its quarterly and annual growth. Domestic demand would show similar behavior, with a high value, higher than that of output. This can be explained partly by the strong behavior of private consumption and investment in machinery and equipment. In the third quarter, investment in construction would have continued with mediocre performance, which would still place it at levels lower than those observed before the pandemic. The trade deficit would have widened due to high imports with a stronger trend than that for exports. It is expected that, in the forecast horizon, consumption would decrease from its current high levels, partly as a consequence of tighter domestic financial conditions, lower repressed demand, higher exchange rate pressures on imported goods prices, and the deterioration of actual income due to the rise in inflation. Investment would continue to lag behind, without reaching the levels observed before the pandemic, in a context of high financing costs and high uncertainty. A lower projected behavior in domestic demand and the high levels of prices for oil and other basic goods that the country exports would be reflected in a reduction in the trade deficit. Due to all of this, economic growth for all of 2022, 2023, and 2024 would be 7.9%, 0.5%, and 1.3%, respectively. Expected excess demand (measured via the output gap) is estimated to be higher than contemplated in the previous report; it would diminish in 2023 and could turn negative in 2024. These estimates remain subject to a high degree of uncertainty related to global political tension, a rise in international interest rates, and the effects of this rise on demand and financial conditions abroad. In the domestic context, the evolution of fiscal policy as well as future measures regarding economic policy and their possible effects on macroeconomic imbalances in the country, among others, are factors that generate uncertainty and affect risk premia, the exchange rate, investment, and the country's economic activity.

Interest rates at several of the world's main central banks continue to rise, some at a pace higher than expected by the market. This is in response to the high levels of inflation and their inflation expectations, which continue to exceed the targets. Thus, global growth projections are still being moderated, risk premia have risen, and the dollar continues to gain strength against other main currencies. International pressures on global inflation have heightened. In the United States, core inflation has not receded, pressured by the behavior of the CPI for services and a tight labor market. Consequently, the U.S. Federal Reserve continued to increase the policy interest rate at a strong pace. This rate is expected to now reach higher levels than projected in the previous quarter. Other developed and emerging economies have also increased their policy interest rates. Thus, international financial conditions have tightened significantly, which reflects in a widespread strengthening of the dollar, increases in worldwide risk premia, and the devaluation of risky assets. Recently, these effects have been stronger in Colombia than in the majority of its peers in the region. Considering all of the aforementioned, the technical staff of the bank increased its assumption regarding the U.S. Federal Reserve's interest rate, reduced the country's external demand growth forecast, and raised the projected trajectory for the risk premium. The latter remains elevated at higher levels than its historical average, within a context of high local uncertainty and of extensive financing needs from the foreign sector and the public sector. All of this results in higher inflationary pressures associated to the depreciation of the Colombian peso. The uncertainty regarding external forecasts and its impact on the country remain elevated, given the unforeseeable evolution of the conflict between Russia and Ukraine, of geopolitical tensions, and of the tightening of external financial conditions, among others.

A macroeconomic context of high inflation, inflation expectations and forecasts above 3%, and a positive output gap suggests the need for contractionary monetary policy, compatible with the macroeconomic adjustment necessary to eliminate excess demand, mitigate the risk of unanchoring in inflation expectations, and guarantee convergence of inflation at the target. In comparison with the July report forecasts, domestic demand has been more dynamic, with a higher observed output level that surpasses the economy's productive capacity. Headline and core inflation have registered surprising rises, associated with the effects of domestic and external price shocks that were more persistent than anticipated, with excess demand and indexation processes in some CPI groups. The country's risk premium and the observed and expected international interest rates increased. As a consequence of this, inflationary pressures from the exchange rate rose, and in this report, the probability of the neutral real interest rate being higher than estimated increased. In general, inflation expectations for all terms and the bank's technical staff inflation forecast for 2023 increased again and continue to stray from 3%. All of the aforementioned elevated the risk of unanchoring inflation expectations and could heighten widespread indexation processes that push inflation away from the target for a longer time. In this context, it is necessary to consolidate a contractionary monetary policy that tends towards convergence of inflation at the target in the forecast horizon and towards the reduction of excess demand in order to guarantee a sustainable output level trajectory.

1.2 Monetary policy decision

In its September and October of 2022 meetings, Banco de la República's Board of Directors (BDBR) decided to continue adjusting its monetary policy. In September, the BDBR decided by a majority vote to raise the monetary policy interest rate by 100 basis points (bps), and in its October meeting, unanimously, by 100bps. Therefore, the rate is at 11.0%.

Boxes

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