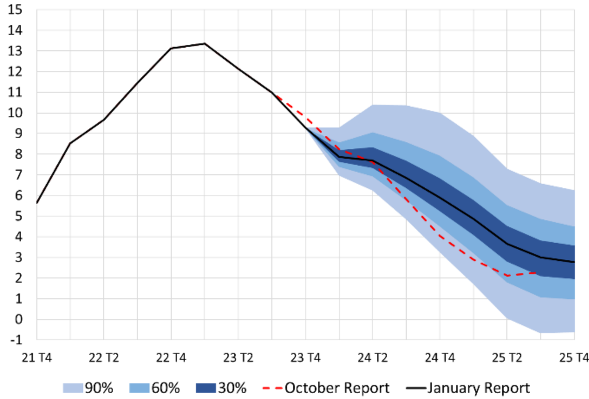
1. Summary

1.1 Macroeconomic Summary

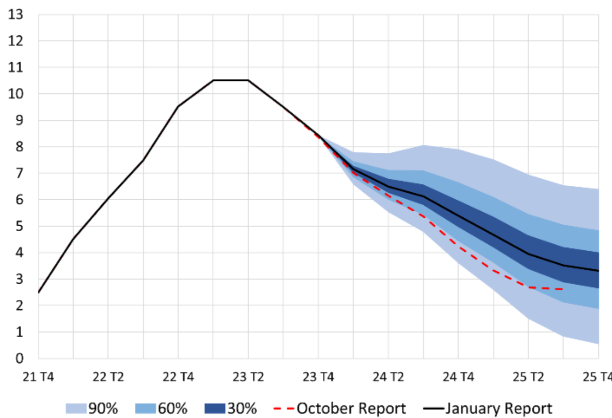
In the fourth quarter of 2023, the decline of headline and core inflation (excluding food and regulated components) exceeded expectations but remained above target. However, cumulative monetary policy actions and the unwinding of some shocks that have affected prices would continue supporting the convergence of inflation towards the 3% inflation target. In December 2023, the reduction in headline (9.3%) and core (8.4%) inflation was slightly above that projected in the October Report in the wake of ameliorating pricing behavior in the food and goods baskets. Conversely, the services component continued to register slightly slower declines than anticipated, while the regulated items basket increased more than expected. All groups continued to exhibit year-on-year changes above the 3% target. Going forward, an effective inflation convergence towards the target in an environment of tight monetary policy, lower international prices and cost pressures, disinflationary exchange rate pressures, weak demand, lower food price adjustments, and price indexation to lower inflation rates than in 2023 is expected. Nonetheless, the forecast for yearend 2024 was revised upwards within a backdrop of high and persistent fluctuations in the services basket prices, a monetary policy stance consistent with achieving the target in 2025, a higher than-estimated increase in the minimum wage, and upward pressures from the regulated items group, particularly from energy prices. Consequently, for 2024, headline and core inflation would reach 5.9% and 5.4%, respectively, versus the 4.0% and 4.2% projected in the October Report (Graphs 1.1 and 1.2). A high degree of uncertainty and significant upside risks surround this forecast, including a stronger-than-expected effect of the El Niño phenomenon on food and energy prices than that foreseen in this Report. Additionally, there continues to be high uncertainty regarding the impact on the regulated items basket associated with possible future fuel price adjustments to moderate fiscal pressures on the Fuel Price Stabilization Fund (*Fondo de Estabilización de los Precios de los Combustibles*, FEPC in spanish). Likewise, uncertainty surrounding external financial conditions implies a risk regarding the future trajectory of the exchange rate and the prices that depend on it. Should inflationary pressures materialize because of these risks, this may accentuate the effect of indexation mechanisms, thus resulting in more persistent inflation than projected in this Report.

Graph 1.1
Consumer Price Index [a/b/]
(annual change; end-of-period)
(percentage)



a/ This graph presents the forecast probability distribution on an eight-quarter time horizon. Density characterizes the prospective balance of risks with areas of 30%, 60%, and 90% probability surrounding the central forecast (mode), through a combination of densities from the Patacon and the 4GM monetary policy models.
b/ The probability distribution corresponds to the forecast exercise from the *January report*.
Source: DANE – calculations and projections by Banco de la República.

Graph 1.2
CPI excluding food and regulated items [a/b/]
(annual change; end-of-period)
(percentage)



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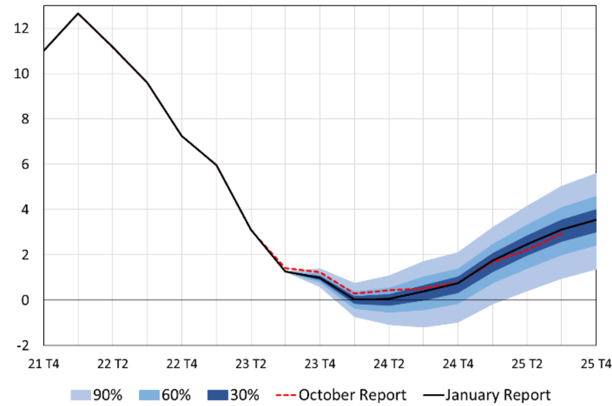
b/ The probability distribution corresponds to the forecast exercise from the *January report.*
Source: DANE – calculations and projections by Banco de la República.

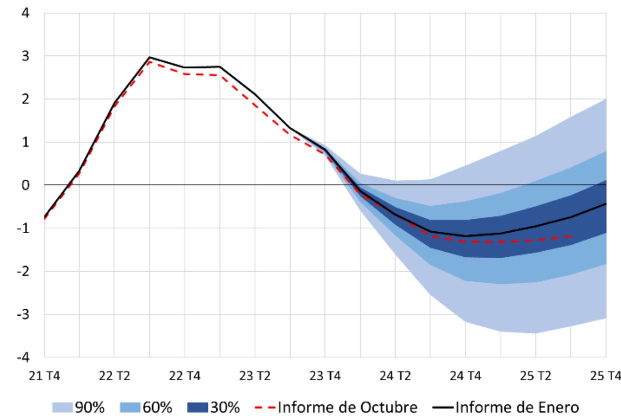
Economic activity in 2023 would have slowed marginally above that projected in the previous Report. In 2024, the economy would continue to record low growth rates but recover to reach an activity level close to its potential towards the year's end. This course would be compatible with bringing inflation to target. In the third quarter of 2023, gross domestic product (GDP) registered a lower-than-expected (0.4%) annual variation of -0.3%. Domestic

Graph 1.3
Gross Domestic Product, four quarter accumulation [a/b/c/]
(annual change)
(percentage)



a/ Seasonally adjusted and corrected for calendar effects.
b/ This graph presents the forecast probability distribution on an eight-quarter time horizon. Density characterizes the prospective balance of risks with areas of 30%, 60%, and 90% probability surrounding the central forecast (mode), through a combination of densities from the Patacon and the 4GM monetary policy models.
c/ The probability distribution corresponds to the forecast exercise from the *January report.*
Source: Banco de la República

Graph 1.4
Output gap [a/b/c/] - Predictive Densities
(four-quarter accumulation)
(percentage)



a/ The historical output gap estimate is calculated as the difference between observed GDP (four-quarter accumulation) and potential GDP (trend; four-quarter accumulation) based on the 4GM model.
b/ This graph presents the forecast probability distribution on an eight-quarter time horizon. Density characterizes the prospective balance of risks with areas of 30%, 60%, and 90% probability surrounding the central forecast (mode), through a combination of densities from the Patacon and the 4GM monetary policy models.
c/ The probability distribution corresponds to the forecast exercise from the *January report*.
Source: Banco de la República

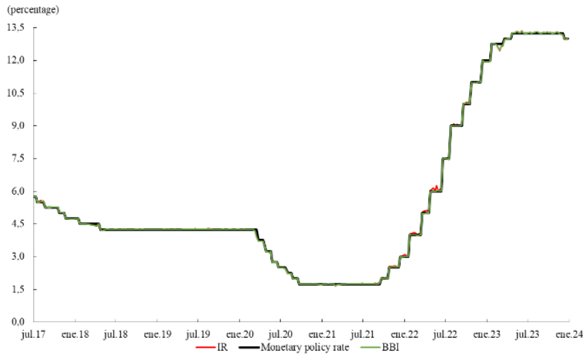
demand continued to fall, mainly because of poor investment performance, reflected in the significant drop in imports and an additional adjustment of the external trade deficit. Available economic indicators suggest a quarterly decline in the fourth quarter, with annual GDP growth of 0.9%. Investment would continue at low levels, while quarterly consumption would have fallen, in line with a contraction in household spending despite a recovery in public consumption. Accordingly, domestic demand would have registered a further annual decline that would have translated into lower imports, which, together with steady export levels, would have resulted in a further reduction of the external trade deficit. All this within a context of low consumer and business confidence levels, lower credit dynamic, and a continued contractionary monetary policy stance. As such, annual GDP growth for 2023 was revised to 1% from the 1.2% estimated in October (Figure 1.3). For 2024, the growth forecast remains at 0.8%, with consumption continuing at levels close to those seen in 2023, as the deceleration in private consumption is offset by the increase in public consumption. Investment would maintain low levels but recover in the second half of 2024, supported by a reactivation of civil works and local investment projects. The trade balance deficit would continue to narrow. The preceding would occur against a backdrop of slightly looser external financial conditions and a contractionary monetary policy compatible with achieving target inflation by mid-2025. A GDP growth of 3.5% is expected by 2025 in an environment of improving external demand, looser external and domestic financing conditions, and inflation that would reach its target level. Productive overcapacity in 2024 would continue at similar levels to those projected in October but would mitigate faster in 2025 than expected resulting from the recovery in economic activity (Graph 1.4) and a less restrictive monetary policy stance moving forward. This assessment is subject to a high degree of uncertainty owing to both external factors, global political tensions, and international financial conditions, as well as domestic factors, such as incertitude surrounding the evolution and impact of the reforms submitted to Congress and the response of domestic demand to local financial conditions.

In 2023, the country's external imbalance as a share of GDP (2.8%) would have experienced a significant reduction, maintaining a similar rate through 2024. Lower domestic demand, consistent with long-term sustainable output levels and the convergence of inflation to the target, has contributed to the reduction in the external imbalance and would continue to support its downward trajectory into the forecast horizon. Consequently, the current account deficit as a share of GDP would decline from 6.2% in 2022 to 2.8% in 2023, reaching 2.9% in 2024. This adjustment mainly reflects a decrease in imports from the high figures recorded in 2022, lower profits remitted abroad by companies with foreign direct investment (FDI), higher income received from remittances, and a rebound in service exports associated with the tourism sector. The year-on-year reduction in the current account deficit improves the country's external position, making the economy less vulnerable to a significant decline in global conditions.

External financial conditions have improved within a context of falling global inflation, albeit at still-high levels, and a less severe slowdown in the world economy than projected. In the United States, the Federal Reserve (Fed) held interest rates steady at a range of between 5.25% and 5.50%, and its new economic forecasts indicate this rate would ease, exhibiting a lower path than that foreseen by the Fed in November. The U.S. economy could slow in 2024 somewhat beyond previous expectations. Long-term interest rates in the United States have declined from the highs reached in October in a setting where private consumption is slowing, and balance is being restored in the labor market. In this framework, Colombia's sovereign risk premium declined to an 18-month low while the peso appreciated. However, the world economy will continue to suffer the effects of elevated global financing costs and the high uncertainty derived partly from geopolitical tensions and conflicts, suggesting a relevant slowdown in external demand for the country in 2023 and 2024. This, together with lower terms of trade, would result in a fall in the national income versus 2022. Uncertainty surrounding external forecasts and their potential impact on the country remains high, given incertitude over the unfolding of global conflicts (e.g., Ukraine and the Middle East), continuing geopolitical tensions, the evolution of foreign trade, and developments in external financial conditions. This is compounded by uncertainty regarding local economic policy and its possible impact on Colombia's sovereign risk perception.

A contractionary monetary policy stance has positively contributed toward reducing the country's macroeconomic imbalances. Nevertheless, although inflation has fallen, it remains above the 3% target, as do most measures of inflation expectations. The macroeconomic situation has been evolving in the anticipated direction, with economic activity adjusting towards levels more compatible with the economy's productive capacity, a more sustainable external position, and declining inflation and inflationary expectations. Credit market activity continues to temper and, although credit risk has increased, the Colombian financial system maintains adequate provisions, solvency, and liquidity levels, which would allow it to face significant macroeconomic declines. Concurrently, the labor market continues to display historically low unemployment rates. Going forward, the outlook is for inflation to continue a downward trajectory, although at a slower pace than anticipated in the October Report, against a backdrop of falling excess productive capacity. The aforementioned is consistent with the announcement by the Board of Directors of Banco de la República that seeks to place inflation at close to its 3% target, plus or minus one percentage point, by the first half of 2025. This macroeconomic situation, characterized by high inflation, inflation forecasts and expectations above 3%, and significant upside price risks, underlines the need to maintain a contractionary monetary policy stance that seeks the convergence of inflation towards its target.

Graph 1.5
Monetary policy interest rate, interbank rate and BBI/
(weekly data)



Sources: Superintendencia Financiera de Colombia and Banco de la República.
1/ IR: interbank rate. BBI: benchmark banking indicator.

1.2 Monetary Policy Decision

At its December 2023 and January 2024 meetings, the Board of Directors of *Banco de la República* (BDBR) opted by majority vote to reduce the monetary policy interest rate by 25 basis points in each meeting, bringing it to 12,75% (Graph 1.5).