Inflation Report - March 2012

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The Monetary Policy Report presents the Bank's technical staff's analysis of the economy and the inflationary situation and its medium and long-term outlook. Based on it, it makes a recommendation to the Board of Directors on the monetary policy stance. This report is published on the second business day following the Board of Directors' meetings in January, April, July, and October.

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In March 2012, annual inflation was 3.4%. This is 15 basis points (bp) less than the rate recorded in December (Graph A). A decreasing trend in annual inflation started in October, when inflation reached its highest level in 2011 (4.0%).

More than half (58%) of the slowdown in annual inflation during the first quarter of 2012 was explained by the lower rate of growth in food prices. This group, which was negatively affected by weather factors, registered 4.6% annual growth in March, after increasing 5.3% in December. During the same period, annual growth in the consumer price index (CPI) for regulated items declined from 5.8% to 4.9%, and contributed 38% to the fall in inflation. Fuel prices saw substantial annual growth during the first quarter of 2012 (4.9% on average); however, it was below the level observed during the previous year (10.5% on average). This behavior explained the moderation in prices for regulated items.

The annual change in non-food CPI and other core inflation indicators calculated by Banco de la República was relatively stable during the quarter. In fact, between January and March, the average of these measurements remained at around 3%, after displaying an upward trend since mid-2010.

Within the CPI excluding food and regulated items, the annual change in tradable goods fell by 12bp in the first quarter and registered 0.7% in March. Appreciation of the Colombian peso in the last few months was responsible fora considerable part of this outcome. During the same period, the annual growth in non-tradable goods went from 3.6% to 3.7%. This mild acceleration was the result of the way rental fees behaved; the rate of their growth has increased since June 2011.

Lower inflation, together with monetary policy action taken by the Board of Directors of Banco de la República, explained the decline in inflation expectations throughout the first quarter. In mid-April, the different measurements of this variable showed rates between 3% and 3.5%. It is reasonable to expect the various measurements of these variables will converge towards the long-term target for inflation (3%). In terms of economic activity, the increase in real GDP during the fourth quarter of 2011 (6.1%) and throughout the year (5.9%) ratified the robust expansion of the economy. The momentum in local demand, which had exhibited an upward trend for several quarters, slowed during the final portion of the year and registered a growth rate of 7.9%, which is equal to the rate observed in the first part of 2011.

The latest information suggests the Colombian economy will grow at a favorable pace during the first quarter of 2012, but less than in the latter part of the previous year. Based on figures to February, the performance of national production and imports (in dollars) of capital goods indicate investment might slow. Similarly, the small coffee harvest and the reduction in oil production, due to problems with law and order, suggest exports will grow at a lower rate during the quarter.

Regarding private consumption, the data available for the first months of the year point to performance similar to what was observed towards the end of 2011. In January and February, retail sales (in pesos) and imports of consumer goods (in dollars) exhibited higher annual growth than the rates observed in the final quarter of last year. Similarly, the labor market performed well. In fact, between January and March the unemployment rate fell once again and salaried employment rose at an average rate of 5%.

The outcome for the consumer confidence index measured by Fedesarrollo confirms the favorable momentum in the various indicators associated with private consumption. Even though this index fell in February and March, its average was higher than what is was in the final quarter of 2011, thus registering a level that is within historical highs.

Consumption and investment continue to be supported by the high increase in credit, especially household loans. Between January and March, consumer loans and, to a lesser extent, mortgage loans grew at elevated rates in real terms, similar to those observed towards the end of the previous year. Meanwhile, commercial lending slowed, but remains on an upward trend that is considerably more than the expansion in the GDP. The interest rate, in real terms, on all types of credit (except for credit cards) has been below its historical average since 2000.

With respect to the external outlook, there has been an improvement in the prospects for global growth in 2012; nonetheless, there is still the risk of a sharp international slowdown, especially due to the European situation. The information at hand for the first quarter suggests a significant number of European countries remain in a recession; however it is less profound than the contraction seen between 2008 and 2009.

In the United States, the indicators of real economic activity for the first three months of the year show the economy continued to expand at a moderate pace that was better than expected, due to momentum in consumption and of industrial production. Even so, the labor market has exhibited new signs of weakness. Moreover, recent information on existing and new housing does not suggest this sector will recover any time soon. As for the emerging economies, China’s GDP slowed during the first quarter of 2012, as expected, while some improvements in industrial activity and the export sector have been observed in the other emerging Asian economies. The major Latin American countries continued to grow at rates slightly below their potential, while their risk premiums fell due to the positive situation in the region at present. The aforementioned factors suggest the effect the contraction in the Euro Zone is having on emerging markets is still limited.

Regarding international prices, , rising geopolitical tensions in the Middle East and in North Africa pushed oil prices to high levels between December 2011 and March of this year. However, by mid- April, these tensions had subsided slightly, thereby allowing for some moderation in oil prices. Meanwhile, global food prices rose mildly in January due to adverse weather conditions. However, they have not exhibited a sharp upward trend such as the one in 2011. This helps to relief some of the inflationary pressures.

In this context, central banks in the major developed economies maintained an expansionary monetary policy. The current prospects and the announcements made by monetary authorities suggest their interest rates will remain low for some time, as inflation permits. In the emerging markets, most central banks have not altered their intervention rates. The notable exceptions are India and in Brazil, where authorities decided to reduce them.

In summary, the current year is likely to see an increase in external demand on the part of Colombia’s major trade partners; however it is expected to be less than in 2011. Terms of trade should remain high, thereby providing a stimulus to national income, while international interest rates will be low and global risk premiums will continue to be affected by the events in Europe. Colombia’s risk premium is at historic low levels.

Given this local and external outlook, the technical staff estimates annual growth in the Colombian economy for

the first quarter of the year will be between 4.5% and 5.9%. For 2012, the range remained unchanged at 4% to 6%. The forecasts on the output gap suggest it will continue to be in positive terrain during 2012 and 2013.

Throughout the first quarter, the main risk to the central forecasts for growth was, and still is, a disorderly adjustment in the European situation. If this risk materializes, global economic growth will be considerably less than expected, international commodity prices might fall, and international risk aversion will exacerbate. All these factors will adversely affect the Colombian economy. Furthermore, political tensions in the Middle East could push up oil prices.

This would elevate export income initially, but eventually would result in more moderate global growth. The main risks to inflation come from excessive growth in domestic demand or higher than expected costs, which would have a strong and persistent impact on expectations and on the credibility of monetary policy. In a longer time horizon, an excessive increase in credit or in asset prices might lead to financial imbalances, which would have negative consequences for the sustainability of output and employment growth.

After evaluating the balance of these risks, the Board of Directors agreed to raise its benchmark rate by 25bp in both January and February 2012. Consequently, the policy rate went from 4.75% in December 2011 to 5.25% in February. At the meeting held in March and April, no changes were made to this level (Graph B).

Additionally, at the meeting in February 2012, the Board decided to extend its program of daily purchases of no less than US$20 million to at least August 4th of the same year. At the April meeting, this time line was extended to at least November 2nd.

The Board will continue to carefully monitor the international situation, as well as the behavior and forecasts for inflation, growth and asset markets. It reiterates that monetary policy in the future will depend on new information that becomes available.

Fuente: https://www.banrep.gov.co/en/news-and-publications/inflation-report/march-2012