Detailed Explanation of the Macroeconomic Situation (only in Spanish)

Must reads

Banco de la República anuncia meta de inflación para 2013 y reduce en 25 puntos básicos la tasa de interés de intervención

A regular meeting of the Board of Directors of Banco de la República was held in the city of Bogotá D.C. on November 23, 2012. In attendance were Mr. Mauricio Cárdenas Santamaría, Minister of Finance and Public Credit, Mr. José Darío Uribe, Governor and Managing Director of Banco de la República, and the full-time co-directors Messrs. Fernando Tenjo, Carlos Gustavo Cano, Juan José Echavarría, Juan Pablo Zárate and César Vallejo. Inflation and the economic situation were discussed with respect to growth and prospects for the future, and monetary-policy decisions were reached.

The inflationary and economic growth situations as well as the outlook for both were discussed and decisions were made in relation to monetary policy. Below is a summary of the main topics dealt with in this meeting.

1. BACKGROUD

a. Recent developments in inflation

Annual consumer inflation was at 3.06% in October, a figure that is similar to what was seen the previous month (3.08%). From the beginning of the year to October, the accumulated rise in the CPI has been 2.48%, which is significantly lower than what was registered for the same period in 2011 (3.15%). This suggests that there is a high probability that the inflation target will be met this year.

The performance of the main subgroups of the CPI in October was very similar to what it was last month. Within the CPI excluding food, the annual change in the prices for the basket of tradables excluding food and regulated prices was close to 1.1% in October. This level has been maintained for several months and is consistent with the stability in the exchange rate. The annual variation in the CPI for non-tradables excluding food and regulated prices remained at 4.0% with its main component, rent, rising 7 bp compared to the previous month and ending up at 4.9%. In the group of non-tradables, items such as education and health services have seen adjustments since the beginning of the year that are over 4.0%. These have been offset by the lower increases in the prices of other services related to entertainment, culture and recreation, and other services.

Regarding regulated items, the prices in this basket rose 3.3% in October in comparison to those registered during the same month last year. This data is similar to that for September. Fuel began to put on upward pressure again (it rose 120 bp to 4.4%) but utilities followed the opposite trend (they dropped 62 bp to 2.0%) due to the discounts on electricity fees that partially compensated for the upswings the month before.

The CPI for food rose 3.6% compared to what had been registered for the same month last year. The decline in the international prices of various food items such as coffee, sugar, a few fats and oils, and grains would have allowed moderation in the adjustment of domestic prices for processed food for which the annual change went from 4.3% to 3.7% between September and October. In October, a smaller decline in the annual change of the CPI for perishable food (from -2.4% to -0.6%) was seen. Eating away from home showed an adjustment of more than 5.0%, which is similar to previous months.

Core inflation did not show significant changes either this last month. A record of 3.11% was seen for the average of the four indicators monitored by the Banco de la República. This is slightly lower than the one for September (3.16%). Since November of last year, this variable has shown few changes as it fluctuated within a range between 3.0% and 3.2%.

The annual variation of the total PPI in October was -1.1%, a record that is lower than the one for September. The PPI for imports stayed in negative territory due to the stability of the exchange rate and the declines in several prices for raw materials. The annual change in the PPI for locally produced and consumed goods dropped from 0.6% in September to -0.5% in October. This situation makes it possible to foresee lower pressures on inflation for the next few months.

With respect to inflation expectations, according to the monthly survey done of analysts in financial entities, the inflation expected for December of this year is 3.0% and, in twelve months, 3.2%. This shows no changes with respect to last month.

b. Growth

In September, mixed signals on the performance of economic activity were seen. Indicators such as indicators of retail sales excluding vehicles showed a significant upsurge while industrial output continued to deteriorate just as had been predicted. Add to this the unanticipated contraction of imports of capital goods and the lower growth of exports.

The Fedesarrollo consumer confidence index, in turn, based on the figures for October remained at levels similar to those seen in September. It was also higher than the data from October last year and than the average calculated since 2001. This suggests that household consumption is maintaining a buoyancy similar to that of its historical average (4%). Even so, the most probable case is that annual growth in this period has been lower that what was seen in the first half of the year partly due to the high base of comparison.

In addition, the monthly regional survey that the Banco de la República does showed that the trend component of sales expectations for a 12-month horizon rose between July and September after having dropped in the first half of the year. The expectations for job creation from the same survey show a similar trend.

In the area of private investment, even if the information is scarce, the results of capital goods imports as of September suggest a weaker performance by this aggregate than what had previously been projected. These purchases fell 24.2% in comparison to the same month last year. Excluding airplanes, the drop was 15.2%. The slump in purchases of industrial machinery, which fell 26% annually compared to the same month last year, is notable and stands in contrast to the positive rates from the months of July and August (20% on average).

In the month of September, the total exports in dollars grew 4.9% in comparison to the same month last year (6.1% if the re-export of airplanes is included). Foreign sales continued to be led by those of petroleum while sales of coal fell again and industrial sales remain at a standstill. Furthermore, exports of agricultural products showed a 7.7% drop compared to the same month the year before given the lower value of the coffee and banana exports. Even if the annual growth this month of total foreign sales were higher than the sales in August, the annual rates of growth for the last few months are lower than what was seen in the first half of the year.

Within the indicators in the area of supply, it is noteworthy that, according to DANE, industrial output excluding coffee threshing registered an annual change in September of -1.3%. The indicators for confidence, orders, inventory, and expectations in the Fedesarrollo survey of industry in September together with the sector’s demand for electricity for October suggest that the contraction of industrial output will be prolonged.

The latest figures for the agricultural and mining sectors are positive. According to the Coffee Federation, coffee production will probably have grown in the third quarter at a rate that is slightly above 20% annually. Petroleum production in September and October likewise registered a significant recovery after the poor results from the previous four months that were attributed to supply shocks.

In conclusion, the growth of the Colombian economy has slowed down based on rates that were seen to be above their trend levels in the second half of 2011. After an annual growth of 4.8% in the first half of 2012, recent indicators of economic activity suggest that growth is moderating a little more than expected. The weakness of the global economy and the decline in domestic demand have been reflected in the more limited growth of exports and the contraction of industrial production. The growth range of the GDP predicted for 2012 is between 3.7% and 4.9% with 4.3% as the most probable rate. For 2013, a growth rate close to the growth of productive capacity is expected.

c. Financial Variables

The moderation in bank credit (N/C and F/C) which has been characteristic so far this year continued in October. Its annual rate of growth was 15.3%, 43 bp and 221 bp lower in comparison to what was seen last month and in June respectively.

The annual growth of the commercial loan portfolio in national currency went from 16.9% in June to

14.2% in October while the component in foreign currency followed suit the same month at 6.2%. The consumer loan portfolio showed a similar trend with growth rates of 22.2% and 18.9% in the abovementioned months. The slowdown in the mortgage portfolio, in turn, has been less accentuated with variation rates of 16.4% and 15.6% in the same period.

The real interest rates (discounting the CPI excluding food) for the October disbursements for consumer, mortgage, and ordinary and preferential commercial loans were at 15.6%, 9.9%, 9.0%, and 5.6% respectively. These levels are lower than their respective averages calculated since 2000. In contrast, the real interest rates for credit cards and the treasury bonds were at 26.5% and 5.3% which are higher than the averages calculated since 2000.

d. Foreign Context

In general terms, global activity has developed in line with what was expected in the last few inflation reports. International uncertainty remains the same due to the risk of a deepening of the crisis in Europe and a possible contraction in the United States in 2013 because of the “fiscal cliff.” The latest information available points to a lower probability of a slowdown in the Chinese economy.

In the euro zone, the GDP contracted again during the third quarter. The information available for the fourth quarter of the year (indices of purchases, confidence indices, etc.) indicates that the contraction in economic activity will probably continue into the fourth quarter. It is noteworthy that the situation in the countries on the periphery will be drawing strength away from Germany and France where a slowdown is expected for the last quarter of the year.

In the United States, expansion has followed a modest pace as evidenced by the performance of retail sales, exports, and industrial activity. However, it should be noted that the real estate market has continued to recover and for the coming quarters it is expected to contribute positively to growth although still at a low level.

In the case of Latin America, the indicators of productive activity show limited growth for the Brazilian economy while Chile and Peru continue to expand at a favorable rate. The Mexican economy is slowing down. Even though the Venezuelan economy grew, a significant slowdown is expected for the next year.

Currencies and risk perception towards economies in the region have not demonstrated significant changes in an environment of monetary stimulus implemented by the developed countries.

The international prices for petroleum have remained relatively stable for the last few weeks. Nevertheless, the geopolitical tensions in the Middle East could cause them to rise again. Prices for food with the exception of wheat have reversed the mid-year peak.

In Colombia, the terms of trade which had declined towards the middle of the year recovered in September and October and are at historically high levels. This is due to the high prices for petroleum and the lower rate of price adjustment for imported goods.

The low inflationary pressures and negative output gaps continue to allow the developed countries to maintain an expansionary monetary policy. The emerging economies have shown economic growth that is better although below their potential with benchmark interest rates that are around the natural one. This situation is expected to continue in 2013.

In the future, the largest risks are still a strong recession in Europe with negative and significant impacts on the terms of trade, confidence, and the aggregate demand of Colombia. The possibility that the so-called fiscal cliff in the United States will occur also continues to be a threat. This could have significant negative effects.

2. DISCUSSION AND POLICY OPTIONS

The board members' main points of discussion and analysis focused on the following aspects:

(i) The international uncertainty continues. Some international economic indicators have improved a little. The weakness in a significant number of industrialized economies and the lack of inflationary pressure allow us to expect that foreign interest rates will remain low for a prolonged period of time.

(ii) Colombian growth has slowed down based on rates that were seen to be above their trend levels in the second half of 2011. After 4.8% annual growth in the first half of 2012, the recent indicators of economic activity suggest that growth is moderating a little more than expected. The weakness of the global economy and the decline in domestic demand have been reflected in the more limited growth of exports and the contraction in industrial production. The predicted range of GDP growth for 2012 is between 3.7% and 4.9% with 4.3% being the most probable result.

(iii) For 2013 moderate but sustained growth in foreign demand for Colombian products, stable levels in international prices, and expansive conditions of international liquidity are expected. Investment will continue to be driven by public works due to the lower interest rates and the expansion of mining-energy projects. Thus, the growth in 2013 is expected to be close to the growth of the productive capacity.

(iv) The growth of credit is still slowing down. Indices of prices for new and used housing are at historically high levels.

(v) Inflation, the average of the indicators for core inflation, and inflation expectations are very close to the mid-point of the target range (3%).

(vi) The major risks in 2013 to economic activity in the country are still a significant recession in Europe or the possibility that there could be a sharp fiscal cutback in the United States.

Some of the members proposed reducing the benchmark interest rate based on several considerations. While inflation and inflation expectations are on the long term target, industrial indicators, imports of capital goods, and sales of durable goods suggest that the economy could be slumping more than expected in comparison to its potential level of growth. Furthermore, in spite of the fact that reductions in the benchmark interest rate seem to be transmitting to the market suitably, the risk perception local agents have remains high.

The other members thought that the benchmark interest rate should be kept unaltered considering the following points: Even if the growth of demand has declined over the course of the year, this has occurred starting at a point of levels of unsustainable growth of private expenditure in the second half of 2011. There is no evidence in the available information that the expenditure adjustment has been or is on its way to being greater than what is required to keep output and employment close to sustainable levels. Even if credit has dipped, financing for companies and households is growing at a positive pace and in a manner that is consistent with a suitable performance for domestic demand. The real interest rates with the exception of credit cards are similar to those this country saw in the first half of 2010 and which were shown to be expansionary. Both inflation and inflation expectations as well as the inflation predictions for this year and the coming one are at around 3%. Even though the levels of uncertainty regarding the worldwide economy remain high, the news and international indicators available this last month show an outlook that is a little more favorable for 2013 than the one seen at the previous Board meeting. Something similar has occurred with consumer confidence and a few other indicators. They also believed that their stance was based on the assumption of significant investments in construction and public works projects as well as the existence of terms of trade that sustain high levels of national revenue.

3. POLICY DECISION

Based on the evaluation of the current balance of risks, the Board of Directors decided it would be suitable to reduce the benchmark interest rate to 4.5%. Based on current information, this is the interest rate level that is compatible with close to productive capacity growth and compliance with the inflation target.

The Board reiterates that the Banco de la República has sufficient tools and resources to cover liquidity needs in national and foreign currency that the economy regularly requires and those that could appear in an environment of international financial turbulence.

The Board will continue to monitor the performance and projections for economic activity and inflation in the country, the asset markets, and international situation carefully. Finally, they reiterate that the monetary policy will depend on the new information available.