Minutes of a Meeting of the Board of Directors of Banco de la República Held on February 22, 2013

Detailed Explanation of the Macroeconomic Situation (only in Spanish) Must reads Banco de la República Lowers the Benchmark Interest Rate by 25 Basis Points Last modified Monday the 29th of April, 2024
A regular meeting of the Board of Directors of Banco de la República was held in the city of Bogotá D.C. on February 22, 2013. 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 full-time co-directors Messrs. Carlos Gustavo Cano Sanz, Juan Pablo Zárate Perdomo and César Vallejo Mejía. Inflation and the economic situation were discussed with respect to growth and prospects for the future, and monetary-policy decisions were reached.

1. BACKGROUNDa. Recent Developments in Inflation
Annual consumer inflation fell sharply in January, much more than anticipated by the market and by Banco de la República's technical team. The outcome that month was 2.00%. This is 44 basis points (bp) less than the figure on record for December, a month that also witnessed a significant drop. As occurred throughout 2012, the slowdown in inflation was explained, once again, by less of an increase in the CPI for food and regulated items.

In the food CPI, the annual change by January (1.69%) reflected a considerable decline (83 bp). The prices of all the major components of this basket slowed, and the reductions in VAT contemplated in the tax reform could have played an important role in that respect. Eating out is a case in point. After posting an annual variation of 5% or more during 2011 and 2012, this item dropped significantly in January, ending the month at 3.9% (100 bp less than in December). The 16% VAT on most of these services was eliminated and replaced by a consumption tax of 8%. Therefore, the indirect taxes were reduced in net terms. Added to this reduction are certain costs with minor adjustments in wages, rental income and public utilities.

Annual inflation in processed foods was 2.2% by January as opposed to 2.8% in December. Here again, the VAT was lowered in the case of coffee, sugar and chocolate, with prices for these items dropping during the month compared to the situation in January of last year. Other prices were down as well (such as those for milk and eggs). Peso appreciation and lower international prices for certain foods during the second half of last year also were circumstances that contributed to the slowdown in the annual variation in this sub-basket. Lastly, the annual change in the CPI for perishables continued to decline (-5.0 in January as opposed to -3.9 in December). This was due to good weather and lower production costs. While prices for some commodities rose in January, as is customary, the increase was less compared to what it was in January 2012.

As part of the non-food CPI, the annual change in regulated prices dropped to 0.67% in January (124 bp less than the figure at December). Most of the downward pressure originated with the COP200 cut in the price of gasoline when tax reform took effect. Similarly, prices for residential natural gas and intercity bus fares declined once again, due to little pressure from international fuel prices during the second half of last year, combined with accumulated appreciation of the Colombian peso. In the case of fares for urban public transportation, the adjustments were positive, but less than those witnessed during the same month last year.

The other two non-food CPI components; that is, tradables and non-tradables, remained relatively stable in January. The annual change in the first of these sub-baskets went from 0.77% in December to 0.73% in January, a lesser reduction than what was observed at the end of 2012. Important disinflationary pressure on this sub-

basket came from air fares, inasmuch as their CPI fell by 1.2% during the month. January also saw further reductions in prices for electrical, electronic and communication devices. This behavior continues to be explained by appreciation in the exchange rate (which came to an annual rate of 4.4% in January for the monthly average) and by scant pressure from international prices.

The non-tradable CPI excluding food and regulated items rose marginally during the past month (by 2 bp) and stood at 3.94%. There were increases in tourism services, possibly related to the hike in VAT from 10% to 16% in the case of hotel services, as dictated by the tax reform. On the other hand, that reform implied a reduction in VAT from 10% to 5% on pre-paid medical care and other health expenses, which translated into price reductions for these items. With respect to rentals, the annual variation declined slightly, as has been the case for three months, and came to 3.8%. There were no major changes in the other items.

Core inflation also declined in January for the fourth month in a row. The average of the four indicators calculated by Banco de la República came to 2.59%, which is 21 bp less than the December figure.

In January, the annual change in the PPI remained in negative terrain, amounting to -2.15% (as opposed to -2.95% in December). The limited pressure from international prices up to mid-January, coupled with accumulated appreciation of the peso and lower tariffs, may explain these reductions during the last four months.

As to inflation expectations, Banco de la República's latest monthly survey of financial market analysts shows inflation expectations for December 2013 have declined to 2.65% (versus 2.82% last month). Even so, there were no important changes in expectations for inflation 12 months out (2.9%). A similar situation is evident in the case of expectations for non-food inflation (which are 2.46% for December 2013 and 2.61% 12 months out). The estimates derived from TES at two, three and five years fell by nearly 20 bp after the January inflation figure was released, and have fluctuated between 2.5% and 2.7% in recent days.

It is important to point out that much of the drop in inflation during January can be attributed to the reduction in VAT and other levies associated with implementation of the tax reform. The VAT shock tends to be temporary, affecting inflation for one year, at the end of which it may return to its initial level.

b. Growth

On the spending side, the success of retail sales during November, the slowdown in the annual growth in consumer lending given the December figures, and the stability of the consumer confidence indicator for the fourth quarter of 2012 are an indication that household consumption would have continued to perform more or less as it did during the third quarter. This is reinforced by the performance of imports of consumer goods in dollars, which posted 14.7% annual growth at December. This represents an increase compared to the November figure, when these imports registered 4.3% annual growth. However, the aggregate figure for the year shows less growth compared to the full-year figure for 2011 (12.3% in 2012 as opposed to 25.7% the year before).

In terms of investment, the figures on dollar imports of capital goods for industry (which, besides manufacturing, would include mining, commerce and construction, among others) rose 7% year on year during the fourth quarter and 10% by December, suggesting investment in machinery and equipment performed relatively well. Imports of transport equipment posted an annual drop of 27% during the fourth quarter, concentrated in December (57%). This was due partly to a high base of comparison in December 2011. Therefore, it is possible that investment in transport equipment (which accounts for 14.9% of total investment and 4.2% of GDP) may not have performed well during the final quarter of 2012. On the other hand, construction of civil works and buildings is still an item surrounded by a great deal of uncertainty in terms of how it will perform, particularly with respect to spending on civil works, construction and buildings.

Total exports in 2012 (excluding re-exports of airplanes) came to US$ 60,235 million, which represents 5.8% growth compared to 2011. This performance is explained largely by the increase in mining exports (8% annual)

and industrial exports (5.9%). On the other hand, exports of agricultural products declined 14% during the year, due to a 27% reduction in coffee exports. The rise in exports of industrial goods is attributed to added sales to Venezuela (52%), the United States (1.8%), Ecuador (1.7%) and the rest of Latin America (7.1%). Exports of this type to other destinations, such as Europe and Asia, posted negative variations during the year (22% and 3%, respectively).

On the supply side, the latest data for the fourth quarter of 2012 confirm major differences in growth among the various sectors of the economy, but with trends similar to those witnessed during the third quarter. The most noticeable difference is between industry and commerce. While industrial production and other indicators for the sector suggest the contraction continued up to the end of the year, with an intensity that was greater than expected, the merchant surveys suggested growth.

ANDI reported industrial production rose 0.7% during 2012 as a whole. With this information, it appears the data for December show a new contraction (in November, industrial production was up 1.0% year on year). According to the survey, manufacturers believe the major problems they faced in 2012 were the exchange rate, access to raw materials and low demand, in that order. The latter has gained ground as of mid-2011, but still remains slightly below its average level since 1997 and the increases have been more gradual than those observed in the 2008-2009 period. Likewise, with the information from the Fedesarrollo survey, the signals on industrial performance are not positive. In December, the indicator of industrial orders still was on a downward trend, while the inventory indicator (which is counter-cyclical) increased significantly last month, suggesting an unexpected accumulation of inventory. Furthermore, the indicator of production expectations at three months in December showed renewed deterioration.

In contrast to the foregoing, the merchants surveyed in December by Fedesarrollo indicated no significant decline in their perception of the current situation for business or its future status. In fact, the trends in this series remain positive and the levels are relatively high. Moreover, retail sales have grown significantly, as mentioned earlier.

With respect to construction, cement production remained sluggish in December, posting an annual contraction of 1.3%. Growth during 2012 as a whole came to 1.4%, as opposed to 13.4% in 2011. This fact, coupled with the data from CAMACOL showing a drop in new home sales nationwide by November, suggests low growth for the sector in the fourth quarter.

Given all of the above, Banco de la República's technical team maintains its forecast of 2.0% to 3.5% for fourth-quarter growth. The span of this range is due to uncertainty about the performance of investment in civil works, which has grown considerably, but without a definite bias. Nevertheless, the latest figures on industry and imports of transport equipment have surprised on the downside, so the central forecast likely is biased toward the lower part of that range. Similarly, the forecast for growth in 2012 as a whole would remain within a range of 3.3% to 3.9%.

As for the expansion in GDP during the first quarter of 2013, unfavorable news has emerged in recent weeks that may curb growth. Coal is a case in point. The paralysis in production for the two most important companies in the sector (Cerrejon and Drummond) is a severe constraint to expansion in the mining sector at the start of the year.

Similarly, in January, vehicle sales reported by Econometrics showed declines in levels with respect to the figure published twelve months earlier. This indicator rose at annual rates of -16.5% and signals to a poor start to the year for consumer durables.

The favorable news during the first month of 2013 includes an increase in oil production to 1,012,000 barrels per day (BD). This is a record high figure that surpasses the forecasts in the last report (one million BD, on average).

Also, in the case of coffee, production in January amounted to 877 thousand 60-kilo bags, which is 64% more than during the same period in 2012. The annual increase in the total demand for energy came to 4.6%. Similarly, the merchants surveyed by Fenalco maintained the positive trend in current sales, although sales expectations at six months showed some deterioration. Finally, another positive factor was consumer confidence as measured by Fedesarrollo, which rose in January compared to December, remaining at relatively high levels similar to those observed during the second half of last year.

Banco de la República's technical team is keeping the full-year forecast for 2013 at 2.5% to 4.5%, with 4% being the most likely figure. A slight acceleration compared to 2012 is expected, based on an international environment that would not deteriorate further, an expansionary monetary policy, continued growth in lending at a good pace despite the recent slowdown, and under the assumption that government spending and investment in civil works increases at a decent rate.

c. Financial Variables

The expansion in bank lending (D/C and F/C) has stabilized. The annual growth rate for this variable went from 15.12% to 15.10% between October 2012 and January 2013. This is the result of a tradeoff between the slowdown in total loans in domestic currency (with a growth rate that went from 15.76% in October 2012 to 14.63% in January 2013) and the recovery in loans in foreign currency (with a growth rate that rose from 5.98% in October 2012 to 21.86% in January 2013).

As to the different categories of lending, the annual increase in the commercial loan portfolio went from 13.2% to 14.1% between October 2012 and January 2013, bolstered largely by the loan portfolio in foreign currency. Meanwhile, the slowdown in lending to households continued. The increase in consumer loans declined from 18.64% to 17.01% between October 2012 and January 2013, while growth in the mortgage loan portfolio went from 15.47% to 14.72% during the same period.

The nominal interest rates on all types of loans reflect a downhill trend compared to their levels at the end of July, when the benchmark interest rate began to be reduced. However, in real terms (discounting the non-food CPI), this descending trend has been curbed by lower inflation. Given this context, the real interest rate in January was 16.7% for disbursements on consumer loans, 10.2% on mortgages and 9.4% for ordinary commercial lending. All these rates are below their respective historical averages calculated since 2000. Meanwhile, the real interest rate on preferential commercial loans was 6.2%, as opposed to 27.4%, for credit card lending, and 5.8% for treasury loans. These rates exceed their averages since 2000.

d. The External Context

During the fourth quarter of 2012, GDP in the Euro Zone contracted again and growth for the full year was -0.5%. Although this economic downturn was expected, its pace surpassed the central forecast contemplated in the December edition of Banco de la República's Inflation Report (-0.4%). The reduced amount of growth in the region was due to a general decline in GDP, even in countries such as France and Germany, which performed comparatively well until 2011, compared to what was seen in the region. However, recent data on real activity in Germany demonstrates some recovery, driven partly by foreign trade with partners outside the Euro Zone. Also, certain indicators of business confidence and expectations for the region have improved somewhat in recent months (December and January).

In the United States, the first estimate of 2012 growth was lower than the central forecast in the previous edition of Banco de la República's Inflation Report. In the fourth quarter, the U.S. economy contracted due to the drop in inventories, the momentum in government spending and less of a contribution from the external sector. Even so, there continued to be modest growth in consumption. During the month of January, the information on real activity showed an improvement in the country's economic performance, as did opinion indexes for the manufacturing and service sectors, and retail sales.

In the case of the emerging Asian economies, the figures at the fourth quarter show the pace of their growth remained stable. As for China, real activity continued to grow in January at a favorable pace, particularly in the industrial sector and with respect to exports.

As for the countries of the region, Brazil's economy is still recovering and the economies of Peru, Chile and Mexico continued to grow at a good pace. A sharp devaluation was decreed in Venezuela, a country that represented the leading destination for Colombian industrial exports and the second for food exports during 2012 (up to November). This fact could have an impact on industrial activity and the agricultural supply in Colombia, insofar as it becomes more difficult to export to Venezuela.

Expectations with respect to an improvement in global activity, especially in China, coupled with broad international liquidity and geopolitical tensions in the Middle East and North Africa, have brought upward pressure to bear on international oil prices in recent weeks. On the other hand, food prices have not changed significantly during this period. Nevertheless, the low prices for coffee and coal and the slight increases in prices for imported goods witnessed during January caused a slight decline in terms of trade.

Inflation, except in the specific cases of Brazil, India, Argentina and Venezuela, remains at low levels in both the developed and emerging economies. In a context of low inflation and weak growth, the central banks in the developed countries have maintained a policy of monetary stimulus.

It is important to mention the case of Japan, where the central bank is committed to an inflation target of 2%. Although the deadline for that target is unclear, analysts have interpreted these announcements as a highly expansive monetary policy, in response to which the yen has depreciated sharply in relation to the United States dollar.

The evolution of government debt markets in the peripheral European countries has been influenced by political uncertainty in Spain and Italy, which resulted in an increase in their risk premiums. Even so, these premiums are at low levels.

In short, the latest fourth-quarter figures for 2012 show the global economy grew somewhat less than expected. However, earlier this year, several indicators of economic activity and expectations in large economies such as Germany, the United States and China, showed signs of recovery and may suggest a moderation in the global slowdown. Moreover, financial conditions have improved. Based on the foregoing, the forecast for demand from Colombia’s trading partners in the first half of 2013 remains weak, with a recovery in the second half of the year, as contemplated in the December edition of Banco de la República’s Inflation Report.

2. DISCUSSION AND POLICY OPTIONS

The Board of Directors considered the following factors in its deliberations:

(i) The growth of the world economy in the fourth quarter of 2012 was somewhat weaker than expected. However, so far during 2013, indicators of economic activity and expectations in some of the larger economies have been more positive and financial conditions have improved

(ii) International oil prices rose and are above the average observed in 2012. If the price remains at these levels, it could offset the low prices for coffee and coal and put terms of trade in 2013 above the average for 2012.

(iii) In Colombia, the economic indicators for the fourth quarter of 2012 suggest private consumption rose slightly less than in the second and third quarters of that year. The uncertainty surrounding the behavior of investment remains high, particularly with respect to investment in civil works and building construction. On the supply side, the leading industrial indicators suggest a further drop in production in this sector during December, while the indicators for commerce point to acceptable growth. This being the case, Banco de la República’s

technical team estimates economic growth in 2012 would be in a range between 3.3% and 3.9%.

(iv) Economic growth in the first quarter of 2013 will be affected by fewer business days during the period, as well as supply shocks to coal exports and the risk of less demand from Venezuela.

(v) In January, annual consumer inflation (2%) was lower than expected, particularly owing to less of an increase in the CPI for food and regulated items. The tax reform helped to reduce some of these prices, a fact that has a temporary impact on the annual change in the CPI. Part of this behavior also is explained by other factors such as lower production costs and moderate wage adjustments.

(vi) The average for both core inflation and inflation expectations is below the long-term target (3%).

(vii) The slowdown in inflation, which was more than expected, occurred in the context of a negative output gap. This situation may keep inflation expectations at low levels for a longer period of time. It also reduces the likelihood that unanticipated increases generated by supply shocks could jeopardize compliance with the inflation target

(viii) Lending continued to decelerate in January, but at a slower pace. Nominal interest rates on the different types of loans declined, with the exception of those on consumer lending, which rose during the month. In real terms, all the interest rates were up, partly because of the reduction in actual inflation and inflation expectations.

In these circumstances, an assessment of the risk balance points to the advisability of lowering the intervention interest rate. The monetary policy action that has been taken is intended to place output near the economy's productive capacity, without risking the inflation target or the country's macroeconomic stability.

3. POLICY DECISION

Pursuant to its assessment of the current risk balance, the Board of Directors unanimously agreed to lower the intervention interest rate by 25 bp. This decision takes into account the fact that the Colombian economy is growing below its potential, observed and forecast inflation are below the target of 3%, and there are no signs of upward pressure being brought to bear on inflation in the near future.

The Board reiterated that Banco de la República has sufficient tools and resources to satisfy the economy's regular liquidity needs with respect to both local and foreign currency, as well as any needs that might arise in an environment of international financial turmoil.

The Board will continue its careful monitoring of performance and projections with respect to economic activity and inflation in Colombia, asset markets and the international situation. Finally, it reiterated that monetary policy will depend on new information as it becomes available.

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Fuente: https://www.banrep.gov.co/en/news/board-directors/minutes-february-2013