Minutes of a Meeting of the Board of Directors of Banco de la República Held on July 26, 2013

Detailed Explanation of the Macroeconomic Situation (only in Spanish, updated 23/08/2013 13:43) Must reads Banco de la Republica keeps the benchmark interest rate at 3.25% 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 July 26, 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 Board Members Carlos Gustavo Cano Sanz, Ana Fernanda Maiguashca Olano, Adolfo Enrique Meisel Roca, César Vallejo Mejía and Juan Pablo Zárate Perdomo. These minutes contain a summary of inflation and the economic situation with respect to growth prospects for the future (Section 1), in addition to a review of the key deliberations and the policy options considered by the Board of Directors (Section 2).

1. SITUATION WITH RESPECT TO INFLATION AND ECONOMIC GROWTHa. Recent Developments in Inflation

Annual consumer inflation was 2.16% in June; this is 16 basis points (bp) higher than the rate in May. The rise in total inflation in June was concentrated in the CPI for regulated items, inasmuch as price increases for the other sub-baskets were moderate.

In June, the annual change in the CPI for regulated items was 1.98%, which represents a hike of 73 bp with respect to the month before. The largest increase was in electricity rates, primarily in Bogotá. It is important to point out that the prices in this sub-basket rose considerably during the last three months. However, the levels are still low compared to the other CPI components and the historic record for the series.

The other two non-food CPI components – tradables and non-tradables – showed little change during the past month. In tradables (excluding food and regulated items), the annual variation rose to 1.1%; that is, four (4) bp more than the rate in May, as has been the case since April. This could be related to depreciation of the peso in recent months. On the other hand, the annual change in the non-tradable CPI (excluding food and regulated items) climbed to 3.78%, which is four (4) bp more than the figure in May, reflecting modest demand-pull inflationary pressure. Rentals, which are the main component of the non-tradable CPI, were near 3.7%, down slightly from the rate in May. This item has exhibited a slow decline since the fourth quarter of last year.

As for the food CPI, the annual variation in June remained low (1.34%), as it has been so far this year. The annual change in the CPI for perishable foods declined slightly (2.4% in June following 2.6% in May), while that of the CPI for processed foods (-0.11% in June) remained stable compared to the month before. The annual change in the CPI for meals outside the home (3.5%) was up by 20 bp in June with respect to the month before.

In June, the average of the four core inflation indicators monitored by Banco de la República rose slightly to 2.52%. This is eight (8) bp above the average in April. The four indicators have been between 2% and 3% since January of this year.

The annual variation in the PPI in June remained negative (-0.2%), but was up compared to the month before (-2.1%). This trend is due, in part, to the pass-through of nominal depreciation to the annual change in the imported PPI, which is on positive ground (0.6%) for the first time in several months. The local component increased as well.

Inflation expectations rose slightly in June, but remained at levels in harmony with meeting the inflation target. The measurements based on Banco de la República's monthly survey of financial market analysts are near 2.6% for December of this year (seven (7) bp more than a month ago) and 3.1% for June 2014 (up eight (8) bp compared to June). On the other hand, inflation expectations derived from the TES yield curve exhibited less change and stayed within a range of 2.3% to 3.1% for different horizons.

b. Growth

The economic indicators for the second quarter suggest GDP growth will exceed the rate on record for the first three months of the year. An important part of this build-up is attributed to the fact that April has more working days and some of the supply shocks witnessed between February and March this year have been overcome.

As for the different components of spending, consumption and exports are expected to be the most dynamic, while there could be a slowdown in investment.

Household consumption would have performed better than during the first quarter, as evidenced by consumer confidence and retail sales. In the first case, the FEDESARROLLO consumer confidence index (CCI) rose significantly in June, reaching levels similar to those on record in late 2011 and surpassing the average for 2012 and the historical level as of 2001. On the other hand, according to the latest results of the Monthly Retail Trade Survey (MMCM, the acronym in Spanish) published by DANE, retail sales rose 6.5% in May, in annual terms, compared to the same period in 2012. When sales of automobiles and motorcycles (which were up by 5.3%) are discounted, the resulting aggregate rose 6.8%, following 3.4% in April.

Gross capital formation is expected to be less dynamic in the second quarter. As for investment, apart from building construction and civil works, performance is expected to be weak. This is evident from the figures on imports of capital goods (especially transportation equipment), which posted declines. Moreover, Banco de la República's Monthly Survey of Economic Expectations (EMEE, the acronym in Spanish) found no recovery in the intention of entrepreneurs to invest in fixed capital. As for investment in building construction and civil works, lower growth rates are anticipated compared to those observed during the first quarter.

There was some recovery in the amount of total exports in dollars during April and May, but annual growth in this respect remains negative (-2.5% in May). The recovery was due to increased exportable quantities of certain commodities (mainly oil and derivatives thereof, ferronickel and coffee). Exports of industrial goods and "others" are a case in point, with 6.7%, annual growth, thanks largely to added exports of vehicles (256%), meat (202%) and chemicals (5.4%). Exports are expected to grow at higher rates during the remainder of 2013, now that some of the supply shocks witnessed this year between January and March have been overcome.

In May, CIF imports in dollars were down 6.6% with respect to the same month in 2012. This performance is explained by a drop of 12.8% in imports of capital goods and 5.7% in intermediate goods. On the other hand, imports of consumer goods rose 2.7%. The trend component of the series for total imports shows gradual increases as of the last few months, but with very low annual growth rates.

With respect to the various branches of the economy, industry is expected to continue to contract, although less so, while mining, construction, agriculture and commerce are expected to perform well.

The indicators at hand point to a setback in industrial GDP during the second quarter, in annual terms. The industrial production index, without coffee threshing, declined 3.1% in May; in terms of levels, one sees a standstill and the trend component ceased to contract. Other indicators for the sector, such as business orders and expectations at three months, based on the FEDESARROLLO survey, speak of weak performance in the sector, as does industrial energy demand. However, the industrial confidence index recovered slightly and its trend component shows an increase for the first time in a year.

With respect to mining, added growth is expected for the second quarter due to the rise observed in coal and oil

production, although the latter experienced a drop in June due to supply shocks. Oil production adds up to more than one million barrels so far this year to June, and coal exports performed remarkably in April-May, following the problems Cerrejon and Drummond faced in February and March.

In the construction sector, the indicators at hand suggest the good performance witnessed in the first quarter would have continued during the three months thereafter. Specifically, annual cement production was up by 1.0% in May and 2.6%, on average, between April and May, following an average annual decline of 6.4% between January and March. Building permits rose 28.9% in April-May, maintaining the strong recovery exhibited during the first three months of the year (31.9%).

As for the agricultural sector, the recovery in coffee production, which increased by about 40% annually in the second quarter according to the Federation of Coffee Growers, coupled with the increase in cattle slaughtered during April and May (approximately 5%), give hope of a turnaround in the low growth rates posted by this sector during the second half of 2012.

Given all of these elements, the Colombian economy is expected to grow by around 3.4% in the second quarter of 2013. This is the most likely figure within a range of 2.5% to 4.0%, the extent of which is determined by uncertainty as to how investment in civil works and public consumption will perform.

The forecast for growth during 2013, as a whole, was revised downward somewhat, compared to the figure published in the last Inflation Report. The new forecast range is between 3.0% and 4.5%, with 4.0% being the most likely figure. This revision is explained, in part, by the actual behavior of the world economy and private spending, which have been weaker than expected.

c. Financial Variables

In June, bank lending (D/C and F/C) posted an annual increase of 14.06%, which is similar to the growth observed in recent months. The annual build-up in the loan portfolio in domestic currency went from 12.67% to 12.86% between May and June, while the increase in loans in foreign currency during that same period went from 34.53% to 33.23%.

As for the different types of lending, the annual variation in consumer loans was 13.66% by June, as opposed to 14.40% in May. On the contrary, annual growth in the mortgage portfolio was up from 13.73% in May to 13.95% in June. The recovery in the commercial loan portfolio that began in March continues to gain strength, having registered a monthly increase of 46 bp in the annual growth rate at June (13.96%).

Interest rates on loans from credit institutions continued to decline for all types of lending, with the exception of credit card and micro-credit rates. Accordingly, by June 2013, the reductions accumulated since the benchmark rate cuts began in July 2012 came to -251 bp for the preferred lending rate, -228 bp for the mortgage rate and -203 bp for the ordinary commercial rate. Other lesser variations include -187 bp for the rate on home construction loans, -179 bp for consumer loans, -156 bp for micro-credit, -144 bp for treasury loans and -101 bp for credit card lending.

The extent of the decline in real interest rates has been less, due to the effect of lower inflation. In real terms, the reduction since July 2012 came to -219 bp for the preferred rate, -195 bp for the interest rate on mortgage loans, -183 bp for ordinary commercial loans, -155 bp for construction loans, -146 bp for consumer loans, and -119 bp for microcredit.

By June, the real interest rates on consumer loans (15.0%), mortgages (8.1%), preferred loans (4.2%), ordinary commercial lending (7.5%) and treasury loans (4.5%) were below their historic averages calculated since 2000. In contrast, the real interest rate on credit card lending (26.1%) was above average.

d. The External Context

The world economy continued to expand slowly during the first half of 2013. Industrial performance and world trade are still being affected by weak global demand.

Although the economic indicators for the Euro Zone continued to decline, they exhibited less deterioration than in previous quarters. These results are explained, in part, by the added growth of the German economy.

In the United States, retail sales, industry and services showed signs of moderate growth. The slowdown in some indicators reflected the increased impact of the fiscal adjustment.

Japan saw a recovery in its exports, aided by a weaker yen and a broad rebound in consumer spending, investment by large corporations, and household and business expectations.

Once again, the emerging countries were the driving force of the world economy. However, their growth would not have matched what was anticipated in the March edition of the Inflation Report. Less momentum in the external sector, coupled with a slowdown in domestic demand, appear to be the reasons why their growth rates have dropped-off.

China has experienced more of a slowdown in production than was anticipated, likely because of less growth in the external sector and in certain components of domestic demand. Annual growth during the second quarter (7.5%) was less than in the first three months of the year (7.7%).

In Latin America, the indicators of productive activity show second-quarter growth continued to abate compared to the increase observed in 2011-2012. The performance of exports and industrial activity in the region is not encouraging.

Weak global demand, coupled with a number of favorable supply conditions, kept international prices for the major commodities at levels below those observed during 2012. This being the case, and despite the growing geopolitical tensions that led to a recent hike in oil prices, the Brent reference price is still less than the average for 2012 and slightly above the central forecast announced in the March edition of the Inflation Report.

The prices of other commodities exported by Colombia continued to decline in recent months and are below the estimate in the last Inflation Report. This situation would be due to the recent decline in the country's terms of trade, which has been offset, in part, by lower international prices for certain imported goods, such as food. Currently, food prices are lower than in 2012, although they have increased slightly in recent weeks.

Inflation in the major developed economies remains low, facilitating an expansive monetary stance. In the case of emerging countries, the situation is similar, but with some exceptions such as Brazil, India and Indonesia, where the central banks have recognized the need to increase their benchmark rates, given the rapid rise in their price levels.

In international financial markets, the interest rates that rose in recent months, following the Fed's announcement of a possible withdrawal of its stimulus program, saw partial declines in the last few weeks. The situation with respect to the volatility indicators, risk indicators and exchange rates was similar.

In short, the outlook for this year signals growth for the country's trading partners and lower terms of trade than in 2012. Global demand is expected to improve as of the second half of this year and during 2014, albeit at a slower pace than was estimated in the last Inflation Report. The cost of foreign financing should remain low, but could increase gradually if the Fed actually begins to tapper its asset purchases.

2. DISCUSSION AND POLICY OPTIONS

The relevant aspects taken into account by the Board of Directors are summarized below.

(i) Global economic growth remains modest, with considerable differences between countries. While the contraction in Europe persists, a rapid recovery in productive activity is ongoing in Japan. In the United States, the build-up in private demand is being offset, in part, by fiscal consolidation, leading to a slight decline in the forecast for growth. Expansion in a good portion of the emerging economies of Asia and Latin America is still robust, but less than anticipated. Consequently, the expectation this year is for growth of the country's trading partners and lower terms of trade than in 2012.

(ii) A stronger dollar and the rise in long-term foreign interest rates during May and June partly reversed in July. The same occurred with risk premiums and the interest rates on government paper in the region.

(iii) The rise in oil, ferronickel and coffee production and the increased rate of growth in foreign industrial sales in dollars during the second quarter of 2013 suggest better export performance. The rise in consumer confidence and the added growth in retail trade also indicate some degree of acceleration in private consumption. On the supply side, the build-up in the economy comes mainly from mining, agriculture and commerce. Industry would contract once again, although less so. Accordingly, the Bank's technical staff estimates second-quarter growth will be somewhere between 2.5% and 4.0%, with 3.4% being the most likely figure.

(iv) The Bank's technical staff lowered its forecast on the most probable growth rate for 2013 from 4.3% to 4%, within a range of 3.0% to 4.5%. This revision is due, in part, to the performance of the world economy and private spending, which have been weaker than anticipated. Economic growth in Colombia is expected to increase throughout the year to the extent that aggregate spending reacts to the monetary policy measures adopted earlier and to the programs being carried out by the national government.

(v)The rise in bank loans in domestic and foreign currency is showing signs of stabilizing at a higher rate than the growth in nominal GDP. Interest rates on loans continue to decline and, in real terms, are below their historic averages (except in the case of credit card lending).

(vi) Annual inflation in June (2.16%) and average core inflation (2.5%) were slightly higher than in May. Analysts' average inflation expectations and those calculated based on government bond rates are similar to the inflation target, which is 3%.

In short, the economic indicators and economic projections show less output than can be generated with the country's installed capacity. It is hoped the monetary and fiscal policy measures adopted so far will help to increase the output rate this year. Inflation is low and expectations are anchored to the long-term target (3%).

3. POLICY DECISION

Pursuant to its assessment of the current risk balance, the Board of Directors unanimously agreed to hold the benchmark interest rate at 3.25%.

The Board will continue to carefully monitor performance and projections concerning 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.

Bogotá, D. C.

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