[Detailed Explanation of the Macroeconomic Situation]

Must reads

[THE BOARD OF DIRECTORS OF BANCO DE LA REPÚBLICA MAINTAINS THE BENCHMARK INTEREST RATE AT 4.5% AND ANNOUNCES THAT IT WILL NOT CONTINUE TO BUY INTERNATIONAL RESERVES]

A regular meeting of the Board of Directors of Banco de la República was held in the city of Bogotá D.C. on December 19, 2014. In attendance were Mr. Mauricio Cárdenas Santamaría, Minister of Finance and Public Credit, Mr. José Darío Uribe Escobar, Governor of the Central Bank, and Board Members Carlos Gustavo Cano Sanz, Ana Fernanda Maiguashca Olano, Adolfo Meisel Roca, César Vallejo Mejía and Juan Pablo Zárate Perdomo.

These minutes contain a summary of the outlook of Banco de la República's technical staff on the macroeconomic situation (Section 1), followed by a review of the main discussion regarding policy alternatives considered by the Board of Directors (section 2).

A more detailed description of the macroeconomic situation prepared by the technical staff from the Central Bank is provided in the data section of the November 2014 edition of the Inflation Report, as well as in the statistical appendix.

1. MACROECONOMIC CONTEXT

Regarding the macroeconomic context, the technical staff highlights the following elements:

1. In the present month, the international price of oil continued to fall, reaching levels that had not been observed since 2009. Apparently some factors of supply and demand suggest that a great part of this downturn is of structural character. Despite this, uncertainty about the future price of oil is still high.
2. The currencies of various emerging countries continue depreciating, their risk premia have increased, and the price of their financial assets has deteriorated. This behavior has been much more accentuated in oil-producing countries such as Colombia.
3. This has taken place in a context of weak global economic activity, in which the main boost is generated by the economy of the United States. The Euro zone continues with low GDP growth, while increases. With this outlook, it is feasible that the average recovery of our trade partners in 2015 may be weaker than was estimated in the past quarterly report.

4. The long-term interest rates in the United States descended again, and the Federal Reserve gave signs that the first increment in the benchmark reference rate would take place at the beginning of the second semester and would continue gradually.
5. The fall in the price of oil and the increase in the international prices of some food items imported by Colombia will be reflected on a greater than expected downturn in the terms of trade of the country. Should these levels continue, this will generate a lower national income in 2015.
6. The downturn in the price of oil affected the country's exports again. In October, external sales [illegible] agricultural products continued recording high increases, while the exports of the other sectors fell, although at a lower rate than those of mining.
7. In the domestic context, the growth of the GDP in the third quarter of 2014 (4.2%) posted within [illegible] trade, together with social, communal and personal services. Mining and industry were the only sectors that presented downturns.
8. The new data on economic activity for the last quarter of 2014 show a mixed behavior. On the [illegible] rate. On the other hand, some supply side indicators such as industry and oil production record low annual increases.
9. In November, annual growth of private companies' borrowing slowed down, which is explained [illegible] which so far in the second semester has only partially reflected the increase registered in the benchmark interest rate.
10. Regarding the results of labor market to October, the seasonally adjusted component for unemployment rate is stabilizing at historically low levels. The number of salaried employees has stabilized, while that of non-salaried employment presents a growing trend.
11. The growth forecast range for 2014 presented in previous reports posted between 4.5% and 5.5% with 5.0% as the most probable figure. New information suggests that downward risks have increased, and that the probability that growth for all of 2014 will go below 5.0% is greater now.
12. Annual inflation in November (3.65%) turned out to match the estimations of the technical staff, [illegible] is explained by the acceleration of the CPI of food and regulated items. The average of the four measures of core inflation also increased, posting at 2.85%.
13. It is highly probable that annual inflation to December 2014 remains close to the current levels and will be within the target range. Analysts' one-year inflation expectations and those for longer horizons derived from public debt bonds increased and are around 3.4%
14. It is expected that the depreciation of the exchange rate will transmitted to domestic prices, [illegible] a risk that consumer inflation continues increasing in 2015. A high transmission could affect the expectations and have more persistent effects on inflation.

In all, domestic demand continues to be dynamic in a context close to the full use of the productive capacity. At the same time, inflation and its expectations are above 3.0%. This takes places within an environment of deterioration of the terms of trade, depreciation of the peso, and growing uncertainty about the recovery of global economic activity and the cost of external financing, factors which may impact the future behavior of aggregate demand.

2. DISCUSSION AND POLICY OPTIONS

The Board of Directors unanimously decided to maintain the benchmark interest rate at 4.5%. The Board highlighted that, as has already been mentioned, the economy will face, in the policy horizon, a slowdown in its growth as a consequence of the shock in the terms of trade and the weak external environment.

Some of the Board Members emphasized the risks of the shock on the fall in oil prices for important trade partners for Colombia such as Venezuela and Ecuador.

The Board Members mentioned that at the end of 2014 inflation will be in the upper half of the target range. The deviation from the mid-point of 3.0% is temporary, and is explained fundamentally by the correction of transitory falls in some prices in the past, as well as by temporary increases in others. Core inflation posts under 3.0%, and it is expected that total inflation converges towards this value.

One of the Board Members mentioned that, in a context of a closed output gap, the current strong dynamism of the economy may generate inflationary pressures.

Finally, the Board is aware that the recent depreciation of the peso may bring an increase in the CPI. This should not affect inflation expectations as long as the depreciation is transmitted to prices only once, and therefore inflation increases will subsequently reverse.

3. POLICY DECISION

The Board of Directors unanimously decided to maintain the benchmark interest rate at 4.5%.

Bogotá D.C.,