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## [Monetary Policy Report](#)

### Must reads

[Banco de la República increases the benchmark interest rate by 25 basis points](#)

A regular meeting of the Board of Directors of Banco de la República took place in the city of Bogotá D.C. on Wednesday, June 22, 2016. In attendance were Mauricio Cárdenas Santamaría, Minister of Finance and Public Credit; José Darío Uribe Escobar, Governor of the Central Bank; and co-directors Carlos Gustavo Cano Sanz, Ana Fernanda Maiguashca Olano, Adolfo Meisel Roca, Cesar Vallejo Mejia, and Juan Pablo Zárate Perdomo.

These minutes contain a summary of the outlook by the technical staff of the Central Bank on the macroeconomic situation (section 1), followed by a review of the main discussion regarding monetary policy by the Board of Directors (section 2).

Further [detail on the macroeconomic situation](#) prepared by the technical staff from Banco de la República will be presented in the Monetary Policy Report of May and in the statistical annex.

## 1. MACROECONOMIC CONTEXT

1. In its meeting of June 16, the Federal Open Market Committee of the FED decided to ~~maintain the benchmark interest rate unchanged~~ ~~at 0.25 percent~~ ~~and~~ ~~the~~ ~~normalization of the monetary policy will be slower than expected.~~ ~~the~~ ~~market anticipates that the~~ ~~normalization of the monetary policy will be slower than expected.~~
2. ~~A few days before the meeting of the FED, a reversal in international financial markets~~ ~~a small increase in risk premia and a slight weakening of their currencies.~~ ~~the~~ ~~market anticipates that the~~ ~~normalization of the monetary policy will be slower than expected.~~
3. ~~The figures for economic activity available from other countries suggest that growth~~ ~~is low.~~ ~~the~~ ~~market anticipates that the~~ ~~normalization of the monetary policy will be slower than expected.~~
4. ~~In the euro zone, retail sales showed a decline in April, and industrial production continued~~ ~~its~~ ~~pace of expansion in May.~~ ~~the~~ ~~market anticipates that the~~ ~~normalization of the monetary policy will be slower than expected.~~
5. ~~In Latin America, GDP data for the first quarter and China in Q1 2016 to April show a~~ ~~reduction in growth in the first quarter (from 7.1 to 6.8 percent in the case of China and~~ ~~available).~~ ~~the~~ ~~market anticipates that the~~ ~~normalization of the monetary policy will be slower than expected.~~
6. ~~For June 20, the price of Brent oil has remained around USD \$50 per barrel. This, with the~~ ~~increases in some of the international prices of some foodstuffs imported by the country.~~ ~~the~~ ~~market anticipates that the~~ ~~normalization of the monetary policy will be slower than expected.~~
7. ~~According to the figures of the balance of payments in the first quarter of 2016, a~~ ~~reduction in the current account and the greater net income from transfers also contributed to~~ ~~this reduction.~~ ~~the~~ ~~market anticipates that the~~ ~~normalization of the monetary policy will be slower than expected.~~
8. Foreign trade information available for the second quarter indicates that both exports and imports continue falling at significant rates (-24.8% and -17.0% in April, respectively).

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9. In the first quarter, GDP exhibited a yearly decrease of 2.5% in line with the forecasts of the Central Bank. In the second quarter, the sectors that grew the most were industry and financial services, while mining was the only one that is contracted.
  10. The figure available for retail and industry in April showed better performance of the economy. In the first half of the year, the sectors that grew the most were industry and financial services, while mining was the only one that is contracted.
  11. The technical staff maintains its growth forecast for the whole year at 2.5%, within a range of 1.5% and 3.2%.
  12. In May, yearly consumer inflation reached 8.20%. The increase is mainly explained by indicators monitored by the Central Bank moved from 6.38 in April to 6.33% in May.
  13. Inflation expectations for December 2016 obtained from the monthly survey to financial institutions increased from 4.0% to 4.1%, and the survey to the general public increased from 3.67% to 3.71%.
  14. Shocks in food prices and depreciation are expected to begin fading in the second half of the year. Monetary policy decisions should aim at inflation towards its target during 2017.

In summary, the Colombian economy continues adjusting in an orderly manner to the strong shocks recorded since 2014. The current account deficit is correcting gradually, and the risk of an excessive deceleration of domestic demand remains moderate. Inflation has accelerated because of the depreciation of the peso, El Niño, and by the activation of some indexation mechanisms.

## 2. DISCUSSION AND POLICY OPTIONS

For the members of the Board of Directors, the data available for the first quarter suggest that domestic demand and output growth continue to slow down, in line with the forecast by the technical staff of the Central Bank. On the other hand, the current account deficit showed a reduction greater than anticipated. This represents a better-than-expected behavior of national income during this period, and means that there was a decline in the external vulnerability of the economy. This corresponds to an orderly adjustment to external shocks that the Colombian economy has been facing since mid 2014.

The majority of the Board Members deemed appropriate to increase the policy interest rate by 25 bp. They consider that this increase, added to the already significant adjustment in the policy interest rate in the past, is needed to underpin the process of convergence of inflation and inflation expectations to their 3.0% +/-1 pp goal in 2017. Despite the strong shocks that have led to recent increases in inflation, previous increases in the Central Bank's interest rate have impacted inflation expectations in the desired direction.

Among the members of the Board who proposed a 25 bp increase of the policy interest rate, some stated that the high volatility of external conditions, the signals of persistence of inflation and of the activation of indexation mechanisms could pose serious threats to achieving the inflation target in 2017, which must be confronted with adjustments in the policy interest rate. In their opinion, the credibility costs of failing to achieve the inflation target in 2017 would make future disinflation much more costly in terms of output growth and employment creation.

One member of the Board considered that the previous increases in the policy rate have led to enough contraction, and that there are signs that domestic demand is adjusting at a convenient pace. Additionally, this member noted that inflation expectations for 2017 have not increased. Therefore, this Board member did not consider an additional increase to the benchmark interest rate necessary.

## 3. POLICY DECISION

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The Board of Directors of Banco de la República, by majority, decided to increase the benchmark interest rate by 25 bp to 7.5%.

Bogotá, D. C.