[Monetary Policy Report]

A regular meeting of the Board of Directors of Banco de la República took place in the city of Bogotá D.C. on Friday, April 28, 2017. In attendance were Mauricio Cárdenas Santamaría, Minister of Finance and Public Credit; Juan José Echavarría, Governor of the Central Bank; and Board Members Gerardo Hernández Correa, Ana Fernanda Maiguashca Olano, Adolfo Meisel Roca, and Juan Pablo Zárate Perdomo.

These minutes contain a summary of the outlook on the macroeconomic situation by the technical staff of the Central Bank (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 the Central Bank will be presented in the quarterly Monetary Policy Report for March 2017 and in the statistical annex (Only available in Spanish).

1. MACROECONOMIC CONTEXT

1. The information available on supply and demand suggests that annual growth of the Colombian economy in the first quarter was weak and slightly lower than expected.
2. For the first quarter of 2017, growth would have posted between 0.8% and 1.8%, with 1.3% as the most likely figure.
3. The Central Bank's technical staff reviewed the 2017 forecast downwards. Thus, for 2017, GDP growth is forecast between 0.8% and 2.6%, with 1.8% as the most likely figure. On the other hand, the current account deficit would be at 3.6% of GDP, within a range between 3.0% and 4.1%.
4. These projections assume an increase of external demand and somewhat better terms of trade than those recorded in 2016. Also, that external financing would be more expensive on account of higher external interest rates.
5. In Colombia, domestic demand would do better than in 2016, due to growth in investment, particularly in civil works. Household consumption would exhibit slightly lower pace of increase than in the previous year, while that for the government would speed up slightly. With this, on the demand side, growth in 2017 would be more balanced than the one observed in 2016.
6. As for inflation, it stood at 4.69% on a yearly basis in March, while core inflation, measured as the average of the four indicators monitored by the Central Bank, continued with no significant changes.
7. While most of the deceleration in the month is explained by the behavior of food, the decline in inflation of tradables (excluding food and regulated items) suggests that the upward effect of the tax reform and the Liquor Act would have taken place, for the most part, in the first months of the year. The acceleration in non-tradable inflation (excluding food and regulated) suggests that the indexation of prices and wages may be gaining importance.
8. Inflation expectations by economic analysts and those obtained from the quarterly survey of economic expectations to December 2017, to twelve and twenty-four months decreased. Those embedded in public debt bonds to two years and over continue their downward trend.
9. As for the external context, the information available for the first quarter suggests that the economies of the United States and the euro zone could have slowed down in the first quarter. However, they would recover in the rest of the year. In China, GDP was above the one observed in 2016, and also above market expectations.
10. In Latin America, the indicators of activity and confidence show stability or some recovery, although still with low growth figures. Capital inflows to fixed income continued in March. The currencies of these countries have continued with a trend towards appreciation.
11. Colombia's terms of trade would have continued at levels higher than a year ago, thanks to the increase in the price of the main commodities exported by the country (particularly oil and coal). As for oil, although there have been significant fluctuations in its price, so far this year it has remained above USD $50 per barrel (Brent).
12. In all, for 2017, it is expected that the strong transitory shocks that diverted inflation from its target continue to fade, in an environment of a slightly weaker economic activity than forecast in the previous quarterly report. The monetary policy actions undertaken so far, which consider these effects, should strengthen convergence of inflation to its target.

2. DISCUSSION AND POLICY OPTIONS

In discussing the policy options, the members of the Board of Directors agreed on the following aspects:

- The Colombian economy has shown an orderly adjustment in the face of strong shocks in the past years, which has been reflected in the existence of excess installed capacity.
- The information available from the last month continues to show an increasing weakness of economic activity, which led the technical staff to reduce the 2017 growth forecast to 1.8% as the most likely figure.
- Inflation expectations and observed inflation declined in the last month. However, their decline is due, in good part, to a reduction in the annual variation in food prices. The indexation mechanisms and the increase in the persistence of inflation were reflected in the increase of the variation in prices of non-tradable goods.
- The current level of the real policy interest rate continues to be contractionary. With the reduction in inflation expectations that took place last month, the current level of the intervention rate is even more contractionary.

Given the above, and facing the risk balance, all Board Members deemed appropriate to reduce the intervention rate, but with differences as to the amount of the reduction.

Four members considered advisable to reduce it by 50 basis points. They felt that this reduction is consistent with the new information regarding the lower growth of the economy, the reduction in inflation expectations, and the expected path of decline in inflation to reach the 3.0% target in 2018.

Other Board Members voted for a 25 bp reduction. They argued that there are reasons to reduce the benchmark interest rate, such as the behavior of inflation expectations and the indicators of real activity. However, the persistence of high levels of inflation and high indexing still exhibited by the economy indicate that the path of reductions in the benchmark interest rate should be gradual, prudent, and moderate, if the desired objectives of the Central Bank are to be met in the policy horizon. Similarly, they emphasized that a 25 bp reduction would be in line with market expectations, consolidating the proper operation of the transmission channels of the monetary policy.

3. POLICY DECISION

The Board of Directors of Banco de la República, by majority, decided to reduce the benchmark interest rate by 50 bp to 6.50%.

The decision to reduce the benchmark interest rate by 50 bp was approved by four (4) members of the Board. The two (2) remaining Board Members voted for a 25 bp reduction.

Bogotá, D. C.

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