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[Banco de la República reduces the benchmark interest rate by 25 bp to 4.5%.](#)

A regular meeting of the Board of Directors of *Banco de la República* took place in the city of Bogotá D.C. on Monday, 29 January 2018. 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, José Antonio Ocampo Gaviria, 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 December 2017** and in the statistical annex (Only Available in Spanish).

1. MACROECONOMIC CONTEXT

1. For the fourth quarter of 2017, several activity and perception indicators would confirm the forecast of a slight slowdown of the economy versus the third quarter. This would be explained, to a large extent, by a higher basis of comparison for the same period of 2016 and to the adverse effect of the air transport strike. However, the estimate for the fourth quarter continues to be higher than observed in the first half of the year, suggesting that the recovery of the economy is taking place, albeit at a slow pace.
2. With this, the technical staff at the Central Bank forecasts that yearly GDP growth for the fourth quarter of 2017 would post between 1.3% and 2.3%, with 1.8% as the most likely figure. Considering this, the forecast for GDP growth remains at 1.6% for 2017, but the forecast range was reduced somewhat (moving from 1.3% and 1.9% to 1.4% and 1.8%).
3. The current account deficit would have posted for the whole year at 3.5% of GDP (within a range between 3.3% and 3.7% of GDP).
4. In real terms, the figures of total credit to December reflect a portfolio that would be recovering slowly due to the behavior of commercial credit (including M/E, external direct, and bonds). The households' portfolio is still slowing down, but still records high real rates of increase.
5. For this year, regarding the external context, the forecast for the country's trading partners was revised upwards, supported by the better performance of the advanced economies and the signs of recovery in some emerging countries. The latter were driven by the improved performance of China and better terms of trade.
6. For 2018, GDP growth is projected between 1.7% and 3.7%, with 2.7% as the most likely figure. This forecast provides for an acceleration of growth that is consistent with a more favorable outlook for the terms of trade and external demand than observed in 2017. The best international prices of raw materials would also favor the expansion of mining investment, which would contribute positively to a mild growth in domestic demand.
7. The current account deficit for 2018 would stand between 2.8% and 3.8% of GDP, with 3.3% in the baseline scenario. This projection, which also incorporates the best scenario of commodity prices and growth of the major trading partners, suggests an additional adjustment of the trade balance. However, it also considers an increase in the cost of external financing as a result of a less expansionary monetary policy stance in the developed economies.
8. In Colombia, at the end of 2017, inflation stood at 4.09%, 109 bp above the inflation target. However, annual inflation in December reduced *vis-à-vis* the figure for November (4.12%). The decline in inflation during the month and versus the previous year can be explained by the contraction in all major components of the food group. On the other hand, core inflation, measured as the average of the four indicators monitored by the Central Bank (4.66%), rose for the second month in a row, after contracting without interruption since August 2016.
9. The different measures of inflation expectations remain above the target (3.0%). The path of analysts' expectations was reduced in the January survey, and inflation expectations for December 2018 are at 3.83%. Those embedded in public debt bonds rose slightly in January and are currently around 3.5%.

In all, inflation is expected to continue lowering in the first quarter of the year, partly as a result of the reversal of the transitory shocks that have diverted it from its target. This takes place in an environment of a recovering economic activity, but still with excess of installed capacity. Monetary policy actions undertaken so far, which consider these effects, should strengthen convergence of inflation to its target.

2. DISCUSSION AND POLICY OPTIONS

The members of the Board agreed that, with the data observed, the economic recovery has not yet been clearly evidenced. However, agents' expectations have begun to improve moderately. Particularly, they highlighted the good performance of exports, which contributed to a better outcome in the current account deficit in 2017.

On the other hand, they mentioned that inflation forecasts for 2018 continue to converge towards the 3.0% target, although such path is now higher than in the last meeting and has increased the uncertainty about the behavior of several of its components.

Four Board Members voted to reduce the benchmark interest rate. In their opinion, the figures of economic activity were still very weak, with no evidence of recovery. To that extent, and given that inflation projections continue to show convergence to the 3.0% target in 2018, a reduction was suitable in order to provide a stimulus that can be significant to the economy, instead of waiting. However, they considered that the space for such reduction was not very wide due to the risks that still persist of a slower convergence of inflation to the target, and therefore decided on a 25 bp reduction.

The remaining Board Members expressed that the risks of a slower convergence of inflation to its target have increased since the last meeting. The adjustment of the minimum wage for this year, the widespread increase in the different components of inflation at the end of the year, and the persistence of inflation in some groups of goods and services were some of the factors mentioned as a source of greater risk. On the other hand, despite the weak dynamics of the economic activity, they observe improvement in the confidence indicators and in several agents' expectations. Their vote was to maintain the benchmark interest rate unaltered until having more information on the trends of inflation, particularly on its inertial components, in the first quarter of 2018.

All Board Members agreed that, with the information available, this decision completes the cycle of reductions.

3. POLICY DECISION

The Board of Directors of *Banco de la República*, at today’s meeting, decided by majority to reduce the minimum transitory expansion benchmark interest rate by 25 bp to 4.5%.

The decision to reduce the benchmark interest rate to 4.5% was approved by four (4) members of the Board. The three (3) remaining Board Members voted to keep it unaltered.

Bogotá, D. C.