Minutes for Banco de la República's Board of Directors Meeting on Oct. 29, 2021

Minutes for Banco de la República's Board of Directors Meeting on Oct. 29, 2021
On October 29, Banco de la República's board of directors (BDBR) decided unanimously to continue to normalize monetary policy. The board voted 5-2 to increase the policy interest rate by 50 basis points to 2.5%, with two dissenting members voting for a 25-point increase.

The decision took into account the following considerations:

Economic activity has recovered faster than previously anticipated, a reflection primarily of strengthening domestic demand that has benefited from monetary, fiscal, and regulatory policies implemented since the start of the pandemic. The persistence of favorable international financial conditions, improvements in international demand, and an increase in terms of trade are expected to continue to drive output recovery over the rest of the year and into 2022. As a result, the technical staff has revised its GDP growth projections upward to 9.8% for 2021 and 4.7% for 2022.

Annual inflation in September was above expectations at 4.51%, in large part due to the price behavior of foods and regulated items. Increased prices and international costs have created upward pressure on various baskets, as have the partial lapse of some price relief measures implemented in 2020 and the increase in domestic demand and consequent reduction in excess capacity. Given the persistence of external shocks, the possible effects of indexation on some prices, and the improvement in economic activity, the technical staff revised its year-end inflation forecasts upward to 4.9% in 2021 and 3.6% in 2022.

Seasonally adjusted figures from the national statistics agency's integrated household survey (GEIH) show a recovery of 5.2 million jobs lost since the start of the pandemic, bringing the total recovery to 88.4%. Close to 1 million jobs were created in the third quarter of 2021. The recovery has led to a decline in seasonally adjusted unemployment rates, which in September fell to 12.6% nationally and 14.1% in Colombia's 13 largest cities. While unemployment levels remain high, the continued recovery in economic activity suggests that favorable labor market trends should continue in the coming months.

The current account deficit is expected to grow to 5.3% of GDP in 2021, primarily as a reflection of significant growth in domestic demand, which has incentivized imports. An expected recovery in earnings for businesses with international investment, as the result of economic recovery and higher coal and oil prices, would also contribute to deficit growth. Deterioration in the balance of payments represents a source of vulnerability, particularly as international financial conditions could become less favorable more quickly than recently anticipated.

In their unanimous decision to continue the gradual process of monetary policy normalization, the members of the board agreed that the monetary stimulus deployed to address the economic effects of the pandemic had largely achieved its objectives, as indicated by the significant increase in domestic demand, which has been the primary driver of economic recovery. However, increased inflation and inflation expectations, and the progressive reduction of excess productive capacity, suggest that maintaining monetary stimulus at current levels could compromise macroeconomic sustainability. The board members also concurred that monetary policy remains accommodative despite the beginning of the normalization process.

Having agreed in their general diagnosis of current macroeconomic conditions, the board differed in its view of the speed with which the normalization process should proceed; five board members voted in favor of a 50-basis point increase to the policy interest rate, while two board members voted for a 25-point increase.

In recommending a more pronounced increase to the policy interest rate, the majority noted the coexistence of increased inflation and expected inflation alongside a marked increase in economic activity. Some members of this group emphasized the notable recovery in private consumption, supported by abundant credit and interest rates that have largely reflected changes to the policy rate, which remains negative in real terms and will continue to provide sustained support for economic recovery. Other members of this group expressed doubts that the productive capacity of the economy could sustain current levels of demand growth in the medium term, which could give rise to internal and external imbalances. Recent data suggests that the output gap could close faster than previously expected. At the same time, the accelerated increase in demand could induce larger external imbalances as international financial conditions tighten. The majority also expressed concern over the increase in expected inflation and reiterated that, in this context, indexation in 2022 could present a risk to price stability. This group agreed that a larger increase in the interest rate was appropriate in this instance, suggesting that a smaller increase could risk the need for a more restrictive monetary policy stance in the future.

The board members who voted for a 25-basis point increase noted persistent uncertainty related over to the evolution of the pandemic, in light of the appearance of new strains of COVID-19 in some countries. They added that the high recent level of consumption may not be sustainable, as it has been based on the deaccumulation of savings accrued during the height of the pandemic. These board members highlighted that significant gaps in employment and investment remain, compared to pre-pandemic levels, and suggested that cash flow problems still being faced by many Colombian companies could be accentuated by an accelerated increase in the interest rate. While they expressed concern over high levels of inflation, these board members noted that part of the increase could be understood as an inevitable adjustment to changes in international prices and the economic effects of the pandemic and recent roadblocks in some parts the country, and as such should not be cause for excessive alarm. They also noted their concern that Colombia may not be making the investments necessary to sustain high levels of growth in the long term. Finally, these board members expressed concern over the impact that a more pronounced increase in the policy rate could have on the dynamism of credit levels, particularly for those segments that were most affected during the critical phases of the pandemic, such as small and micro-businesses.

Fuente: https://www.banrep.gov.co/en/minutes-banco-republicas-board-directors-meeting-oct-29-2021