Minutes for Banco de la República's Board of Directors Meeting on January 28, 2022

Attachments

Determinantes de las Dinámicas de los Mercados de Capitales (Only Available in Spanish) Anexo estadístico (Only Available in Spanish)

On January 28, Banco de la República's board of directors (BDBR) voted 5-2 to approve a 100-basis point increase to the benchmark interest rate, bringing it to 4.0%; two dissenting members voted for a 75-point increase.

The decision took into account the following considerations:

- Both headline and core inflation closed the year above expectations and on upward trajectories.
- Inflation expectations are high and also ended the year on an upward trajectory. The technical staff revised its inflation forecast accordingly, projecting year-end headline and core inflation above the target for 2022 (4.3% and 4.5%, respectively) and 2023 (3.4% and 3.6%).
- Interest rate increases in money, credit, and capital markets beginning in the second quarter of 2021 can be explained in part by increased inflation expectations.
- Private and public consumption drove a continued expansion in economic activity in the last months of 2021. Private investment, by contrast, has been less dynamic. In response, the technical staff was able to reaffirm its GDP growth forecast for 2021 at close to 10%, with which remaining excess capacity in the economy would be nearly eliminated. GDP growth in 2022 would be forecast at around 4.3%.
- Aggregate demand performance and import growth that was faster than for exports led to an increase in the current account deficit from 3.5% of GDP in 2020 to an estimated 5.7% in 2021. This deficit is expected to remain at 4.9% of GDP in 2022, despite a positive international price outlook for Colombia's main export commodities.
- External financing will come under less favorable conditions than in 2021, given the imminent normalization of monetary policy in the United States and in other advanced economies.

Moderating inflation expectations represents the most significant monetary policy challenge in the current environment. Unanchored inflation expectations could push price and salary indexation to above levels considered by the 3% target. The proximate elimination of excess capacity in the economy, after a significant recovery in demand and a lagging supply response, could make this risk more acute.

Given the above, the board members were unanimous in their view on the need to continue normalizing monetary policy away from the strongly expansionary stance adopted in response to the pandemic. However, as in previous sessions, there remained differences of opinion over the speed with which this process should take place.

The board members voting for a 100-basis point increase emphasized the following points:

- Interest rate increases, in many cases exceeding the 100 basis-point adjustment, have already been observed in diverse financial markets, reflecting increased inflation expectations.
- Increased inflation expectations could affect price and salary formation in coming months.
- A widening of the current account deficit that would:
    - Reflect the inability of domestic supply to respond to demand.
    - Imply a demanding financing process, given an imminent tightening of international financial conditions and taking into account the increase to Colombia's sovereign risk premium.

The two directors who voted for a 75-point increase justified their preference for a more gradual adjustment based on the following considerations:

- Significant uncertainty remains around the state of the economy and its future outlook, as reflected in the variability of diverse forecasts analyzed over the past month.
- Anomalies and challenges in the labor market could grow more acute if normalization comes very quickly, especially amid continued high unemployment.
- A significant portion of the supply shocks that have affected prices on certain groups of goods, especially foods, have been notably transitory in nature.
- Excluding foods and regulated goods and services, inflation is below the target at 2.49%.
- Investment flows are lagging economic activity which, given the latter's interest rate sensitivity, could be perpetuated by a very rapid normalization of monetary policy. This would affect growth and employment.
- Performance in some sectors that are particularly sensitive to changes in the interest rate, such as small and micro-enterprises, remains weak.

The BDBR emphasized that its monetary policy remains in position to stimulate the economy despite the 100-basis point increase to the benchmark interest rate. This takes into account the fact that in real terms the intervention rate continues in negative territory and below the natural rate of interest. Finally, the board reiterated its commitment to the 3% annual inflation target.

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