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[Principales variables del pronóstico macroeconómico (Only Available in Spanish)]

Keep in mind

The Monetary Policy Report presents the Bank's technical staff's analysis of the economy and the inflationary situation and its medium and long-term outlook. Based on it, it makes a recommendation to the Board of Directors on the monetary policy stance. This report is published on the second business day following the Board of Directors' meetings in January, April, July, and October.

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Starting in October 2019, the quarterly Inflation Report produced by the technical staff of the Central Bank will be known as the Monetary Policy Report. The document, which is used for the technical staff´s monetary policy recommendation, will be published on the working day after the meeting of the BDBR in January, April, July, and October, simultaneously with the Board minutes.

Publication Date:

Thursday, 30 June 2022

1.1 Macroeconomic summary

Annual inflation continued to rise in the first quarter (8.5%) and again outpaced both market expectations and the technical staff's projections. Inflation in major consumer price index (CPI) baskets has accelerated year-to-date, rising in March at an annual rate above 3%. Food prices (25.4%) continued to contribute most to rising inflation, mainly affected by a deterioration in external supply and rising costs of agricultural inputs. Increases in transportation prices and in some utility rates (energy and gas) can explain the acceleration in regulated items prices (8.3%). For its part, the increase in inflation excluding food and regulated items (4.5%) would be the result of shocks in supply and external costs that have been more persistent than expected, the effects of indexation, accumulated inflationary pressures from the exchange rate, and a faster-than-anticipated tightening of excess productive capacity. Within the basket excluding food and regulated items, external inflationary pressures have meaningfully impacted on goods prices (6.4%), which have been accelerating since the last quarter of 2021. Annual growth in services prices (3.8%) above the target rate is due primarily to food away from home (14.1%), which was affected by significant increases in food and utilities prices and by a rise in the legal monthly minimum wage. Housing rentals and other services prices also increased, though at rates below 3%.

Forecast and expected inflation have increased and remain above the target rate, partly due to external pressures (prices and costs) that have been more persistent than projected in the January report (Graphs 1.1 and 1.2). Russia's invasion of Ukraine accentuated inflationary pressures, particularly on international prices for certain agricultural goods and inputs, energy, and oil. The current inflation projection assumes international food prices will increase through the middle of this year, then remain high and relatively stable for the remainder of 2022. Recovery in the perishable food supply is forecast to be less dynamic than previously anticipated due to high agricultural input prices. Oil prices should begin to recede starting in the second half of the year, but from higher levels than those presented in the previous report. Given the above, higher forecast inflation could accentuate indexation effects and increase inflation expectations. The reversion of a rebate on value-added tax (VAT) applied to cleaning and hygiene products, alongside the end of Colombia's COVID-19 health emergency, could increase the prices of those goods. The elimination of excess productive capacity on the forecast horizon, with an output gap close to zero and somewhat higher than projected in January, is another factor to consider. As a consequence, annual inflation is expected to remain at high levels through June. Inflation should then decline, though at a slower pace than projected in the previous report. The adjustment process of the monetary policy rate wouldcontribute to pushing inflation and its expectations toward the target on the forecast horizon. Year-end inflation for 2022 is expected to be around 7.1%, declining to 4.8% in 2023.

Economic activity again outperformed expectations. The technical staff's growth forecast for 2022 has been revised upward from 4.3% to 5% (Graph 1.3). Output increased more than expected in annual terms in the fourth quarter of 2021 (10.7%), driven by domestic demand that came primarily because of private consumption above pre-pandemic levels. Investment also registered a significant recovery without returning to 2019 levels and with mixed performance by component. The trade deficit increased, with significant growth in imports similar to that for exports. The economic tracking indicator (ISE) for January and February suggested that firstquarter output would be higher than previously expected and that the positive demand shock observed at the end of 2021 could be fading slower than anticipated. Imports in consumer goods, retail sales figures, real restaurant and hotel income, and credit card purchases suggest that household spending continues to be dynamic, with levels similar to those registered at the end of 2021. Project launch and housing starts figures and capital goods import data suggest that investment also continues to recover but would remain below pre-pandemic levels. Consumption growth is expected to decelerate over the year from high levels reached over the last two quarters. This would come amid tighter domestic and external financial conditions, the exhaustion of suppressed demand, and a deterioration of available household income due to increased inflation. Investment is expected to continue to recover, while the trade deficit should tighten alongside high oil and other export commodity prices. Given all of the above, first-quarter economic growth is now expected to be 7.2% (previously 5.2%) and 5.0% for 2022 as a whole (previously 4.3%). Output growth would continue to moderate in 2023 (2.9%, previously 3.1%), converging similar to long-term rates. The technical staff's revised projections suggest that the output gap would remain at levels close to zero on the forecast horizon but be tighter than forecast in January (Graph 1.4). These estimates continue to be affected by significant uncertainty associated with geopolitical tensions, external financial conditions, Colombia’s electoral cycle, and the COVID-19 pandemic.

External demand is now projected to grow at a slower pace than previously expected amid increased global inflationary pressures, high oil prices, and tighter international financial conditions than forecast in January. The Russian invasion of Ukraine and its inflationary effects on prices for oil and certain agricultural goods and inputs accentuated existing global inflationary pressures originating in supply restrictions and increased international costs. A decline in the supply of Russian oil, low inventory levels, and continued production limits on behalf of the Organization of Petroleum Exporting Countries and its allies (OPEC+) can explain increased projected oil prices for 2022 (USD 100.8/barrel, previously USD 75.3) and 2023 (USD 86.8/barrel, previously USD 71.2). The forecast trajectory for the U.S. Federal Reserve (Fed) interest rate has increased for this and next year to reflect higher real and expected inflation and positive performance in the labormarket and economic activity. The normalization of monetary policy in various developed and emerging market economies, more persistent supply and cost shocks, and outbreaks of COVID-19 in some Asian countries contributed to a reduction in the average growth outlook for Colombia’s trade partners for 2022 (2.8%, previously 3.3%) and 2023 (2.4%, previously 2.6%). In this context, the projected path for Colombia’s risk premium increased, partly due to increased geopolitical global tensions, less expansionary monetary policy in the United States, an increase in perceived risk for emerging markets, and domestic factors such as accumulated macroeconomic imbalances and political uncertainty. Given all the above, external financial conditions are tighter than projected in January report. External forecasts and their impact on Colombia’s macroeconomic scenario continue to be affected by considerable uncertainty, given the unpredictability of both the conflict between Russia and Ukraine and the pandemic.

The current macroeconomic scenario, characterized by high real inflation levels, forecast and expected inflation above 3%, and an output gap close to zero, suggests an increased risk of inflation expectations becoming unanchored. This scenario offers very limited space for expansionary monetary policy. Domestic demand has been more dynamic than projected in the January report and excess productive capacity would have tightened more quickly than anticipated. Headline and core inflation rose above expectations, reflecting more persistent and important external shocks on supply and costs. The Russian invasion of Ukraine accentuated supply restrictions and pressures on international costs. This partly explains the increase in the inflation forecast trajectory to levels above the target in the next two years. Inflation expectations increased again and are above 3%. All of this increased the risk of inflation expectations becoming unanchored and could generate indexation effects that move inflation still further from the target rate. This macroeconomic context also implies reduced space for expansionary monetary policy.

1.2 Monetary policy decision

Banco de la República’s board of directors (BDBR) continues to adjust its monetary policy. In its meetings both in March and April of 2022, it decided by majority to increase the monetary policy rate by 100 basis points, bringing it to 6.0% (Graph 1.5).

Boxes

Box 1: Recent Housing Market Performance

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Box 2: Methodological Updates and Primary Changes to the Comprehensive Household Survey (GEIH)

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Box 3: Inflation Diffusion in Colombia

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