Minutes for Banco de la República's Board of Directors meeting on December 16, 2022

Attachments

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

Four Board Members voted in favor of this decision. One Bord Member voted for an increase of 125 bp, and another voted for an increase of 25 bp.
In their policy discussion, the Board of Directors considered the following elements:

- In November, the annual headline inflation was 12.5%, and core inflation (excluding food and regulated products) was 8.8%. In both cases, this exceeded the technical staff's forecasts (11.8% and 8.6%, respectively). Food supply shocks, accumulated exchange rate pressure on prices, and indexation to high inflation rates accounted for most of the surge in inflation. Currently, nearly 97% of the items in the consumer basket show annual changes that exceed the 3.0% target.
- Annual GDP growth in the third quarter reached 7.1% and exceeded the technical staff's forecast (6.4%). The higher-than-expected growth was partly attributable to better domestic demand spurred by investment in housing and machinery and equipment. Private consumption registered a drop in quarterly terms and a lower-than-expected annual growth. Growth of 8.0% is forecast for 2022 despite the signs of a slowdown in the economy that are already becoming apparent. These are likely to be accentuated in 2023 and lead to a 0.5% growth.
- Inflation expectations remained above target at all horizons. The monthly survey of analyst expectations done by Banco de la República in December showed headline and non-food inflation expectations of 7.5% and 7.0% for 2023, and 4.5% and 3.9% for 2024, respectively. Inflation expectations for 2 and 5 years calculated on the basis of public debt instruments (adjusted for liquidity premia and inflationary risk) stand at 6.8% and 5.3%.
- The current account deficit reached a historically high level of 7.2% of the GDP in the third quarter of 2022. International financial conditions for Colombia have improved after a worrisome deterioration during the third week of October. This has been made evident in the recent falls in TES rates and risk premia as well as in the decline and lower volatility of the exchange rate. Globally, financial conditions remain tight, in a context in which the world economy is expected to slow down and interest rates are expected to rise across the board.

In view of the conditions described above, all the members of the Board agreed on the need to continue tightening monetary policy. However, they differed as to the amount of the required interest rate increase. Four Board Members voted in favor of a 100 bp increase, one supported a 125 bp increase, and another preferred a 25 bp increase.

The majority group emphasized that the rising trend in headline and core inflation that continued through November and contrasted with the falls in inflation that are beginning to be seen in other economies called for a significant increase in the interest rate to achieve a process of convergence of inflation towards the target within a reasonable period of time. They pointed out that excess demand continues to be evident, and that the strength of the loan portfolio remains high since it reached an annual growth rate of close to 17.0% at the beginning of December. They added that, despite the correction of the exchange rate in recent weeks, the depreciation of the peso, which over the last year has been 20%, will continue to exert upward pressure on prices. They pointed out that the persistence of high and still rising inflation as well as inflation expectations that are above the target continue to stimulate price indexation processes that hinder the convergence of inflation to the target. Finally, they expressed their concern about the country's high foreign deficit in an international environment in which financing conditions abroad continue to be tight. With respect to this, they thought that the government's fiscal efforts were necessary and noted that they are key to the reduction of the foreign current account deficit.

The Board Member who voted for a 125 bp interest rate hike insisted that economic activity remains at robust levels, inflation remains elevated across all baskets, and inflation expectations remain high. This suggests that the inflation target is not likely to be achieved over the policy horizon. S/he noted that the foreign imbalance has reached worrying levels and that, despite its expected decline in the coming year, its financing continues to be a challenge. Finally, s/he pointed out that the 16% increase in the minimum wage for 2023 impacts inflation through not only higher production costs and the reinforcement of demand, but also the higher nominal benchmark that such an increase establishes for the adjustment of other prices in the economy.

The Board Member who voted in favor of a 25 bp increase in the policy rate emphasized that between October and November there had been a significant slowdown in aggregate demand. This s/he deduced from leading indicators such as the consumer confidence index (CCI) which has been showing consecutive declines and had reached levels in November similar to those observed in mid-2021. Likewise, there have been decreases in the business confidence index (BCI) which, after having achieved a significant recovery towards the end of 2021, reverted to levels in November similar to those seen in March 2021, when the country was experiencing new waves of Covid. Other indicators such as the trend in imports, passenger transportation, new vehicle registrations, energy demand, fuel deliveries, and creation of employment, etc., confirm this deceleration. All of this could evidence that the growth of demand in the economy has already slowed down and may even be in contraction. From this point of view, this Board Member argued that the purpose of monetary policy to control excess demand has already been achieved, so further interest rate hikes are counterproductive. S/he also pointed out that the tripartite minimum wage increase reflects the increase in inflation for low-income households plus the increase in productivity, and these together add up to 15.6%. Moreover, s/he added that although international financial conditions are still tight, there has been a recent improvement for Colombia as shown by the decline in and stability of the exchange rate during the last few weeks, the reduction of risk margins for public debt in international private markets, and the decrease in TES interest rates. Finally, s/he noted that the current account imbalance reflects, to a large extent, the increase in imports which are already beginning to decline due to the weakening of domestic demand.

The Board reiterated that with the decision adopted by the majority, the process of adjusting the monetary policy continues in order to drive inflation towards its 3.0% target in the medium term, in the context of sustainable economic growth. They emphasized that to this end, they will continue to make the decisions they deem necessary based on new information available.

Publication Date:
Thursday, December 22, 2022 - 12:00

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