BanRep Minutes: The Board of Directors of *Banco de la República*, by a majority vote, opted to reduce the benchmark rate by 50 basis points to 10.75%

Attachments

[Determinantes de las Dinámicas de los Mercados de Capitales (only in Spanish)]

[Anexo estadístico (only in Spanish)]

- Annual inflation rose slightly from 7.16% to 7.18% between May and June. Core inflation excluding food and regulated items decreased from 6.1% to 6.0%, aligning with the technical staff's forecasts. Annual food inflation continued to increase, from 4.4% to 5.3%, driven by climatic factors affecting the prices of some perishable foods. This increase was offset by a reduction in regulated items inflation, which dropped from 13.7% to 13.3%, as well as a decrease in the annual inflation of non-food and non-regulated goods, which fell from 1.7% to 1.4%, supported by positive global supply and the Colombian peso's appreciation against the US dollar.
- Twelve-month inflation expectations from the Bank's survey of economic analysts in July decreased from 4.3% to 4.2% compared to the June survey, while 24-month inflation expectations remained steady at 3.4% in the sample median. Expectations derived from public debt markets fell across all horizons, with some projections beginning to enter the Bank's mid-2025 target of 3+/-1% announced last November.
- Economic activity indicators suggest that GDP would remain on a recovery path during the second quarter, with varying performances among sectors. The primary sector and certain public sector and entertainment services performed well, while secondary activities, including industry and construction, showed negative annual growth but exhibited initial signs of improvement on a monthly basis. The technical staff forecasts continued recovery in economic activity, projecting GDP growth of 1.8% in 2024, up from the 1.4% forecast in April.
- The downward trend in inflation in the United States and other developed economies, coupled with the marginal deterioration of the U.S. labor market suggests potential easing of external financing conditions. This expectation is based on anticipated more accommodative monetary policies from central banks in these countries.

As in previous sessions, the Board of Directors unanimously agreed on the necessity of continuing to reduce the benchmark rate to stimulate economic activity. This consensus reflects the recognition of favorable conditions that support a shift towards a less contractionary monetary policy stance. This is confirmed by the declining trends in both headline and core inflation, as well as their expectations, the moderate pace of economic growth, the significant reduction in the current account deficit, and the prospect of easing global financial conditions. Simultaneously, the Board members emphasize the importance of maintaining prudence in the process of cutting interest rates, given the remaining risks to inflation. These risks include the evolution of food prices, the unsustainable fiscal costs of postponing increases in prices and tariffs of regulated goods and services, the downward rigidity of inflation in some services, and potential exchange rate pressures due to volatile external conditions. In this context, there were differing opinions on the appropriate size of the rate cut. Based on the available information, five Directors voted to reduce the policy rate by 50 basis points, while two Directors voted for a 75 basis point cut.

The majority group reiterated several factors supporting the shift towards a less contractionary monetary policy stance but cautioned that a policy interest rate reduction exceeding 50 basis points might not be sustainable over time and could jeopardize the continuity of the process. They highlighted the persistent risks to inflation behavior, which diminish the likelihood of reaching the target within the proposed time frame. Notably, they observed that service inflation remains high, close to 8.0%, driven by the rigidity of key items such as rents and food away from home. They emphasized that the absence of exchange rate pressures cannot be assumed in an environment of significant external uncertainty and oil price volatility. Additionally, they noted that the country's risk premiums are relatively high amid challenging fiscal conditions, which create uncertainty for economic activity and investment, as reflected in recent documents from the Medium Term Fiscal Framework and the General Budget of the Nation. Under these conditions, they underscored that a 50 basis point cut in the policy interest rate is substantial, leading to a reduction in the real interest rate. This places it below the real intervention interest rate levels of countries like Brazil and Mexico, which have lower inflation rates than Colombia.

The directors who voted for a 75 basis-point reduction in the benchmark rate acknowledge that inflation behavior is not without risks, as highlighted by the technical staff's analysis and that of other Board members. However, they emphasize that the downward trend in inflation indicators and the decrease in inflation expectations across various horizons reflect the success of the contractionary policy and the likelihood of reaching the target next year. They particularly note that the reduction in some expectations derived from the debt market suggests that inflation could return to levels close to the 3% ± 1% target by mid-2025, within a context of more favorable international financial conditions, which bodes well for continuing efforts to bring inflation to its target. These directors also highlight the higher labor informality reported by DANE, indicating a deterioration in the quality of employment. They caution that the sectors with the most significant weight in the labor market structure are not the ones driving the highest employment and that employment levels are sustained by certain service branches associated with less stable jobs. In this context, these directors stress the need to persist in strengthening the economic recovery. Despite the technical staff's increased growth estimate for 2024 to 1.8%, Colombia still lags behind the regional average growth rate (2.0%) and peer countries such as Brazil (2.5%) and Chile (2.3%). Finally, they argue that the adjustment of Central Government spending and the commitment to comply with the fiscal rule in 2024 and 2025 create a better macroeconomic environment, opening a window of opportunity for a further policy interest rate cut.

The Board members emphasized that the decision gives a new boost to economic growth recovery while maintaining the necessary prudence in light of persistent risks to the inflation outlook. The Board of

Directors reiterates that future decisions will be determined based on new information available.

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