BanRep Minutes: The Board of Directors of <em lang="es">Banco de la República decided by majority vote to maintain the monetary policy interest rate unchanged at 9.5%

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- In December, annual inflation remained at 5.2%, unchanged from the levels seen in November. Monthly inflation (0.46%) driven by food price inflation, which climbed from 2.3% to 3.3%, exceeded the expectations of both the market (0.40%) and the technical staff (0.34%). Core inflation, excluding food and regulated items, fell from 5.4% to 5.2%, primarily driven by lower inflation in services prices, whose inflation remains at 7%. Regulated items inflation stood at 7.3%, while annual goods inflation remained unaltered at 0.6%.
- By yearend 2024, the cumulative annual inflation rate fell as of March 2023 by 8.1 percentage points and is expected to continue to converge to its 3% target. Nevertheless, the process faces challenges associated with (i) a more significant annual increase in the producer price index (PPI), which climbed from 1.6% to 5.8% between October and December as a result of upward pressures originating from both local and imported sources; (ii) an increase in the minimum wage that exceeded the observed inflation by nearly six percentage points (pp) and the inflation target by 8 pp when the transport subsidy is included therein; (iii) a recent rebound for all measures of inflation expectations, which survey respondents place close to 4.0% by yearend 2025. Underscoring this scenario are fiscal uncertainties and exchange rate volatility.
- The labor market continues on positive ground, with coincident increases in the employment rate and decreases in the unemployment rate, which stood at 9.7% for the national aggregate in December. The technical staff estimates annual GDP growth of 2.3% for the fourth quarter of 2024, surpassing the increase seen in the three previous quarters. Economic growth for 2024 is estimated at 1.8% and for 2025 at 2.6%.
- External financial conditions are likely to become more restrictive in the face of the new US Government trade, energy, and migration policies, which could exert inflationary pressure. Long-term interest rates in global markets continued to increase steadily, and the expected pace of the Fed’s rate cuts has ameliorated while the US dollar has strengthened.

All members of the Board of Directors underscore the advances attained in 2024 to control inflation and encourage its convergence towards the target, fostered by a monetary policy that, albeit restrictive, allowed for the strengthening of domestic demand and the recovery of economic growth. The directors concurred that these advances helped ameliorate the social welfare sacrifice associated with the required adjustment process. However, the Board members pointed out that new internal and external elements have arisen, such as those mentioned above, which hinder the continued progress of inflation toward the target within an economic growth environment. Therefore, to avoid jeopardizing the achievements thus far it is necessary to monitor and assess recent inflationary pressures and remain cautious in monetary policy decisions. After their considerations, five directors voted to maintain the policy rate unchanged, one director voted for a 25 basis point reduction, and one director voted for a 50 basis point decrease.

The directors who voted to keep the interest rate unchanged considered it prudent to grant a respite in the policy rate cut process, providing a window to assess the effect of the multiple recent shocks on inflation and other macroeconomic variables. They pointed out that the significant increase in the minimum wage for 2025 could highlight the inflation inertia experienced by the services group, a primary influencer of the disinflationary process. In past years, persistent inflation in this aggregate has been more significant than in other baskets, mainly as a result of the indexation of many of its elements to minimum wage increases. Furthermore, the recent higher producer price inflation poses the risk of heightening inflation within the CPI goods components, which have thus far played a significant role in helping to reduce inflation. They noted that the increase in inflation expectations poses important challenges, not only because of the manifold determinants that come into play in this factor - which may include the pesos' devaluation, fiscal uncertainty, and the credibility of monetary policy - but also because higher inflation expectations reinforce the price indexation processes. These directors also observed that the rebound in inflation expectations has reduced the real exogenous interest rate and underlined that the growing fiscal deterioration limits the room for maneuvering through monetary policy to reduce the interest rate. Finally, they stressed the vulnerability of inflation to a potential exchange rate devaluation that could arise from the complex and unpredictable external environment and fiscal uncertainty.

Some of the directors of this majority group highlighted that financing the fiscal deficit has competed for the resources needed by the private sector to finance its activities. Of the total resources that reached the banking sector, which includes liabilities subject to reserve requirements and *Banco de la República*'s repos, almost half were absorbed by Government financing through its issuance of TES bonds in 2024. Additionally, the figure invested in TESs by credit institutions almost doubles the provision of loans to the private sector provided by said institutions. Along the same lines, another director pointed out that the contractionary stance of the monetary policy, with evident consequences on the cost of credit for the private sector, is the result of having significant fiscal imbalances that inevitably place the burden of achieving macroeconomic stability on the monetary policy.

The director who voted for a 25 basis point reduction emphasized the progress achieved in the disinflation process since March 2023. Regarding economic activity, they highlighted that the improved growth forecast for 2025 was driven by investment recovery, which improved during the later months of 2024. They considered that continuing to lower the benchmark rate, even at a more gradual pace, serves as a signal that could help reinforce investment recovery and facilitate the more significant growth foreseen for 2025 and 2026. Among its advantages, they noted that accelerated growth would provide greater tax revenues that, together with spending cuts, would help reduce the fiscal deficit and ensure debt sustainability. In this context, they underscored the advantageousness of a 25 bp cut, which would continue the contractionary stance of monetary policy without jeopardizing the convergence of inflation to the target by the end of 2025.

Finally, the director who voted for a 50 basis point decrease stressed that despite recent increases in several measures of inflation expectations, there is awareness among economic agents that inflation will continue its downward trend. They pointed out that the fears expressed surrounding the effects of the minimum wage increase on inflation and unemployment are open to discussion, given the particular characteristics of the labor market. Such a phenomenon has been observed in recent years, including during 2024, whereby inflation has continued to decline despite increases in the minimum wage, and employment has enjoyed a positive performance. On the fiscal front, they highlight the Government's commitment to macroeconomic stability and meeting debt payments, which should contribute to dispelling uncertainty in this area and to maintaining a responsible monetary policy of lowering the benchmark rate as inflation continues to move towards the target. In this regard, they emphasized that the interest rate is a fundamental macroeconomic cost for future investment decisions and the revival of economic growth.

All directors agreed that the hiatus in interest rate adjustments accorded by majority vote underscores the Board's commitment to the convergence of inflation to the target in the context of recovering economic growth.

They emphasized that new information available in the coming months will provide greater detail on the magnitude and speed at which monetary policy can be relaxed.

Fuente: https://www.banrep.gov.co/en/news/board-directors/minutes-january-2025