BanRep Minutes: The Board of Directors of *Banco de la República* decided by majority vote to maintain the benchmark rate unchanged at 9.25%

Attachments

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

In its policy discussion, the Board of Directors considered the following factors:

- After recording 5.5% y-o-y change in October, headline inflation fell slightly to 5.3% in November. This drop was driven by a decline in food inflation, which dropped from 6.6% to 5.7%, mainly due to lower inflation in perishable goods. Similarly, services inflation eased, falling from 5.9% to 5.7%. This was partly offset by an increase in regulated items inflation, especially public utilities. Nonetheless, headline inflation remained above the level seen at yearend 2024. Core inflation, which excludes food and regulated items, stood at 4.9%, reversing some of October's increase.
- Most measures of inflation expectations derived from the public debt market, the derivatives market, and surveys increased and continue above the 3% target for one- and two-year horizons.
- GDP grew at an annual rate of 3.4% in the third quarter in its seasonally adjusted series, exceeding the technical staff's forecast (3.0%). Domestic demand drove annual GDP growth, led by the expansion of total consumption (5.6%). In contrast, net external demand was a negative contributor to annual GDP growth, as imports rose faster than exports over the year. Available indicators for the fourth quarter suggest that the Colombian economy would have continued to show significant momentum. Based on the above, the technical staff revised its growth forecast for 2025 upward from 2.6% to 2.9%.
- The current account deficit in the balance of payments during the third quarter of the year was 2.4% of GDP, higher than in the same quarter of 2024 (-1.5%). The expansion of this imbalance was primarily due to the trade deficit in goods, in an environment of high growth in domestic demand and lower sales of crude oil and coal, partially offset by an increase in non-mining exports. This was compounded by the increase in net factor income expenditures, partially offset by the surplus in the services balance and the growth in current transfers, particularly remittances from workers abroad.
- External financial conditions continue to ease following a third consecutive reduction of the US benchmark rate, which recently placed within a range of 3.5% to 3.75%, the lowest level seen in the last three years. In addition, trade uncertainty has been significantly reduced thanks to trade

agreements reached between the United States and some of its main trading partners, including China. However, geopolitical tensions remain high.

All members of the Board concurred in highlighting the positive GDP performance during the third quarter, which led to a general upward revision of economic growth forecasts for this year. They emphasize that this strong momentum has stimulated job creation. However, they warn of deepening underlying imbalances that could compromise the sustainability of this growth. In this regard, they note that the strengthening of domestic demand at a rate well above that of GDP is contributing to a widening of the trade deficit in the balance of payments. They also point out that growth in gross capital formation, while positive, is insufficient to reach its pre-pandemic trend, which could weaken the economy's potential output in the medium term. They agree that a determined effort at fiscal strengthening would contribute significantly to correcting these imbalances and thus to the sustainability of economic growth. In this context, four directors voted to keep the policy interest rate unchanged, two directors voted for a 50-basis-point reduction, and one director voted for a 25-basis-point cut.

The majority cohort underscores that, based on currently available information, a policy interest rate path above its current level is needed in order for inflation to converge to the target by 2027. They support this position through various arguments. Firstly, they note that the process of falling inflation observed during 2024 was interrupted in 2025, to the point that consumer price inflation is now higher than it was a year ago. They also warn that one-year inflation expectations have risen significantly, moving substantially away from the 3.0% target. They emphasize that both the increase in inflation and its expectations have led to a reduction in the real policy interest rate relative to that observed months ago, thus making monetary policy less contractionary. Additionally, they note that, as a result of expansionary fiscal policy, growth in domestic demand has been driven by public and private consumption, particularly in the third quarter, leading to demand exceeding the economy's productive capacity, in turn creating a positive output gap reflected in a widening current account deficit and more persistent inflation. They express concern that this situation, combined with a less contractionary monetary policy, will deepen macroeconomic imbalances and prevent inflation from converging to the target within the desired time frame. They remarked that, although external financial conditions eased after the third consecutive reduction in the US benchmark rate, this relief has been largely offset by increases in Colombia's country risk spreads, which are currently considerably higher than those of all comparable countries in the region. Some members of this group add that the easing of external financial conditions has also been partially offset by recent Bank of Japan rate increases, which have brought its benchmark rate to its highest level in decades. All directors within this cohort insist that the increase in the cost of Colombia's external debt tends to be exacerbated by the growing imbalance in public finances, which is reflected in an increase in the primary deficit and greater financing requirements. On the other hand, they highlight the inflationary risks that a marked increase in the minimum wage would bring about, in turn having a significant fiscal impact. Given these circumstances, they urge the need to strengthen the countercyclical role of monetary policy, especially in the absence of a clear fiscal anchor, in a context of broad spending rigidities and difficulties for improving revenues. Two of these directors voted to raise the policy interest rate at this Board meeting, given that, under the conditions described, no dilemma exists as far as monetary policy is concerned. However, given a tied vote, they reconciled their position with the majority decision. They emphasize that accelerating upward adjustments in the interest rate tends to yield greater payoffs in terms of higher growth, while postponing these may require maintaining high rates for a more extended period.

The members of the Board who voted for a 50 basis-point reduction in the policy rate consider it necessary and appropriate to implement a benchmark rate cut, given the strengthening, favorable macroeconomic indicators across various areas. In this regard, they note that third-quarter economic performance was outstanding, allowing them to anticipate growth of between 2.8% and 2.9% in 2025. Inflation in November fell from October, and the trend suggests it could close the year between 5.1% and 5.2%. The unemployment rate has fallen to historic lows, and overall, the economic outlook is perceived as favorable. In this context, these directors argue that a cut in the policy rate would help consolidate these promising results by providing the economy with greater access to productive credit at reasonable rates. This is especially true considering that the current interest rate is contractionary and discourages investment. On the other hand, one of these directors questions the use of the benchmark rate as the sole instrument for controlling inflation. This is because inflation can have multiple causes, such as supply shocks, indexation mechanisms, high price margins, high prices for regulated goods and services, etc. The director remarked that, in these circumstances, the first step needed is to clearly identify the source of inflation in order to use the most appropriate instrument for each situation. Trying to solve everything by resorting to interest rate hikes is not only ineffective but also counterproductive for the economy.

Finally, the Board member who voted for a 25 bp policy rate reduction supports a review of heterodox economic inflation theories and empirical exercises employing various tools. The starting point is an analysis of the role of productive rigidities, sectoral structure, distributive conflicts, and market power in price formation. This shows that the economy is changing and investment is beginning to respond to demand. Therefore, the recovery cycle from the crisis is not yet over, and differs in that we are at a point where there is efficient use of the country's potential resources. The director explains that analyzing inflation using different tools allows us to understand that controlling it requires comprehensive policies—productive, distributive, and regulatory—in tandem with monetary policy tools. They conclude that the persistence of inflation has causes not moderated by interest rate increases and, quite the reverse, considers there remains room to continue reactivating the economy in non-traditional sectors and improving employment through moderate interest rate reductions.

The Board of Directors reiterates that the majority decision incorporates the identified risks regarding the convergence of inflation to the target. It emphasizes that future interest rate movements will reflect variations in inflation and its expectations, the behavior of economic activity, and the internal and external risk balance.

Publication Date:
Friday, December 26, 2025 - 12:00

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