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Minutes for Banco de la República's Board of Directors Meeting on July 30, 2021

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After a thorough evaluation of economic activity, inflation and international financial conditions, Banco de la República's board of directors (BDBR) on July 30 voted by majority to hold the benchmark interest rate at 1.75%.

The monetary policy discussion centered on the following considerations:

Leading indicators suggest a return to the prevailing growth trajectory after a recent slowdown in economic activity caused by roadblocks and other disruptions to public order. These indicators include figures from June and July suggesting significant recoveries in ground freight transportation, unregulated energy demand and the consumer confidence index. As a result, the technical staff has revised its growth projection for 2021 upward from 6.5% to 7.5%.

Inflation increased from below 2.0% in the first quarter to 3.30% in May and 3.63% in June. This acceleration was due primarily to shocks in supply, including increases in perishable food prices caused by roadblock-related supply difficulties in some cities, higher inflation on regulated items due to the partial lapse of price relief measures on utility rates, and an increase in fuel prices. External factors, including increased international prices for basic goods and raw materials and higher logistics and maritime transportation costs, accentuated these pressures. Nevertheless, inflation excluding food and regulated items continued at low levels (1.87% in June).

The global economy has continued to recover thanks to progress in vaccination programs and fiscal and monetary stimulus that has driven growth in advanced economies and some emerging markets. However, new variants of the coronavirus continue to pose a significant risk to the world economy. Meanwhile, inflationary pressures in the United States and other advanced economies suggest the risk of a return to less favorable international financing conditions.

The technical staff projects an increase in the current account deficit from 3.4% of GDP in 2020 to 4.5% of GDP in 2021. This would be consistent with the expected recovery in domestic demand, which would be driven by household consumption and investment and by increases in spending and the public deficit. This imbalance should begin to correct in 2022 thanks to a fiscal reform package recently presented by the national government for consideration in Congress, the rapid implementation of which will be critical.

Given recent inflation behavior and its possible persistence, as well as the previously noted upward revision to the growth forecast, the board members concurred that the space available to maintain current levels of monetary stimulus is closing. In response, the policy discussion centered on whether to delay or to proceed immediately with a decision to partially withdraw monetary stimulus that the economy has been receiving since the start of the pandemic.

Five board members advocated in favor of holding the policy interest rate. They outlined their support for the eventual normalization of monetary policy but suggested that continued uncertainty on a variety of economic fronts created a need for more information prior to modifying the current monetary policy stance.

Among the arguments supporting their position, this group of board members highlighted that the output gap remains in negative territory and that gross domestic product has not yet returned to 2019 levels. This has been reflected in an unusually high unemployment rate, and a remaining need to recover a significant number of jobs lost as a result of the pandemic. This group expressed its concern that the events of May could have caused more significant damage to the means of production than has so far been measured, and that as a result it would be prudent to wait for second-quarter GDP figures prior to making any decision to raise rates. The group also noted that a portion of inflationary pressures have originated in supply shocks, which should correct with the return to pre-pandemic production and mobility conditions. They highlighted that core inflation continues to be low and that expected inflation at two years remains anchored to the target. They also noted that the appearance of new, more contagious variants of COVID-19 could produce significant risks to recovery in international demand, and that, should these strains of the virus take hold in Colombia, they could weaken the recovery in domestic demand and economic growth. These board members also expect loose financial conditions to persist for some time, in line with recent Fed and ECB announcements.

One of these board members further underlined that a significant cause of the observed increase in inflation has been in higher costs due to readjustments in production chains and domestic and international transportation, and that an increase in the interest rate would not be very effective in addressing these issues. This member also suggested that the private sector has over-adjusted to the fiscal imbalance and that an increase in rates would affect activity levels more so than prices. Additionally, the member noted that it would be desirable to improve the monetary policy transmission mechanism, creating conditions for more significant growth in private sector credit.

Two board members argued that recent inflation behavior and its possible persistence, as well as the upward revision to the growth forecast, suggest that monetary stimulus should not be postponed. They advocated for a 25-basis point increase to the benchmark interest rate.

In support of this proposal, the board members highlighted that the output gap, though still negative, has been tightening and that this process would accelerate in consonance with the technical staff's upward revision to the growth forecast. These board members highlighted that expected inflation for this year and next have been increasing and that, while supply factors have been significant in explaining price increases, demand and external factors should not be ignored. They also expressed their concern over the increase in the current account deficit projected by the technical staff and noted the upward inclination of the technical staff's inflation and growth projections, positing that a possible de-anchoring of inflation expectations or effects on the exchange rate could introduce additional pressures on prices. Finally, they suggested that any delay in a necessary adjustment to the interest rate could lead to the need for a more forceful monetary policy reaction in the future, sacrificing the benefits of a gradual adjustment.

Fuente: https://d1b4gd4m8561gs.cloudfront.net/en/minutes-banco-republicas-board-directors-meeting-july-30-2021