Intervention by the Governor of Banco de la República at the Economic Outlook Forum organized by Valora Analitik and El Colombiano

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Governor Leonardo Villar explained the risks facing the Colombian economy and noted that the Board of Directors must continue to be cautious until inflation reaches its target.

Publication Date: Thursday, 20 of November 2025 Bogotá, *Club El Nogal*, noviembre 12, 2025Turbulent times

- By March 2023, (i.e., two and a half years ago), inflation had risen above 13.4%, and interest rates had to be significantly adjusted upwards to levels similar to those of inflation.
- In Colombia, as in many countries around the world, we were experiencing particularly turbulent times.
- Following the global recession associated with the 2020 pandemic, we experienced an extraordinarily rapid recovery that generated clear excess demand and inflationary pressures, which exacerbated in 2022 due to the increase in grain prices and agricultural inputs in the context of the Russian invasion of Ukraine.
- These circumstances led global interest rates to move from historically low levels in 2020, with negative policy rates in several major advanced countries, reaching by 2023 the highest levels observed in the last forty years.
- Colombia increased its policy rate from 1.75% to 13.25% over a period of a year, between September 2021 and March 2023.

Performance of inflation in Colombia: Two phases in the reduction process. Before and after November 2024
Observed inflation fell 820 basis points (bps) between March 2023 and November 2024, when it stood at 5.2%. From that point on, the reduction process was interrupted, and the inflation rate began to fluctuate around that level. The figure released last Monday for the October 2025 inflation (5.51%) shows a 31-bps increase compared to the level observed in November 2024 and 70 bps compared to the figure observed in June.

Core inflation (excluding food and regulated items) continued to decline until May 2025, when it reached 4.77%, but from that point on it began a slight upward trend that accelerated in October, when it stood at 4.99%.

Inflation expectations for the end of 2025 have risen from levels that were around 3.7% in November 2024 to levels that, according to surveys conducted before the poor October results were known, stood between 5.0% and 5.2%.

Expectations for the end of 2026 have also increased significantly. In November 2024, they were around 3.4%, with a relatively small deviation from the target, and they are now somewhat above 4.0%.

Factors explaining the change in trend:

- The **adjustment to the minimum wage** implied an 11% increase in the cost of hiring a minimum wage worker, and the expectation that this may be the case for 2026 again makes the process of reducing inflation more costly and difficult.
- Change in the **fiscal situation** and in the perception of public debt. According to the Independent Fiscal Rule Committee (CARF in Spanish), toward the end of 2024 it was estimated that the primary fiscal deficit (excluding interest) would be very close to 0 (0.2% of GDP) in 2025, which was consistent with the fiscal rule. It is now estimated at 2.4% of GDP, with risks of being higher. The total deficit is now estimated at 7.1% of GDP, and interest payments absorb one-third of the government's tax revenues. Naturally, the burden of these interest payments will continue to grow as long as the primary deficit remains negative, meaning that debt will have to increase by amounts greater than those required to cover interest payments.
- Partly as a consequence of the deficit increase, there has been an **acceleration in domestic demand**, with growth rates above 4.0% in each of the last four quarters.

    - In the short term, this has generated a notable recovery of GDP, which is expected to grow around 2.6% this year. This has also supported an increase in the number of employed people as of September, with annual growth of 2.7% in the thirteen main cities and 3.0% nationwide. The unemployment rate in September was 8.1% in the thirteen main cities and 8.2% nationwide, figures that are lower than those observed for many years. This accelerated growth of demand, however, generates inflationary pressures to the extent that production cannot respond at the same pace.
    - The accelerated growth of domestic demand compared to national production has also been reflected in a sharp increase in the US dollar value of imports, which in recent months has grown at double-digit rates while exports have remained stagnant, particularly due to the weak performance of oil and mining sectors. This has resulted in a partial reversal of the adjustment observed in the country's external trade balance after the large deficits recorded in 2022. Despite the strong growth in workers' remittances and a reduction in profit and dividend payments on foreign investment, the current account deficit has not deteriorated as sharply but is expected to reach around 2.5% and 3.0% of GDP in 2026, considerably above the 1.7% recorded in 2024.

The exchange rate and its impact on inflation

- It should be noted that the acceleration of inflation and inflation expectations has occurred over the past year despite a **significant appreciation of the peso vis-a-vis the US dollar.**
- A few brief comments on the recent performance of the exchange rate and an appreciation that has surprised many observers.
- Comparing the exchange rate we had this Tuesday (COP 3,923 per dollar) with the rate at the beginning of the year, there is a notable appreciation of the peso (close to 15%).
- Until about three months ago, the appreciation of the Colombian peso vis-a-vis the US dollar could be fully explained by an international phenomenon: the depreciation of the dollar against almost all currencies in the world. In fact, such appreciation of the peso was very similar to that of our regional peers, and even of the euro, relative to the US dollar.
- Over the past three months, the appreciation of the peso has been more pronounced than that of other currencies, which is likely explained to a significant extent by the debt-management operations of the National Treasury (TGN in Spanish) and the monetization of external financing resources to cover the needs generated by the fiscal deficit.
- **The Central Bank's policy has been to refrain from intervening in the foreign exchange market**, and it has maintained this stance for several years, without prejudice to the possibility of doing so under extraordinary conditions. International as well as Colombia's own experience suggest that foreign

exchange interventions are not highly effective in influencing the performance of the exchange rate and generate monetary impacts that may contradict the objectives pursued through interest rate policy.

- Of course, **this does not mean that the performance of the exchange rate is irrelevant to decision-making by the Central Bank's Board of Directors**. Exchange-rate trends provide highly relevant information for monetary policy decisions to the extent that they affect inflation outlooks. This, of course, is part of what the Board evaluates in each session when decisions on the interest rate are made.
- It is worth noting that the **real exchange rate** stands at levels that do not differ significantly from those observed in Colombia before the pandemic (between 2015 and 2019) and is clearly higher than in the period prior to the 2025 decline in oil prices.

Interest Rate Policy

- The change in inflation dynamics since November 2024 has implied a notable slowdown in the pace at which policy interest rates were being adjusted.
- After a 350-bps reduction in the previous year (Dec. 2025–Nov. 2024), over the past twelve months the rate was reduced only twice (in Dec. 2024 and April 2025), for a total of 50 bps.
- The possibility of further lowering the interest rate in recent months has been postponed and appears increasingly distant, while the likelihood of a rate increase, reversing part of the reductions made in the previous period, began to emerge as a risk in the outlook for several Board Members, even before the October inflation data were released.
- Our policy interest rates remain at levels that reflect a **contractionary monetary policy**. Both nominal and real interest rates are higher than those considered by the Central Bank’s technical taff as neutral and desirable in the medium and long term, once inflation has converged to its 3.0% target and the economy grows at a pace close to its potential.
- When **compared with the rest of Latin America**, we have found many countries that, like us, have an inflation-targeting strategy and have been able to advance more in their processes of lowering interest rates because inflation is already within the target ranges set by their respective central banks. Examples include Perú, Uruguay, Paraguay, Chile, Costa Rica, and even Mexico in the most recent period.
- **The case of Brazil**, on the other hand, is striking. Inflation in that country is currently at 5.2%, similar to what we had in Colombia until September, but lower than it was observed in October. The Central Bank of Brazil had been advancing a significant process of policy interest rate reduction, similar to the one observed in Colombia. After maintaining that rate at 13.75% until August 2023, it lowered it to 10.5% by mid-2024. However, in the second half of 2024, a context of major concerns about the Brazilian government's fiscal situation emerged, the real experienced a notable depreciation, and inflation expectations increased, which forced the central bank to raise the rate again rapidly, from 10.5% to its current level, 15%. Both in terms of the nominal interest rate and the ex-post real interest rate, this level is above 9.0%, more than 5 percentage points higher than in Colombia.
- Looking ahead, uncertainty is high, both due to domestic and international factors. Decisions in every session of the Board will depend on a number of variables whose behavior we will need to assess at the time. However, I can say that, under the current inflation-targeting policy framework, decisions must continue to be cautious and aimed at ensuring that inflation converges toward the target. I am personally convinced that this strategy is the most appropriate way to promote sustainable economic growth in the future.

Fuente: https://d1b4gd4m8561gs.cloudfront.net/en/publications-research/intervention-governor-economic-outlook-forum-analitik-elcolombiano