BanRep Minutes: The Board of Directors of Banco de la República decided by majority vote to increase the benchmark rate by 100 basis points (bps) to 10.25%

BanRep Minutes: The Board of Directors of *Banco de la República* decided by majority vote to increase the benchmark rate by 100 basis points (bps) to 10.25%

- Headline inflation in December stood at 5.1%, slightly lower than the 5.2% figure for year-end 2024. Core inflation - which excludes food and regulated items - rose from 4.85% to 5.02% between November and December, and it was also at a level close to that recorded in December 2024 (5.15%). These results occurred despite the contractionary stance that monetary policy maintained over the course of 2025.
- Inflation expectations in January rose sharply compared to December's measurements. Analysts' sample median inflation expectations for the end of 2026 increased from 4.6% to 6.4%, and for the end of 2027 rose from 3.8% to 4.8%. Expectations from debt markets also increased, surpassing 6% over a two-year horizon.
- Fourth quarter economic activity indicators in 2025 suggest GDP would have maintained a strong dynamism, driven by strong domestic demand fueled by private and public consumption. For its part, gross fixed capital formation continues on a moderate recovery path thanks to investment in machinery and equipment, as shown by the preliminary figures for imports of capital goods as of December. Consequently, the technical staff estimates the Colombian economy would have grown by 2.9% in 2025.
- The current account deficit in the balance of payments continues to widen and is estimated to reach 2.4% of GDP in 2025, following the 1.6% recorded in 2024, primarily attributed to significant growth in imports driven by strong domestic demand. In comparison, exports grew only slightly amid shifts in the export matrix, as mining and energy exports declined while manufacturing, agricultural, and services exports increased.
- Uncertainty surrounding external conditions remains high, amid potential risks associated with escalating trade conflicts, U.S. immigration measures, geopolitical tensions, and perceptions of Colombia's sovereign risk. This occurs in an environment of less restrictive external financing conditions, reflecting the reduction in the U.S. policy interest rate and increased demand for risk assets.

The majority of the Board members who voted to increase the policy interest rate by 100 basis points acknowledged that this is a demanding decision for the economy, but considered it necessary to prevent a persistent de-anchoring of inflation from the target, a deterioration of economic activity over the medium and long term, and to preserve macroeconomic stability. The decision was deemed essential to address the serious risk of undermining the Board's credibility regarding its commitment to the inflation target and its ability to fulfill its constitutional mandate. Since its introduction in 2000, the inflation-targeting framework has delivered clear macroeconomic benefits to the country, and the Board considers it its duty to continue safeguarding this framework, particularly given that 2025 marked the fifth consecutive year in which inflation exceeded the target. Among the factors supporting this decision, the directors noted that inflation ceased to decline in 2025, while inflation expectations increased significantly during the second half of the year, in a context of deteriorating public finances and strengthening domestic demand. They added that the Government's decision to set the minimum wage increase for 2026 above 23% further aggravated this situation by triggering a marked rise in

inflation expectations. Moreover, this decision threatens to amplify other macroeconomic imbalances, including the current account deficit and the fiscal deficit, due to its significant impact on public spending, particularly on pensions and other expenditure items. The directors emphasized that the increase in one-year inflation expectations by around 200 basis points between December and January weakened the restrictive stance of monetary policy by reducing the ex ante real interest rate by a similar magnitude. As a result, the monetary policy stance became neutral, in a context in which it should remain contractionary. They warned that this shift is not fully offset by the 100 basis point increase in the nominal policy rate, implying that the Board's decision should be understood as the beginning of a new monetary tightening cycle. Additional elements were highlighted to reinforce the need for this adjustment. Recent economic activity data point to strong momentum, reflected in the decline of the unemployment rate to historically low levels. However, domestic demand is growing faster than domestic production, resulting in negative net external demand, a widening current account deficit, and additional inflationary pressures. According to estimates by the technical team, the most recent data suggest that the output gap has been positive since at least the third quarter of 2024 and widened toward the end of 2025. Finally, these directors stressed that, during phases of monetary policy tightening, front-loading increases in the policy interest rate is advisable, as it facilitates a faster re-anchoring of inflation expectations and helps reduce the short-term costs of the adjustment in terms of economic growth and employment.

The directors who voted for a 50 basis point reduction in the policy interest rate argued that the recent behavior of annual inflation has been largely driven by increases in food and regulated prices, stemming from supply shocks and indexation mechanisms, over which monetary policy has limited influence, given that it cannot affect the supply conditions of specific sectors. They expect these shocks to dissipate over the course of the year, which, together with an appreciation of the exchange rate, would help ease inflationary pressures. They noted that, in light of lower oil prices and the appreciation of the exchange rate, the Government is expected to implement reductions in fuel prices in 2026, which would contribute to a significant downward revision of inflation forecasts for that year. They argued that, under current conditions—characterized by a significant stimulus to aggregate demand resulting from the minimum wage increase, higher non-traditional exports, economic growth, and declining unemployment—increases in the policy interest rate could generate inflationary effects, through higher financial costs and a contraction in production, thereby operating as a supply-side shock on prices. The directors emphasized that compensation of salaried workers has increased its share in GDP, reflecting minimum wage increases above observed inflation. In this regard, they argued that focusing the debate solely on inflationary pressures arising from the minimum wage overlooks this distributive dimension and frames as a macroeconomic problem what is essentially a recomposition of income in favor of labor. They warned that a substantial increase in the policy interest rate would discourage economic growth, with undesirable effects on the emerging development pattern driven by household consumption oriented toward the domestic market, as a substitute for the growth model based on mining and energy exports. They also noted that a sharp increase in the policy rate, in a context of foreign exchange inflows, could intensify the appreciation of the Colombian peso. Finally, one director pointed out that the new semi-structural 4GM-LM model used by the technical team for policy analysis has limitations, as it does not adequately explain the effects of monetary policy observed in the past.

The director who voted to keep the policy interest rate unchanged highlighted several positive developments in the Colombian economy, some of which are unprecedented. These include an improvement in domestic demand at both the national and regional levels, greater dynamism in household spending, improved financing conditions, and a recovery in credit. They noted a shift in the export structure, with reduced dependence on the mining and energy sector, as well as changes in the labor market structure, with certain sectors generating formal and permanent employment. They also pointed to the incipient recovery of the post-crisis cycle of productive investment, occurring in a context of increased confidence in the economy. The director acknowledged that the minimum wage increase above expectations led to a rise in inflation expectations, but argued that this does not necessarily translate into higher inflation if the economy undergoes a reorganization toward more competitive margins. Drawing on a review of the relevant literature, he emphasized two main conclusions: first, that real

wage growth has lagged behind productivity growth for more than three decades; and second, the presence of high profit margins, which in some sectors reach up to 78% above marginal cost, while wages remain around 11% below their marginal product. According to this view, these factors contribute to an economy characterized by low productivity and limited complexity. Finally, the director argued that maintaining the policy interest rate to observe this process of economic reorganization would help avoid potentially irreversible effects associated with an excessive tightening of monetary policy, while providing space for investment to recover.

The majority decision adopted by the Board of Directors to increase the benchmark rate by 100 basis points aims to return inflation to a downward trajectory. Future decisions will consider new information as it becomes available.

Fuente: https://d1b4gd4m8561gs.cloudfront.net/en/news/board-directors/minutes-january-2026