PUBLIC VERSION

Working Papers from the
Board of Directors
Banco de la República

Monetary Policy Report

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OFFICE OF THE DEPUTY TECHNICAL GOVERNOR
MARCH 2019

Monetary Policy Report of April 2019

I. External Context

In the last month, the announcements of the Fed suggest greater downside risks to economic growth in the United States vis-à-vis the forecasts in the previous report. This, together with the absence of inflationary pressures, has significantly reduced the likelihood of increases in the benchmark interest rate this year and the next. Given the above, a lower cost of international financing than the one anticipated earlier is expected. For Colombia, this should bring about a lower path for risk premia, with a slower convergence to its historical average. In this environment, there were no substantial changes in the growth forecasts for the country's trading partners. However, there are still risks of a more pronounced slowdown in the advanced economies as well as in some emerging economies. The price of oil has exceeded the forecasts made a month ago, although this is estimated to be a transitory phenomenon. For the next few months, it is expected to return to its long-term level (USD $62 per barrel, Brent), with which the average for the year is expected to be USD $63.4 per barrel. In this context, it is estimated that the current account deficit would continue to expand in 2019 and would be close to 4.3% of GDP.

1. The events of the past two months in the international context allow to expect lower external financing costs for Colombia and other emerging economies in the coming quarters than had been forecasted in earlier reports. Particularly, the increasing concern for economic growth in the advanced economies, together with the absence of inflationary pressures, has led to the announcement made by central banks regarding a pause in their processes of monetary policy normalization in 2019.
2. In this environment, there has been a greater optimism in stock markets, a declining trend in long-term interest rates despite some recent increases, and a reduction of the financial volatility indicators. At the same time, the risk premia of Latin American economies so far in April, except for Brazil, have been declining for several consecutive months, while the exchange rates, including the Colombian peso, have remained relatively stable.
3. Together with that, so far this year (including the past few weeks), an upward trend in international oil prices has been observed, currently placing the price above the forecasts presented in earlier reports. To a great extent, this increase has resulted from the supply constraints observed and expected for the crude oil market. In this report, however, these increases are still expected to be temporary and that they be reversed in the coming months, when prices would converge to more sustainable levels. Therefore, this document presents a marginal increase in the price expected for the average of 2019, while the forecast for 2020 remained unchanged.
4. On the other hand, weaker results in some economic indicators in the United States and the euro zone, together with greater uncertainty in some countries in the region, have resulted in a slight downward revision of the growth figures for the country’s trading partners for 2019 and 2020.

However, the risk balance of this forecast scenario has exhibited a downward trend, given that there is a noticeable increase in the probability of a more pronounced slowdown both in the advanced and emerging economies.

Baseline or more likely scenario (Table 1)

5. The average growth projection of Colombia's main trading partners was revised downward in this report for 2019 and 2020 to 2.21% and 2.14%, respectively (See Table 1). These growth rates represent a slowdown *vis-à-vis* the data observed for 2018 (2.5%), although they remain higher than the data of 2015 and 2016 (1.85% on average). These forecasts do not consider the effects of the changes in the trading policy of the United States with its trading partners.
6. The growing concern regarding economic growth in the United States, together with the low levels of inflation and the few pressures anticipated on this front, suggest a less restrictive monetary policy by the Fed. Thus, unlike what was contemplated a month ago, on this occasion, no changes are expected in the Fed's interest rate for 2019 and 2020, hence it shall remain within a range between 2.25% and 2.5%. On the other hand, it is assumed that the program of balance sheet reduction would be slower, according to the announcement by the Fed at its meeting in March.
7. As for the European Central Bank, as was announced, no changes are expected in its benchmark interest rates in 2019, and liquidity conditions are expected to remain stable.
8. In the last month, oil prices have stood above USD $70 per barrel (*Brent*), with which the average price for the year to date is USD $65.14 per barrel. This increase, higher than expected, has been associated with the supply cuts applied by the OPEC and its allies, the additional cuts by Saudi Arabia, the US sanctions to crude oil exports from Iran and Venezuela, and the conflict in Libya. However, uncertainty about the duration of these restrictions is high. Additionally, it is likely that today's relatively high prices continue stimulating the supply from other producing countries, especially that of the United States. For this reason, this report continues to consider that the price increases in recent months are temporary, and that they should return to levels close to USD $62 per barrel in the coming months. Thus, the average for this year is expected to be USD $63.4 per barrel (*Brent*) and USD $62 for 2020.
9. In the last month, sovereign risk premia in the region have continued to decline, except for Brazil. For Colombia, these premia (measured through five-year *CDS*) have fallen from 110.5 in March to 103.2 so far in April 2019, on average. However, the factors that suggest an increase in risk premia in the future still persist. Considering the recent behavior of these measures and a less restrictive monetary policy in advanced economies in the coming quarters, this report estimates that the path of convergence of the country's risk premia towards its historical average would be slower.
10. The baseline forecast scenario of the country's trading partners' growth continues to face important downside risks. Some of the factors that could reinforce this future downward cycle are the adoption of protectionist measures in the United States and other countries, greater

weakness in the euro zone, and an eventual traumatic outcome of *Brexit*, among others. There are also medium-term risks on account of the high levels of debt recorded in some advanced and emerging economies.

11. A positive risk factor for the Colombian economy would be that the price of oil be higher than considered in the baseline scenario. This would happen in case the restrictions of the global oil supply are prolonged and/or increase, and that production in the United States does not offset this situation.

Table 1 Growth projections for trading partners and prices of some *commodities.*

Country or Region	2018	2019			2020*		
	Baseline	Low	Baseline	High	Low	Baseline	High
USA	2.9	1.4	2.3	3.0	0.7	1.7	2.7
		1.4	2.4	3.1	0.7	1.7	2.7
Euro Zone	1.8	0.5	1.2	1.9	0.4	1.4	2.3
		0.7	1.5	2.1	0.5	1.5	2.5
China	6.6	5.4	6.2	6.7	5.0	6.0	7.0
		5.4	6.2	6.7	5.0	6.0	7.0
Brazil	1.1	1.0	2.2	3.5	1.0	2.4	3.5
		1.4	2.3	3.5	1.3	2.4	3.4
Ecuador	1.4	(1.0)	0.6	2.0	0.2	1.2	2.0
		(0.7)	0.6	2.3	0.2	1.2	2.0
Venezuela	(14.0)	-12.0	-7.0	(3.0)	-10.0	-5.0	(1.0)
		(12.0)	(7.0)	(3.0)	(10.0)	-5.0	(1.0)
Peru	4.0	2.5	3.8	5.0	2.4	3.7	5.0
		2.5	3.8	5.0	2.4	3.7	5.0
Mexico	2.0	0.5	1.8	3.0	0.5	1.9	3.0
		0.7	1.9	3.0	0.6	2.0	3.2
Chile	4.0	2.3	3.3	4.3	2.1	3.1	4.1
		2.3	3.3	4.3	2.1	3.1	4.1
Total partners (excluding Venezuela)	2.5	1.3	2.21	3.1	1.3	2.1	3.0
Total partners (excluding Venezuela-Mar-19)		1.4	2.3	3.1	1.3	2.2	3.0

Item	2018	2019			2020		
	Observed	Low	Baseline	High	Low	Baseline	High
Oil (Brent)	71.6	53	63.4	73	50	62	72
		52	63	73	50	62	72
Coal	85.8	69	80	90	60	75	88
		70	81	91	62	77	90
Coffee	1.37	1.16	1.31	1.45	1.17	1.37	1.57
		1.20	1.35	1.50	1.20	1.40	1.60
Gold	1,269	1,500	1,300	1,150	1,550	1,350	1,150
		1,500	1,300	1,150	1,550	1,350	1,150

The current forecast is shown in black.

The forecast of the March report is shown in red.

II. Foreign Trade and Balance of Payments

Exports of Goods

12. In February 2019, total exports in US dollars registered a yearly 6.2% growth supported by increases in the group of mining goods (7.4%). Coal and crude oil were the items that grew the most, contributing 4.4 percentage points (pp) to the variation of the month (Table 2).

13. In the two-month period of January-February, total exports fell 1.2% annually, explained by the contraction of external sales of mining products (-3.6%). The group of goods of agricultural origin and other exports grew 4.3% and 1.6%, respectively.

14. So far this year to February, the value of exports declined due to falls in prices. The price index presented an annual 4.8% contraction; the index of quantities, on the other hand, increased 3.8%. The decrease in the prices in annual terms is explained by the fall of prices in the three groups of goods. The strongest contraction took place in mining, 5.2%, lower than a year ago. Agricultural goods and that of other exports fell 5.0% and 4.7%, respectively.

Table 2 Behavior of Exports in US dollars

EXPORTS				
February 2019				
	Annual Variation [Contribution]	**Main contributing items to annual variation, in the same direction:**		
		Item	**Annual variation of the item**	**Contribution to annual variation**
Total Exports	6.2%			
Mining goods	7.4% [4.2]	Coal, Lignite, and Peat	13.6%	2.4
		Oil	6.9%	2.0
		Oil Refining and others	1.0%	0.1
Agricultural goods	11.2% [1.4]	Flowers	20.8%	0.9
		Coffee (not roasted)	10.4%	0.6
		Banana	-4.2%	-0.1
Other exports*	1.6% [0.5]	Machinery and Equipment	41.4%	0.4
		Others from the agricultural sector, hunting, etc.	22.0%	0.3
Aggregate for January-February 2019				
Total Exports	-1.2%			
Mining goods	-3.6% [-2.2]	Coal, Lignite, and Peat	-11.7%	-2.2
		Oil	-5.5%	-1.7
Agricultural goods	4.3% [0.6]	Coffee (not roasted)	5.6%	0.4
		Flowers	5.2%	0.2
		Banana	-0.6%	0.0
Other exports*	1.6% [0.4]	Motor Vehicles and other types of Transportation	39.1%	0.5
		Chemical Products	3.1%	0.2

Source: DANE

Imports of Goods

15. The value of imports declared in February grew 8.2% compared to the same month of 2018, explained particularly by the intermediate goods and capital goods, which contributed 3.4 pp and 3.1 pp to the total variation, respectively. The increase in external purchases of transport equipment stands out, increasing 25.9% in annual terms and contributing 1.7 pp to total growth (Table 3).

16. In the two-month period of January-February, total imports increased 9.4% on a yearly basis, with increases in the three groups of goods. The greatest growth was observed in foreign purchases of raw materials, which explain 4.8 pp of the total variation.

Table 3 Behavior of Imports in US dollars

IMPORTS				
February 2019				
	Annual Variation [Contribution]	**Main contributing items to annual variation, in the same direction:**		
		Item	**Annual variation of the item**	**Contribution to annual variation**
Total Imports	8.2%			
Capital Goods	10.4% [3.1]	Transport Equipment	25.9%	1.7
		Capital Goods for Industry	6.6%	1.3
Raw materials	7.3% [3.4]	Raw Materials for Industry	34.4%	1.2
		Fuel	15.7%	1.2
Consumer Goods	7.3% [1.7]	**Durable consumption goods**	**7.3%**	**0.9**
		Pharmaceutic Products and Toiletries	16.3%	0.7
		Non-durable consumption goods	**7.3%**	**0.8**
		Private Transport Vehicles	12.6%	0.7
Aggregate for January-February 2019				
Total Imports	9.4%			
Capital Goods	10.2% [3.1]	Transport Equipment	23.7%	1.6
		Capital Goods for Industry	5.7%	1.1
Raw materials	10.3% [4.8]	Raw Materials for Industry	8.0%	2.8
		Fuel	24.8%	1.7
Consumer Goods	6.4% [1.5]	**Durable consumption goods**	**7.8%**	**0.8**
		Private transport vehicles	14.6%	0.7
		Non-durable consumption goods	**5.2%**	**0.7**
		Pharmaceutic Products and Toiletries	10.3%	0.4

Source: DANE

Balance of Trade for Goods

17. With the above results, the trade balance in February exhibited a USD $581 million (FOB) deficit. This means a USD $92 million (FOB) increase in the deficit *vis-à-vis* the previous year.

18. In the two-month period of January-February, the deficit stood at USD $1,605 million (FOB), which means a USD $729 million (FOB) increase, as compared to the same period of 2018, due to a higher growth in imports (9.4%) than in exports (-1.2%).

Balance of Payments

19. With results from 2018 and the external context scenario presented hereinbefore, the estimate of the current account deficit for 2019 is 4.3% of GDP (USD $14,302 m) in the baseline scenario. The forecast range for said period would be between 3.9% and 4.7% of GDP, determined by the risks on the terms of trade, the cost, and the availability of external financing, as well as by global growth.

20. The larger current account deficit estimated for 2019 compared to that observed in 2018 (3.8% of GDP), would be explained mainly by the widening of the trade deficit of goods (Table 4). The other items in the current account are expected to partially offset the larger deficit estimated for the trade balance.

21. The thrust that the value of exports of the main products experienced in 2018 would fade in 2019, in line with the setback expected in the terms of trade (-6.8%). To a greater extent, this is due to the fact that the price forecasts for oil, coal, and coffee are lower than in 2018. Thus, the value of exports of the main products is expected to decrease 3.9% in 2019. Additionally, moderate growth of external sales of industrial goods is expected (4.6%), in the context of a slight slowdown in the growth of the country's main trading partners.

22. On the other hand, the positive growth path of imports is estimated to continue, in line with the higher growth expected in domestic demand. All this explains the significant increase of the trade deficit in goods (Table 4).

23. On the contrary, a lower deficit of non-factor services and of factor income is expected. To a larger extent, the latter is a result of the lower income from exports by oil and mining firms with FDI. Also, the positive contribution of revenues from remittances would continue, in line with economic growth in the countries where they originate.

24. International financial conditions that are more lax than those expected at the beginning of this year continue to be forecast. Thus, in terms of the country’s current account financing, other investment flows are expected to continue in 2019, caused both by contracting new debt as by the liquidation of external assets. FDI flows are expected to grow driven by the resources allocated to sectors different from the oil and mining sectors; also, the purchase of TES by foreigners is expected to continue, although at a slower pace than in the previous year.

25. The current projection of the balance of payments for 2019 only considers purchases within the program of accumulation of reserves until 10 April, totaling USD $1,478 million. Additionally, it includes the direct purchase of USD $1,000 m by the Central Bank to the National Treasury.

Table 4. Projection of the Balance of Payments

BALANCE OF PAYMENTS (Millions of US Dollars)	**2018** (pr)	**2019** Baseline
CURRENT ACCOUNT (A+B+C+D)	**-12,661**	**-14,302**
Percentage of GDP	**-3.8**	**-4.3**
A. Goods	**-5,316**	**-9,320**
a. Exports	44,316	43,868
Main	30,790	29,405
Other Exports	13,527	14,462
b. Imports	49,633	53,188
B. Non-factor Services	**-3,809**	**-3,015**
a. Exports	9,457	10,299
b. Imports	13,266	13,315
C. Factor Income	**-11,141**	**-10,206**
D. Current Transfers	**7,605**	**8,293**
FINANCIAL ACCOUNT (A+B+C+D)	**-11,981**	**-14,302**
A. Direct Investment (ii-i)	**-5,888**	**-6,723**
B. Portfolio Investment	**1,222**	**-3,500**
C. Other investment (loans, credits, and other derivatives)	**-8,502**	**-7,636**
D. Reserve Assets	**1,187**	**3,557**
ERRORS AND OMISSIONS	679	0

Memo Item:

Mining and oil sector (a-b)[1]	**20,224**	**19,688**
a. Exports	24,776	23,307
b. Factor Income Revenue	4,552	3,620

[1] Including oil and derivatives, coal, and ferronickel

III. Growth, Domestic Demand, and Credit

For the first quarter of 2019, annual growth of the Colombian economy would continue to increase gradually. The information available allows to forecast an acceleration of the dynamics of domestic demand that would offset the negative contribution of external demand, which would subtract more from GDP than in the fourth quarter of 2018. This is due partly to a higher dynamism of imports than expected a month ago and to a less favorable performance of coal exports. Therefore, in this report, the technical staff confirms its GDP growth forecast for the first quarter of 2019 at 3.2%, a figure close to the long-term growth estimate for the Colombian economy.

26. The new information available for the first quarter of 2019 allows to confirm the technical staff's forecast of 3.2% for the annual GDP growth rate, seasonally adjusted and considering calendar effects. This rate, close to the long-term growth of the Colombian economy, represents an acceleration *vis-à-vis* the record for the end of last year (2.9%). The increase between quarters would be 0.8%, which corresponds to an annualized 3.3% rate.

27. Despite the fact that the forecast for GDP growth was maintained from March, the technical staff revised the performance of the items that compose it versus the data. On this occasion, a good performance of domestic demand is observed, somewhat greater than had been forecast a month before, and which would be higher than in the fourth quarter of 2018. In the first quarter of 2019, domestic demand would have been driven by investment and public consumption, above all. On the contrary, the recent performance of the foreign trade indicators allow to forecast a more negative contribution from net exports.

28. Regarding investment (gross capital formation), it is estimated that the greatest drive would have come from construction and spending on machinery and equipment. In the first case, civil works and non-residential buildings are expected to have registered a significant acceleration in 2019-Q1 versus the performance observed for the aggregate of 2018. This is due in part to the good execution by regional and local governments, as well as by recent advances in the works of 4G highways and *Hidroituango*. Housing construction, on the other hand, would report increases between quarters, but lower annual growth rates due to a high basis of comparison for the same period in 2018. In the case of machinery and equipment, accelerations toward positive growth rates are expected, after the falls recorded toward the end of last year.

29. Regarding public consumption, the forecast for 2019-Q1 suggests a good annual growth rate for this aggregate, but with a slowdown in quarterly terms. Thus, the good year-on-year performance would obey largely to a low basis of comparison for the same period in 2018, but the behavior between quarters suggests an orderly adjustment for this item of GDP, as has been anticipated in previous reports. It should be noted that this forecast does not assume impacts of the enlargement of the fiscal goal of 2019 in the first quarter. Also, it should be noted that the information available on this aggregate is still very scarce.

30. This report still expects a slowdown of the annual growth figure for private consumption for the first quarter of 2019, although somewhat lower than was forecasted in the March report, as suggested by the available indicators. In a good part, the slowdown is due to a high base of comparison for the same period in 2018. In quarterly terms, expansion of all the items that make up this aggregate of GDP is still expected.

31. The revision of the composition of the forecast for GDP growth considers a net external demand that would be contributing more negatively than expected a month ago. Growth of real exports was revised slightly downwards *vis-à-vis* the expectations from a month ago, mainly due to the poor results of external sales of coal. In contrast, the performance of imports was revised upward. The information available allows to forecast a good growth of this component of GDP during 2019-Q1, albeit somewhat lower than towards the end of last year. Thus, this forecast includes a trade deficit in constant pesos that would have expanded during the first three months of the year.

32. The recent results of economic indicators support the forecast scenario described above (see Table 5). The figures for retail sales of goods suggest a satisfactory performance of household consumption during the first quarter, while at the same time the confidence of households has been showing signs of recovery compared to the levels in the fourth quarter of last year.

33. The series of imports of capital goods (in constant pesos) and the seasonally adjusted series of the balance of investment expectations of the EMEE suggest that investment in capital goods would have grown at a significant pace during the first quarter of 2019.

34. On the supply side, the indicators exhibit uneven results (see Table 5). While the industry, retail, and oil production exhibited favorable growth figures, coffee and coal production (the latter according to the quantities exported) continue to perform weakly.

35. Total national employment and in the 13 areas increased in the first quarter after the falls observed at the end of last year. Despite this, the UR remained at relatively high levels for the 13 areas, and increased in the national total. This happened because the economically active population, and with it the overall participation rate (economically active population / working age population), grew at a higher rate than employment, particularly in the national total.

36. By branch of activity, the sector of community, social and personal services contributed the most to annual employment growth in February at the national total, while real estate activities, business, and leases, together with retail, hotels, and restaurants, remained as the branches of larger negative contributions in this aspect. At the urban level, this recovery was reflected, particularly, in salaried and formal occupied individuals.

37. Finally, the seasonally adjusted series corrected for calendar effects in the monthly economic monitoring indicator (ISE) of DANE recorded an annual 2.8% growth in February, an acceleration *vis-à-vis* 2.5% in January. The aggregate of the two-month period reported a yearly 2.7% expansion (vs. 2.9% observed for the fourth quarter of 2018). The figures in the original ISE (uncorrected) revealed an annual 2.7% expansion in February (2.6% for the two-month period of January-February and 2.8% for 2018-Q4).

38. Considering this and the results of the forecast models, the technical staff maintained the projection for GDP growth in the first quarter of 2019 at 3.2%.

Table 5 Main indicators of demand and supply

	Indicator	2018Q4		2018		January		February		March		Year to date	
		Original	SACCE*	Original	SACCE*	Original	SACCE*	Original	SACCE*	Original	SACCE*	Original	SACCE
Demand Indicators	Retail sales excluding fuel (annual variation, %)	9.0%	9.3%	7.0%	6.9%	3.3%	3.3%	7.1%	6.0%	N/Avail.	N/Avail.	5.1%	4.6%
	Retail sales excluding fuel and motor vehicles (annual variation, %)	5.8%	6.4%	5.4%	5.5%	4.7%	4.5%	7.9%	4.4%	N/Avail.	N/Avail.	6.2%	4.5%
	Retail vehicle sales (annual variation, %)	28.8%	26.4%	16.1%	15.4%	-4.2%	-4.3%	2.7%	2.8%	N/Avail.	N/Avail.	-0.8%	-0.9%
	Records of total enrollments (annual variation, %)	22.1%	20.6%	7.6%	6.5%	-2.8%	-2.8%	0.7%	1.0%	3.3%	3.2%	0.6%	0.4%
	Records of enrollment, private use (annual variation, %)	19.9%	18.4%	4.2%	3.1%	-7.3%	-7.3%	-4.8%	-4.5%	-4.8%	-5.1%	-5.6%	-5.7%
	Records of enrollment, commercial use (annual variation, %)	24.3%	23.2%	11.4%	10.4%	2.1%	2.1%	6.4%	6.6%	12.5%	12.2%	7.2%	6.9%
	Expectations survey - Sales (levels, balance)[\1]	9.94	4.32	1.19	1.22	2.91	4.36	7.61	6.53	N/Avail.	N/Avail.	5.26	5.44
	Consumer Confidence Index (CCI, balance, levels)[\1]	-9.75	N/Applic.	-0.50	N/Applic.	-2.79	N/Applic.	-5.57	N/Applic.	1.19	N/Applic.	-2.39%	N/Applic.
	Expectations Survey - Investment (levels, balance)[\1]	5.76	1.88	-0.30	-0.30	7.82	5.63	4.35	5.86	N/Avail.	N/Avail.	6.08%	5.74%
	Imports in constant pesos: Capital goods (annual variation, %)	31.5%	30.5%	11.5%	10.8%	15.1%	15.1%	17.2%	16.7%	20.5%	18.0%	17.6%	16.7%
Supply Indicators	Industrial Production Index (annual variation, %)	3.1%	2.7%	2.9%	3.0%	3.0%	3.0%	2.8%	3.0%	N/Avail.	N/Avail.	2.9%	3.0%
	Coffee Production (annual variation, %)	-6.6%	-6.4%	-4.5%	-4.0%	14.6%	15.2%	-8.7%	-9.2%	-11.9%	-12.7%	-1.9%	2.7%
	Oil production (annual variation, %)	2.6%	N/Applic.	1.4%	N/Applic.	4.5%	N/Applic.	8.4%	N/Applic.	3.3%	N/Applic.	5.4%	N/Applic.
	Energy demand (annual variation, %)	3.7%	N/Applic.	3.3%	N/Applic.	3.8%	N/Applic.	5.2%	N/Applic.	4.0%	N/Applic.	4.3%	N/Applic.
	Construction Licenses, total (annual variation, %)	-8.8%	N/Applic.	-6.4%	N/Applic.	-12.5%	N/Applic.	3.3%	N/Applic.	N/Avail.	N/Applic.	-4.5%	N/Applic.
	Construction Licenses, housing (annual variation, %)	-9.8%	N/Applic.	-6.5%	N/Applic.	-9.2%	N/Applic.	-8.3%	N/Applic.	N/Avail.	N/Applic.	-8.8%	N/Applic.
	Cement Production (annual variation, %)	5.1%	N/Applic.	1.2%	N/Applic.	2.2%	N/Applic.	3.1%	N/Applic.	N/Avail.	N/Applic.	2.6%	N/Applic.
	Cement dispatches (annual variation, %)	4.1%	N/Applic.	0.2%	N/Applic.	1.0%	N/Applic.	2.1%	N/Applic.	N/Avail.	N/Applic.	1.6%	N/Applic.
MEMI (ISE)	Monthly Economic Monitoring Indicator, Seasonally Adjusted Series, ISE (annual variation, %)	2.8%	2.9%	2.7%	2.7%	2.5%	2.5%	2.7%	2.8%	N/Avail.	N/Avail.	2.6%	2.7%

* SACCE = Seasonally adjusted and corrected for calendar effects
\1 Average for the quarter and year-to-date.
N/Applic. = Not applicable
N/Avail. = Not available

V. Behavior of Inflation and Prices

Annual consumer inflation in March was slightly higher than expected a month ago, but lower than expected in the January Quarterly Report. The increase in annual inflation was widespread, except for the non-tradable segment. Food inflation was driven by supply problems in the south of the country, while the tradable component rose slightly after continuous falls. Also, the generalized increase in the fees for public utilities explained the upward pressure exerted by the group of regulated items on the CPI. Inflation excluding food and regulated items fell more than expected to 2.38%, and the average of core inflation indicators remained stable, posting at 2.82%. Analysts' expectations stand between 3.25% and 3.28% to horizons not greater than 24 months and those derived from public debt bonds around 3.3%.

39. In March, yearly headline inflation stood at 3.21%, increasing 20 bp versus the figure in the previous month (Table 6). The result was higher than expected by the market (3.09%) and by the Short-Term Forecast by the Central Bank's technical staff.

40. The annual inflation rate was driven mainly by the price adjustments for food and regulated items, and, to a lesser extent, by those of tradable goods and services.

41. Despite the above, the average of core inflation indicators in March (2.82%) did not register any significant changes compared to February, completing three consecutive months below 3.0%. In March, the different core inflation indicators exhibited a mixed behavior: the Core 20 CPI fell (from 3.13% to 3.09%), the CPI excluding food products increased from 3.14% to 3.26%, while the CPI excluding primary food products, fuels, and public utilities (2.57%), and the CPI excluding food and regulated items (2.38%) did not vary (Table 6).

42. Per baskets, in March, the largest increase was concentrated in the CPI for food (which includes meals outside the home), whose annual change stood at 3.26% *vis-à-vis* 2.84% in February. Annual variation accelerated both for perishable foods (from 8.32% to 9.98%, which can be attributed partly to the indigenous strike in the south of the country), as well as for processed items (0.64% to 1.43%). Contrastingly, meals outside the home set back from 3.97% to 3.43%). It is important to note that the impact of the *El Niño* phenomenon on food CPI seems to be small, judging by the supply, which—except for the days of the indigenous strike—, continued at relatively high levels.

43. The annual CPI variation for tradable goods rose (from 0.80% to 0.90%), after six months of consecutive falls. Liquors led such increase due to the fact that the new taxes approved by the Financing Act started to apply in March. In this sense, this increase takes place once and has transitory effects on inflation.

44. Similarly, the annual CPI variation of regulated items increased in March (from 5.72% to 6.42%), remaining at high rates with respect to the target. As has been happening several months ago, in March, public utility rates (which rose from 7.33% in February to 8.80% in March) exerted the greatest upward pressures. In the last month, there were increases in residential gas, aqueduct and sewerage, and energy fees. In the latter case, major increases in the year to date have been concentrated in the cities of the Atlantic Coast, which would be associated with the greater exposure of *Electricaribe* to the spot market of energy (currently more expensive). Also in March there were adjustments in the price of fuels (from 0.29% on a monthly basis) with an annual variation that accelerated to 5.85%. The annual variation of the CPI for public transport remained stable (4.26%).

45. In March, the annual CPI variation for non-tradable inflation continued to decline (to 3.29% from 3.38% in February). In this group, it was still evident that there has been a low transmission of the increase in the minimum wage (6.41% including the transportation subsidy) to consumer prices, especially to personal services. Added to this is the indexation of several of their prices (leases and education, among others) to inflation at the end of last year (3.18%). Similarly, this segment of the basket incorporated a downward pressure due to methodological changes in the measurement of tuition fees for preschool, elementary, and secondary education. The effects of this last downward shock on headline inflation should remain during the rest of the year.

Table 6 Indicators of consumer prices and inflation

Headline and Core Inflation to March 2019

Description	New CPI Weights[a/]	Dec 2017	Mar 2018	June 2018	Sept 2018	Dec 2018	Jan 2019	Feb 2019	Mar 2019
Headline Inflation	**100.00**	**4.09**	**3.14**	**3.20**	**3.23**	**3.18**	**3.15**	**3.01**	**3.21**
Non-Food Inflation	**76.16**	**5.01**	**4.05**	**3.81**	**3.71**	**3.48**	**3.46**	**3.14**	**3.26**
Tradables	19.16	3.79	1.80	1.83	1.57	1.09	0.99	0.80	0.90
Non-Tradables	42.31	5.49	4.76	4.27	4.13	3.79	3.87	3.38	3.29
Regulated items	14.69	5.86	6.01	5.82	6.03	6.37	6.08	5.72	6.42
Food Inflation	**23.84**	**1.92**	**0.98**	**1.74**	**2.05**	**2.43**	**2.56**	**2.84**	**3.26**
Perishables	3.15	5.84	7.13	8.47	9.51	8.88	8.89	8.32	9.98
Processed food	11.90	(0.91)	(2.01)	(0.91)	(0.72)	(0.08)	0.22	0.64	1.43
Eating out	8.79	5.21	3.32	3.13	3.32	3.68	3.68	3.97	3.43
Core Inflation Indicators									
Non-food inflation		5.01	4.05	3.81	3.71	3.48	3.46	3.14	3.26
Core 20		4.87	4.04	3.58	3.56	3.23	3.09	3.13	3.09
CPI excluding perishable foods, fuel and utilities		4.02	2.99	2.71	2.81	2.76	2.69	2.57	2.57
Inflation excluding food and regulated items		4.76	3.49	3.23	3.04	2.64	2.70	2.39	2.38
Average of Core Inflation Indicators		**4.66**	**3.64**	**3.33**	**3.28**	**3.03**	**2.98**	**2.81**	**2.82**

Source: DANE. Calculations by *Banco de la República*.

46. To March, consumer inflation seemed to be subjected to slight upward pressures on account of non-labor costs. This is inferred from the behavior of annual inflation of the total PPI for domestic supply, which stood at 3.65% in this last month *vis-à-vis* 3.35% in February. In the last month, both the imported component (from 4.24% to 4.46%) as well as the local component (from 2.98% to 3.31%) accelerated.

47. Regarding labor costs, with figures to February, the annual wage adjustment for industry (from 5.23% in January to 5.00% in February) and trade (from 8.32% to 4.69%) decreased. On the other hand, with figures to March, the salary adjustment for housing construction increased (from 3.11% in February to 3.49% in March), while that for heavy construction lowered (from 3.74% to 3.50%). No wage pressures on consumer prices are expected for the remainder of the year, according to the latest estimates of the NAIRU rate for 2019, which would stand consistently below the expected urban unemployment rate.

48. Inflation expectations exhibited a mixed performance with figures to April. Those by analysts (collected monthly) to December 2019 increased from 3.23% according to the survey from March to 3.28% in the survey from April. Contrastingly, inflation expectations to twelve months contracted from 3.32% to 3.25%, as did those to twenty-four months (from 3.28% to 3.25%). Those to December 2020 showed no significant changes (3.25%).

49. On the other hand, those implicit in public debt bonds (*Breakeven Inflation*, BEI) stood on 23 April at 3.04%, 3.17%, 3.31%, and 3.50% to 2, 3, 5, and 10-year horizons, respectively. Measurements with respect to the last meeting of the Board of Directors on 22 March varied in 9 bp, 17 bp, 23 bp, and 20 bp, respectively.

50. Using the *Forward Break-Even Inflation* curve (FBEI), inflation expectations for the years 2020, 2021, and 2022 correspond to 3.22%, 3.31%, and 3.38%, respectively.