PUBLIC VERSION

Working Papers from the Board of Directors Banco de la República

Monetary Policy Report

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Board of Directors
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OFFICE OF THE DEPUTY TECHNICAL GOVERNOR
NOVEMBER 2018

Monetary Policy Report of December 2018

Public Version

I. External Context

Until the third quarter, external conditions favored the performance of the Colombian economy. In recent months, however, the figures observed and projected for oil prices fell, and those for the average growth of the country's trading partners moderated. In this environment, an increase in risk premia and in the country's exchange rate has been observed, while a smaller increase in international interest rates is expected compared with the forecasts in the previous report. The new estimates suggest that the adjustment of the external imbalance would have stopped in 2018, and that the current account deficit would expand somewhat in 2019.

1. In recent months, the price of oil fell from USD $85 per barrel in the first week of October to USD $61 per barrel in the past few weeks. This decline resulted, to a large extent, from supply factors, among which the increase in production by the United States, Saudi Arabia, and Russia, and the easing of sanctions on crude oil exports from Iran stand out. Added to the above were the concerns on global economic growth, which have resulted in weaker prospects of global oil demand. A decline in this variable was expected in previous reports, but not so soon and as marked as has been observed.
2. On the other hand, stress in financial markets continued. This has been reflected by the fall of most stock market indices, among other things. This has resulted from several factors such as a greater concern about a likely global economic slowdown, the uncertainty regarding the trade dispute between the United States and China, and the situation in Europe on account of the fiscal problems in Italy and the *Brexit*.
3. This has entailed a modest increase in country-risk premia for several economies in the region, including Colombia.
4. As a result of the recent fall of oil prices, inflation in advanced economies has given ground in the last month, standing at levels close to their long-term targets. Thus, these countries are expected to continue their process of normalization of monetary policy, although more slowly than had been anticipated. Recent announcements by the president of the Fed about the reference rate being close to its neutral level suggest this.

Baseline or more likely scenario (Table 1)

5. This report revises the average forecast growth figures for the country's trading partners for 2018 and 2019 slightly downwards to 2.5% and 2.4%, respectively (see Table 1). These growth rates are still higher than those observed in 2015 and 2016 (1.85%, on average).
6. In the United States, inflation has decreased in the last month largely due to lower oil prices. On the other hand, the labor market remains strong, with an unemployment rate at its minimum for almost 50 years, moderately pressing wages upwards.
7. Taking this into account, the Fed is expected to continue with its strategy of increasing rates. However, recent announcements by the Fed on the closeness of the reference rate to its neutral level amidst economic indicators below expectations and lower oil prices show that such normalization would take place more slowly than announced in October. Thus, in line with expectations, at its meeting on 19

December 2018, the Fed increased its reference rate by 25 basis points (bp), within a range of 2.25% to 2.5%. Additionally, this report forecasts two 25-bp increases in 2019 (one less than in the previous report). Added to this, the program for the reduction in the balance sheet would continue to be met as announced.

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

Country or Region	2018			2019		
	Low	Baseline	High	Low	Baseline	High
USA	2.7	2.9	3.1	1.4	2.5	3.6
	2.71	2.9	3.1	1.4	2.5	3.6
Euro Zone	1.8	1.9	2.0	0.7	1.7	2.5
	1.8	2.0	2.2	0.8	1.8	2.6
China	6.5	6.6	6.7	5.4	6.2	6.8
	6.4	6.6	6.8	5.4	6.2	6.8
Brazil	1.0	1.3	1.6	1.2	2.3	3.6
	1.0	1.3	1.6	1.2	2.3	3.4
Ecuador	0.4	0.9	1.3	-0.3	0.8	2.6
	0.2	1.4	2.4	0.0	1.1	3.0
Venezuela	-17.0	-14.0	-11.0	-11.0	-6.0	-1.0
	-17.0	-14.0	-11.0	-8.0	-5.0	-2.0
Peru	3.6	3.9	4.2	2.5	3.8	5.0
	3.6	4.0	4.2	2.2	3.9	4.4
Mexico	1.8	2.2	2.4	1.0	2.2	3.5
	1.9	2.2	2.5	1.0	2.3	3.5
Chile	3.7	4.0	4.3	2.4	3.4	4.4
	3.6	3.9	4.2	2.4	3.4	4.4
Total (excluding Venezuela)	2.3	2.5	2.7	1.5	2.4	3.4
Total (excluding Venezuela) September-18 Report	2.2	2.6	2.9	1.7	2.5	3.5

COMMODITIES	2017	2018			2019		
	Observed	Low	Baseline	High	Low	Baseline	High
Oil (Brent)	54.79	71	72	73	55	66.5	80
		72	74.5	76	65	73	81
Coal	70.32	84	85	86	65	79	90
		82	84	87	61	76	86
Coffee	1.52	1.36	1.37	1.38	1.20	1.40	1.60
		1.33	1.36	1.39	1.20	1.40	1.60
Gold	1,258	1,285	1,270	1,255	1,500	1,270	1,100
		1,320	1,280	1,240	1,500	1,280	1,100

The current forecast is shown in black.

The forecast from the previous quarterly report is shown in red.

8. On the other hand, the European Central Bank (ECB) confirmed the end of its program for net purchase of assets, among other measures. This announcement was made while inflation remains contained and some economic activity indicators exhibit significant deterioration. Consequently, no changes in benchmark interest rates by the ECB are expected before the first half of 2019.

9. Given the fall in oil prices in the past two months, and their relative stability at levels close to USD $60 per barrel in the last few weeks, this report reduced its forecast for 2018 and 2019. So far in 2018 to December 17, the average price of oil (*Brent*) has been USD $72.31 per barrel. Thus, the average for this year is expected to be USD $72 per barrel, and USD $66.5 for 2019. This implies an increase in the price of oil from current levels, which in turn entails a reduction of supply mainly by OPEC member countries and their allies. This increase would be limited by the increased production in the United States and by a lower increment of global demand.

10. The baseline scenario for the external context described above faces downside risks. Concerns over the duration of the current expansionary phase of global economy have increased recently. A greater likelihood of a strong economic slowdown at the turn of a year or so is now being considered. In these circumstances, a decline in the prices of oil and other commodities on par with an increase in sovereign risk premia could be expected. This future down cycle could be strengthened by the adoption of protectionist measures in the United States and other countries, by a faster-than-expected cooling of the Chinese economy, and by the persistence of some risks in Europe on account of *Brexit* and uncertainty concerning the Italian Government's budgetary target, among others.

II. Foreign Trade and Balance of Payments

Exports of Goods

11. In October 2018, total exports in US dollars registered an annual 15.8% growth, explained by increases in the group of mining goods. In this sector, external sales of all items (except gold) increased in this month. Oil and refining continued to exhibit a good performance, contributing 10.8 percentage points (pp) to the monthly variation (Table 2).

12. As for the variation from January to October, total exports exhibited an annual 14.0% growth, explained by the increase in foreign sales of mining goods (21.3%) followed by other exports (8.2%). The group of agricultural goods contracted 6.0%, annually.

13. So far this year, the value of exports in US dollars increased mainly due to improvements in prices, which are reflected in an annual 18.2% increase in the consumer price index, which was partially offset by the 3.7% fall in quantities. The improvement in prices in annual terms took place in the group of mining goods (30.6%), which offset the fall in agricultural goods and of other exports (-7.5% and -0.6%, respectively).

Table 2: Behavior of Exports in US dollars

	Annual Variation [Contribution]	Main contributing items to annual variation, in the same direction: Item	Annual variation of the item	Contribution to annual variation
October 2018				
Total Exports	15.8%			
Mining goods	25.0% [15.2]	Oil	18.0%	5.7
		Coal, lignite, and peat	30.1%	5.1
		Oil refining and others	73.2%	4.3
Agricultural goods	-6.8%	Coffee (not roasted)	-11.1%	-0.7
	[-0.8]	Bananas	-17.5%	-0.3
Other exports*	5.0%	Food, beverages, and tobacco (excluding coffee)	11.8%	0.7
	[1.4]	Rubber and plastic	39.0%	0.6
Accumulated value for January - October 2018				
Total Exports	14.0%			
Mining goods	21.3%	Oil	28.9%	8.4
	[12.5]	Oil refining and others	46.8%	2.6
Agricultural goods	-6.0%	Coffee (not roasted)	-11.8%	-0.8
	[-0.8]	Bananas	-8.1%	-0.2
Other exports	8.2%	Food, beverages, and tobacco (excluding coffee)	8.1%	0.5
	[2.3]	Chemical products	6.1%	0.5

Source: DANE

Imports of Goods

14. The value of imports in US dollars declared in October grew 31.1% *vis-à-vis* the same month in 2017, explained by the recovery of all groups of goods, particularly capital and intermediate goods, which contributed 13.3 pp and 11.5 pp to the total variation, respectively. The increase in external purchases of raw materials for industry stands out, which increased 25% in annual terms and contributed 8.4 pp to total growth (Table 3).

15. From January to October, total imports grew 10.7% in annual terms, supported by increases in the three groups of goods. The greatest growth was observed in foreign purchases of raw materials, which account for 5.1 pp of the total variation.

Balance of Trade for Goods

16. With the aforementioned results, the trade balance in October exhibited a deficit of USD $1,158 million (FOB). This represents a USD $669 million increase in the deficit compared with the previous year.

17. As to the period from January to October, the deficit stood at USD $5,582 million FOB, which translates into a 5.6% reduction compared with the same period in 2017 due to higher growth in exports than in imports.

Table 3: Behavior of Imports in US dollars

October 2018				
	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	31.1%			
Capital Goods	42.4% [13.3]	Transport equipment	97.3%	7.8
		Capital goods for industry	26.7%	5.2
Raw materials	26.8% [11.5]	Raw materials for industry	25.0%	8.4
		Fuel	47.4%	3.0
Consumer Goods	24.5% [6.3]	**Durable consumption goods**	**38.3%**	**4.3**
		Private transport vehicles	58.2%	3.1
		Non-durable consumption goods	**13.6%**	**1.9**
		Food products	18.3%	0.8
Accumulated value for January - October 2018				
Total Imports	10.7%			
Capital Goods	10.5% [3.2]	Capital goods for industry	11.8%	2.2
		Transport equipment	8.9%	0.7
Raw materials	11.2% [5.1]	Raw materials for industry	16.0%	5.4
		Raw materials for agriculture	9.7%	0.4
Consumer Goods	10.1% [2.4]	**Non-durable consumption goods**	**8.3%**	**1.1**
		Pharmaceutic products and toiletries	7.5%	0.3
		Durable consumption goods	**12.3%**	**1.3**
		Appliances and household devices	16.4%	0.4

Source: DANE

Balance of Payments

18. With the information available for the year to date and the external context scenario presented in the previous section, the preliminary review of the forecast of the current account deficit for 2018 results in 3.6% of GDP in the baseline scenario. The increase in the current account deficit versus the estimate in October is explained by the good results from imports and the lower price of oil observed so far during the fourth quarter.

19. The larger current account deficit estimated for 2018 compared to the one observed a year ago (3.3% of GDP) would be explained mainly by the expansion of factor income and, to a lesser extent, by the larger trade deficit in goods and services. On the contrary, higher income from current transfers would continue to contribute positively to the narrowing of the external imbalance.

20. As for the financing of the current account, for 2018, direct investment is forecast to continue being the main inflow of foreign capital. An increase in the number of loans by the public sector is expected (net disbursements), contrasting the net amortizations in 2017. Regarding portfolio investments, the baseline scenario for 2018 assumes a lower issuance of bonds by the Government and public sector, as well as lower purchases of TES by foreigners compared with the previous year.

21. For 2019, a decline in the prices of the main export products is expected, while growth of exports of goods would take place due to the increase in external sales of industrial products and the larger quantities of traditional goods. The path of positive growth in imports is expected to continue, in line with a greater economic growth. This would imply a larger trade deficit of goods versus the forecasts for 2018.

Additionally, a lower deficit of non-factor services is expected, as well as of factor income. Thus, the preliminary exercises suggest that the current account deficit projected for 2019 would be somewhat higher than the estimate for 2018.

III. Growth, Domestic Demand, and Credit

In the third quarter, domestic demand turned out better than expected, mainly by investment in construction. Despite this, the forecast for GDP growth for 2018 remained at 2.6%. This means that the positive shock observed in public consumption at the beginning of the year fades in the fourth quarter, considering that the effects of the electoral cycle and the population census would have faded. The forecast also assumes that part of the acceleration in the construction of buildings is transitory given the extensive inventory levels that can still be observed in the real estate market and the scarce dynamism exhibited by the prices of these assets.

22. According to the most recent publication of GDP figures (Tables 4 and 5), the Colombian economy maintained a moderate pace of expansion in the third quarter, similar to the one forecast by the technical staff at the Central Bank (2.6% for the seasonally adjusted figures and adjusted for the calendar effect). However, the composition of growth on the side of expenditure was somewhat different than expected. On the one hand, domestic demand exhibited a better performance than projected mainly due to a positive impact of investment in construction (which is also seen in the sectorial GDP). Household consumption also contributed positively. Additionally, the positive impact of public consumption continued to boost GDP growth, as expected by the technical staff. As will explained herein, part of these shocks would be transitory and would be reverted in the fourth quarter. On the other hand, net exports contributed negatively, more than had been anticipated. Exports exhibited a lower-than-expected performance on account of a sluggish behavior of the sales of coal, coffee, and non-traditional goods. Imports expanded at a significant rate, as had been considered by the forecasts a quarter ago.

23. The information available for the fourth quarter of the year suggests that the Colombian economy would have maintained a growth rate similar to that of the third quarter. As for the domestic demand estimated by the technical staff, these preliminary projections consider a similar or somewhat greater annual growth figure than observed in the third quarter. However, in terms of quarterly growth rates, they lead to a slowdown. It is worth cautioning that the magnitude of the statistical discrepancy in the measurements of GDP implies great uncertainty in these estimates, and makes it difficult to identify trends.

24. Private consumption would record satisfactory annual and quarterly increases, driven primarily by a greater dynamics of consumption of durable goods (coinciding with the Motor Show). However, these would be offset by lower levels forecast for public consumption, considering that the effects of the electoral cycle and the population census on public spending would have faded.

Table 4: GDP for Supply - Annual Variations

Branch of activity	2017	2018		
	Whole Year	1st Q	2nd Q	3rd Q
Farming, forestry, hunting and fishing	**5.6%**	**3.5%**	**4.3%**	**0.4%**
Mining and quarrying	**-4.3%**	**-3.8%**	**-3.2%**	**1.3%**
Manufacturing	**-2.0%**	**0.5%**	**1.7%**	**2.4%**
Electricity, gas and water	**0.8%**	**1.2%**	**2.4%**	**2.9%**
Construction	**-2.0%**	**-5.6%**	**-5.3%**	**3.7%**
Buildings	-5.3%	-3.1%	-5.9%	4.1%
Civil works	7.5%	-6.8%	-4.6%	-0.9%
Specialized construction activities	-4.2%	-2.0%	-6.4%	1.3%
Retail, repairs, transport and lodging	**1.2%**	**2.6%**	**3.3%**	**3.3%**
Information and communications	**-0.1%**	**1.7%**	**2.5%**	**3.7%**
Financial and insurance activities	**6.9%**	**6.2%**	**3.3%**	**1.1%**
Real Estate activities	**2.8%**	**2.3%**	**2.1%**	**2.1%**
Professional, scientific and technical activities	**3.5%**	**5.5%**	**5.7%**	**2.9%**
Public Administration and defense, education and hea	**3.8%**	**5.6%**	**4.7%**	**5.1%**
Artistic, entertainment, and leisure activities	**3.9%**	**2.2%**	**2.4%**	**1.6%**
Subtotal value added	**1.5%**	**2.7%**	**2.7%**	**2.1%**
Taxes minus subsidies	**4.3%**	**5.7%**	**3.2%**	**2.7%**
GROSS DOMESTIC PRODUCT	**1.8%**	**2.6%**	**2.5%**	**2.6%**

Source: DANE, calculations by *Banco de la República*

Table 5: GDP for Demand - Annual Variations

	2017	2018		
	Whole Year	1st Q	2nd Q	3rd Q
Total consumption	**2.2%**	**2.9%**	**3.2%**	**3.6%**
Household consumption	1.8%	1.9%	2.9%	3.3%
Non-durables	2.0%	4.2%	4.5%	3.7%
Semi-durables	-2.4%	0.1%	3.0%	3.4%
Durables	0.7%	5.9%	4.0%	2.0%
Services	2.3%	1.8%	2.4%	2.4%
Government final consumption	4.0%	6.6%	5.0%	4.6%
Net Capital Formation	**0.6%**	**-3.0%**	**1.0%**	**4.5%**
Fixed net capital formation	3.3%	-2.0%	-1.0%	4.0%
Housing	1.2%	-5.8%	1.8%	1.5%
Other buildings and structures	0.3%	-6.3%	-4.4%	2.1%
Machinery and equipment	-2.0%	4.9%	3.7%	4.9%
Cultivated biological resources	-0.6%	-4.7%	1.2%	5.5%
Intellectual property products	14.6%	6.1%	4.4%	2.2%
Domestic Demand (C+FBK)	**1.9%**	**1.6%**	**2.8%**	**3.8%**
Domestic Demand (GDP-X+M)	**1.8%**	**2.1%**	**2.9%**	**3.3%**
Total Exports	**-0.7%**	**-0.3%**	**2.5%**	**1.6%**
Total Imports	**0.3%**	**-1.5%**	**4.8%**	**5.4%**
GROSS DOMESTIC PRODUCT	**1.8%**	**2.6%**	**2.5%**	**2.6%**

Source: DANE, calculations by *Banco de la República*

25. Gross capital formation would also provide significant annual growth rates, but they would coincide with quarterly slowdowns. The good performance of investment in capital goods would not offset the reversal of the positive shocks observed during the second and third quarters of 2018 for investment in construction of buildings.

26. On the side of external demand, the technical staff forecasts a recovery of exports, but also an acceleration of imports (between quarters as well as in the annual variation). For this reason, the trade deficit in real terms would expand and net exports would continue to contribute negatively to GDP expansion.

27. The recent behavior of economic indicators supports this scenario (see Table 6). On the one hand, with figures to October, retail sales of goods exhibits a satisfactory behavior mainly due to good sales records of vehicles. The report of license enrollments confirms this. This contrasts with the negative data in consumer confidence index in November, and a less favorable behavior of the labor market with figures from the moving quarter ending in October.

28. It is important to note that the strong decline in consumer confidence in November was caused by a deterioration of the expectations component of the index, rather than by the current economic conditions of the households. Additionally, the staff believes that this fall may have a significant transitory component, making it necessary to observe its behavior in the following months to confirm the trends.

29. Regarding the labor market, in October, the seasonally adjusted series exhibited increases in the unemployment rate (UR) nationwide. The thirteen areas exhibited decreases in the urban Overall Participation Rate (OPR) and in the Occupancy Rate (OR). Similarly, there were marginal falls of the number of employed persons in the two geographic domains mentioned above. However, this poor performance could be the result of the reversion of the positive shock that these indicators suffered at the beginning of the year, which would be associated mainly with the behavior of public consumption given the electoral cycle and the population census.

30. Regarding gross capital formation, the series of imports of capital goods (in constant pesos) suggest that investment in this type of goods would yield a better dynamics in the fourth quarter. Added to this is the register of vehicle licenses for cargo and passenger transport, which are considered as investment in transportation equipment. As for investment in construction, (both of housing as well as civil works and non-residential buildings), the technical staff assumes that the positive effect of the shocks observed between the second and third quarters would have faded partially in the fourth, inasmuch as there are still large inventory levels in the real estate market and the low dynamism in the prices of these assets.

31. On the supply side, indicators exhibit mixed results. On the one hand, industry, trade, and oil production exhibit favorable growth figures. However, some indicators related to construction continue to show some weakness in the performance of the sector, contrary to the positive results of the third quarter (see Table 6).

32. Considering this, annual GDP growth for the fourth quarter of 2018 is projected at 2.7%. With this, GDP expansion for the full year would be 2.6%.

Table 6: Main demand and supply indicators

	Indicator	2018Q2		2018Q3		October		November		Year to date	
		Original	SACCE*	Original	SACCE*	Original	SACCE*	Original	SACCE*	Original	SACCE
Demand Indicators	Retail sales excluding fuel (annual variation, %)	6.8%	5.9%	5.6%	5.7%	6.8%	7.6%	N/Avail.	N/Avail.	6.2%	6.2%
	Retail sales excluding fuel and motor vehicles (annual variation, %)	6.2%	5.9%	4.8%	5.0%	5.5%	7.0%	N/Avail.	N/Avail.	5.3%	5.4%
	Retail vehicle sales (annual variation, %)	10.3%	4.9%	10.3%	10.4%	14.3%	11.0%	N/Avail.	N/Avail.	11.4%	11.5%
	Records of total enrollments (annual variation, %)	3.8%	3.6%	5.6%	5.9%	9.2%	10.2%	24.4%	22.5%	4.9%	4.5%
	Records of enrollment, private use (annual variation, %)	2.1%	2.1%	0.7%	0.9%	6.6%	7.4%	20.9%	19.7%	1.4%	1.1%
	Records of enrollment, commercial use (annual variation, %)	5.8%	5.7%	11.2%	11.4%	12.1%	13.2%	28.0%	26.5%	9.0%	8.5%
	Expectations survey - Sales (levels, balance)\1	-3.45	-0.10	1.76	2.72	N/Avail.	N/Avail.	N/Avail.	N/Avail.	-1.73	0.45
	Consumer Confidence Index (CCI, balance, levels)\1	8.63	N/Applic.	4.60	N/Applic.	-1.30	N/Applic.	-19.64	N/Applic.	0.21	N/Applic.
	Expectations Survey - Investment (levels, balance)\1	-1.09	2.05	-1.27	0.30	N/Avail.	N/Avail.	N/Avail.	N/Avail.	-2.32	-0.88
	Imports in constant pesos: Capital goods (annual variation, %)	4.2%	1.4%	5.0%	5.2%	50.6%	44.7%	22.3%	22.8%	9.8%	9.0%
Supply Indicators	Industrial Production Index (annual variation, %)	5.1%	4.8%	3.5%	3.4%	5.8%	5.9%	N/Avail.	N/Avail.	3.2%	3.5%
	Coffee Production (annual variation, %)	13.2%	12.9%	-13.8%	-13.8%	1.2%	1.5%	-0.3%	-0.9%	-2.8%	-2.6%
	Oil production (annual variation, %)	1.2%	N/Applic.	1.1%	N/Applic.	1.7%	N/Applic.	3.8%	N/Applic.	1.3%	N/Applic.
	Energy demand (annual variation, %)	2.9%	2.9%	4.1%	4.1%	3.3%	3.3%	N/Avail.	N/Avail.	3.2%	3.2%
	Construction Licenses, total (annual variation, %)	5.7%	N/Applic.	-5.3%	N/Applic.	-3.6%	N/Applic.	N/Avail.	N/Applic.	-5.2%	N/Applic.
	Construction Licenses, housing (annual variation, %)	6.1%	N/Applic.	-7.5%	N/Applic.	-13.0%	N/Applic.	N/Avail.	N/Applic.	-6.2%	N/Applic.
	Cement Production (annual variation, %)	0.7%	N/Applic.	2.0%	N/Applic.	2.4%	N/Applic.	N/Avail.	N/Applic.	0.1%	N/Applic.
	Cement dispatches (annual variation, %)	2.6%	N/Applic.	-0.5%	N/Applic.	5.2%	N/Applic.	N/Avail.	N/Applic.	-0.4%	N/Applic.

* 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

IV. Behavior of Inflation and Prices

Observed inflation has been somewhat lower than expected, due mainly to a more favorable performance of prices for food and for tradable goods, despite upward pressures in the group of regulated items. The negative output gap would have contributed to this performance. Analysts' expectations stand between 3.3% and 3.5% to horizons greater than or equal to one year, and those derived from public debt bonds between 3.7% and 3.9%.

33. In November, annual consumer inflation stood at 3.27% a figure somewhat lower than in October (3.33%) and very similar to that in September (3.23%). Since March, inflation has remained relatively stable at a level slightly above the long-term target (Table 6). Inflation for the year to date (2.87%) was lower than last year (3.69%), and the monthly inflation (0.12%) was lower than had been estimated by the market (0.16%) and by the technical staff.
34. The average of core inflation indicators stood at 3.26% in November, a level similar to that of the previous months. Inflation excluding food and regulated items registered the lowest value (2.88%), while the CPI excluding food presented the highest (3.70%) (Table 7).

Table 7: Indicators of consumer prices and inflation

Headline and Core Inflation to November 2018

Description	Weight	Dec 2017	Sept 2018	Oct 2018	Nov 2018	Participation percentage in monthly deceleration	Participation percentage in deceleration of the year to-date
Headline inflation	**100.00**	**4.09**	**3.23**	**3.33**	**3.27**	**100.00**	**100.00**
Non-food inflation	**71.79**	**5.01**	**3.71**	**3.78**	**3.70**	**85.72**	**109.36**
Tradables	26.00	3.79	1.57	1.52	1.29	82.75	71.46
Non-Tradables	30.52	5.49	4.13	4.13	4.05	34.23	52.61
Regulated items	15.26	5.86	6.03	6.41	6.53	(31.26)	(14.71)
Food inflation	**28.21**	**1.92**	**2.05**	**2.25**	**2.22**	**14.28**	**(9.36)**
Perishables	3.88	5.84	9.51	9.66	7.96	110.23	(11.95)
Processed food	16.26	(0.91)	(0.72)	(0.54)	(0.15)	(91.69)	(15.27)
Eating out	8.07	5.21	3.32	3.52	3.55	(4.26)	17.85
Core inflation indicators							
Non-food inflation		5.01	3.71	3.78	3.70		
Core 20		4.87	3.56	3.58	3.57		
CPI excluding perishable foods, fuel and utilities		4.02	2.81	2.89	2.90		
Inflation excluding food and regulated items		4.76	3.04	3.02	2.88		
Average of core inflation indicators		**4.66**	**3.28**	**3.32**	**3.26**		

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

35. Within the CPI excluding food, the components that exhibited declines in the last month were tradables (from 1.52% in October to 1.29% November) and non-tradables (from 4.13% to 4.05%). On the contrary, the annual variation of regulated items increased (from 6.41% to 6.53%).

36. As for regulated items, upward pressures came from the CPI for fuels (from 7.79% to 8.75%) and from the CPI for regulated transport (from 5.22% to 5.43%). In the first case, the depreciation of the peso would have more than offset the reduction in the international price of fuels. Regarding public transport, the increase in its annual variation was due more to a low basis for comparison in the same month last year than to increases in the last month.

37. Within regulated items, public utilities continued to exhibit volatility, with high annual adjustments. In November, their annual variation was 6.76% *vis-à-vis* 6.98% in the previous month, having contributed to this decline the lower adjustments in the rates for aqueduct and gas services.

38. The non-tradable component of the CPI excluding food maintained a downward trend in November, hand in hand with mild declines in the annual variations in leases and indexed items (education and health services, among others). On the contrary, some items that are sensitive to the exchange rate exerted upward pressures, as did soccer tickets.

39. In November, the group of tradables (excluding food and regulated items) continued to exhibit the lowest adjustments within the main components of the CPI, with results that were once again lower than those forecast by the technical staff at the Central Bank. Also, the latest figures do not suggest a pass-through of the depreciation of the peso in recent months (from COP $2,800 per US dollar in April to about COP $3,200 in November). The reduction of the annual variation in November was made possible by lower monthly adjustments in items such as air tickets (-2.35%) and vehicles (-0.24%). The automobile show last month is likely to have contributed to this result.

40. Annual food inflation stopped increasing in November after three consecutive months of increments. This performance was led by perishable foods, whose annual variation reduced, reflecting the high supply of these items in recent weeks. Processed foods (which include several imported goods) tended to

increase slightly, perhaps affected by recent exchange-rate pressures. Meals outside the home did not exhibit significant changes.

41. In November, non-labor costs exerted downward pressures on consumer inflation, judging by the fall observed in the annual inflation of the total PPI for domestic supply (domestically produced and consumed items plus imported goods) from 4.23% in October to 3.32% in November. This fall was led by the local component (mining) decreasing from 5.0% in October to 3.47% in November, which can be attributed to the decline in the price of oil. On the contrary, the imported component (affected by depreciation) rebounded from 2.42% in October to 2.99% in November.

42. On the other hand, labor costs (industry, retail sales and construction wages) exhibited mixed behaviors. The annual adjustment in wages for housing construction (3.6%) and heavy construction (3.7%) remained stable, according to the information to November. The one for retail sales increased (from 6.0% to 6.5%), and the one for industry declined (from 6.3% to 5.2%), according to the data to October. Given the slack of the labor market, no inflationary pressures are expected from wage costs in the coming months.

43. The figures for inflation expectations by analysts', collected monthly, lowered to different horizons: to December this year, from 3.29% in November to 3.20% in December; to twelve months, from 3.67% to 3.50%; and to twenty-four months, from 3.38% to 3.26%. On the other hand, those embedded in public debt bonds (*Breakeven Inflation*, BEI) averaged, so far to 18 December, 3.89%, 3.78% and 3.71% to 2, 3 and 5 year-horizons, respectively. Measurements *vis-à-vis* the latest meeting of the Board of Directors on 30 November varied by 23 bp, -1 bp, and -18 bp, respectively.

44. Using the Forward Break-Even Inflation (FBEI) curve, the estimation of annual inflation for 2018 is 3.20% (obtained by adding the inflation expectations for the remainder of the year to the accumulated observed inflation). For 2019, 2020 and 2021, it is 3.71%, 3.68% and 3.71%, respectively.