PUBLIC VERSION

Working Papers from the

Board of Directors

Banco de la República

Monetary Policy Report

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Economic Studies Division

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I. External Context and Balance of Payments

1. In recent months there has been a recovery in the terms of trade due to increases in the prices of the main products exported by the country. Particularly, oil has returned to levels close to USD $50 per barrel, remaining close to that level since May. This led the technical staff at *Banco de la República* to revise the forecasts for the rest of 2016 upward.

2. The stability in the price of oil would be associated with a reduction in the excess supply due to lower production and investment in the United States, decreases of production in some countries, and better figures of economic growth for China.

3. Since the end of June, the main event in the international scenario was the *brexit*, which had an immediate impact on the volatility of the financial markets, which declined thereafter. The rates for European and United States' bonds fell sharply (in some cases reaching negative levels), as also did the risk premia for Latin America. Additionally, capital flows to emerging economies have increased.

4. As for the United States, performance in the first quarter (1.1% a.q.) was lower than expected. However, according to the most recent indicators, the second quarter should be more dynamic than the first. During July, positive data on the labor market and housing construction were published. Regarding prices, total inflation remains at low levels, while core inflation is close to the Fed's target (2.0%).

5. While the euro zone has exhibited growth indicators that would raise the forecasts, the uncertainty generated by the *brexit* darkens the outlook for the region. The first data for June still show no deterioration in the confidence of agents. Meanwhile, inflation remains stable at low levels.

6. In China, GDP in the second quarter was slightly higher than expected. The economy is exhibiting a slower expansion of investment, while retail sales continue to grow at the same pace as last year.

7. In Latin America, the most recent information on GDP shows that Chile and Mexico continue with low growth rates, while Brazil, Ecuador and Venezuela would continue in recession. However, there are indications that the recession in Brazil might be reaching an end. Peru stands out with expansions of its output over 4.0%.

8. Inflation in the region has ceded, approaching the target ranges set by its monetary authorities, except for the Colombian economy. Only Mexico and Colombia have increased their reference rates recently.

9. The exchange rate in the countries of the region has been relatively stable in recent weeks, with Chile and Brazil presenting slight appreciations. However, depreciations have taken place over the past few days in Colombia, Chile, and Peru.

10. Finally, last week, Fitch Ratings reduced the outlook of the Colombian economy to negative. Justifications for this downgrade are associated with the high current account deficit and the level of public indebtedness.

a. Exports

11. In May, the value of exports in US dollars registered a yearly 20.0% fall due to setbacks in external sales for all groups of products. The strong fall in the group of mining goods stands out (-28.6%). Year to date, exports have registered a 27.9% decrease, also with a substantial decline in external sales of mining goods (**Table 1**).

Table 1: Behavior of Exports in US dollars

May 2016			
	Annual Variation	Main contributing items:	
		Item	Annual variation of the item
Total	-20.0%		
Agricultural goods	-2.5%	Coffee	-22.1%
		Flowers	-4.3%
Mining goods	-28.6%	Oil	-52.1%
Other exports*	-9.1%	Chemical products	-20.5%
		Others	-20.6%
Accumulated value for January-May 2016			
Total	-27.9%		
Agricultural goods	-6.7%	Coffee	-15.0%
		Flowers	-3.2%
Mining goods	-40.7%	Oil	-53.9%
		Coal	-22.8%
Other exports*	-10.2%	Chemical products	-16.5%
		Others	-16.7%

* By destinations, the falls toward Venezuela (29.9%) and to Ecuador (19.5%) stand out. Contrastingly, an increase was observed in external sales of this item towards the European Union (20.1%), and United States (5.0%). Source: DANE

12. So far this year, the index of the quantities of total exports registered a 4.6% yearly fall, while the price index fell 24.6%.

13. According to the preview for foreign trade by DIAN, exports excluding oil grew -7.5% on a yearly basis in June.

b. Imports

14. In May, CIF imports in US dollars registered an annual fall of 19.3% due to setbacks in all groups of goods. The contraction of imports of capital goods stands out: -20.1%. So far this year, external sales have fallen 22.4% (**Table 2**).

Table 2: Behavior of Imports in US dollars

May 2016			
	Annual Variation	Main contributing items:	
		Item	Annual variation of the item
Total	-19.3%		
Capital Goods	-20.1%	Industrial machinery	-23.1%
		Office Machines and appliances	-19.1%
Raw materials	-19.9%	Fuels	-33.3%
		Mining Products (for industry)	-21.1%
Consumer Goods	-17.0%	Private vehicles	-24.6%
		Weapons and military equipment	-97.7%
Accumulated Value for January-May 2016			
Total	-22.4%		
Capital Goods	-33.3%	Transport equipment	-67.9%
		Industrial machinery	-26.8%
Raw materials	-15.8%	Chemical and Pharmaceutical products	-14.0%
		Mining Products (for industry)	-22.7%
Consumer Goods	-18.2%	Private vehicles	-28.8%
		Pharmaceutical products and toiletries	-10.3%

Source: DANE

15. So far this year, the index of the amounts of total imports registered an 8.8% yearly fall, while the price index fell 14.9%. This would indicate that external sales fall due to a combined effect of reductions in prices and quantities, although the former continues to be more important.

16. According to the preview for foreign trade by DIAN, CIF imports recorded a 15.5% annual fall in June.

II. Projections of External Variables

a. External Growth Scenarios
Baseline or more likely scenario (Table 3)

17. In the present report, growth forecasts for both the United States and Ecuador, two of the main trading partners of Colombia, were revised downwards for 2016. Additionally, the forecast for China was revised upwards. However, growth for the group of countries with which Colombia holds trading relations remained at 0.6%. It is expected to accelerate to 1.6% towards 2017.

18. Regarding the United States, consumption and residential investment are expected to lead growth; the labor market is also expected to continue recovering. Meanwhile, non-residential investment and exports

will be affected negatively by the strength of the US dollar, weak global demand, and global uncertainty. Inflation will remain close to current levels, with some increases in 2017.

19. Given the aforesaid, together with greater risks perceived at the global level, the increase in the policy rate of the Fed would be slower than anticipated in the March Inflation Report. The next increase of this rate would take place towards the end of 2016 or early in 2017.

20. The economy of the euro zone would also be supported by consumption and investment, as exports are not likely to contribute to growth in the region. The ECB would maintain a highly expansive policy, expanding the existing measures. The *brexit* implies financial, economic and political risks whose consequences are difficult to quantify with the information available. The impact is expected to be significant in the United Kingdom and in the euro zone, and that the effects be greater in 2017.

21. In China, the economy is expected to continue with a slow deceleration.

Table 3: Growth Projections of some Trading Partners

Economic Growth Forecasts for Colombia's main Trading Partners

Country or Region	2016			2017		
	Low	Baseline	High	Low	Baseline	High
USA	1.3	1.9	2.3	1.2	2.2	2.6
Euro Zone	0.8	1.6	2.0	0.0	1.2	1.8
China	6.2	6.6	6.9	5.2	6.2	6.6
Brazil	(4.5)	(3.5)	(2.8)	(0.5)	0.7	2.0
Ecuador	(5.0)	(3.0)	(1.0)	(3.0)	(1.0)	1.0
Venezuela	(10.0)	(7.0)	(4.0)	(7.0)	(4.0)	(1.0)
Peru	3.0	3.8	4.2	3.0	4.2	5.0
Mexico	1.8	2.4	2.8	1.8	2.7	3.3
Chile	1.2	1.8	2.2	1.5	2.5	3.5
Trading partners	(0.4)	0.6	1.4	0.4	1.6	2.5

22. Regarding the prices of commodities exported by the country, the forecast of several of them for 2016 and 2017 was revised upwards in this report. Particularly, in the case of oil, an average price of USD $43 per barrel (Brent) is expected for this year, which implies a level of USD $46 per barrel in the second semester, and of USD $50 per barrel for 2017.

Risks to the Baseline Scenario

23. Some downside risks in the central scenario are:

    a. A generalized drop in consumer and business confidence due to terrorist threats and the political uncertainty in several countries.
    b. The fragile situation of Italy's financial system and the impact that an eventual crisis at this level might have on the economies of other countries of the European periphery.
    c. A stronger-then-expected slowdown in China due to problems of financial stability.
    d. Political uncertainty in the United States.

b. Projection of the Balance of Payments

24. During the first quarter of 2016, the current account deficit was US$ 3,381 m, US$ 1,809 m lower than last year. As a proportion of GDP, it stood at 5.6%, which meant a reduction of 1.4 pp compared to 7.0% of GDP during the first quarter of 2015. This was the result of a contraction of debits greater than the one of credits.

25. A reduction in the trade balance deficit for goods and services was observed, lower net outflows by factor income and higher income from current transfers.

26. The reduction in the trade deficit for goods (US $324 m) was the result of a substantial contraction of imports in USD ($3,308 m, i.e., -24.5%), which more than offset the reduction of exports by USD $2,984 m (-29.7%).

27. Added to this was a lower deficit by factor income (US $762 m) and a reduction in net outflows related to services (USD 571 m) compared to a year ago. In both cases, this was the result of a significant reduction of the debits associated with these items.

28. The adjustment observed in the current account deficit was higher than estimated in the March report. The discrepancy is explained mainly by a

stronger-than-expected reduction in profits of enterprises with FDI and in the net outflows of the balance of services.

29. Regarding capital flows, net inflows were recorded (without reserve assets) for USD $3,339 m, lower by USD $2,019 to those observed a year ago, when they reached USD $5,358 m.

30. Net direct investment (USD $3,594 m) rose by USD $668 m compared to the one observed in the first quarter of 2015. This was the result of an increase in FDI which was partially offset by higher direct investment by Colombians abroad. In the case of FDI, the increase in the flow is explained mainly by the sale of Isagen. Discounting this transaction, FDI declined around 31.0%.

31. On the other hand, the country received USD $2,169 m of foreign portfolio investment during the first quarter of 2016, lower by USD 1,892 m to the one obtained a year ago.

32. Due to other capital flows, the country constituted assets abroad by USD $2,060 m, originated particularly in deposits made by entities from the public sector. This amount contrasts with net disbursements of USD $1,733 m received in the first quarter of 2015.

33. For the remainder of 2016, it is estimated that the trend of adjustment of the current external imbalance observed in the first quarter will be maintained, which would be favored additionally by a better-than-expected scenario for prices of raw materials for the second semester compared to the forecast of the March Report.

34. For 2016, a lower current account deficit is forecast, both in US dollars as well as relative to GDP (around 5.3%, USD $14,978 m). This forecast incorporates the effect of the additional fall in the price of oil (although lower than the one expected in the previous Report) on different accounts of the external balance, as well as the effects of a moderate deceleration of economic activity in Colombia. In this sense, it is estimated that the balance in trade of goods would remain in deficit, but less than the one recorded in 2015. Table 4

Table 4

BALANCE OF PAYMENTS - (Millons of US dollars)	2015	2016
		Baseline
CURRENT ACCOUNT (A+B+C+D)	**(18,755)**	**(14,978)**
Percentage of GDP	**(6.4)**	**(5.3)**
A. Goods	**(13,918)**	**(12,524)**
a. Exports	38,121	31,413
Main products	23,854	17,854
Other exports	14,267	13,558
b. Imports	52,038	43,937
B. Non-factor Services	**(4,145)**	**(2,728)**
C. Factor Income	**(5,809)**	**(5,208)**
D. Current Transfers	**5,117**	**5,483**

35. Regarding the projection presented a quarter ago for 2016, a lower contraction of traditional exports is estimated, particularly due to the revision of price of oil from USD $35 to USD $43 per barrel (Brent). On its part, the growth forecast of exports excluding main products (others) was revised downwards due to the greater slowdown of these external sales in the first semester compared to what was expected. Consequently, in the baseline scenario, exports of the main products would fall around 25.2%, while total exports in US dollars would contract 17.6%.

36. Additionally, the forecast of external purchases is somewhat lower than the one presented three months ago, given the behavior exhibited by external purchases so far this year and the slowdown estimated for domestic demand, particularly due to the fall of intensive investment in imports. Thus, external purchases in US dollars would contract compared to those observed in 2015 (-15.6% yearly).

37. Similarly, an additional reduction in the deficit of the balance of services is forecast compared to the one observed in 2015, driven by the effects of depreciation on the net balance of some services such as business and tourism, and the reduction of prices of imported services such as cargo freight. A decrease in net outflows related to factor payments is also expected, associated particularly with lower remittances of profits from the mining and energy sector as well as from the other sectors. In both cases, the reduction of the deficit in services and factor payments is lower than expected a quarter ago, given the

impact of the recovery of the price of oil on the value of the freight and revenues from the mining-energy sector.

38. As for financing of the 2016 deficit, capital flows are expected to be lower than those estimated for 2015, affected mainly by a reduction in the flows from the foreign investment portfolio. Particularly, lower resources derived from bonds placed in international markets are estimated for both public and private sectors, as well as lower investment by foreigners in the local public debt market. This would be partially offset by higher net inflows of direct investment and resources from external credit (**Table 5**).

Table 5

BALANCE OF PAYMENTS - (Millons of US$)	2015	2016 Baseline
CAPITAL AND FINANCIAL ACCOUNT (A+B+C+D+E)	**(18,948)**	**(14,978)**
A. Net Foreign Investment in Colombia	**(7,724)**	**(8,437)**
a. Foreign Investment in Colombia	11,942	11,937
b. Colombian Investment abroad	4,218	3,500
B. Portfolio Investment	**(9,531)**	**(1,463)**
a. Public sector	(6,212)	(3,283)
b. Private sector	(3,319)	1,820
C. Derivative Instruments	**1,544**	**(190)**
D. Other investment (loans and other credits)	**(3,651)**	**(5,420)**
a. Assets	(429)	(522)
b. Liabilities	3,222	4,898
E. Reserve Assets	**415**	**533**
ERRORS AND OMISSIONS	(193)	0
Financial Account without Reserve Assets	**(19,363)**	**(15,510)**

39. Net foreign direct investment is projected to be greater than last year as a result of lower FDI resources for all sectors in general, but to a greater extent in oil and mining, which would be more than offset by resources resulting from the sale of Isagen and lower investment by Colombians abroad compared to the figures observed for 2015.

40. The greatest income from external credit would be associated with a higher indebtedness of the national government with multilateral banks, and to other credits to the rest of the non-financial public sector.

41. Uncertainty around the conditions and availability of financing, as well as the sensitivity of some capital flows to the prospects of the mining-

energy sector and economic activity in general, determine the forecast range for the current account deficit in 2016, which would stand between 4.6% and 5.8% of GDP.

42. For 2017, a lower current-account deficit is foreseen, both in US dollars as well as relative to GDP. This would be mainly associated with a better result of the goods trade balance, together with a better outlook for the prices of some of the main export products, a recovery of country´s main trading partners, and an additional reduction of the deficit in services.

III. Growth, Domestic Demand and Credit

43. The available information suggests that the Colombian economy would have expanded at a slightly faster pace than the one recorded during the first three months of 2016 (2.5%). The forecasts presented here incorporate the calendar effect on GDP growth, on account of a greater number of working days and the Easter holiday in March (instead of in April, as was the case last year).

44. During the second quarter of the year, domestic demand would have grown at a somewhat faster pace than in the first quarter, within a context in which the fall in the terms of trade would not have deepened and in which the exchange rate showed no further depreciation. By components, investment would have fallen at a slower pace, which would have offset the moderation of private consumption and low growth rates for public consumption. Additionally, net exports would have contributed positively to the expansion of GDP, according to the most recent figures for foreign trade (in constant pesos).

45. This is the outlook according to short-term indicators. On the one hand, the seasonally adjusted series of the economic activity index (ISE) published by DANE rose 0.6% on a yearly basis in April (compared to 3.0% of the aggregate for the first quarter of 2016).

46. In May, the retail sales index (excluding fuels) of the Monthly Survey of retail trade (EMCM) of DANE recorded a 0.8% fall compared to the same month in 2015. The two-month period of April-May exhibited a

2.3% growth on a yearly basis, which denotes an acceleration compared to the figure of 1.5% for the first three months of the year.

47. Excluding vehicle sales, the indicator grew 0.1% on a yearly basis during the same month. The two-month period of April-May exhibited a 2.7% growth on a yearly basis, a figure lower than that for the aggregate of January-March (3.5% on a yearly basis).

48. On its part, the index of vehicle sales in the survey fell 5.9% on a yearly basis in May, and for the period of April-May it fell -0.3%, with which the behavior was less negative than that of the first quarter (-9.3%).

49. Other auxiliary indicators, somewhat correlated with the growth rate for household consumption, also suggest a slowdown of this component of the GDP during the second quarter of the year.

50. The Consumer Confidence Index (ICC) published by *Fedesarrollo* with information to June recorded no significant changes compared to May and April. Although the level of the aggregate for the second quarter was slightly higher than in the first, it continues significantly below the average calculated for the series since November 2001.

51. Something similar can be inferred from the results of the Monthly Survey of Economic Expectations (EMEE) by *Banco de la República* to May. The balance of sales in this survey suggests a slight slowdown of private consumption for the second quarter of 2016.

52. Regarding the labor market, the seasonally adjusted series of the unemployment rate (TD) shows a moderate upward trend for the national total since a year ago. In the case of urban areas, the TD does not present a clear trend. However, the decline in the TD observed in recent months is explained by a fall of TGP. Total employment has slowed down, but it continues to be driven by increases in salaried workers. As for wages, in general terms, the adjustments continue above the inflation target, but below inflation in June.

53. The indicators related to gross fixed capital formation suggest that investment (other than construction of buildings and civil works) would have recorded a setback of less magnitude than the one observed for the

first quarter of the year. This is derived from analyzing the figures for imports of capital goods in constant pesos, which allow to foresee lesser contractions of investment in machinery, equipment, and transport equipment during the second quarter of 2016.

54. The results of the balance of investment expectations of the survey in May also suggest that gross formation of fixed capital, excluding construction of buildings and civil works, would fall at a somewhat slower pace than the one recorded during the first three months of the year.

55. Regarding investment in construction of civil works and buildings, growth rates higher than those which would have been observed for the other items of the GDP are foreseen. In the first case, despite the lower level of implementation of local and regional governments (product of the effect of the political cycle), there is a relatively low base than in the same period last year. In the second, the behavior of the construction licenses suggest a good performance of this item in the second quarter.

56. Regarding foreign trade, an expansion of real exports is foreseen for the second quarter. This is derived from the figures for exports in US dollars converted to constant pesos. Additionally, the dynamism of exports of services observed in the balance-of-payments to the first quarter of the year is expected to continue.

57. Something similar occurs with imports. When converting the figures of purchases abroad in US dollars to constant pesos, contractions for the aggregate of the second quarter can be appreciated. These falls would have taken place mainly in capital goods and durable consumption goods, consistent with the behavior shown by investment different from construction and durable consumption during that period.

58. On the supply side, the indicators available for the second quarter of 2016 show mixed results. While those for industry suggest a favorable performance, those associated with mining, agriculture, and energy suggest a lower dynamism.

59. According to the Monthly Manufacturing Survey (EMM) by DANE, the Industrial Production Index (IPI) excluding coffee threshing grew

4.5% in May, which meant a 6.3% expansion for the two-month aggregate of April-May (greater than the figure of 5.4% in the first quarter). Excluding oil refining, the growth rates for May and the two-month period were 0.7% and 3.1%, respectively. The latter was greater than the 2.3% registered in the first quarter.

60. Added to this behavior, improvements in the volume of orders and the stock level (countercyclical to production) were reported in June by the enterprises business opinion survey (EOE) by *Fedesarrollo*. However, production expectations from the same survey to three months recorded a fall in the margin.

61. As for trade, the same survey reported that traders perceive a somewhat lower level for the balance of the current economic situation. In spite of this, the trend component of this series shows a positive slope. On the other hand, declines in the balance of sales expectations to six months were recorded in June, a fact that contrasts with the perception of the current economic situation and with the good results submitted after the EMCM for May.

62. The indicators for energy, gas and water utility sectors suggest a mediocre performance of this branch. In June, total energy demand fell 0.3% on a yearly basis. The trend component of the series continues to deteriorate versus the records for late 2015. The aggregate for the second quarter of 2016 fell 0.05%, which contrasts with the 4.5% increase on a yearly basis observed for the aggregate of the first three months of the year.

63. Also, according to the latest information from the National Hydrocarbons Agency (ANH), in June, oil production stood at 888 mdb, which represented an 11.8% fall versus the same month in 2015. Thus, the aggregate for the second quarter contracted 11.5%, which represented a further slowdown compared to the figure for the first quarter of the year (-7.4%).

64. As for agriculture, according to the National Federation of Coffee Growers of Colombia (FNC), coffee production fell 6.6% on a yearly basis in June. The aggregate for the second quarter of 2016 grew 1.1% on a yearly basis, slowing down when compared with the records for

the first quarter of the year and for all of 2015 (8.9% and 16.8%, respectively).

65. All of the above allows foreseeing a yearly expansion of GDP for the second quarter of 2016 somewhat greater than the one observed in the first quarter of the year. Thus, this Inflation Report expects an economic growth between 2.0% and 3.2%. For all 2016, the technical staff at *Banco de la República* foresees an annual GDP expansion of around 2.3%, within a range of 1.5% and 3.0%.

IV. Behavior of Inflation and Prices

66. By the end of the first semester of 2016, yearly consumer inflation stood at 8.60%, a level 40 bp higher than the previous month (**Table 6**). Accumulated inflation in the first six months closed at 5.10%, above the 3.33% registered in the same period of 2015. Monthly variation stood at 0.48%, a figure that exceeded the forecasts of the market (0.28%) as well as those of the technical staff at the Central Bank.

Table 6

Description	Weight	dic-14	dic-15	mar-16	abr-16	may-16	jun-16	Participation percentage in monthly acceleration	Participation percentage in acceleration of the year to-date
Headline inflation	**100.00**	**3.66**	**6.77**	**7.98**	**7.93**	**8.20**	**8.60**	**100.00**	**100.00**
Non-food inflation	**71.79**	**3.26**	**5.17**	**6.20**	**6.02**	**6.07**	**6.31**	**45.15**	**43.32**
Tradables	26.00	2.03	7.09	7.38	7.57	7.88	7.90	**2.69**	10.32
Non-tradables	30.52	3.38	4.21	4.83	5.00	4.78	4.97	**15.98**	12.89
Regulated items	15.26	4.84	4.28	7.24	5.78	6.00	6.71	**26.47**	20.11
Food inflation	**28.21**	**4.69**	**10.85**	**12.35**	**12.63**	**13.46**	**14.28**	**54.85**	**56.68**
Perishables	3.88	16.74	26.03	27.09	28.62	33.44	34.94	11.76	23.92
Processed food	16.26	2.54	9.62	10.83	10.89	11.04	12.09	38.95	22.33
Eating out	8.07	3.51	5.95	7.53	7.53	7.92	8.11	4.14	10.43
Core inflation indicators									
Non-food inflation		3.26	5.17	6.20	6.02	6.07	6.31		
Core 20		3.42	5.22	6.48	6.69	6.55	6.82		
CPI excluding perishable foods, fuel and utilities		2.76	5.93	6.57	6.72	6.61	6.77		
CPI excluding food and regulated items		2.81	5.42	5.91	6.08	6.08	6.20		
Average of core inflation indicators		**3.06**	**5.43**	**6.29**	**6.38**	**6.33**	**6.52**		

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

67. All the major components of the CPI basket contributed to the acceleration of yearly inflation between May and June. However, food and regulated items concentrated the greatest upward pressures. In contrast, non-tradables and tradables excluding food and regulated items contributed little to this rebound.

68. Core inflation, measured by the average of the four indicators monitored by the Central Bank, increased in June, reaching 6.52%

(compared to 6.33% in May). All indicators rose in the last month, with core 20 bearing the highest increase (6.82%) and the CPI excluding food the lowest (6.20%). The CPI excluding food rose from 6.07% in May to 6.31% in June.

69. The increase in the CPI excluding food was concentrated in regulated and non-tradable items. The yearly rebound in the case of regulated items in June was associated with major adjustments in the rates of public utilities (12.5%), especially by the increases in energy rates (which rose from 9.8% in May to 13.6% in June). These rates have exhibited high variability recently on account of the lag with which the decisions of the energy savings plan (implemented by the government to counteract the effects of the most recent *El Niño)* are transmitted to the CPI. Annual variations of the CPI for gas, water and sewage also increased, but on a much smaller scale. As for fuels, prices have remained stable in the last month, with which their yearly variation stood at -3.63%.

70. The yearly variation of non-tradables excluding food and regulated items rose to 4.97% from 4.78% in May. This behavior was concentrated in the CPI for services related with entertainment, particularly soccer tickets, so this is a transitory shock. The other segments of the non-tradable group excluding food and regulated items remained stable: leases at 4.17%, indexed (by CPI or salary) at 6.03%, and the items affected by the exchange rate at 5.75%.

71. After three months of continuous increases in their yearly variation, the group of tradables excluding food and regulated items showed no changes of importance in June (closing at 7.90%). Anyhow, significant increases in the prices of several items such as vehicles and school fees, among others, continued to be seen.

72. Regarding the CPI for food, its yearly variation rose from 13.46% in May to 14.28% in June. These results were higher than those expected by the technical staff at the Central Bank and by the market.

73. Inflationary pressures on food prices focused on the group of processed foods, which includes beef, one of the items whose price increased the most (its yearly variation rose from 14.0% in May to 18.7% in June).

The increase of this price in recent months would be partly explained by *El Niño*, which decreased the weight of the herd, and the consolidation of a cattle-retention phase (diminished supply and upward prices) as reported by the cattle-raising guild. According to them, this retention phase would take as long as the end of the year.

74. Perishable goods also pushed food inflation upwards, moving from 33.44% in May to 34.94% in June. This last subgroup exhibited significant increases in the prices of several products, including potato. Apparently, food supply (particularly perishables) in urban centers was negatively affected by the agricultural strike (from 31 May to 12 June), and more recently by the trucking strike that began on 6 June and lasted until July 22.

75. It is likely that the effects of the latter bring a further increase in food prices in CPI from DANE for July. Consequently, the impact of these strikes (not referred to in prior forecasts) must be added to the effects of *El Niño* anticipated in previous reports. On previous occasions, once the strikes have been overcome, prices have returned to normal levels quickly. This is expected to happen again in August and September.

76. On the other hand, the annual CPI for meals outside the home increased slightly in June, standing at 8.11%.

77. Non-labor costs continued to exert upward pressures on consumer inflation. Yearly variation of the PPI for domestic supply (domestically produced and consumed items plus imported goods) remained high, although less than in May (9.64% vs. 9.96%). The decline is explained by the PPI for imported goods, whose yearly adjustment fell from 11.5% in May to 9.99% in June. By contrast, the yearly growth of the PPI for domestically produced and consumed goods moved from 9.3% in May to 9.5% in June, explained mainly by agricultural/livestock and industrial products.

78. Regarding labor costs with information to May, wage adjustments for industry and trade continued close to the increases in the minimum wage and inflation of the end of last year (7.3% and 6.6%, respectively). As for construction, the adjustments remain lower, between 4.0% and 4.5%.

79. Inflation expectations to December 2016, obtained from the monthly survey to financial analysts at the beginning of July, rose from 6.23% in June to 6.53%. Similarly, inflation expectations to 12 months increased from 4.37% in June to 4.61% in July. Expectations to 24 months showed no significant changes, moving from 3.67% to 3.68%. On the other hand, inflation expectations from the latest quarterly survey of July 2016 stood at: 7.36% to December 2016, 6.09% to 12 months, and 5.40% to 24 months. Finally, on average to July 26, versus average data from June, break-even inflation embedded in Colombian sovereign bonds in pesos and UVR remained stable (increasing 5 bp and 3 bp for 2 and 3 years, respectively, while those for 5 years decreased 1 bp). Thus, the average BEI so far in July to 2, 3 and 5 years posted at 4.47%, 4.22%, and 3.99%, respectively.