



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. The main news for the Colombian economy from the external front is the view that increases in the benchmark interest rate in the United States by the Fed would be slower than what the market and the technical staff of *Banco de la República* expected in the March Inflation Report. This is due to the decision of the FOMC at its meeting of June not to increase the benchmark rate and the announcements that it perceives that the US economy would be weaker than anticipated.
2. On the other hand, in June, Colombia's terms of trade indicator would have continued to show higher levels than those observed at the beginning of the year, thanks to the fact that international prices of oil and other commodities exported by the country would have stabilized (oil) or would have continued to increase (coffee, coal and nickel), compared to the records of the previous month. Part of the effect of this on the terms of trade would be offset by the recent increases in international prices in some of the foodstuffs imported by the country, which would be associated with falls in supply due to climatic factors.
3. Regarding oil, so far in June its international price has remained at about USD \$50 per barrel for Brent, above the forecast of the technical staff of the *Banco de la República* in the March Inflation Report. This is the result of a drop in global supply due to several unexpected cuts in production. Additionally, production and inventories in the United States continue to decline gradually. Despite this, high production in the OPEC countries, high levels of global inventories, weakness of the overall economic activity and the possibility that production could resume in some wells that were not profitable with the low prices of the beginning of the year are important downside risks and suggest that prices would not exceed their current levels.
4. A few days prior to the meeting of the Fed, risk aversion in international financial markets increased, and the US dollar strengthened. This would be associated with uncertainty around the normalization of the Fed's monetary policy and with the risk of the UK exiting the European Union.
5. In this context, the long-term bonds rates in the United States and in the major countries of the euro zone fell. Latin American economies exhibited a small increase in risk premia and a slight weakening of their currencies.

6. The data available for April and May suggest that growth of the country's trading partners would have continued to be very modest. A downward revision for the remainder of the year has not been discarded.
7. In the United States, figures for May show a mixed outlook. On the one hand, the records for economic activity in the services sector point at a slowdown compared to the one observed at the beginning of the year, while the industrial sector continues to decline on a yearly basis. Additionally, job creation showed a significant moderation, considering that in May only 38 thousand new jobs were generated (versus 165 thousand expected by the market). In contrast, retail sales and consumer confidence suggest an improvement in the dynamics of household spending, which continues to be the main engine of this economy. Core inflation did not change *vis-à-vis* the previous month, remaining at 2.1%, while total inflation exhibited a slight setback, moving from 1.1% to 1.0%, and remaining below the long-term target level of the Fed (2.0%).
8. In the euro zone, figures for industrial production and retail sales in April suggest a slowdown compared to the first quarter. Consumer confidence and manufacturing industry indicators for May have remained relatively stable at levels that are consistent with a slow economic recovery. Regarding the variation in prices, in May, the indicators of total yearly inflation and core inflation did not exhibit significant changes and continue at low levels (-0.1% and 0.8%, respectively). In this context, the European Central Bank (ECB) continued with a highly expansive monetary policy.
9. In China, there was a fall in the growth of fixed asset investment in May, especially in the private sector, and in retail sales. The expansion rate for industrial production stabilized at historically low levels. These results suggest that the gradual slow down of this economy continues. On its part, annual inflation lowered versus the records from April, moving from 2.3% to 2.0%.
10. In Latin America, the figures for GDP growth in the first quarter for Chile, Mexico and Peru exhibit a yearly growth higher than in the past quarter, but lower than the average for the last few years. In Brazil, GDP continued to contract sharply in annual terms. In Ecuador and Venezuela, although there are no updated figures, strong deterioration of their terms of trade and the higher costs of external financing should deepen the recessions they are going through.
11. For the second quarter, the records of April of the monthly indexes of economic activity for Chile and Peru show a moderate growth compared to the first three months of the year. For Brazil, the index indicates that the economy continues

to contract sharply, although at a slower pace than in the first quarter of the year.

12. Concerning yearly inflation, the records of May for Brazil, Chile and Peru continued exhibiting reductions, although they remain at high levels with respect to the targets of their monetary authorities. Inflation in Mexico fell, remaining at the lower section of the target range of its central bank.

a. Exports and Imports

13. In April, the value in US dollars of exports registered a yearly fall of 24.8%, due to setbacks in the external sales of mining goods and the group of other exports. In contrast, during this month exports of agricultural goods grew 29.9% annually. Year to date, exports fell 30.0%, with a substantial decline in external sales of mining goods (**Table 1**).

Table 1 Behavior of Exports in US dollars

| April 2016 | | | |
|---|------------------|---|------------------------------|
| | Annual Variation | Main contributing items: | |
| | | Item | Annual variation of the item |
| Total | -24.8% | | |
| Agricultural goods | -29.9% | Coffee | 56.5% |
| | | Flowers | 12.8% |
| Mining goods | -41.0% | Oil | -52.2% |
| | | Coal | -25.9% |
| Other exports* | -14.7% | Chemical products | -22.1% |
| | | Food, beverages and tobacco, excl. Coffee | -12.6% |
| Accumulated value for January-April 2016 | | | |
| Total | -30.0% | | |
| Agricultural goods | -7.6% | Coffee | -13.6 |
| | | Banana | -2.8 |
| Mining goods | -43.9% | Oil | -54.6% |
| | | Coal | -33.6% |
| Other exports* | -10.5% | Chemical products | -17.8% |
| | | Others | -15.5% |

* By destinations, the falls towards Ecuador (45.0%) and Venezuela (44.3%) stand out. Contrastingly, an increase was observed in external sales of this item towards the European Union (41.6%), Asia (13.7%), and United States (3.8%).

Source: DANE

14. So far this year, the index of the amounts of total exports registered a 5.5% yearly fall, while the price index decreased 26.0%. This would suggest that the fall in the value of exports is due mainly to the decline in prices.

15. In May, according to the preview release of foreign trade by DIAN, exports excluding oil grew on a yearly basis 2.4%.
16. In April, CIF imports in US dollars registered an annual fall of 17.0%, due to setbacks of external purchases in all groups of goods. The contraction in imports of capital goods is remarkable: -23.3%. Year to date, imports fell 23.1% (**Table 2**).
17. So far this year, the index of quantities of total imports registered a 9.0% yearly fall, while the price index decreased 15.5%. This would be a sign that imports fall by a combined effect of reductions in prices and quantities.
18. According to the preview release of foreign trade by DIAN, CIF imports recorded a 20.2% annual fall in May.

Table 2 Behavior of Imports in US dollars

| April 2016 | | | |
|--|------------------|--------------------------------------|------------------------------|
| | Annual Variation | Main contributing items: | |
| | | Item | Annual variation of the item |
| Total | -17.0% | | |
| Capital Goods | -23.3% | Industrial machinery | -33.4% |
| | | Office appliances and machinery | -29.5% |
| Raw materials | -12.7% | Fuels | -51.1% |
| | | Chemical and Pharmaceutical products | -14.5% |
| Consumer Goods | -16.9% | Private vehicles | -23.4% |
| | | Pharmaceutic products and toiletries | -14.1% |
| Accumulated Value for January-April 2016 | | | |
| Total | -23.1% | | |
| Capital Goods | -36.0% | Transport equipment | -70.8% |
| | | Industrial machinery | -27.7% |
| Raw materials | -14.8% | Chemical and Pharmaceutical products | -14.4% |
| | | Mining Products (for industry) | -23.0% |
| Consumer Goods | -18.6% | Private vehicles | -29.9% |
| | | Pharmaceutic products and toiletries | -11.6% |

Source: DANE

19. According to the figures of the balance of payments, in the first quarter of 2016 the current account deficit was US\$ 3,381 million (m), equivalent to 5.6% of GDP. Compared to a year ago, the deficit lowered both in levels as well as relative to GDP. The annual reduction of the current account deficit in the first quarter of 2016 (US\$1,809 m) is mainly explained by a lower primary income deficit (US\$762 m) and a lower services deficit (US\$571 m). The lower trade balance deficit (US\$324 m) and the higher secondary income (US\$152 m) also contributed to this reduction.

II. Growth, Domestic Demand and Credit

20. According to the most recent publication of the quarterly national accounts from DANE, during the first quarter of the year economic activity expanded 2.5% compared to the same period of 2015, in line with the forecast of the baseline scenario presented in the previous *Inflation Report*. The increase between quarters was 0.2%, which corresponds to an annualized rate of 0.6%.
21. By branch of activity, the sectors that grew most were the industry and financial services. Mining was the only sector that exhibited a contraction (**Table 3**). Annual variations for non-tradables and tradables sectors were 3.4% and 1.0%, respectively. Excluding mining, tradable GDP expanded 2.4% on a yearly basis. In all cases, decelerations were observed compared to the fourth quarter.

Table 3 GDP on the supply side.

| Branch of activity | 2014 | 2015 | | | | 2015 | 2016 |
|--|------------|-------------|-------------|-------------|-------------|------------|-------------|
| | Whole Year | 1st Quarter | 2nd Quarter | 3rd Quarter | 4th Quarter | Whole Year | 1st Quarter |
| Farming, forestry, hunting and fishing | 3.1 | 2.2 | 2.4 | 3.0 | 5.8 | 3.3 | 0.7 |
| Mining and quarrying | (1.1) | 0.4 | 4.2 | (0.5) | (1.5) | 0.6 | (4.6) |
| Manufacturing | 0.7 | (2.0) | (0.1) | 3.2 | 3.9 | 1.2 | 5.3 |
| Electricity, gas and water | 3.4 | 2.5 | 1.6 | 3.8 | 3.8 | 2.9 | 2.9 |
| Construction | 10.5 | 3.1 | 8.1 | 0.2 | 4.6 | 3.9 | 5.2 |
| Buildings | 8.1 | 1.4 | 9.0 | (7.9) | 7.1 | 2.1 | 10.9 |
| Civil works | 13.4 | 4.7 | 6.5 | 7.1 | 3.2 | 5.4 | 0.4 |
| Retail, repairs, restaurants and hotels | 5.1 | 4.6 | 3.5 | 4.7 | 3.8 | 4.1 | 2.7 |
| Transportation, warehousing and communications | 4.7 | 2.6 | 0.4 | 2.2 | 0.7 | 1.4 | 1.8 |
| Financial, real estate and corporate services | 5.7 | 4.8 | 3.8 | 4.2 | 4.3 | 4.3 | 3.8 |
| Social, community and personal services | 5.2 | 2.4 | 2.5 | 3.4 | 3.5 | 2.9 | 1.7 |
| Subtotal value added | 4.3 | 2.5 | 2.9 | 3.0 | 3.4 | 3.0 | 2.5 |
| Taxes minus subsidies | 5.6 | 4.1 | 4.0 | 4.6 | 3.4 | 4.0 | 2.3 |
| GROSS DOMESTIC PRODUCT | 4.4 | 2.7 | 3.1 | 3.1 | 3.4 | 3.1 | 2.5 |

Source: DANE, calculations by Banco de la República

22. Related to expenditures, annual growth of domestic demand was 1.3%, somewhat higher than expected in the last *Inflation Report*. Total consumption recorded a 3.2% expansion as a result of growth of household consumption from 3.4% (a figure higher than the one of the fourth quarter of 2015) and a 1.6% expansion of public consumption (slowing down, as compared to the previous quarter). On the contrary, investment reduced due to falls in tradable sectors that were not completely offset by the performance of investment in the non-tradable sectors. Net exports contributed positively to GDP growth (**Table 4**).

Table 4 GDP on the side of demand.

| Branch of activity | 2014 | 2015 | | | | 2015 | 2016 |
|--|--------------|-------------|-------------|--------------|--------------|--------------|--------------|
| | Whole Year | 1st Quarter | 2nd Quarter | 3rd Quarter | 4th Quarter | Whole Year | 1st Quarter |
| Total consumption | 4.3 | 4.4 | 3.7 | 4.3 | 3.3 | 3.9 | 3.2 |
| Household consumption | 4.2 | 4.7 | 3.7 | 4.2 | 2.8 | 3.8 | 3.4 |
| Non-durables | 3.2 | 4.3 | 3.9 | 4.6 | 3.7 | 4.1 | 3.9 |
| Semi-durables | 3.1 | 5.9 | 2.8 | 6.8 | 3.2 | 4.6 | 3.9 |
| Durables | 13.5 | 10.5 | 2.4 | (7.0) | (11.9) | (2.0) | (4.6) |
| Services | 4.7 | 4.4 | 4.1 | 4.5 | 3.7 | 4.2 | 3.8 |
| Government final consumption | 4.7 | 2.2 | 2.3 | 3.1 | 3.8 | 2.8 | 1.6 |
| Net Capital Formation | 11.6 | 6.5 | 0.6 | 3.2 | 0.4 | 2.6 | (3.7) |
| Fixed net capital formation | 9.8 | 7.4 | 3.3 | 0.4 | 0.3 | 2.8 | (4.8) |
| Farming, forestry, hunting and fishing | 1.5 | (5.9) | (2.8) | 0.4 | 2.9 | (1.5) | (0.2) |
| Machinery and equipment | 7.1 | 0.7 | (1.9) | (0.3) | (5.4) | (1.8) | (10.1) |
| Transport equipment | 10.0 | 41.2 | 6.0 | 3.3 | (5.2) | 9.4 | (32.9) |
| Construction and building | 14.0 | 2.2 | 10.1 | (8.2) | 8.1 | 2.7 | 11.4 |
| Civil works | 11.0 | 3.4 | 6.4 | 7.0 | 4.2 | 5.2 | 0.4 |
| Services | 11.0 | 1.4 | 4.7 | (3.8) | 1.5 | 0.9 | 1.4 |
| Domestic Demand | 6.0 | 4.7 | 3.1 | 4.1 | 2.5 | 3.6 | 1.3 |
| Total Exports | (1.3) | 4.2 | 0.4 | (4.8) | (2.1) | (0.7) | 2.1 |
| Total Imports | 7.8 | 11.7 | 0.3 | 8.0 | (3.6) | 3.9 | (1.5) |
| GROSS DOMESTIC PRODUCT | 4.4 | 2.7 | 3.1 | 3.1 | 3.4 | 3.1 | 2.5 |

Source: DANE, calculations by Banco de la República

23. On the other hand, according to DANE, the seasonally adjusted series of the Economic Activity Index (ISE) registered a 3.5% growth on a yearly basis in March 2016. The accumulated value for the first three months of the year grew 3.1%, a figure higher than the one of GDP.
24. The information available for the second quarter is still preliminary, but the results of the surveys of industry and retail to April foresee a better performance than the one recorded in the first quarter, partly due to calendar effects and in line with the forecast of the technical staff.
25. In April, the figures of the monthly survey of retail sales (EMCM) of DANE revealed a 5.8% increase compared with the same month of 2015, accelerating *vis-à-vis* March, which exhibited a 3.6% fall on a yearly basis. In other regards, the estimates by the technical staff of the Central Bank that correct for the calendar effects suggest that total sales would have increased 2.8% in April (vs. 1.4% for the first quarter). It also shows stagnation in the trend component.
26. Excluding vehicle sales, the remaining aggregate increased 5.8% annually in April, which represents an acceleration compared to -1.0% in March and 1.6% in the first quarter. In the case of motor vehicle sales, the increase was 5.6%, a higher rate than the one in March (-16.7%) and that of the first quarter (-9.3%). Correcting for calendar effects, sales excluding vehicles would have increased 4.6% in April while vehicle sales would have fallen 2.8% on a yearly basis (a better record than in the first quarter, -5.8%).

27. Other auxiliary indicators confirm these results. The figures to May from the Colombian Automotive Committee (ACC) report for licenses revealed an annual 13.6% fall in this aggregate. With this, the April-May figures recorded a 10.4% contraction, slightly lower than the -17.5% of the first quarter. By segments, the falls were observed in both vehicles for private use, with -12.8% annually (durable consumption), and commercial use with -14.4% (investment in transportation equipment).
28. The results of the Monthly Survey of Economic Expectations (EMEE) of the Central Bank to April suggest that sales would not have varied significantly versus March. In spite of this, the quarterly moving average continues to show a negative slope, which might suggest a slowdown in private consumption.
29. The survey to consumers by *Fedesarrollo* suggests something similar. In May, the Consumer Confidence Index (ICC) recorded no significant changes compared to the data from April, but it is still significantly below the average of the series calculated since November 2001.
30. The labor market indicators do not reveal a clear trend. In April, the series for the unemployment rate continued increasing in annual terms in all domains, except for the thirteen areas. However, in the moving quarter (with seasonally adjusted series) completed in April, the unemployment rate of the thirteen areas decreased to levels similar to those observed mid last year, and close to their lowest levels since 2000. Additionally, employment has continued to slow down in the national total, while showing some recovery in the thirteen areas on back of salaried employment.
31. Regarding investment excluding construction of buildings and civil works, data of imports of capital goods (in real terms) and the balance of investment expectations of the EMEE to April continue anticipating a new contraction of this expenditure in the second quarter of 2016.
32. On the supply side, the indicators available for the second quarter of 2016 show mixed results. Those related to industry and trade had good dynamics, while other associated with agriculture, mining and energy revealed a less optimistic performance.
33. According to DANE, the industrial production index excluding coffee threshing presented an annual 8.4% increase in April. Excluding oil refining, the real production of manufacturing increased 6.2% compared to the same month in

2015. In both cases, an acceleration with respect to March was registered. This apparent better behavior was due largely to the calendar effect of Easter and the holidays. The estimates of the technical staff correcting the calendar effects show that in April, total industry and excluding oil refining would have grown 2.6% and 0%, respectively.

34. On its part, the business opinion survey by Fedesarrollo revealed that, in April, there were increases in the volume of orders and falls in the level of stock (countercyclical to production). Production expectations to three months continued exhibiting a good performance, both in the original series as in its trend component.
35. In the case of the retail sector, the same survey revealed improvements both in the perception of the current economic situation as well as in the economic situation expected six months ahead. The trend component of the two series registered a positive slope, which foresees a good performance of this branch of the GDP.
36. In construction, growth of production and cement shipments in April stood out (5.0% and 5.9%, respectively). Both series have shown acceleration compared with the aggregate of the first quarter. Correcting the calendar effects, the growth rates for these series were 0.6% and -1.5%.
37. In contrast with the above, with information to May, total energy demand fell by 2.0% on a yearly basis. The trend component of the series continues to deteriorate. According to the reports by XM, non-regulated energy demand from the industry recorded a 1.7% contraction.
38. In the same month, according to the National Coffee Growers Federation of Colombia (FNC), coffee production fell 0.2% annually. With this, the aggregate of the two-month period of April-May expanded 5.6%, a lower rate than the one recorded for the first quarter of the year (8.9%).
39. In the case of mining, according to the latest information from the Ministry of Mining and Energy, in May, oil production fell 12.0% *vis-à-vis* the same month of the previous year. Thus, the aggregate of the two-month period of April-May fell 11.4%, which represented a further slowdown compared to the registry of the aggregate for the first quarter of the year (-7.4%).
40. For the second quarter of 2016, GDP growth is forecast to be higher than the one observed in the first three months of the year, influenced by the calendar

effect of Easter and the holidays. For all 2016, the growth forecast would stand between 1.5% and 3.2%, with 2.5% as the most likely outcome.

III. Behavior of Inflation and Prices

41. Yearly consumer inflation in May stood at 8.20%, a level 27 bp higher than the previous month (**Table 5**). Year to date, the increase in the CPI amounted to 4.60%, above 3.22% observed in the same period of 2015. The monthly variation stood at 0.51%, a figure that exceeded the forecasts of the market (0.41%).
42. The increase in yearly inflation in May was explained mainly by the food segment, especially due to the larger adjustments observed in the prices of perishable goods. Tradables and regulated items also contributed to the acceleration of yearly inflation. The non-tradable CPI was the only subgroup that exhibited decreases in the annual variation.
43. Despite the increase in total inflation, core inflation, measured as the average of the four indicators monitored by the Central Bank, lowered slightly for the first time since September 2014 (moving from 6.38% in April to 6.33% in May). Three of the indicators either fell or remained unchanged in the last month, with the CPI excluding primary foodstuffs, fuels and utilities (the latter at the highest level) falling to 6.61% and the Core 20 CPI to 6.55%, while the CPI excluding food and regulated items remained at 6.08%. The only indicator that increased was the CPI excluding food, although very slightly (from 6.02% in April to 6.07% in May)

Table 5

Behavior of Inflation to May, 2016

| Description | Weight | dic-15 | mar-16 | abr-16 | may-16 | Participation percentage in monthly acceleration | Participation percentage in acceleration of the year to-date |
|--|---------------|--------------|--------------|--------------|--------------|--|--|
| Headline inflation | 100.00 | 6.77 | 7.98 | 7.93 | 8.20 | 100.00 | 100.00 |
| Non-food inflation | 71.79 | 5.17 | 6.20 | 6.02 | 6.07 | 16.77 | 42.80 |
| Tradables | 26.00 | 7.09 | 7.38 | 7.57 | 7.88 | 27.67 | 12.48 |
| Non-tradables | 30.52 | 4.21 | 4.83 | 5.00 | 4.78 | (25.71) | 12.01 |
| Regulated items | 15.26 | 4.28 | 7.24 | 5.78 | 6.00 | 14.81 | 18.30 |
| Food inflation | 28.21 | 10.85 | 12.35 | 12.63 | 13.46 | 82.23 | 57.20 |
| Perishables | 3.88 | 26.03 | 27.09 | 28.62 | 33.44 | 60.97 | 27.37 |
| Processed food | 16.26 | 9.62 | 10.83 | 10.89 | 11.04 | 9.38 | 17.62 |
| Eating out | 8.07 | 5.95 | 7.53 | 7.53 | 7.92 | 12.88 | 12.21 |
| Core inflation indicators | | | | | | | |
| Non-food inflation | | 5.17 | 6.20 | 6.02 | 6.07 | | |
| Core 20 | | 5.22 | 6.48 | 6.69 | 6.55 | | |
| CPI excluding perishable foods, fuel and utilities | | 5.93 | 6.57 | 6.72 | 6.61 | | |
| CPI excluding food and regulated items | | 5.42 | 5.91 | 6.08 | 6.08 | | |
| Average of core inflation indicators | | 5.43 | 6.29 | 6.38 | 6.33 | | |

Source: DANE. Calculations by Banco de la República.

44. The increase in yearly CPI inflation excluding food was concentrated in tradables (excluding food or regulated goods) and regulated items, whose annual variations rose from 7.57% in April to 7.88% in May in the first case, and 5.78% to 6.00%, in the second. As for tradables, the accumulated depreciation since July 2014 has continued passing through to the prices of this subgroup (despite the appreciation observed between the end of February and mid May). In the last month, increases in the prices of vehicles and some products for personal hygiene stood out.
45. On its part, the increase in the CPI for regulated items is associated with the rise in the yearly variation of fuel, from -3.9% in April to -2.7% in May. The increase of \$104 pesos in the price of gasoline decreed by the National Government in May explains this situation. The increase in the prices of utilities remained at 10.2%, as did the ones of transport (4.8%).
46. Despite the stability in the yearly variations in the subgroup of public utilities in the last month, there were important changes within the subgroup. The most prominent case is the price of energy, which registered a monthly 4.0% increase during the month, with which its yearly variation rose from 8.4% in April to 9.8% in May. In fact, this single item explained more than 25% of the total monthly consumer inflation in May. The increase was focused in Bogota, where energy rates recorded an increase of over 20.0%, which seems to correspond with the reversal of the rebates in this price that took place in the previous two months due to the Government's energy-savings program called "Apagar paga." For the coming months, falls in the prices of energy are not to be discarded on account of the rebates by the savings plan yet to be implemented in several cities in the country, which should be reverted one or two months later.

47. In contrast with energy, the price for gas fell 2.2% in May, reflecting lower demand by the thermoelectric plants once the Guatapé hydro-power plant entered into operation (although partially) and the rainy season began. In the case of water, waste-disposal and sewage rates, a reduction in the rate is expected for the third quarter, which for Bogotá is expected to be over 2.0% after the application of a new regulatory framework (resolution CRA-720 of 2015 and a modification with respect to the entry into force known as CRA-751 of 2016).
48. The yearly variation of non-tradables excluding food and regulated items fell in May to 4.78%, from 5.00% in April. This behavior is explained by the CPI of services related with entertainment (which includes soccer tickets), whose yearly growth increased from 14.5% in April to 0.5% in May. A year ago, the variation of this item in May was very high (14.7%), and this situation did not take place in 2016 (0.6%). On its part, the non-tradable segments of indexed items and those affected by the exchange rate remained stable at 5.97% and 5.74%, respectively. The only subgroup that slightly picked up within non-tradables was leases (4.15% in April to 4.17% in May). In the last two months, yearly fluctuations of leases have increased a little, possibly due to the activation of the indexation mechanisms based on past inflation, which had not taken place in the first quarter of the year.
49. Regarding food CPI, yearly variation increased again in May, standing at 13.46%. This month, there were increases in the group of perishable foods (such as potato, onion and tomato), whose annual variation moved from 28.62% in April to 33.44% in May. The prices in this group still reflect the negative impact of *El Niño*, which has just finished, on the decisions regarding sowings and agricultural productivity. Currently, according to the latest information from international meteorological agencies, this phenomenon could give way to an episode of *La Niña* with a 75% probability, which is characterized by abundant rains.
50. In May, the yearly CPI for processed foods increased slightly (from 10.89% to 11.04%). However, an important increase in the yearly CPI for beef was observed this month (from 8.7% to 14.0%), which would be the result of both the lagging effect of *El Niño* as well as of the impact of a phase of cattle retention, which, according to Fedegán, has been taking place in recent months.

51. In the case of meals outside the home, the yearly variation increased from 7.53% in April to 7.92% in May. This would reflect the higher costs of food, of the adjustment of the minimum wage, and the increases in leases.
52. Further transitory increases in food prices are not discarded in June, associated with the agricultural and trucking strikes.
53. On the side of non-labor costs, additional inflationary pressures on consumer items were perceived in May. Yearly change of the PPI for domestic supply (domestically produced and consumed items plus imported goods) increased from 8.6% in April to 10.0% in May. By origin, the PPI of imported goods rose to 11.5% in May, from 10.2% in April. In contrast, the yearly growth of the PPI for domestically produced and consumed goods moved from 7.9% in April to 9.3% in May, explained mainly by agricultural and mining products.
54. As for labor costs, with information to April and May, salary adjustments continued surpassing the inflation target, although at rates lower than the adjustment to the minimum wage and inflation in December (except for industry). With information to April, the adjustment of salaries for retail remained stable at 6.6%, while that for industry increased from 7.0% to 7.2%. With data to May, in the case of wages for heavy construction, the increase was 3.6% on a yearly basis for employees and 5.2% for construction workers, while those for housing construction posted at 4.3%.
55. Inflation expectations to December 2016, obtained from the monthly survey to financial analysts at the beginning of June, rose from 6.02% in May to 6.23% in June. In contrast, expectations to 12 months fell from 4.53% in May to 4.37% in June. The expectations to 24 months showed no changes of importance, moving from 3.69% to 3.67%. Inflation expectations embedded in bonds in pesos and UVR (Breakeven Inflation), on average to June 17, decreased for all maturities compared to the average data of May (2, 3, and 5 years: -24, -23, and -22 bp, respectively). Thus, the average BEI so far in June to 2, 3 and 5 years posted at 4.47%, 4.26%, 4.40%, and 4.07%, respectively.