



PUBLIC VERSION

Working Papers from the
Board of Directors
Banco de la República

Monetary Policy Report



PUBLIC VERSION

Working Papers from the
Board of Directors
Banco de la República

Monetary Policy Report

Economic Studies Division

APRIL

2016

I. External Context and Balance of Payments

1. The most recent records of economic activity of Colombia's main trading partners show that, as had been forecast, growth in the second quarter would have been better than in the first.
2. In the United States, data for April on retail sales and consumer confidence in May suggest a recovery of consumption from the low dynamism observed in the first quarter. Additionally, industrial production to April exhibited lower contractions than those observed in previous months, and the labor market maintained a favorable trend.
3. The Minutes of the Federal Open Market Committee's (FOMC) meeting of April convey a message of policy rate increases closer than was expected by the market, although they warn that they are subject to the data of economic activity in the second quarter.
4. On its part, total inflation in the United States increased slightly in April (from 0.9% to 1.1%), although it remained below the Fed's long-term goal (2.0%); the indicators for core inflation showed a slight fall (from 2.2% to 2.1%).
5. In the euro zone, there was a modest quarterly growth in GDP in the first quarter (0.5%), but slightly better than the one at the end of last year. To April, consumer confidence indexes and those for industry remained positive. Regarding the variation in prices, the indicators of yearly total inflation and core inflation in April were slightly lower than those of March (-0.1% and 0.7%, respectively). In this context, the European Central Bank (ECB) continued with a highly expansive monetary policy.
6. In China, retail sales slowed down in April, and industrial production continued with a low growth level. Fixed asset investment has remained stable during recent quarters thanks to the adopted fiscal stimuli. These results indicate a more gradual slowdown of the Chinese economy than had been expected. Yearly inflation in April remained low (2.3%).
7. In Latin America, the figures available for GDP growth in Mexico and Chile for the first quarter of 2016 exhibit a yearly growth larger than in the past quarter, but lower than the average of the last few years. The monthly indexes of economic activity for March suggest that Peru continues to be dynamic, while Brazil would continue to decline sharply. Although there are no recent figures

for Ecuador and Venezuela, the strong deterioration of their terms of trade and the tighter conditions for external financing should deepen the recession they are going through.

8. The records of inflation to April for Brazil, Chile and Peru have begun to recede, although they remain at high levels with respect to the targets of their monetary authorities. On its part, inflation in Mexico slowed down, remaining at the lower part of the target range of its central bank.
9. In April, the international prices of oil and other commodities exported by the country continued to rise from the low levels recorded in mid-February.
10. To May 24, the price of Brent oil increased 8.9%, compared to the records of the previous month. Part of this increase would be explained by a reduction of supply due to lower production levels in Nigeria, Libya and Iraq caused by the disruption of public order, and in the United States by the lower levels of extraction at non-conventional oil deposits. Added to this were the temporary interruptions of Canada's production due to forest fires and the fear among the leading analysts that the political problems in Venezuela affect the extraction of oil. Despite this situation, inventories remain at historically high levels, and the excess supply would persist.
11. The prices of commodities exported by countries in the region have remained at the levels observed in recent months, except for the price of soy and coal, which have exhibited increases.
12. So far in May, the indicators of financial volatility stabilized at the levels reached in the previous months, associated with a low global risk aversion. Additionally, the US dollar strengthened *vis-à-vis* most currencies in the world, while the stock exchange indexes fell. The rates of long-term sovereign bonds of the main developed economies remained low.
13. In this environment, risk premia for Latin America did not exhibit significant changes compared to previous months. By contrast, the currencies of the region weakened *vis-à-vis* the US dollar. With figures to May 25, the Colombian peso recorded a 7.4% depreciation compared to the minimum value in April (April 29). For the Peruvian, Chilean and Mexican currencies, depreciation was 3.0%, 4.8% and 7.6%, respectively, *vis-à-vis* its minimum value of April.

a. Exports and Imports

14. In March, exports registered an annual fall of 33.4% due to setbacks in the external sales for all groups of goods. The strong fall in the group of mining goods stands out (-49.4%). So far this year, exports have registered a 31.8% decrease, also with a substantial decline in external sales of mining goods (**Table 1**).
15. According to the preview for foreign trade by DIAN, exports excluding oil fell 8.6% on a yearly basis in April.
16. In March, CIF imports recorded an annual fall of 22.6%, due to setbacks in external purchases for all groups of goods. The contraction in imports of capital goods stands out: -33.5%. So far this year, imports have fallen 25.1% (**Table 2**).
17. According to the preview for foreign trade by DIAN, CIF imports recorded a 19.5% annual fall in April.

Table 1 Behavior of Exports in US dollars

March 2016			
	Annual Variation	Main contributing items:	
		Item	Annual variation of the item
Total	-33.4%		
Agricultural goods	-8.9%	Coffee	-16.0%
		Flowers	-17.8%
Mining goods	-49.4%	Oil	-57.4%
		Coal	-45.0%
Other exports*	-5.4%	Chemical products	-9.2%
		Others	-21.5%
Accumulated value for January-March 2016			
Total	-31.8%		
Agricultural goods	-18.5%	Coffee	-30.4
		Banana	-7.4
Mining goods	-45.1%	Oil	-55.3%
		Coal	-36.1%
Other exports*	-8.9%	Chemical products	-16.1%
		Others	-16.4%

* By destinations, the falls towards Ecuador (28.9%), Venezuela (14.6%), and Asia (8.6%) stand out. Contrastingly, there was a moderate increase in external sales of this item towards the European Union (10.4%).

Source: DANE

Table 2 Behavior of Imports in US dollars

March 2016			
	Annual Variation	Main contributing items:	
		Item	Annual variation of the item
Total	-22.6%		
Capital Goods	-33.5%	Transport equipment	-66.3%
		Industrial machinery	-36.1%
Raw materials	-16.4%	Fuels	-22.3%
		Mining Products (for industry)	-24.2%
Consumer Goods	-19.6%	Private vehicles	-40.5%
		Clothing and other textiles	-29.2%
Accumulated Value for January-March 2016			
Total	-25.1%		
Capital Goods	-39.4%	Transport equipment	-76.5%
		Industrial machinery	-25.9%
Raw materials	-15.4%	Chemical and Pharmaceutical products (for ind)	-14.4%
		Mining Products (for industry)	-23.8%
Consumer Goods	-19.1%	Private vehicles	-32.3%
		Pharmaceutical products and toiletries	-10.8%

Source: DANE

II. Growth, Domestic Demand and Credit

18. With information to February, the seasonally-adjusted Real Activity Index (ISE) increased 3.0%, somewhat below the figure for January (3.2%), and the one observed for the aggregate for the fourth quarter of 2015 (3.2%). Industry and construction would have contributed to the growth of this series in that month (figures not published officially).
19. In March, the figures of the monthly survey of retail trade (EMCM) of DANE recorded a 3.6% fall in retail sales excluding fuels compared to the same month of 2015, which is significantly lower than the 5.5% registered in February. Excluding vehicle sales, the annual growth rate was -1.0% (compared to 7.0% in February). Regarding vehicles, the contraction in March was 16.9%, a rate higher than in February (-2.6%).
20. For the aggregate of the first quarter, the total sales of trade excluding fuels accelerated versus the records for the fourth quarter of 2015 (from -0.4% to 1.6%). Excluding vehicles, the remaining aggregate slowed down from 4.9% to 3.7%. Finally, vehicle sales reduced the decline rate from -24.2% in the period of October-December of 2015 to -9.6% for January-March of 2016. When adjusting for seasonality and calendar effects, the series of retail sales excluding vehicles continued to show a moderate deceleration in the first quarter, similar to the one observed in not seasonally adjusted data.

21. The balance of sales in March of the Monthly Survey of Economic Expectations (EMEE) by *Banco de la República* continued to fall compared to the records of previous months, which also suggests a slowdown in private consumption.
22. Regarding investment different to that in construction of buildings and civil works, with figures to March, both imports of capital goods (in real terms) and the balance of investment expectations of the EMEE anticipate a slowdown of this item in the first quarter.
23. On the supply side, total industry exhibited an annual increase of 1.4% in March, and excluding oil refining, the remaining production fell 1.6%. Compared to the previous month, this lower rate of annual growth is explained largely by the seasonal phenomenon of Easter, for which this effect should be reversed next month. When adjusting for calendar effects, in March, the seasonally adjusted series for total industry and the one excluding refining would have exhibited a yearly increase of 8.3% and 5.0%, respectively. For the quarter, the industry is expanding at an annual rate of 5.7%; excluding refining, the expansion is 2.8%.
24. According to the March survey by *Fedesarrollo*, although the indicator for orders and the one for inventories (countercyclical to production) deteriorated *vis-a-vis* the previous month, the trend components of each one of them point to a better performance of industry compared to previous quarters. Production expectations to three months continued to show an important recovery.
25. In construction, the falls in production and cement shipments, both with an annual contraction of 6.7%, stand out. Analyzing the quarterly figures, a slowdown versus the fourth quarter of 2015 may be observed, with cement production moving from 7.8% to 1.7%, and shipments from 7.2% to 0.2%. In this case, the statistical evidence also suggests that this data is affected by the Easter holiday.
26. Given the above, the most recent information available for the first quarter of 2016 allows to maintain the mid-point and the forecast range for GDP growth as presented in the previous Inflation Report (i.e., 2.5%, between 1.8% and 3.2%, respectively).
27. The indicators for the second quarter are still scarce and do not allow to forecast GDP growth for this period.

28. Regarding the indicators related to private consumption, in April the Consumer Confidence Index (ICC) from *Fedesarrollo* improved slightly compared to the observations along the first three months of the year. However, its level is well below the average of the series calculated since November 2001.
29. Information to March shows that the unemployment rate continues to increase in all geographical areas except for rural areas, explained by the slowdown in employment, which has been stronger in urban areas. This could contribute to a slowdown in the pace of private consumption growth in the following quarters.
30. On the other hand, the latest information from the vehicle license report published by the Colombian Automotive Committee suggests that this series registered a 7.2% fall in April, less negative than the -17.5% of the aggregate for the first quarter. Analyzing by segments, falls occur both in private vehicles as in those for commercial use, although they were greater in the latter case than in the former.
31. Additionally, in April the real interest rates for households deflated by inflation expectations (consumption, cards, usury and mortgages) continue registering increases in the margin.
32. On the supply side, with information to April, the oil sector continues to show significant deterioration, while that of coffee maintains a strong dynamism. Oil production reported an annual 10.8% fall and remained below 1 million barrels per day for the seventh consecutive month (914 tbd) (with respect to the previous month, the variation was -0.3%). Coffee production, on the contrary, grew 12.9% annually and registered 1.043 thousand bags, with which the production value accumulated for the year reached 4.2 million (9.8% compared to last year) according to the Federation of Coffee Growers.
33. In April, total energy demand grew 2.2% on a yearly basis, a figure lower than in the first quarter (3.3%), while its trend component has a downward slope. The demand for unregulated energy grew 0.8% and that for regulated energy did so by 2.7%.
34. It is worth mentioning that the forecasts for the second quarter implicit in the one for the whole year consider that the negative results associated to the seasonal effect of the Easter holiday (observed in March) would have been reversed in April. For the whole year, the technical staff maintained its forecast

range for GDP growth between 1.5% and 3.2%, with 2.5% as the most likely figure.

III. Behavior of Inflation and Prices

35. Annual consumer inflation in April stood at 7.93%, a level 5 bp lower than in the previous month (**Table 3**). For the year to date, the increase in the CPI amounted to 4.05%, higher than the 2.95% observed in the same period of 2015. The monthly variation of the CPI was 0.50%, a figure lower than the market forecasts (0.66%).
36. The lower annual inflation in April was explained exclusively by the regulated component of the CPI due to downward shocks in the price of public utilities. By contrast, the other major categories of consumer items increased on account of the effects of *El Niño* along with the pass-through of the accumulated depreciation of the *peso* and indexation.
37. Despite the decline in total inflation, core inflation, measured as the average of the four indicators monitored by the Central Bank, increased again in April to 6.38% (compared to 6.29% in March). Except for the CPI excluding food, all indicators increased last month, being the CPI without primary food, fuel and public utilities the highest (6.72%). On the other hand, the CPI excluding food and regulated items closed at 6.08%, and Core 20 at 6.69%. The CPI excluding food, the lowest, decreased to 6.02% (18 bp less than in March) (**Table 3**).

Table 3

Inflation to April 2016

Description	Weight	Dec 2015	Jan 2016	Feb 2016	Mar 2016	Apr 2016	Participation percentage in monthly acceleration	Participation percentage in acceleration of the year to-date
Headline inflation	100.00	6.77	7.45	7.59	7.98	7.93	100.00	100.00
Non-food inflation	71.79	5.17	5.54	5.88	6.20	6.02	320.13	48.74
Tradables	26.00	7.09	7.39	6.97	7.38	7.57	(92.93)	9.01
Non-tradables	30.52	4.21	4.46	4.86	4.83	5.00	(116.08)	20.63
Regulated items	15.26	4.28	5.02	6.35	7.24	5.78	529.15	19.10
Food inflation	28.21	10.85	12.26	11.86	12.35	12.63	(220.13)	51.26
Perishables	3.88	26.03	31.31	27.42	27.09	28.62	(175.83)	19.69
Processed food	16.26	9.62	10.22	10.26	10.83	10.89	(38.96)	19.50
Eating out	8.07	5.95	6.78	7.09	7.53	7.53	(5.33)	12.06
Core inflation indicators								
Non-food inflation		5.17	5.54	5.88	6.20	6.02		
Core 20		5.22	5.56	6.25	6.48	6.69		
CPI excluding perishable foods, fuel and utilities		5.93	6.13	6.41	6.57	6.72		
CPI excluding food and regulated items		5.42	5.69	5.75	5.91	6.08		
Average of core inflation indicators		5.43	5.73	6.07	6.29	6.38		

Source: DANE. Calculations by Banco de la República.

38. As in the case of total CPI, the decline in non-food CPI was explained exclusively by regulated items, whose annual variation fell from 7.24% in March to 5.78% in April. This time, public utilities concentrated the greatest drops (the CPI for utilities rose from 14.0% in March to 10.1% in April). The monthly decline took place mainly in energy (-6.5%) and gas (-4.2%), and to a lesser extent in aqueduct services (-0.5%).
39. In April, the behavior of energy prices was related to two phenomena. Firstly, with the decrease in the price of energy at the stock exchange market, which took place due to the increase of rains and the likelihood of the emergence of a phenomenon of *La Niña*. Secondly, and more important in this month, the effect of the government's program "Apagar Paga" for households rates on energy. This program rewarded consumers who saved energy with a two-month reduction in the rate for (March and April). As a result, for Bogotá, the CPI for energy fell 25.0% just this month. According to information from DANE, these discounts still have to be applied at other cities, with which further falls are expected in May and probably also in June. The demand for gas fell sharply due to the beginning of the rainy season and the resumption of operations at *Guatapé* hydro-power plant, generating a surplus in the national market. Additionally, the international price of this hydrocarbon has declined, also driven by greater global supply.
40. On the contrary, annual variations in the other items that make up the CPI of regulated items increased: transport, from 4.5% in March to 4.9% in April, and fuel, from -4.7% to -3.9%. In the latter case, an \$87 peso increase was observed in the local price of gasoline, as decreed by the National Government, which can be attributed to increases in international prices for a couple of months, which are not being offset by movements in the exchange rate.
41. The annual CPI variation for tradable goods excluding food and regulated items increased again in April (7.57%) compared to March (7.38%). The accumulated depreciation has continued passing to the prices of this subgroup (despite the appreciation observed between mid-February and the end of April). In the last month, increases in the prices of vehicles and some products for personal hygiene stand out.
42. After a pause in March, the annual variation of non-tradables excluding food and regulated items increased again in April (to 5.0%, from 4.83%). This time, the increase was concentrated on rents (from 3.9% to 4.2%). For this price it is possible that the indexation mechanism is starting to activate based on past

inflation, something that was not evident in the first quarter. In other service items (such as education and health) this mechanism has been observed for several months. It should be noted that in these sectors which are intensive in skilled or semi-qualified work, wage increases may also be a factor that is pushing up prices in addition to past inflation.

43. As for the CPI for food, annual variation increased again in April and posted at 12.63% (compared to 12.35% in March). On this occasion, that behavior was due to the increases in the group of perishable foods (such as potato and some vegetables) whose annual variation moved from 27.09% in March to 28.62% in April. The effects of *El Niño* still persist, particularly due to the postponement of sowing and by the reduction in agricultural productivity. This climatic disturbance is already weakening and would have disappeared by midyear, giving way to a new episode of *La Niña* with a probability of 75%, according to information from international meteorological agencies.
44. On its part, annual variation of processed foods registered 10.89% (compared to 10.83% in March). Increases of some consideration took place in bakery products, eggs, beef, and sugar, among others. Annual variation for food outside the home remained at 7.53%.
45. On the side of non-labor costs, additional inflationary pressures on consumer items were not perceived in April. Annual variation of the PPI for domestic supply (produced and consumed internally plus imported goods) remained at 8.6%, while that of the component for imported goods fell to 10.2% (from 11.5% in March), which is attributed to the appreciation of the *peso* against the US dollar during the month of April. By contrast, the annual growth of the PPI for goods produced and consumed locally moved from 7.3% in March to 7.9% in April, a rebound explained mainly by agricultural products.
46. As for labor costs, with information to March and April, adjustments continued surpassing the inflation target, although at rates lower than that for the adjustment to the minimum wage and inflation in December. In the case of wages for heavy construction, the increase in April was 3.8% on a yearly basis for employees and 5.4% for construction workers, while that for housing construction was 4.6%. On the other hand, the salary adjustment for trade rose from 6.1% in February to 6.6% in March, while that for industry moved from 8.8% to 7.0%.
47. Inflation expectations to December 2016 and the next twelve months obtained from the monthly survey to financial analysts at the beginning of May,

remained stable at 6.02% and 4.53%, respectively. Expectations to twenty-four months fell slightly from 3.81% to 3.69%. On the other hand, with average data to April, so far in May inflation expectations (Break-even Inflation, BEI) embedded in sovereign bonds in pesos and RVU diminished slightly for all terms (2, 3, 5, and 10 years): -2, -6, -10, and -6 bp, respectively). Thus, break-even inflation (BEI) to 2, 3, 5 and 10 years posted at 4.73%, 4.50%, 4.29% and 4.34%, respectively.