



**BANCO DE LA REPÚBLICA
DIVISION OF ECONOMIC STUDIES**

**Description of the external circumstances facing the Colombian economy, the
developments in foreign trade, the performance of domestic demand, output and
lending, and the behavior of inflation and inflation expectations
Data from the Inflation report of November, 2014**

I. The External Context, Exports and Imports

1. The second estimation of the growth of the GDP in the United States for the third quarter shows that this economy continues to maintain a good dynamism. In this period, the growth of the product was of 3.9% on a yearly rate. (2.4% on a yearly basis), as compared to the 4.6% on a yearly rate (2.6% on a yearly basis) of the second quarter. By components, the net external commerce and all the items of internal demand contributed to its growth, where a good behavior of exports and investment stands out.
2. The figures available for real activity and confidence so far in the last quarter of the year suggest that the US economy would maintain a good behavior. The registrations for October show that the labor market continued its recovery (5.8%), which resulted in a new fall of the unemployment rate, as well as in improvements in the other indicators monitored by the Federal Reserve (underemployment rate, vacancies, long-term unemployment, etc.).
3. Inflation in the United States did not present changes in October (1.7% on a yearly basis) and continues to be under the 2% target of the Federal Reserve.
4. Regarding the euro zone, the registration of the GDP for the third quarter shows that the expansion of the economic activity continues to be very modest (0.6% on a yearly rate). Per countries, the horizon continues to be heterogeneous. Peripheral economies displayed favorable growth rhythms, with France growing more than was expected. In contrast, Germany showed a mediocre rate, and Italy entered into recession again. The indicators for household and entrepreneur confidence suggest that the weakness of the European economy would continue during the fourth quarter.
5. Annual inflation in the euro zone increased slightly to 0.4% in October, with which the risks of deflation continue.
6. In the case of emerging economies, the figures for China in October indicate that the real activity would continue slowing down during the last quarter of the year. As for Latin America, the registrations of the GDP for the third quarter in Chile, Mexico and Peru show that growth continued to be low (0.8%, 2.2% and 1.8% on a yearly basis, respectively). In the case of Brazil, the index of real activity in September suggests that this economy would have contracted again.

7. Inflation in Latin America showed a growing trend, partly associated to the depreciation of its currencies and with some shocks in the offer that would be transitory.
8. The international prices of oil continued falling during November, as had been forecast in the previous report, as a result of the smaller prospects of global demand of oil, while it is expected that production would continue at the level observed in recent months. Several analysts have significantly reduced their projections of the prices for the upcoming months, which would indicate that in the short time it is not expected that prices show any upward trend.
9. On its part, the international prices of coffee remained relatively stable in the high level observed since the beginning of the year, while the prices of coal and nickel have not changed significantly.
10. The prices of some imported foods showed increases due to the fact that less favorable climactic factors would have caused the projections of the production in the United States to be revised downwards.
11. Regarding the international financial markets, volatility reduced from the high levels observed in the previous month. On the other hand, the stock market indexes of advanced economies recovered, while the rates for long-term sovereign bonds of the United States and the euro zone did not present significant changes.
12. As for the financial markets in Latin America, an increase in the risk premia was observed. In this context, the currencies of the region continued to weaken during November, being the Colombian peso and the Brazilian real the ones that depreciated the most during this period.
13. In terms of the monetary policy of the advanced economies, the Central Bank of Japan increased its assets purchase target from 70 to 80 trillion yens. In turn, several economic analysts consider highly probable that the European Central Bank would extend its bond purchase program, including sovereign and corporate bonds. Finally, the agents of the financial markets expect that the increase in the rates by the Federal Reserve be delayed and that it takes place by the end of 2015. The Central Bank of China has adopted some monetary stimulus measures.

- 14.Regarding the Colombian foreign trade, during September the total exports in dollars recorded a growth of 4.9% on a yearly basis thanks to the greater volumes dispatched, which compensated the fall in the prices.
- 15.This month, the external sales of the main mining commodities, those of agricultural origin, and those from the remainder of goods increased 3.6%, 32.9%, and 1.8% on a yearly basis, respectively. In the first group, the greater increases were observed in coal (22.4%) and oil (3.8%); in the second one, there was growth in coffee (42.9%) and banana (87.9%); and in the third one, the increases in food and beverages stand out (18.9%), rubber and plastic (16.2%), and leather manufacturing (40.6%).
- 16.So far this year, the total exports in dollars reduced 1.9% against the same period of the previous year, as a product of the fall in prices that could not be compensated by the greater quantities exported.
- 17.This contraction is the result of the reduction in the external sales of the categories of main mining commodities (-2.8%) and of the other types of goods (-4.8%). Regarding the first, reductions on refined goods (-26.6%) and gold (-34.3%) stand out; within the rest of exports, those registered for vehicles (-40%), all other agricultural exports (-40%), and meat (-60.8%).
- 18.Exports of agricultural commodities showed a growth of 17% in the accumulated value from January to September against the same period of 2013. In this group, increases were observed in coffee (25%), banana (27.6%) and flowers (1.4%).
- 19.In turn, in September the imports in dollars grew 12.5% on a yearly basis, as a result of the increase in capital goods (21.4%), consumer goods (18.3%) and intermediate goods (3.7%). The increase in the former is explained by capital goods for the industry as much as by transportation equipment; while imports of intermediate goods increased basically by the growth in commodities for the industry (8.7%).
- 20.So far this year to September, imports recorded a growth of 7.4% on a yearly basis, with increases in the main group of commodities: 9.8% for intermediate goods, 9% for consumer goods, and 3.3% for capital goods. In the first case, the increment is due to a large extent to fuels and lubricants (21.2%), and

commodities for the industry (6.6%). In the last one, the item that grew was that of capital goods for the industry (6.6%).

II. Domestic Demand, Growth and Credit

21. The information available for the third quarter of 2014 indicates that the economic activity in Colombia would have expanded at a somewhat greater pace than the one registered in the second quarter. Household consumption and investment would have maintained a good momentum, while external sales would have increased. With this, the forecasts presented in the previous Inflation Report would be confirmed.
22. Regarding consumption, according to the most recent information from the *Encuesta mensual de comercio al por menor (Monthly Retail Trade Survey, EMCM)* applied by DANE, in September the index of retail sales grew 9.1% against the same month of 2013. Thus, the third quarter presented an expansion of 7.6% on a yearly basis, a figure somewhat greater than the one registered between April and June (6.6%). Subtracting vehicle sales, the increments were of 6.8% and 6.5% for September and the third quarter, respectively.
23. Within private consumption, the expense in durable goods would stand out, especially in vehicles. For the latter, annual expansions of 18.9% and 12.9% were recorded for September and for the third quarter, respectively, which shows an acceleration against the previous quarter (2.9% on a yearly basis).
24. The results of the *Encuesta mensual de expectativas económicas (Monthly Survey of Economic Expectations, EMEE)* applied by *Banco of the República* also indicate a good dynamism of private consumption. According to this survey, between July and September the balance of sales reported by the traders recorded a greater level than the one observed during the previous quarter.
25. As for the labor market, the unemployment rate in September continued to reduce in annual terms, in all the geographical domains. These downturns are explained by increases in employment, particularly salaried one, which continues to increase at a good pace.
26. Prospects of an expansion similar to that of the second quarter are maintained for the rough formation of fixed capital without construction of buildings or of civil works. This is inferred from the behavior of the imports of capital goods in real

terms, as well as from the balance of investment expectations derived from the EMEE.

27. The index of exported quantities of mining commodities showed an important recovery against the data registered during the second quarter of the year. This would indicate a reversion of the collisions in the supply that took place a year ago in the carbon sector.
28. On the side of the supply, the most recent indicators suggest that manufacturing production has continued to grow slowly, partly due to the presence of some shocks in the supply (such as the closing of Reficar). In September, the annual variance of the IPI without coffee threshing was of 1.3%, 1.1% in the third quarter, and so far this year 1.6%. Excluding oil refining, the growth of manufacturing in September was of 2.2%. Although a rate of positive expansion was observed in the third quarter, after the contraction registered three months before, the trend component of the series shows some stagnation. Thus, the recovery of the sector would be gradual.
29. As for the construction sector, the figures to September showed uneven behaviors in the different indicators. The building permits plummeted during the month (-29.6% on a yearly basis), with which the growth accumulated for twelve months passed from 8.7% to 3.7%. This slowdown is influenced by an important fall of licensing in Bogotá, and takes place after a strong increase in previous months, something that could be explained by the legal uncertainty over the *Plan de Ordenamiento Territorial* (Territorial Ordainment Plan, POT). In turn, the production of cement in the third quarter slowed down against the previous one, although it maintains a high rate of expansion (passing from 14.2% to 10.2%).
30. On the contrary, the dispatches of cement had a favorable momentum, passing from growing 8.4% on a yearly basis in the second quarter to 12% in the third. Finally, the figures of concrete produced by the industry for the period of July-September suggest that civil works and non-housing buildings would continue to present a good behavior (annual growth rates of 14.0% and 27.5%, respectively).
31. With the aforesaid, the annual growth range forecast for the third quarter is maintained between 4.0% and 5.2%, with 4.6% as the most probable figure. The new information does not suppose changes in the results of the model against previous estimations.

32. For the fourth quarter of 2014, the information is still scarce, and is available only for the month of October. Nevertheless, the figures allow to continue foreseeing an annual expansion of the GDP for the period similar to the one expected for the third quarter.
33. The index of consumer confidence (ICC) published by *Fedesarrollo*, increased in October and is above its average since 2001, at a level similar to that of the third quarter. Both the component of economic conditions as well as that of expectations showed good results.
34. In turn, the figures for retail sales of vehicles published in the monthly joint report by ANDI, *Fenalco* and *Econometría* show an annual expansion of 10.3% in October, which represents a slight slowdown with respect to the third quarter (17.2%). In spite of the aforesaid, the trend component of this series reveals a great momentum that is expected to continue during what is left of the year, thanks to the Automobile Fair that takes place in the last weeks of November.
35. Additionally, the household consumption portfolio continues to grow. Specifically, consumption credit accelerated in the margin (it increased 12.5% on a yearly basis in October) against the registration of the third quarter (11.8%). Consumption interest rates descended, which would also favor a good performance of household expenses.
36. As for supply, indicators available for the fourth quarter suggest that the dynamism would continue. The figures from the *Federación Nacional of Cafeteros* recorded in October coffee production above a million 60 kg-bags (1.101.000), which represents an annual expansion of 4.1% (against 25% in the third quarter). So far this year to October, growth corresponds to 14.8%, with a production close to ten million bags.
37. In turn, the demand for total electric energy in October grew 4.0% in annual terms. The trend component maintained its positive slope, although lower than that of previous months. As for the production of oil, the same month recorded again a level above one million daily barrels (1002 mdb). This implied an annual growth of 1.7%, after a quarter of negative variance.
38. As for manufacturing, with information to October, the survey of entrepreneurial opinion (EOE) by *Fedesarrollo* indicates a slight diminution of the indicators for confidence, orders, and stock, while the expectations to three months improved.

Nevertheless, the trend components of each one of these series continue to show a good performance. The aforesaid suggests a positive but moderate growth for the sector in what is left of the year.

39. Given this, the annual growth forecast range of the GDP for 2014 presented in this report continues to be between 4.5% and 5.5%, with 5.0% as the most probable figure. No changes in the forecast range were registered for 2015, with which the most probable figure of expansion of the GDP would be 4.3%, with a floor of 3.0% and a ceiling of 5.2%. It is worth mentioning that these forecasts suppose a good performance of public consumption and of civil works, as well as a greater price of oil than the one observed in the last few weeks.

III. Behavior of Inflation and prices

40. As had been foreseen, annual consumer inflation accelerated in October, posting at 3.29% (**Chart 1**). This significant increase (43 basis points against the data of September) is explained partly by the very low comparison base of October last year. An important and unusual fall in the prices of foods as well as of the total monthly inflation (-0.26%) took place then, attributable, in good part, to a transitory phenomenon.

41. In October, the monthly variation of the CPI amounted to 0.16%, very close to the figure anticipated by the technical staff at *Banco of the República*, but higher than the one expected, on the average, by the market (0.06%), according to the monthly survey of expectations applied by the Central Bank. The increase was focused on the baskets of food and of regulated goods. So far this year, the variation in consumer prices accumulates 3.25%, a figure higher than the mid-point of the target range.

42. In October, basic inflation also accelerated, although in a smaller amount than total inflation, still remaining under the mid-point of the target range. The figure for said month, according to the average of the four indicators monitored by the Bank, amounted to 2.76%, that is, 13 bp more than last month (**Chart 1**). The four indicators increased: Core 20 showed the greatest level (3.0%), and CPI, without basic foods, fuels or public utilities, the lowest (2.5%). Inflation without food posted at 2.9%, (21 bp more than the data of September).

Chart 1

Behavior of Inflation to October 2014								
Description	Dec-13	Jan-14	Mar-14	Jun-14	Jul-14	Aug-14	Sep-14	Oct-14
Total	1.94	2.13	2.51	2.79	2.89	3.02	2.86	3.29
Without food	2.36	2.49	2.62	2.66	2.75	2.84	2.70	2.91
Tradables	1.40	1.57	1.65	1.94	1.60	1.57	1.59	1.66
Non tradables	3.76	3.61	3.55	3.45	3.17	3.29	3.26	3.26
Regulated	1.05	1.66	2.21	2.14	3.60	3.83	3.25	4.07
Foods	0.86	1.20	2.23	3.11	3.26	3.47	3.25	4.27
Perishable	- 0.16	2.13	3.17	8.92	9.18	8.91	7.61	15.1 4
Processed	- 0.24	- 0.18	0.92	1.44	1.66	2.09	2.14	2.13
Foods out of the home	3.26	3.29	4.13	3.52	3.45	3.47	3.23	3.43
Indicators of basic inflation								
Without food	2.36	2.49	2.62	2.66	2.75	2.84	2.70	2.91
Core 20	2.72	2.69	2.86	3.04	2.73	2.98	2.89	3.02
CPI without perishables, comb., or public utilities	2.19	2.27	2.53	2.53	2.33	2.42	2.39	2.53
Inflation without foods or regulated goods	2.74	2.74	2.74	2.81	2.51	2.56	2.55	2.58
Average of indicators of basic inflation	2.51	2.55	2.69	2.76	2.58	2.70	2.63	2.76

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

43. Within the CPI without food, bull pressures were originated basically in that of regulated goods, whose annual variance accelerated more than was expected by the technical staff at the Bank, passing from 3.3% in September to 4.1% in October. During the last month, a new readjustment in the CPI of electric energy took place (0.5% on a monthly basis), adding to the almost successive increases from the beginning of the year, which have led the annual increase in this area to 6.0%, a rate that had not been observed for several years. In October, there was also an increase in the rates for natural gas for households (1.5%), which led its annual variance to 7.0%.

44. The CPI of tradable goods without food nor regulated goods also showed an acceleration, closing the month at 1.7% annual (**Chart 1**). Airline tickets showed considerable increases, with which the annual variance of this item amounted to 10.1%. On the other hand, the CPI for cell phones and accessories continued descending significantly, while that of vehicles did not present variations after

several months falling. Until October, the accumulated depreciation of the rate of exchange (of around 12% between August and said month) has not been reflected upon the CPI of tradable goods without food nor regulated goods. Nevertheless, one must keep in mind that the transmission occurs at least a quarter later, for which it is probable that greater increases be observed in the future months, inasmuch as the exchange rate keeps at current levels or continues to weaken.

45. In turn, the annual variance of the CPI without food nor regulated commodities remained at 3.3% reflecting few pressures of demand, as was suggested by the estimation of the output gap presented in the previous report, indicating that it would post slightly over 0.0%. The annual variation of leases, the most important item, did not fall this time, remaining at 3.1%.
46. Regarding the prices of food, they accelerated 102 bp in October against the previous month (4.3% on a yearly basis). An important part of this increase is explained by a low comparison base effect. In processed food and foods out-of-the-home, no significant monthly increases were observed. To that date, no transmission of the depreciation of the peso to the prices of food was perceived.
47. As for prices to producers (PPI), in recent months, a significant acceleration of the annual variance has been observed (passing from 3.7% in September to 4.9% on a yearly basis in the last month), which in the future could be translated into bull pressures upon costs. These increases have partly resulted from the effect of the accumulated depreciation of the peso, which is transferred immediately to the PPI for imports. Likewise, the greater inflation to producers is explained through increases in the prices of locally-produced goods, especially those of farm origin.
48. Salary costs have continued to present adjustments compatible with the long-term inflation target, as suggested by the salaries for sectors such as manufacturing and construction, which continue increasing at an annual rate of nearly 4.0%. Nevertheless, it must be pointed out that in the last two months the information available regarding commercial salaries has shown an acceleration of this indicator above the target (8.0% in September). Given the volatility displayed by this series, new data are required to determine if this obeys to a change in the trends.
49. According to the monthly survey applied by the Central Bank to market analysts, inflation expectations to December 2014 increased: these were estimated at

3.46% against 3.38% a month ago. In spite of this, the twelve-month expectations remained unaltered at 3.1%, which suggests that analysts consider the acceleration of inflation towards the end of the year as transitory. Measurements in a 2, 3 and 5 year-horizon performed on the basis of the profitability curve for TES appeared as much more volatile in the last few weeks, due to significant expirations of bonds, which makes it more difficult to detail their trend; however, on the average, they post a little above 3,0%.