



**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**

I. The External Context, Exports and Imports

1. In the United States, the indicators of real activity for the third quarter show that the economy maintained the dynamism shown in the previous quarter. The figures for industrial production in September showed acceleration in their expansion rhythm, while the annual growth of the retail sales continues to reflect a good behavior of household consumption, despite the slight reduction observed during the last month.
2. The records for September show that the labor market continued with its rally, which resulted in a new fall of the unemployment rate. In the same sense, the other indicators monitored by the Federal Reserve (Fed), such as the rate of underemployment or the long-term unemployment, continue to show improvements, although they still remain far from their pre-crisis levels. The confidence indexes of entrepreneurs and consumers suggest that in the remainder of the year the American economy could present a good behavior.
3. Inflation in the United States was reduced in September and remains under the Fed's goal of 2.0%. Likewise, the measures of basic inflation are lower than 2.0%.
4. As for its monetary policy, the end of the assets purchase program was announced in the meeting of October, as was expected by the market. The press release after this meeting contained no indications of changes over the start of the increment of the reference rate, although it did mention the possibility of anticipating the increase of the interest rates if the economy surpasses the expectations, or to hold up the increment if the progress of the economy is slower than expected.
5. In the euro zone, industrial production in August displayed a fall versus the same month of the previous year, as a result of a reduction in the manufacturing activity of the main countries of the region. It must be noted that these behaviors differ among countries, highlighting the case of Spain positively, and that of France negatively. Surveys to industrialists suggest that this sector would continue weakening in what is left of the year.

6. With respect to private consumption, retail sales in the euro zone continue to show a mediocre growth rhythm. This item could present a low dynamism in the following months. Besides, no improvements are observed in the labor market, and household confidence continues to plummet significantly. On the other hand, exportations to countries outside the zone have become stagnant in recent months.
7. Annual inflation was reduced to 0.3% in September, with which the risks of deflation in the region are still present. In this context, the European Central Bank began its guaranteed bond purchases program during this month, with the purpose of promoting the offer of credit.
8. In China, the annual growth of the GDP during the third quarter reduced to 7.3%. With figures to September, retail sales and investment on fixed assets showed a downward trend, which contrasted with the good behavior of exportations and the slight rally of the industrial production.
9. In Latin America, with figures to August, the annual variance of the indicators of economic activity for Brazil, Chile, Mexico and Peru suggest that the growth of these countries during the third quarter of the year would continue to be weak.
10. As for inflation in the emerging economies of Asia and Latin America, with information to September, a heterogeneous panorama is observed. On the one hand, in Mexico, Chile and Brazil inflation remained above the goal of their respective central banks. On the other, in Peru and in the main Asian economies, it has lowered. The case of China stands out, given that the annual variance of the prices has plummeted along the year, posting at 1.6% by the end of the third quarter.
11. The prospect of lower economic growth worldwide has pressured the international quotes for basic goods downward. In the case of oil, greater production in the United States and the re-establishment of the offer in Libya were additionally observed, which have also contributed to the significant fall of the price of this basic good. This has caused the expectations of its quotes for the remainder of the

year and for 2015 to be located significantly under the levels that had been observed in recent years.

12. The price of nickel has lowered importantly in the last few weeks, as a result of a decumulation of inventories in China as well as of a smaller demand of this metal. In turn, the international quotes for coffee plummeted, although in smaller amounts, given the prospect of favorable climatic conditions in Brazil that would allow for the rally of their production.
13. Meanwhile, the quotations of some imported foods maintained a strong downward trend, thanks to the greater offering of good crops in the United States and in Europe, as well as to the abatement in the price of oil and the lower demand worldwide.
14. As for the financial markets, volatility indexes showed increments during the last month, in an environment of greater aversion to risk. This is explained to a large extent by the weakening of growth in the euro zone and in the emerging economies, the fall of the prices of basic goods, and uncertainty over the decisions of monetary policy in the United States and in Europe. In this context, the stock market indexes and the rates of the long-term bonds of the United States, Germany and France were reduced. Likewise, the dollar itself has strengthened.
15. The financial markets of Latin America have shown an increment in the risk premiums as a result of volatility in the global financial markets. In this context, the currencies of the region continued to weaken during the month of October, being the Chilean peso the only exception. The Chilean currency continues to be the one with highest depreciation along the year (11.2%).

a. Exports and imports

16. In August, the total value of Colombian exportations decreased 3% with regard to the same month of the previous year, a variance which can be explained due to lower prices. This fall takes place because of the lower exportations of the main mining goods (-7.6%), a behavior that was partially compensated by the increases registered in the external sales among the group of other exports (11.2%), as well as

of the main goods of agricultural origin (7.8%). The reduction of exportations of mining goods is explained by the smaller exportations of oil (-8.5%) and refined oil derivatives (-33.8%). On the side of the exportations of agricultural goods, a joint growth of the coffee sales (30.7%) and banana (57%) was recorded, while those of flowers plummeted 35%.

17. The exportations of the remainder of products (of which 96% are industrial goods) showed an important growth in chemical products (18%), as well as in food and beverages (24.5%). Exportations grew by country of destination, chiefly towards Venezuela (46.4%), Ecuador (14.6%), Brazil (22.2%) and the United States (10.6%).
18. Along the year until August, the total value of the exportations in dollars plummeted 2.7% with regard to the same period of the previous year. This dynamics is caused by the abatement of 3.5% in the external sales of mining products and of 5.6% in the group of other exports. The greatest reductions of the group of main mining goods businesses were those of external sales of derivatives (-26.2%) and gold (-37.1%); and in the case of other goods, the lower external sales of vehicles stand out (-44.6%), other agricultural goods (-40.1%), chiefly by livestock, and other industrial goods (-12%). On the other hand, the exportations of the main agricultural goods grew 15.3% in annual terms, given the joint increase of the external sales of coffee (22.8%), banana (23.2%) and flowers (1.8%).
19. In the month of August, imports had an annual variance of -1.5%, as a product of the joint fall in the imports of capital goods (-7.1%) as well as of intermediate goods (-3.8%). In turn, the imports of consumer goods increased 11.7%. Regarding capital goods, the main fall took place in transportation equipment (-20.1%), given the smaller value imported in rolling stock (-44.5%). As for intermediate goods, the decrease is caused by the smaller purchases of commodities for agriculture (-23.1%) as well as of fuels and lubricants (-13.4%). In the case of consumer goods, growth was observed in durable goods (14.9%) as well as in non-durable goods (8.6%), with vehicles (19.9%) and food (26.8%) being the areas that contributed mostly to the growth in each group.

20. In the accumulated from January to August, imports had an expansion of 6.8% thanks to the joint increase of imports of intermediate goods (10.7%), consumption (7.8%) and capital (1.4%). The imports of fuels and lubricants contribute the most to the growth of those of intermediate goods with an increase of 26%, while in the case of consumer goods the major increase occurred in durable goods with a variance of 11.3%. The increase of capital goods is explained by an expansion of 4.9% in the imports of capital goods for industry, to a large extent compensated by the fall of 4.9% in those of transportation equipment.
21. It is worthwhile mentioning that the closing of the refinery in Cartagena has partially explained the deterioration in the trade balance of the country. Therefore, a partial correction of the trade deficit could be expected once the new refinery begins to operate next year.

II. Domestic Demand, Growth and Lending

22. The available information suggests that during the third quarter of 2014 the economic activity would have presented a lower growth than was observed in average for the first half-year of the year (5.4%). According to the indicators, a good dynamics in the performance of household consumption persists, while the investment would have slowed down. Regarding external demand, the figures would have improved in relation to the behavior of the previous quarters.
23. In relation to household consumption, the most recent results from the DANE Monthly Retail Trade Sample (MRTS) show that in August retail sales increased 8.5% annually, which represented a growth of 6.8% for the months of July-August. Not counting vehicles, sales increased 7.5% and 6.2% for the same period, respectively.
24. The expense in durable goods reflected in the figures of vehicle and motorcycle sales of the same survey, also presented a good dynamics in the period. According to DANE, the sales of those goods grew 9.5% annually during the months of July-August (13.6% in August).

Additionally, with information to September, the figures for motor vehicle sales published by *ANDI-FENALCO-Econometría* confirm that said dynamism would have continued (for all the third quarter these grew 17.4% annually, versus 1.4% in the second quarter).

25. In turn, the balance of sales of the Monthly Survey of Economic Expectations (MSEE) conducted by Banco de la República also indicates at a good rhythm of expansion of household consumption during the third quarter.
26. In spite of the recent falls, the average of the index of consumer confidence published by Fedesarrollo for the third quarter did not show significant differences with regard to the data of the second one. It is worth mentioning that its level posted above the average since 2001. By components, the average of the index of economic conditions remained in a similar level to that of the second quarter, while that of expectations was reduced slightly.
27. Other indicators supporting the good performance of family expenses are those associated to the behavior of the labor market. The information to August indicates that the unemployment rate has continued plummeting in all geographical regions. These downturns are explained by the increments in employment, particularly of salaried employment, which continues to grow at a good rhythm.
28. On the other hand, the consumption portfolio of leases for the third quarter grew 11.8% versus the same period of 2013, which indicates that the growth rhythm of the credit to homes in nominal terms was maintained during July-September. It is worth highlighting that access to credit was not more expensive during the latest months: in the third quarter, the interest rates of consumption in real terms posted, on the average, similarly to the levels to the registered during the second quarter.
29. With regard to the raw formation of capital, according to the balance of the investment expectations question of the EMEE, the raw formation of capital excepting civil works and construction would record similar expansions to those of the second quarter. Based on information to August, the estimations in constant pesos of imports

of capital goods for the industry and transportation equipment head in the same direction.

30. Regarding foreign trade, the estimation in constant pesos for the exportations of the third quarter show a positive evolution versus the second quarter. As for imports, similar increases to those registered in the first half of the year are expected, following the registers by DANE and those of foreign trade of DIAN.
31. On the side of offer, the available indicators suggest that the GDP of the industry in the third quarter would grow annually after the contraction registered between April and June (-1.4%). In August, the index of industrial production (IIP) —except for coffee threshing— grew 0.3% annually, with a registration of 1.0% for the months of July-August. This behavior is influenced in part by the closing of Reficar, which brought as a consequence a backward movement of the sub-branch of refining (-16.9% annual). Excluding the latter from the IIP without coffee threshing, an annual expansion around 1.1% was observed for the month of August and of 2.3% for the months of July-August.
32. According to the survey by Fedesarrollo with information to September, the stock indicator (which is counter-cyclical) continued to be favorable and its trend component improved (in the third quarter the balance plummeted 5 points). The current volume of orders increased set against the prior month and its trend component maintained an ascending slope (the balance passed from -2.6 to 4.5). Finally, although the expectations presented a slight diminution versus August, the trend component maintained a positive behavior (in quarterly terms, the balance passed from 34.8 to 39.5). Thus, the confidence of entrepreneurs remained at levels higher than their historical average.
33. In the case of commerce, the information from Fedesarrollo showed that the current perception of sales remained unchanged, for which its trend component maintained a positive slope. On the contrary, the expectations for six months recorded a reduction versus the prior months, with which the trend stopped growing.

34. As for the mining industry, although the data of the production of oil in the month of September (993 mbd) was higher than that of the two prior months (979 mbd in average), the deterioration continued for a second consecutive quarter. As a matter of fact, oil production during the third quarter posted, on average, under one million barrels (983.7 mbd), and presented an annual fall of 3.1%, similar to the one registered one three months before (-3.6%).
35. Regarding the construction sector, cement production recorded an annual expansion of 6.9% in September. With this, the third quarter grew 10.2%, after the 14.2% reported a quarter before. Licenses grew 8.1% in the months of July-August, and the accumulated for twelve months maintains an important rate of expansion of 8.7% annually to August.
36. In the agricultural and livestock sector, the Federación of Cafeteros reported that in September the production of coffee posted 912 thousand 60-kilo bags, which implied a yearly growth of 6.0%. With this, the third quarter accelerated importantly, reporting an annual rate of 24%, after having presented an almost null expansion during the second quarter (0.2%). On the contrary, cattle slaughter in August plummeted 2.9% in annual terms as a result of the retention phase that the activity has at present within its production cycle (a quarter before the fall had been 7.8%).

III. Behavior of Inflation

37. Annual inflation to the consumer closed the third quarter of 2014 at 2.86%, slowing down with regard to the prior month (3.02%) and posting again under the midpoint of the goal range (3.0%) (**Table 2**). To date, a variance of the CPI of 3.08% was accumulated, versus 2.16% for the same period of 2013. The forecast of the market for the monthly inflation of September was 0.19%, 5 bp above the one observed (0.14%).
38. As did the total inflation, the average of the four indicators of basic inflation monitored by the Central Bank also set back in September. This average was maintained under the inflation goal, reaching a

level of 2.63%, 7 basis points (bp) lower than the registration in August. The accumulated variance of this indicator to date is 2.23%, greater than the one registered during the same period of 2013 (2.10%). The four indicators analyzed posted under the medium point of the goal range, and they plummeted with regard to last month. Core 20 continued to show the greatest level (2.9% annually), while the CPI without perishable food, fuels or public utilities was the lowest (2.4% annually) (**Table 2**). Annual inflation without food posted 2.7%, decreasing 14 bp, while inflation without food or regulated goods (2.6% annual) recorded the lowest fall (just 1 bp).

39. Within the CPI without food, regulated goods —and, to a smaller extent, non-tradable goods— exercised downward pressures that had been forecast by the technical staff. Regarding regulated goods, the downturns concentrated on the rates of aqueduct and gas utilities, considering the other components (fuels, public transport, and electric power) did not present variations of importance. With this, annual change posted at 3.25%, plummeting significantly versus its register in August (3.83%) (**Table 2**). It is important to point out that the rates of electric power slowed down their annual increment significantly, from 9.2% in August to 5.2% in September, by simple statistical comparison: while the growth in September of this year was close to zero, twelve months ago it surpassed 4.0%. For October and even November, a recovery in the group of regulated goods is expected, given the recent adjustment in the fares for taxis, *Transmilenio* and *SITP* (public transportation systems).
40. In turn, non-tradable goods except for food and regulated goods fell only 3 bp, closing September in 3.3% (**Table 2**). The descending trend shown by this basket during the third quarter is a reflection, to a large extent, of the slowdown in the annual variance of the leases. Particularly, this item has been presenting a fall in its annual adjustment after February, when it reached its most recent ceiling (3.58%).
41. In general, the recent depreciation of the peso has not pressured the annual variance of tradables, except for food and regulated goods, to a rise (1.59% in September) (**Table 2**). Nevertheless, its effect started to be felt strongly in some goods. This was the case for washing machines, texts, beer, soap, detergent, and, in general,

cleaning products. Thus, it is expected that the trend towards depreciation of the exchange rate from the end of July generates new rises in this sub-basket for what is left of this year. It is worth remembering that different studies show that the transfer of the increase in the price of the dollar to consumer prices of tradable goods in Colombia can be observed between three to four months later.

Table 2
Behavior of Inflation to September 2014

Description	Dec-13	Jan-14	Mar-14	Jun-14	Jul-14	Aug-14	Sep-14
Total	1.94	2.13	2.51	2.79	2.89	3.02	2.86
Without food	2.36	2.49	2.62	2.66	2.75	2.84	2.70
Tradables	1.40	1.57	1.65	1.94	1.60	1.57	1.59
Non tradables	3.76	3.61	3.55	3.45	3.17	3.29	3.26
Regulated goods	1.05	1.66	2.21	2.14	3.60	3.83	3.25
Foods	0.86	1.20	2.23	3.11	3.26	3.47	3.25
Perishable	-	0.16	2.13	3.17	8.92	9.18	8.91
Processed	-	-	0.24	0.18	0.92	1.44	1.66
Foods out of the home	0.24	0.18	0.92	1.44	1.66	2.09	2.14
	3.26	3.29	4.13	3.52	3.45	3.47	3.23
Indicators of basic inflation							
Without food	2.36	2.49	2.62	2.66	2.75	2.84	2.70
Core 20	2.72	2.69	2.86	3.04	2.73	2.98	2.89

CPI without perishables, comb., or public utilities	2.19	2.27	2.53	2.53	2.33	2.42	2.39
Inflation without foods or regulated goods	2.74	2.74	2.74	2.81	2.51	2.56	2.55
Average of indicators of basic inflation	2.51	2.55	2.69	2.76	2.58	2.70	2.63

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

42. With regard to the CPI for food, although its annual variation plummeted from 3.5% in August to 3.3% in September, it is considered that this behavior is transitory, and an important acceleration is foreseen for the remainder of the year by a low statistical comparison base. It is worth remembering that the fourth quarter of 2013 presented a negative growth in the CPI of food, which is not expected to happen at the end of this year for two reasons: 1) The cattle-raising retention phase with prices on the rise, and 2) the depreciations of the peso that would raise the prices of tradable foods, although the fall of its international quotes could moderate this bull effect.
43. In September, the greatest downward pressures stemmed from the basket of perishable foods, especially potato, as well as several vegetables and fruits. In spite of the good behavior of this group in the month, it is expected that this downward trend will not be maintained for the remainder of the year as well as during the beginning of 2015, according to its cycle of production. Likewise, the growth of foods outside the home slowed down. In this month, this segment was favored by the lower adjustment in the CPI of leases, public utilities, and food in general.