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Board of Directors

Banco de la República

Monetary Policy Report

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Monetary Policy Report

Economic Studies Division

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I. External Context and Balance of Payments

1. Global economy continued to expand at a moderate pace in the second quarter, driven by domestic demand in advanced economies and in China. However, performance in Latin America continued to be mediocre, exhibiting little evidence of recovery, with few exceptions.
2. In the United States, non-residential investment in the first quarter became the main engine of growth, followed by consumption. The market expects higher growth in the second quarter. This seems to be supported by good results of the confidence, production, and labor market indicators.
3. However, inflation in the U.S. has decreased in the past four months, reaching 1.6% on a yearly basis in June. Results were similar in core inflation, which registered 1.7% on a yearly basis in the same month. This is attributed to temporary downward pressures, explained by mobile telephone services and medicines.
4. As a result, the market has revised inflation expectations, which would only be above the implicit 2.0% goal of the Fed towards the second quarter of 2018.
5. Information available on the euro zone for the second quarter suggests that its favorable pace of expansion would continue. In the United States, non-residential investment in the first quarter became the main engine of growth.
6. The data from the second quarter of the year suggest that this behavior would continue. Consumer confidence would be reaching the highest levels of the last 16 years, and the PMI for manufacturing would have continued to grow.
7. Inflation in the euro zone has also declined in the last few months. In June, it recorded 1.3% on a yearly basis, mainly due to lower food prices.
8. In the second quarter, the Chinese economy grew 6.9%, driven by investment and consumption. This value is higher than the one observed for 2016 (6.7%) and to the growth target for 2017 (6.5%).
9. In Latin America, the information on GDP growth for the first quarter exhibits slowdowns in Chile, Peru, and Colombia. The data available on monthly economic activity suggest that during the second quarter the region's economies would continue to grow significantly below the figures observed in previous years, except for Mexico, where projections have been revised upward.
10. To June, inflation in Latin America shows a downward trend, except for Mexico. This would be associated with the accumulated depreciation of the Mexican peso and the rise in fuel prices.
11. Colombia's terms of trade during the second quarter have declined somewhat versus the first quarter, mainly explained by lower oil prices. In recent months, it has become evident that a price close to USD 54 per barrel stimulates the supply

of oil. Although the terms of trade for Colombia exhibit recovery *vis-à-vis* 2016, they have decreased in the course of 2017.

Exports

12. In May, exports in US dollars registered an annual 23.4% growth rate due to increases in all groups of goods. Once again, the 33.2% yearly variation in the sales of mining assets stands out, as does the recovery of agricultural goods and the rest of exports (Table 1).

Table 1 Behavior of Exports in US dollars

	May 2017			
	Annual Variation [Contribution]	Main contributing items to annual variation, in the same direction:		
		Item	Annual variation of the item	Contribution to annual variation
Total Exports	23.4%			
Agricultural goods	24.7%	Banana	46.2%	1.8
	[3.5]	Coffee	26.5%	1.4
Mining goods	33.2%	Coal	88.5%	13.8
	[18.2]	Gold	76.7%	2.7
Other exports*	5.7%	Foods, Beverages, and Tobacco, excluding Coffee	33.7%	1.8
	[1.8]	Machinery and Equipment	64.7%	0.8
	Accumulated value for January-May 2017			
Total Exports	24.9%			
Agricultural goods	10.2%	Coffee	19.6%	1.6
	[1.7]	Banana	7.6%	0.3
Mining goods	47.1%	Coal	72.0%	9.7
	[23.4]	Oil	34.5%	8.9
Other exports	-0.7%	Vehicles and other means of transportation	-15.2%	-0.3
	[-0.2]	Chemical Products	-1.8%	-0.2

* Within this group, the destinations which contributed the most to growth were United States, Ecuador, and the European Union, with 28.5%, 7.6%, and 10.0% annual increases in May, respectively.
Source: DANE

13. So far this year, total exports grew 24.9%, explained mainly by the 47.1% growth in the external sales of mining goods. The group of other exports is the only one that presents an annual contraction (-0.7%).
14. For this period, the value of exports grew as a result of improvements in prices, reflected in their index, with a significant annual increase of 27.2%, while the figure for quantities decreased slightly (-1.5%). This improvement in prices took place in the three groups of goods, with those of agricultural origin standing out (variation of 43.3% on a yearly basis).

15. According to the preview for foreign trade by DIAN, exports excluding oil and its derivatives increased 6.1% on a yearly basis in June mainly due to external sales of coal and coffee. (According to this source, this group of exports had varied 33.6%; however, later reports by DANE indicated 35%). Also based on this preview, an estimation for the group of other exports indicates that it grew 15.1% per year in June.

Imports

16. In May, CIF imports in US dollars registered an annual 4.0% increase, mainly explained by the increase in external purchases of capital equipment and raw materials (Chart 2).
17. Regarding consumer goods, May recorded a 1.8% annual fall, explained by the lower imports of both durable and non-durable goods, which registered an annual contraction of 2.3% and 1.1%, respectively.

Table 2: Behavior of Imports in US dollars

	Annual Variation [Contribution]	Main contributing items to annual variation, in the same direction: Item	Annual variation of the item	Contribution to annual variation
May 2017				
Total Imports	4.0%			
Capital Goods	8.8% [2.6]	Industrial Machinery	17.5%	1.2
		Transport equipment	21.3%	0.5
Raw materials	4.0% [1.8]	Fuel	13.2%	1.0%
		Chemical and pharmaceutical products	5.6%	0.9
Consumer Goods	-1.8% [-0.4]	**Non-durable consumption goods**	**-2.3%**	**-0.3**
		Food products	-20.2%	-1.0%
		Durable consumption goods	**-1.1%**	**-0.1**
		Private transportation vehicles	-10.9%	-0.7
Accumulated Value for January-May 2017				
Total Imports	6.7%			
Capital Goods	10.4% [3.1]	Transport equipment	65.6%	1.8
		Parts and accessories for transport equipment	12.0%	0.5
Raw materials	6.8% [3.2]	Mining products	9.4%	0.8
		Chemical and pharmaceutical products	5.5%	0.8
Consumer Goods	2.0% [0.5]	**Non-durable consumption goods**	**-2.0%**	**-0.3**
		Food products	-6.3%	-0.3
		Tobacco	-36.3%	-0.1
		Durable consumption goods	**6.9%**	**0.7**
		Private transportation vehicles	7.5%	0.4
		Household machines and appliances	7.7%	0.2

Source: DANE

18. So far this year, total imports grew 6.7% on a yearly basis. The indexes for quantities and prices showed an annual 5.2% and 1.4% increase, respectively. This would suggest that, despite the fact that the increase in imports is due to a

combined effect, the contribution of the quantities, focused on capital goods, is more relevant.

19. According to the preview for foreign trade by DIAN, CIF imports recorded an annual 3.1% increase in June. (According to this source, they had grown 2.2% in May; however, the figure reported later by DANE was 4.0%).

II. Projections of External Variables

a. External Growth Scenarios

Baseline or more likely scenario (Table 3)

20. This report registered few changes in growth forecasts for the country's main trading partners, compared to the ones published in the March quarterly report. Recovery in 2017 is still expected compared to 2016, with a somewhat better second half of the year.
21. Growth in the United States was reduced *vis-à-vis* a quarter ago, taking into account that the data from the first quarter were lower than expected by the market. Consumption would continue driving the economy, supported by the continuous improvement of the labor market.
22. In the baseline scenario, an increase in the policy interest rate of the Fed is expected in the remainder of 2017 and another one in 2018. Thus, at the end of 2018, its upper limit would be 1.75%. The baseline scenario does not consider the possible effects of the program recently announced by the Fed to reduce its balance sheet.
23. Growth of the euro zone was revised slightly upwards, taking into account the good results observed. The political outlook has improved considerably in recent months, which contributes to consumer and business confidence.
24. To date, it is expected that growth in the euro zone to slow down in 2018 due to the impact of Brexit.
25. Monetary policy by the European Central Bank would continue to be expansive, although less than before, considering recent announcements. Inflation is expected to remain at low levels.
26. As for China, growth for 2017 was slightly revised upwards, considering the good results from the first and second quarters. Henceforth, this economy would continue to slowdown, relying more on consumption. Measures to reduce credit growth are expected to continue, which suggests a more contractionary monetary policy in the future. Additionally, fiscal stimulus measures by the government will continue in order to avoid a sharp slowdown.
27. Again, the risk balance would be biased downwards. Some of the risks that could negatively affect growth are:

- The levels of leverage in China continue to pose a risk to global financial stability.
- The negative shock on investment, if tax cuts are not implemented in the US, according to some analysts.

28. In contrast, an upward risk is that low inflation be persistent for structural reasons, which would allow for a more expansionary monetary policy in the euro zone or the US than considered in the baseline scenario.
29. Given the events of 2017, it is reasonable to think that the price of Brent oil which is close to the forecast presented in the March report (54 US dollars per barrel) stimulates its global supply excessively. However, several factors would prevent it from falling even more:

- The OPEC agreement would continue to be partially met.
- The recovery of growth in advanced economies would favor prices.
  Considering these factors, an average price of USD 51 per barrel (Brent Reference) is projected for 2017 (which implies a price of 48.5 USD, on average, for the rest of the year), and 52 USD per barrel for 2018.

Table 3

Economic Growth Forecasts for Colombia's main Trading Partners

Country or Region	2017			2018		
	Low	Baseline	High	Low	Baseline	High
USA	1.8	2.2	2.6	1.0	2.2	3.0
	1.5	2.3	3.0	1.0	2.3	3.0
Euro Zone	1.4	1.8	2.2	0.5	1.6	2.2
	1.2	1.7	2.2	0.5	1.7	2.2
China	6.2	6.6	6.8	5.2	6.2	6.8
	6.0	6.5	6.8	5.2	6.2	6.8
Brazil	(0.3)	0.4	1.0	0.4	2.1	3.2
	(0.5)	0.5	1.5	1.0	2.5	4.0
Ecuador	(1.5)	0.0	0.8	(1.5)	0.5	1.5
	(1.5)	0.2	1.0	(1.5)	0.5	1.5
Venezuela	(10.0)	(7.0)	(2.0)	(5.0)	(1.0)	1.0
	(9.0)	(6.0)	(1.0)	(3.0)	0.0	1.0
Peru	2.4	3.0	3.6	3.0	4.0	5.0
	2.3	3.5	4.3	3.0	4.0	5.0
Mexico	1.2	2.0	2.8	1.0	2.2	3.0
	0.5	1.6	2.5	1.0	2.2	3.0
Chile	0.8	1.4	2.0	1.0	2.6	3.5
	0.8	1.8	2.8	1.0	2.6	3.5
Trading partners	1.1	1.8	2.4	1.2	2.3	3.0
	1.5	1.8	3.0	1.0	2.3	3.0

b. Projection of the Balance of Payments

30. With results to March 2017, the information available to date for the second quarter and the external context scenario presented in the previous section, the new estimate of the current account deficit for 2017 is 3.7% of GDP (USD 11,461 m) in the baseline scenario, with a 3.3% estimation for the low-growth scenario for Colombia's trading partners, and 4.2% for the high-growth scenario. Uncertainty about the conditions and availability of financing, as well as the sensitivity of some capital flows to the prospects of the general economic activity, determine the forecast scenarios.
31. The current account deficit projected for 2017 is lower than in 2016, when it reached 4.3% of GDP (USD 12,236 m). This correction is mostly explained by the lower deficit in the trade of goods, as a result of the expected improvement in the terms of trade (**Table 4**). In addition to this, there would be higher income transfers and a deficit of services similar to a year ago. On the contrary, a widening of the deficit of factor income is expected, due to a great extent to the improvement in export prices.
32. Thus, the additional adjustment to the current account for 2017 would be explained not by a reduction of expenditures, as happened last year, but by the increase in revenues, mainly due to higher exports of goods.
33. Regarding exports of goods, an annual 10.9% growth is estimated in the baseline scenario, particularly due to increases in the international prices of the main products. For the rest of goods (other than mining and main agricultural products) yearly growth is expected to be 5.3%. As for imports in US dollars, an annual 4.0% increase is expected, driven mainly by the growth observed in the first half of the year.
34. Additionally, the services trade is expected to be in a deficit in 2017 similar to the one observed a year ago. On the one hand, revenue increases are expected associated to a large extent with tourism, due to the larger number and expected expenditure by foreign travelers in Colombia. As for expenditures, higher payments of freight are expected, given the increase of imports and of the price of oil. Also, increases of imports of services related to the oil industry are forecast.
35. Compared to 2016, an increase in net outflows from factor income is forecast, associated with the increase in the profits of companies of the mining and energy sector and to the higher payments of interests on loans and bonds.
36. Regarding the forecast presented a quarter ago, the current account deficit in US dollars for 2017 increased by USD 409 m, and as a proportion of GDP it moved from 3.6% to 3.7%.
37. The upward revision of the current account deficit in US dollars was explained mainly by a lower projection of exports of goods. This results particularly from

the downward revision of prices of the country's main export commodities, and, to a lesser extent, of their quantities (exception for coal). As for imports, a growth rate higher than the one from a quarter ago is expected, given the annual 6.5% growth rate expected for the first half of the year. For the rest of items, the deficit in services and factor income was revised downward, and transfers and exports of industrial products were revised upward.

Chart 4

BALANCE OF PAYMENTS - (Millons of USD)		2016	2017 Baseline	Variation
CURRENT ACCOUNT (A+B+C+D)		**-12,236**	**-11,461**	**775**
Percentage of GDP		**-4.3%**	**-3.7%**	**0.6%**
A.	**Goods**	**-9,858**	**-7,953**	**1,905**
	Exports	33,381	37,003	3,622
	Imports	43,239	44,956	1,718
B.	**Non-factor Services**	**-3,151**	**-3,164**	**-13**
	Exports	8,008	8,670	**662**
	Imports	11,159	11,834	**675**
C.	**Factor Income**	**-5,074**	**-6,462**	**-1,388**
D.	**Transfers**	**5,846**	**6,118**	**272**

38. As for capital flows, resources from direct investment are expected to be the main source of funding in 2017, despite being lower than those recorded in 2016, followed by portfolio inflows and other external loans and credits (**Table 5**).
39. Foreign direct investment flows in Colombia would record an annual 20.5% fall as a result of the base effect from the sale of Isagen in 2016. Aside from this effect, FDI would grow 4.7%, driven by increased investment in mining and energy, manufacturing, and retail activities.
40. Added to this, net capital inflows from portfolio investment are expected, largely associated with the placement of government bonds and with the purchase of shares in the local market by foreign investors. Resources from the purchase of TES by foreigners are also considered, although not reaching the amounts observed in 2016.
41. In addition, capital inflows related to loans and other external credits granted mostly by multilateral agencies would be considered.

Table 5

		2016	2017 Baseline
FINANCIAL ACCOUNT (A+B+C+D+E)		**-12,818**	**-11,461**
A.	**Direct Investment (ii-i)**	**-9,171**	**-7,504**
	i. Foreign Investment in Colombia	13,687	10,874
	ii. Colombian Investment abroad	4,516	3,371
B.	**Portfolio Investment**	**-3,716**	**-4,360**
C.	**Other investment (loans, credits, and other derivatives)**	**-97**	**-189**
D.	**Reserve Assets**	**165**	**592**
ERRORS AND OMISSIONS		**-582**	**0**

III. Growth, Domestic Demand, and Credit

42. The new information available on the performance of real activity in Colombia continues to suggest a weak GDP growth for the second quarter of 2017, even lower than the one implicit in the projections of the technical staff three months ago.
43. The dynamics observed for the seasonally adjusted series in the monthly economy activity indicator (ISE) by DANE confirms this. This indicator grew 1.2% on a yearly basis in May, exhibiting a slowdown *vis-à-vis* April (1.5%). The aggregate for the two-month period of April-May increased 1.3%.
44. Throughout the second quarter, there would have been an expansion of domestic demand, underpinned not only by consumption, but also by investment, unlike what happened in previous quarters. Total consumption would have grown at a rate similar to the one observed in the first three months of the year, as a result of mild acceleration in both the public and private component. Once more, net exports would have contributed negatively to GDP, on account of a contraction of external sales (particularly of the main export commodities such as coffee and oil), and an increase in real imports.
45. Particularly, according to the results of the monthly retail survey (EMCM) by DANE, retail sales in May lowered 0.3% compared to the same month in 2016. The aggregate of the April-May period shrank 1.2% on a yearly basis, compared with -1.7% in the first quarter.
46. Excluding vehicle sales, the remaining aggregate fell 0.9% on a yearly basis during the same month. The aggregate for the two-month period barely reduced 0.3%, which contrasted with the -1.4% growth figure in the first quarter.
47. Vehicle sales fell 3.0% on a yearly basis in May. The aggregate for the two-month period fell 6.3% *vis-à-vis* the same period last year, which meant a deepening of the poor performance observed in the first quarter (when it fell 3.0% annually).
48. Other auxiliary indicators suggest that performance of private consumption would remain low, although somewhat higher than in the first three months of the year. The consumer confidence index (ICC) in June recovered slightly versus the records of April and May, but remains significantly lower than the average calculated since November 2001. The average of the ICC for the second quarter of 2017 is somewhat higher than that in the first three months of the year.
49. The seasonally adjusted series of the balance of sales to May from the monthly survey of economic expectations (EMEE) by the Central Bank also allows to anticipate that private consumption would have registered low growth rates.
50. Regarding the labor market, the seasonally adjusted series to May show stability in the unemployment rate nationwide, but an increasing trend for nearly a year for that of the thirteen areas. As for employment, the number of individuals employed

in the thirteen areas remains the same. For this same geographical domain, with information to the moving quarter ending in May, the seasonally adjusted series exhibit an increase in salaried employment and a reduction of non-salaried employment versus their levels in the previous month.

51. Regarding gross capital formation, the figures for imports of capital goods (in constant pesos) from the second quarter of 2017 suggest that growth of investment in machinery, equipment, and transport equipment would have recovered after several quarters of negative growth. The results of investment expectations from the EMEE to May confirm this projection.
52. As for international trade, the figures published by DANE to May and the information published by DIAN to June suggest a fall of real exports in the second quarter. Particularly, this behavior would be consistent with the poor performance reported for oil and coffee production. Imports, on the other hand, would have grown at a moderate pace.
53. On the supply side, the indicators available for the second quarter of 2017 continue exhibiting a weak performance. The figures signal a deterioration of the industry, construction of buildings, and mining in that period, while energy demand has improved.
54. According to the Monthly Manufacturing Survey (EMM) by DANE, the Industrial Production Index (IPI) showed a 0.6% contraction, higher than expected by the technical staff. Excluding oil refining, the rest of the industry contracted at a yearly 0.8% rate. Regarding oil refining, the result was an annual 0% variation, with which the impulse coming from said branch is now null. So far this year, total industrial production fell 1.3%, while industry excluding oil refining did so by 3.0%.
55. With information to June, the volume of orders and the level of stocks (counter-cyclical to production) as reported by firms in the Business Opinion Survey (EOE) by Fedesarrollo improved slightly versus the records from May. Additionally, production expectations from the same survey to three months recorded an increase. Despite this, the trend components of the three series exhibit weakening of the sector. With all of this, industrial confidence improved slightly.
56. For the retail sector, the same survey showed a slight upturn in the appreciation of the current economic situation and the prospects for sales to six months. It should be noted that despite the recovery, the trend components of both series show a significant deterioration.
57. As for agriculture, according to the National Federation of Coffee Growers of Colombia (FNC), coffee production stood at 1,049,000 bags, which represented a 9.4% reduction on a yearly basis in June. The aggregate for the second quarter of 2017 contracted 17.4%, contrasting with the record on the first quarter, when production expanded 12.9%.

58. On the contrary, the sector of utilities (electricity, gas and water) indicators suggest a recovery after the contraction observed in the first three months of the year (from -2.4% to 1.7%). The trend component of the series has a positive slope. While the regulated component grew 2.7%, the non-regulated one fell 0.3%.

IV. Behavior of Inflation and Prices

59. Annual consumer inflation fell again (from 4.37% in May to 3.99% in June), completing 11 months of continuous decline. Since January 2015, annual inflation had not posted below the ceiling of the target range (3.82%) (**Table 8**).
60. So far this year, accumulated inflation posted at 3.35%, lower than the figure recorded for the same period in 2016 (5.10%). Monthly inflation (0.11%) was lower than that registered in June 2016 (0.48%), and lower than estimated by the market (0.21%) and the technical staff.
61. In the last month, the fall of annual headline inflation was explained mainly by the behavior of processed foods and tradable items.
62. Core inflation, measured by the average of the four indicators monitored by the Central Bank, fell for the second month in a row to 5.09%, from 5.33% in May. This measurement had been very stable around 5.5% during the first four months of the year.
63. All core inflation indicators declined in June. The CPI core 20, which has the highest level, was the one that fell the most (from 5.59% to 5.31%). On the other hand, the CPI excluding food moved from 5.35% to 5.12%; the CPI excluding food and regulated items from 5.09% to 4.87%; and the CPI excluding primary food, fuel, and utilities did so from 5.29% to 5.07% (**Table 8**).

Table 8

Headline and Core Inflation to June 2017

Description	Weight	Dec 2016	Mar 2017	Apr 2017	May 2017	June 2017	Participation percentage in monthly deceleration	Participation percentage in deceleration of the year to-date
Headline inflation	**100.00**	**5.75**	**4.69**	**4.66**	**4.37**	**3.99**	**100.00**	**100.00**
Non-food inflation	**71.79**	**5.14**	**5.13**	**5.60**	**5.35**	**5.12**	**42.37**	**3.33**
Tradables	26.00	5.31	5.59	5.35	4.88	4.41	29.29	12.63
Non-tradables	30.52	4.85	5.33	5.22	5.25	5.21	3.18	(5.08)
Regulated items	15.26	5.44	4.05	6.75	6.24	6.01	9.91	(4.22)
Food inflation	**28.21**	**7.22**	**3.65**	**2.49**	**2.09**	**1.37**	**57.63**	**96.67**
Perishables	3.88	(6.63)	(13.09)	(14.47)	(14.13)	(14.72)	7.50	26.50
Processed food	16.26	10.74	6.28	5.12	4.39	3.29	45.99	65.77
Eating out	8.07	8.54	8.94	8.08	7.79	7.62	4.14	4.40
Core inflation indicators								
Non-food inflation		5.14	5.13	5.60	5.35	5.12		
Core 20		6.18	6.01	5.84	5.59	5.31		
CPI excluding perishable foods, fuel, and utilities		6.03	5.61	5.37	5.29	5.07		
CPI excluding food and regulated items		5.05	5.44	5.28	5.09	4.87		
Average of core inflation indicators		**5.60**	**5.55**	**5.52**	**5.33**	**5.09**		

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

64. The three main components of the CPI excluding food (tradables, non-tradables, and regulated items) exhibited a decrease in their annual variation. The most outstanding decrease was for the CPI for tradables, which lowered from 4.88% in May to 4.41% in June, completing four months of declines in this indicator. This confirms that the upward pressure on account of the accumulated depreciation until April and the tax increase have continued to fade. Added to this are the low pressures derived from a very weak domestic demand.

65. Regarding the non-tradable CPI, the decline in its annual variation was minimal (5.21%), remaining at levels very similar to those of the past three months. Within this subgroup, the stability for leases (4.33%) and the sub group of indexed items (6.90%, driven by education and health services) stands out, despite the poor performance of demand. Additionally, the annual variation of the subgroup "affected by the exchange rate" increased in June due to the increase in the rates of pay-TV services, which could be related to the depreciation of the exchange rate of the past two months.

66. Annual variation in regulated items fell from 6.24% in May to 6.01% in June. All the components fell, except for transport. Utilities fell from 5.53% in May to 5.01% in June, thanks to the reductions of energy fees this month and to very low adjustments in the previous two months *vis-à-vis* a year ago. Transport (from 5.92% to 6.06%) pushed inflation upwards due to inter-municipal bus fares, which increased close to 10.0% in Bogotá in June.

67. The annual variation of food decreased again and stood at 1.37%. Thus, the uninterrupted downward trend of this indicator completes eleven months, while the shocks of *El Niño* and the trucking strike have been reversed. The models of the technical staff suggest that this trend should continue until next month, but starting in August there could be an increase.

68. In June, all CPI components for food decreased. Processed foods fell the most (from 4.39% to 3.29%), thanks to the decreases in the price of beef. As for perishable foods, the decline was lower (from -14.13% to -14.72%), inasmuch as significant falls are accumulated for most of these items. On the other hand, meals outside the home moved from 7.79% to 7.62%.

69. As for cost pressures, in June, non-employment costs continued to decline, as has been observed since mid-2016. Yearly adjustment of the PPI for domestic supply (domestically produced and consumed items plus imported goods) fell further (from -0.16% in May to -0.83% in June). The annual IPP variation in domestic supply continued to be negative (-0.09%), below the figure for the same period last year (2.38%).

70. Labor costs did not exhibit significant changes, according to the latest information available. Wages in the manufacturing industry adjusted to an annual 6.5% rate in May; those for retail to 5.3%; and those for housing and heavy construction in

May did so in June to 5.7% and 4.4%, respectively. Thus, wages continued adjusting to rates much higher than the inflation target, despite the relative slack estimated for the labor market.

71. According to the latest monthly survey to financial analysts by the Central Bank (applied at the beginning of July), inflation expectations to one-year (maximum) fell, while those to a longer term increased. The inflation figure expected for December 2017 fell from 4.37% in May to 4.28% in June; expectations to twelve months did so from 3.62% to 3.60%. In contrast, those to 24 months increased from 3.34% to 3.38%.
72. Inflation embedded in public debt bonds (Breakeven inflation, BEI) extracted from the TES denominated in pesos and UVR to July 25 stood at 2.93% to 2 years, at 3.07% to 3 years, and 3.25 to 5 years. Compared to the average for June, average BEI lowered 4 bp and 1 bp for 2 and 3 years, respectively, while it increased 4 bp for 5 years.
73. Finally, using the Forward Break-Even Inflation (FBEI) curve, the estimation of annual inflation for 2017 is 4.88% (obtained by adding the accumulated inflation observed to the inflation expectations for the remainder of the year). For 2018, 2019 and 2020 it is 3.26%, 3.42% and 3.52%, respectively.