



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

OFFICE OF THE DEPUTY TECHNICAL GOVERNOR J

JUNE 2018

I. EXTERNAL CONTEXT

1. In recent months, the persistence of international oil prices at levels above \$70 US dollars per barrel has been relevant to Colombia in the external context. So far, until 19 July, Brent oil has reached \$71.59 US dollars per barrel, on average.
2. The monetary policy of some advanced economies has continued its normalization process so far this year, especially in the United States. Thus, in line with expectations, the Fed increased its benchmark interest rate 25 bp both in March and June. This has led to an increase of several long-term interest rates in these countries, particularly in the United States, where they reached a peak in May (since 2013).
3. In this environment, the risk perception toward emerging economies increased, but it has had considerable effects only on economies considered as more vulnerable.
4. Despite this, the information available shows that, so far in 2018, the recovery of the country's trading partners' economic growth continues.
5. The United States economy continues to grow on a solid path. The latest data confirm the trends: a strengthening of the labor market, a strong investment, and greater confidence and income of households that has favored consumption.

Baseline or more likely scenario (Table 1)

6. In this report, the growth forecast for the country's trading partners for 2018 exhibited few changes *vis-à-vis* the data presented before (2.4%). Thus, an acceleration with respect to 2017 is still expected. Consumption and investment, and retail as a reflection of them, would continue to drive growth in advanced economies. For 2019, a growth dynamics similar to the forecast for 2018 is expected from the country's trading partners.
7. In the baseline scenario, two additional increases in the Fed's policy interest rate are expected in the remainder of 2018. Thus, it would move from the current range (1.75%-2.00%) to 2.25%-2.50% by the end of 2018. Added to this, the balance sheet reduction program would continue to be met as announced.
8. The baseline scenario does not consider the effects of tariffs that the United States and its trading partners implemented in recent weeks. Neither does it include impacts associated with the recent financial stress that some emerging economies have experienced.
9. The expectation for oil prices in this report is USD \$71 per barrel (Brent reference) for 2018, on average, and USD \$67 for 2019. These values are

higher than those in the previous quarterly report, but still imply a reduction in price. The factors that would contribute to this decline are:

- i. An increase in production, which would be stimulated by the high prices observed in recent months.
 - ii. Gradual erosion of the OPEC and Russia agreements.
10. Some of the risks that could adversely affect the growth of the country's trading partners and the external context in general are:
- i. A greater rise in the cost of external financing than the one considered in the baseline scenario, as a result of the normalization of monetary policy in advanced economies.
 - ii. A staggering of protectionist trade policies by the United States and its trading partners resulting in a significant negative impact on world trade, which in turn can discourage global economic growth.
 - iii. An accentuation of political risks, among them a failed renegotiation of the North American Free Trade Agreement (NAFTA) and adverse news related to the negotiation of Brexit.

Table 1: Growth Projections of Trading Partners

Country or Region	2018			2019		
	Low	Baseline	High	Low	Baseline	High
USA	2.1	2.8	3.2	1.4	2.4	3.4
	2.0	2.8	3.6	1.4	2.4	3.4
Euro Zone	2.0	2.2	2.7	1.0	2.0	2.6
	1.9	2.4	2.9	1.0	2.0	2.6
China	6.2	6.6	6.8	5.6	6.4	7.0
	5.8	6.5	7.0	5.5	6.3	7.0
Brazil	1.6	2.1	2.6	1.0	2.7	3.5
	1.6	2.6	3.6	1.0	2.7	4.0
Ecuador	0.5	1.8	3.0	0.0	1.5	3.0
	0.5	1.8	3.0	0.0	1.5	3.0
Venezuela	(10.0)	(7.0)	(4.0)	(7.0)	(4.0)	(1.0)
	(10.0)	(7.0)	(4.0)	(6.0)	(3.0)	0.0
Peru	2.7	3.5	4.0	2.0	3.8	4.3
	2.6	3.8	4.6	2.5	3.8	4.7
Mexico	1.5	2.2	3.0	1.0	2.3	3.5
	1.3	2.2	3.0	1.0	2.3	3.5
Chile	2.8	3.5	3.8	2.0	3.3	4.0
	1.7	3.0	3.7	1.0	3.0	4.0

The current forecast is shown in black.
The forecast from the previous quarterly Report is shown in red.

The current forecast is shown in black.

The forecast from the previous quarterly report is shown in red.

II. FOREIGN TRADE AND BALANCE OF PAYMENTS

Exports of Goods

11. In May 2018, the value of total exports in US dollars registered a yearly 5.0% growth due to increases in mining goods (5.6%) and in the group of other exports¹ (11.4%). (Table 2). Something similar happened so far this year with total exports, mining exports, and the group of “others,” which grew 14.5%, 17.5%, and 17.8%, respectively.
12. Within mining exports, the external sales of oil and coal stand out. In the group of “others,” the dynamism of chemicals, foods, and beverages stands out.
13. In contrast, the group of agricultural goods of shrank 9.0% in May, explained by lower external sales of bananas and coffee. Year-to-date, there is a 3.6% fall. *Flowers* was the only item that showed a positive annual variation within this group in May (14.1%).

Table 2: Behavior of Exports in US dollars

May 2018				
	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	5.0%			
Agricultural goods	-9.0% [-1.3]	Bananas	-40.1%	-1.7
		Coffee (not roasted)	-1.8%	-0.1
Mining goods	5.6% [3.4]	Oil	34.5%	8.8
		Oil refining and others	47.5%	2.4
Other exports*	11.4% [2.9]	Chemical products	10.4%	0.7
		Motor vehicles and other transport	60.5%	0.7
Accumulated value for January - May 2018				
Total Exports	14.5%			
Agricultural goods	-3.6% [-0.5]	Coffee (not roasted)	-10.1%	-0.8
		Bananas	-7.8%	-0.2
Mining goods	17.5% [10.4]	Oil	19.5%	5.8
		Coal, lignite, and peat	20.2%	3.7
Other exports	17.8% [4.6]	Chemical products	17.4%	1.2
		Food, beverages, and tobacco (excluding coffee)	16.4%	0.9

- * In this group, there were significant annual growth rates of external sales to other destinations, Ecuador, and Asia (46.5%, 35.1%, and 30.4%, respectively).

Source: DANE

Imports of Goods

1. Excluding oil and its derivatives, coal, nickel, gold, coffee, bananas, and flowers. Including other mining and agricultural goods. Exports of manufactured goods accounted for 94.1% of this group in April.

14. The value of imports declared in May increased 21.1% *vis-à-vis* the same month of 2017, explained mainly by the group of intermediate goods, which contributed 11.1 pp to the total variation (Table 3). So far this year, expansion of imports was 6.0%.
15. As for the group of capital goods, in May, all items contributed positively to the variation, except for capital goods for agriculture, which subtracted 0.1 pp. It is important to note that external purchases of transport equipment expanded 62.9% after contracting in the previous month.
16. On the other hand, among external purchases of raw materials, those destined for industry and agriculture stand out, having grown 34.4% and 23.6% annually. So far this year, expansions stand at 12% and 8.7%, respectively.

Table 3: Behavior of Imports in US dollars

IMPORTS				
May 2018				
	Annual Variation [Contribution]	Main contributing items to annual variation, in the same direction:		
		Item	Annual variation of the item	Contribution to annual variation
Total Imports	21.1%			
Capital Goods	24.4% [7.6]	Transport Equipment	62.9%	4.3
		Construction materials	12.8%	2.6
Raw materials	24.3% [11.1]	Raw materials for industry	34.4%	11.1
		Raw materials for agriculture	23.6%	1.1
Consumer Goods	10.3% [2.4]	Durable consumption goods	6.8%	0.7
		Appliances and household devices	21.6%	0.6
		Non-durable consumption goods	13.3%	1.6
		Food products	28.6%	1.1
Accumulated value for January - May 2018				
Total Imports	6.0%			
Capital Goods	6.4% [2.0]	Capital good for industry	11.7%	2.2
		Construction materials	6.3%	0.2
Raw materials	5.3% [2.5]	Raw materials for industry	12.0%	4.0
		Raw materials for agriculture	8.7%	0.4
Consumer Goods	6.8% [1.5]	Non-durable consumption goods	10.9%	1.3
		Food products	8.6%	0.4
		Pharmaceutic products and toiletries	7.4%	0.3
		Durable consumption goods	2.2%	0.2
		Appliances and household devices	25.0%	0.5

Source: DANE

Balance of Payments

17. With the information available to date and the external context scenario presented in the previous section, the new estimate of the current account deficit for 2018 is 3.2% of GDP (USD 11,151 m) in the baseline scenario, within a range between 2.9% and 3.5% in the low and high-growth

scenarios, respectively. It is worth mentioning that uncertainty about the conditions and availability of financing, as well as the sensitivity of some capital flows to the prospects of the external context and to economic activity in general determine this range.

18. Although the current account deficit as a share of GDP projected for 2018 (3.2%) is lower than the one observed in 2017 (3.3%), current projections would imply a USD 714 m increase (Table 4). The lower trade deficit of goods and a higher income due to current transfers would contribute to reducing the external deficit. On the contrary, factor income is expected to expand, and a similar level of the deficit in non-factor services is expected.
19. As for exports of goods, an annual 15.7% growth in the baseline scenario is estimated. This dynamism would be explained by the expansion of external sales of oil and its derivatives and of industrial products, in a context of better prices and higher growth of the country's main trading partners. Regarding imports, a 10.8% growth figure is expected, higher than in 2017.
20. The deficit in services is estimated in 2018 at levels similar than those of 2017. On the side of expenses, these would increase mainly as a result of increased traveling expenses by Colombians abroad, the increase in outflows for freight, and the growth of technical services for the oil industry given the higher international prices of oil. On the other hand, income would increase mainly by the larger inflows associated with tourism, in line with the improvement of global growth.
21. Due to factor income, higher net outflows are expected *vis-à-vis* 2017, mainly due to the increase of the profits of foreign companies in the oil sector, and, to a lesser extent, to the improvement of the profits of companies that operate in sectors different from mining and energy. This is consistent with the higher growth expected for the economy. Higher interest payments on the external debt are also forecast.
22. An additional factor that would contribute to a lower deficit in 2018 is the increase in income from current transfers as a result of the higher growth expected from countries where remittances are originated.

Table 4

BALANCE OF PAYMENTS (Millions of US Dollars)	2017	2018 Baseline	2019 Baseline
CURRENT ACCOUNT (A+B+C+D)	-10,437	-11,151	-11,833
Percentage of GDP	-3.3	-3.2	-3.2
A. Goods	-4,759	-3,366	-5,613
<i>a. Exports</i>	39,482	45,674	47,651
Main	27,319	32,029	32,127
Other Exports	12,163	13,645	15,524
<i>b. Imports</i>	44,241	49,040	53,264
B. Non-factor Services	-4,184	-4,196	-3,692
<i>a. Exports</i>	8,342	9,476	10,275
<i>b. Imports</i>	12,525	13,673	13,967
C. Factor Income	-8,089	-10,882	-10,593
D. Current Transfers	6,594	7,293	8,066

Memo Item:

Mining and oil sector (a-b)¹	17,661	20,875	20,783
a. Exports	20,803	25,821	25,416
b. Factor Income Revenue	3,142	4,946	4,633

¹ Including oil and derivatives, coal, and ferronickel

23. In terms of the current account financing, direct investment is expected to continue as the main source of foreign capital inflows in 2018 (Table 5). However, the flows of foreign direct investment (FDI) in Colombia would record an annual 8.4% decline (Table 5). This would be explained by the effect of the basis for comparison originated in the resources received by companies from the communications sector in the previous year. It is important to note that, disregarding such effect, these would increase 12.3%, driven largely by investments in the mining and oil sectors.
24. Additionally, increased borrowing is expected from the public sector (net disbursements), in contrast to the net amortizations of 2017. As for portfolio investment, the baseline scenario for 2018 assumes a lower issuance of bonds by the public sector, and a greater dynamism by foreigners in the TES market.

Table 5

	2017	2018 Baseline	2019 Baseline
FINANCIAL ACCOUNT (A+B+C+D+E)	-9,831	-11,151	-11,833
Percentage of GDP	-3.1%	-3.2%	-3.2%
A. Direct Investment (ii-i)	-10,235	-8,653	-8,976
i. Foreign Investment in Colombia (FDI)	13,924	12,756	13,369
ii. Colombian Investment abroad	3,690	4,103	4,392
B. Portfolio Investment	-1,597	-219	-844
i. Public Sector	-7,250	-3,303	-1,860
a) Assets	-555	3,262	-140
b) Liabilities	6,695	6,565	1,720
ii. Private Sector	5,653	3,084	1,016
C. Other investment (loans, credits, and other derivatives)	1,455	-2,867	-2,974
D. Reserve Assets	545	587	961
ERRORS AND OMISSIONS	606	0	0

25. For 2019, a slight fall in the prices of main export products is foreseen, while growth of exports of goods would take place by the dynamism of external sales of industrial products. The positive growth path is estimated to continue in imports, in line with the greater economic growth expected. This would imply a larger trade deficit in goods versus the forecasts for 2018 (Table 4). Additionally, a lower deficit in non-factor services and a slightly lower level in factor income are expected. Thus, the current account deficit projected for 2019 in the baseline scenario is USD 11,833 m (3.2% of GDP).
26. Regarding funding, an increase in FDI flows and other investments is expected for 2019, inasmuch as the purchase of TES by foreigners continues. Additionally, a lower issuance of bonds by the Government and public entities is anticipated, as well as lower portfolio outflows by the private sector.

III. GROWTH, DOMESTIC DEMAND, AND CREDIT

27. The information available for the second quarter of the year suggests that GDP growth would be slightly lower than the one observed in the first three months. The negative effect of the investment shock would not have totally reversed during this period, while the positive effect of the public consumption shock would have faded partially.
28. The seasonally adjusted series, corrected for calendar effects, of the Economic Monitoring Indicator (ISE) by DANE confirms this. This indicator grew at a yearly 2.4% rate in May, higher than the 1.4% recorded in April. Thus, the two-month period expanded 1.9% on a yearly basis, a figure lower than the one observed for the aggregate of the first three months of 2018 (3.0%). The increases for the series of the original ISE (uncorrected) were 2.4% and 3.0% for May and the two-month period of April-May, respectively (2.2% of the aggregate for 2018-Q1).
29. In this context, the baseline scenario considers that, during the second quarter, domestic demand (measured as the sum of the total consumption plus total investment) would have accelerated as a result of a better performance of private consumption and a smaller decline in investment. External demand, on the other hand, would have contributed positively to GDP expansion, although less than in 2018-Q1.
30. According to the results of the Monthly Retail Survey (EMCM) by DANE, retail in May (excluding fuel) increased 6.6% on a yearly basis. The

aggregate for April-May recorded a 6.8% annual expansion, which implies an acceleration *vis-à-vis* 5.9% in the first quarter of the year.

31. Excluding vehicle sales, the remaining aggregate expanded 6.5% on a yearly basis in the same month. For the quarter, growth was 5.7% on a yearly basis, which also meant a better performance versus 4.8% in the previous quarter.
32. According to the same survey, the index of retail sales of motor vehicles in May increased 7.7% on a yearly basis. For the two-month period, the figure was 13.0%, similar to the record in the first quarter (13.2%). The series of records of licenses published by Fenalco suggests a similar behavior.
33. Additionally, other indicators that support the estimated recovery of household consumption are the Consumer Confidence Index (ICC) published by Fedesarrollo, and the balance of sales of the monthly Survey of Economic Expectations (EMEE) by the Central Bank. Particularly, the ICC continued on a recovery trend, and its level was higher than the one recorded in previous months. After three years, the ICC posted above its average calculated since November 2001.
34. Regarding gross capital formation, the series of capital goods imports (in constant pesos) and the seasonally adjusted series of the balance of investment expectations of the EMEE suggest that this item of GDP would have declined, although to a lesser extent than observed in the first quarter.
35. As for international trade, an expansion of real exports is expected, while imports would register falls (although of lesser magnitude than those observed a quarter ago). In the first case, a good sales performance of non-traditional goods and services exports is projected.
36. On the supply side, retail, industry, the oil sector, and coffee production exhibited favorable performances, while indicators related to construction showed setbacks.
37. In May, total industrial production (IPI) grew 2.9%. Excluding oil refining, the rest of the industry exhibited a 4.2% growth. For the aggregate of the two-month period of April-May, the seasonally adjusted series of the IPI adjusted for calendar effects grew 4.9% according to the DANE.
38. Energy demand recorded an annual 3.7% expansion in June. The trend shows a positive slope. The regulated and non-regulated components increased 3.3% and 5.0%, respectively.
39. Oil production in June stood at 864 mbd, resulting in an annual 0.9% increase. With this, the average level for the second quarter (865 mbd.) grew 1.2% cent on a yearly basis, and was higher than in the first quarter (847 mbd).
40. On the other hand, according to the figures from the Federation of Coffee Growers, coffee production stood at 1,087,000 bags in June, which

represents a 3.6% increase. During the first half of the year, production grew by 2.6% on a yearly basis.

41. In contrast, housing licenses exhibited a setback in May (-5.3%). So did cement production and shipments, which fell 1.5% and 1.6% during this month, respectively.
42. As for the labor market, the seasonally adjusted series to May exhibit stability in the national unemployment rate, and a slight reduction in the 13 areas. In both geographic domains, the increasing trend in the number of employed individuals continues, being more pronounced in the case of urban areas. For the moving quarter ending in May, the seasonally adjusted series for the 13 major metropolitan areas registered increases in non-salaried and informal employment higher than the corresponding growth figures for salaried and formal employment.
43. With this, the technical staff at the Central Bank maintained its GDP growth forecast for the second quarter of 2018 at 2.6% on a yearly basis, within a forecast range between 2.0% and 3.0%.
44. Regarding the GDP growth projections for 2018, the Central Bank's technical staff maintained the central point presented in the previous Inflation Report: 2.7% as the most likely figure, albeit within a narrower range (between 2.0% and: 3.2%, vs. 2,0% to 3,5% as reported previously). As usual, the ceiling and the floor of the range, as well as the central figure for GDP growth in 2018, are consistent with the assumptions of external fundamentals of the scenarios for the balance of payments discussed above.
45. Given the greater economic growth of our main trading partners compared to 2017, a positive contribution of external demand to GDP expansion is expected. Additionally, the increase in the forecasts of international prices of raw materials would allow for a greater increase in the level of the country's terms of trade than the one presented in the previous report. Similarly, the level of the current account deficit for 2018 would expand slightly in US dollars versus the records for 2017. This implies a greater inflow of resources to the country which would coincide with the expansion of domestic demand.
46. On the side of expenditure, private consumption is expected to expand at a faster pace than in 2017. This item should be favored by the reduction in inflation, increased confidence, and by the reduction of market interest rates. In contrast, public consumption growth was revised downwards for 2018, in line with the assumptions of the medium-term fiscal framework (MFMP). This would also be in line with the expected adjustment in the fiscal accounts of the National Central Government (GNC) in order to comply with the deficit allowed by the fiscal rule.

47. Regarding investment, no growth is expected for the civil works component in 2018, while the construction of buildings will contract. In the first case, the forecast of the technical staff assumes that the shock observed in the first three months of the year will only be fully dissipated in the second half of the year, as long as the delays in financial closures that have affected investment in these projects is overcome. In the second, the weak demand and excess supply in the sector of non-residential buildings are expected to continue.
48. The poor performance of gross capital formation in construction would not be offset by the expected behavior of investment in capital goods. In this sense, the growth of this sub-component of GDP is expected to gain momentum slowly during the second half of the year, inasmuch as the higher international prices of oil provide incentives for investment in the oil sector, and the reduction of the tax burden to firms referred to in the Tax Reform (through the elimination of taxes on wealth, the reduction of income tax, and VAT refunds for purchase of machinery, among others) stimulates spending on this type of goods.
49. Regarding the foreign trade accounts, a positive contribution of external demand to GDP growth is expected. Sales abroad would be driven by the better performances of exports of non-traditional goods and services. Imports would record positive growth rates, albeit low. This would take place considering the low performance expected largely from investment.
50. On the sectoral side, financial activities and insurance, and the sector of information and communications are expected to be the most dynamic branches in 2018. The industry would cease to fall this year, a forecast based on the good performance of this sector during the first five months of the year. On the other hand, mining would fall less than last year, based mainly on a higher oil production. As for construction, this sector would deepen its fall in 2018 due to the persistence of poor performance in the construction of buildings, and almost no growth of civil works during this year. Finally, a more moderate growth figure is projected for the agricultural sector than last year, explained by the lower expansion of crops and livestock.

IV. BEHAVIOR OF INFLATION AND PRICES

51. In June, annual consumer inflation stood at 3.20%, only 4 bp more than the result of May, and significantly below the figure at the end of last year (4.09%). In the past four months, annual inflation has been stable, oscillating between 3.1% and 3.2%, slightly above the inflation target

(Table 6). Inflation year-to-date stood at 2.47% at the end of the first half of the year, lower than in the same period last year (3.35%). Monthly variation of the CPI in June was 0.15%, a figure below the expectations of the market (0.18%) and the technical staff at *Banco de la República*.

52. The fall in annual inflation between December 2017 and June 2018 was concentrated in the tradable and non-tradable segments (excluding food and regulated items, “Sinar”) of the CPI, and, to a lesser extent, in meals outside the home (Table 6).
53. Specifically in June, the slight pickup in annual inflation was due to the upward pressure of tradables excluding food and regulated items, fuel, and food in general.
54. The average of core inflation indicators in June fell 10 bp versus May, and 133 bp compared with December, closing the first semester at 3.33%. The level of the four core inflation indicators monitored by the Central Bank was lower than the one observed in May. Only the CPI excluding primary food, fuel, and public utilities (2.71%) stood below the inflation target (3.0%), while the CPI excluding food remained at the highest level (3.81%).

Table 6

Headline and Core Inflation to June 2018

Description	Weight	Dec 2016	Dec 2017	Mar 2018	Apr 2018	May 2018	Jun 2018	Participation percentage in monthly deceleration	Participation percentage in deceleration of the year to-date
Headline inflation	100.00	5.75	4.09	3.14	3.13	3.16	3.20	100.00	100.00
Non-food inflation	71.79	5.14	5.01	4.05	3.80	3.85	3.81	(65.84)	93.48
Tradables	26.00	5.31	3.79	1.80	1.51	1.58	1.83	141.14	51.45
Non-Tradables	30.52	4.85	5.49	4.76	4.59	4.57	4.27	(217.45)	41.84
Regulated items	15.26	5.44	5.86	6.01	5.65	5.79	5.82	10.47	0.19
Food inflation	28.21	7.22	1.92	0.98	1.52	1.50	1.74	165.84	6.52
Perishables	3.88	(6.63)	5.84	7.13	8.98	7.75	8.47	70.12	(13.73)
Processed food	16.26	10.74	(0.91)	(2.01)	(1.59)	(1.15)	(0.91)	93.69	(0.46)
Eating out	8.07	8.54	5.21	3.32	3.40	3.12	3.13	2.04	20.71
Core inflation indicators									
Non-food inflation		5.14	5.01	4.05	3.80	3.85	3.81		
Core 20		6.18	4.87	4.04	3.72	3.79	3.58		
CPI excluding perishable foods, fuel and utilities		6.03	4.02	2.99	2.77	2.80	2.71		
Inflation excluding food and regulated items		5.05	4.76	3.49	3.27	3.29	3.23		
Average of core inflation indicators		5.60	4.66	3.64	3.39	3.43	3.33		

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

55. Within the CPI excluding food, in June, there were upward pressures originated by tradable and regulated items (particularly fuel). Annual CPI variation for tradable goods has increased slightly over the past two months (to 1.83% in June), thus interrupting the downward trend observed in the first four months of the year, when the shock caused by the VAT increase faded. The recent increase is explained by the rise in airfares and telephone services. In the case of airfares, it is possible that the strike at the end of last year has continued to affect the prices of tickets. Added to this are the

increase in the international price of oil in previous months, and the recent depreciation of the peso.

56. The annual variation in the CPI for regulated items has increased in the last two months (from 5.65% in April to 5.82% in June), mainly reflecting the adjustment in domestic fuel prices (the annual variation of this item stood at 8.47% in June, compared to 6.49% a month before). This item would have been driven by the increase in international oil prices.
57. In contrast, during June, both public utilities (which moved from 6.21% in May to 5.73% in June) and transport (from 5.03% to 4.93%) exerted downward pressures on the CPI. In the coming months, new downward pressures on these items are unlikely. In this regard, it should be noted that an adjustment in garbage collection rates in Bogotá has just been announced. Additionally, there are upward pressures contained particularly in water and sewerage rates, on account of the investments destined to expand coverage that have been driving the CPI for this item. Also, the adjustment in the taxi fares is still expected, while the difficulties with the implementation of new technological platforms are solved.
58. Contrasting with tradable and regulated goods, the annual variation for non-tradable inflation excluding food and regulated items continued to fall in June (to 4.27% from 4.57% in May). Thus, six months of decline were completed for this indicator, a performance that may be observed in its main components. In June, the CPI of leases was adjusted downwards once more, as has happened since the beginning of the year (4.28% in December 2017 to 3.67% in May, and to 3.61% in June). Additionally, there were declines in the segment of indexed items (from 5.87% in May to 5.76% in June); also, in those affected by the exchange rate (from 4.74% to 3.61%); and in “others” (from 7.18% to 4.14%).
59. The annual variation in food picked up from 1.50% in May to 1.74% in June. This upward pressure was concentrated on perishable foods (from 7.75% to 8.47%) and processed items (from -1.15% to -0.91%). It is important to clarify that food has been available widely throughout the semester, and that the upward trend in annual food inflation in the last four months is a consequence, especially, of a low statistical base for comparison, although some upward pressures have also taken place due to the exchange rate and some international prices. The CPI for meals outside the home again showed a low annual variation (3.13%).
60. The annual adjustment in non-labor costs, proxied by the total PPI for domestic supply (domestically produced and consumed plus imported items) completed three consecutive months increasing (the last month stepping from 2.81% to 3.08%). The advance of the annual inflation rate to producers in June is explained by the local component (from 3.91% in May

to 4.37% in June), while the imported component fell (from 0.25% to 0.11%).

61. Labor costs remained stable in June. The wages of housing construction (3.8%) and heavy construction (3.7%) did not exhibit significant changes in the past four months. With figures to May, the salaries for retail fell (from 6.7% in April, to 5.7% in May) as well as those for industry (from 7.2% to 6.3%). No additional upward pressures on wages are expected for the rest of the year, given the current slack with which the labor market has been operating. It is worth noting that the forecasts for the urban unemployment rate place it above the NAIRU estimates for 2018, which would be compatible with low inflationary pressures from the labor market for the remainder of the year.
62. According to the latest monthly survey to financial analysts by the Central Bank (applied at the beginning of July), inflation expectations to December this year (3.37%) and those twelve months ahead (3.32) did not exhibit significant changes. However, the expectations to 24 months increased slightly (from 3.21% in June to 3.27% in July), as well as those to December 2019 (from 3.30% to 3.33%). Besides, according to the latest quarterly expectations survey (July 2018), the market expects headline inflation in December 2018 to reach 3.52%, that to twelve months 3.45%, and to twenty four months 3.46%.
63. Inflation embedded in the public debt bonds (Breakeven Inflation, BEI) derived from the TES denominated in pesos and UVR (with information to 25 July), decreased 8 bp, 8 bp, and 5 bp for the estimates to 2, 3, and 5 years, while it increased 7 bp for the estimate to 10 years, respectively. The average BEI so far in July posts at 3.01%, 3.18%, 3.40%, and 3.62% for 2, 3, 5, and 10 years, respectively.
64. Using the Forward Break-Even Inflation (FBEI) curve, the estimation of annual inflation for 2018 is 4.02% (obtained by adding the accumulated inflation observed for the remainder of the year to inflation expectations). For 2019, 2020, and 2021, it stands at 3.41%, 3.60%, and 3.72%, respectively.