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Working Papers from the

Board of Directors

Banco de la República

Monetary Policy Report

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Board of Directors
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Monetary Policy Report

Economic Studies Division

FEBRUARY

2018

I. External Context and Balance of Payments

1. The information available shows that, so far in 2018, the recovery of Colombia's trading partners' economic growth continues.
2. In the fourth quarter, the United States' GDP was revised downward to 2.5%, compared to 2.6% as had been previously estimated. This expansion is still rooted in domestic demand. On the other hand, the euro zone recorded a 2.7% yearly growth figure in the fourth quarter.
3. In terms of prices, inflation in the US remains slightly above 2.0%, registering 2.2% on a yearly basis in February. In contrast, core inflation indicators continue below 2.0%. In fact, the measure preferred by the Fed, the implicit deflator for consumption, exhibited a 1.7% annual expansion in January.
4. As for the euro zone, headline inflation declined in February, standing at 1.2%, after having posted at 1.3% on a yearly basis in January. Excluding energy and non-processed food, the annual variation would have remained at 1.2%, same as in January.
5. The Chinese government has set the growth target for 2018 at 6.5%, a figure similar to that observed for 2017. It should be noted that this economy would have grown 6.8% annually during the fourth quarter of 2017.
6. In Latin America, the information on GDP growth for the first quarter exhibits slight slowdowns in Mexico and Peru. On the other hand, Brazil continues to recover significantly.
7. Colombia's terms of trade to December continue to exhibited recovery, mainly explained by higher oil prices.
8. Although there has been some reduction of international oil prices in the last month, after the significant rebound in the beginning of the year, these prices continue at levels above those observed during 2017.

a. External Growth Scenarios

Baseline or more likely scenario (Table 1)

9. This report revised growth forecasts for the country's main trading partners slightly upwards, compared to the information presented in the previous quarterly report. Consumption and investment would continue to drive growth in advanced economies. Emerging economies would exhibit recovery, supported by a greater demand from advanced economies and by better terms of trade. A very similar dynamics to that expected for 2018 is anticipated for trading partners in 2019.

10. Growth figures in the United States were revised slightly upwards for 2018, given that its economic indicators have turned out to be better than anticipated earlier. Additionally, consumption would continue stimulating the economy, supported by improvement in the labor market.
11. In the United States, the best prospects for growth and the emergence of signs of inflationary pressures suggest that the baseline scenario considers four increases in the FED's benchmark interest rate during 2018. This implies a higher path than had been forecasted in the previous Report. Thus, it would move from the current range (1.25-1.50) to 2.25 to 2.50 by the end of 2018. Added to this, the program for the reduction in the balance sheet would continue to be met as announced.
12. Growth in the euro zone was revised upwards for 2018, based on better recent results than had expected.
13. Monetary policy by the European Central Bank would continue to be expansive, although less than before, considering recent announcements regarding the reduction of the asset purchase program. Inflation is expected to remain at low levels.
14. In Latin America, growth figures for 2018 were revised upwards in three of the countries monitored by the technical staff: Brazil, Ecuador, and Chile. In contrast, the figures were lowered for Peru and Venezuela.
15. Although for 2019 a slowdown in the advanced economies and in China is anticipated, this would be partly offset by the best performance in Latin American economies.
16. This time, the risk balance would be level. The likelihood that some of the risks materialize has declined *vis-à-vis* the previous report. Some of the risks that could negatively affect growth are:
    a. A downward correction to financial markets, which could negatively affect global financial stability.
    b. An eventual implementation of trade policies that may negatively affect growth, particularly in the USA, is not ruled out. This risk would be more acute during 2019, due to the fact that the two-year term to negotiate Brexit would end that year, and that the effects of any renegotiation of NAFTA would mainly be seen that year.

    The upside risks would be:

    c. A package of spending on infrastructure that boosts economic growth in the short term could take place in the United States.
17. Given the better prospects for global economic growth, an average oil price of USD 62 per barrel (Brent) is forecast for 2018, and of USD 60 for 2019. These levels are higher than the average observed in 2017 (USD 54.8). However, the forecast expected for 2018 implies a reduction of the price compared to the high levels recorded at the beginning of the year for the following reasons:

a. The high prices observed in the last few months would lead to an increase in production, particularly in the United States, which would be concentrated in the second half of the year.
b. Gradual erosion of the OPEC agreements is expected.

Table 1: Economic Growth Forecasts for Colombia's Major Trading Partners

Country or region	2018 Low	2018 Baseline	2018 High	2019 Low	2019 Baseline	2019 High
US	2.0	2.8	3.6	1.4	2.4	3.4
	1.6	2.6	3.4	-	-	-
Euro Zone	2.0	2.5	3.0	1.0	2.0	2.6
	1.5	2.3	2.9	-	-	-
China	5.8	6.5	7.0	5.5	6.3	7.0
	5.5	6.5	7.0	-	-	-
Brazil	1.0	2.5	3.8	1.0	2.7	4.0
	1.0	2.4	3.4	-	-	-
Ecuador	0.5	2.0	3.5	0.0	1.5	3.0
	0.0	1.5	2.5	-	-	-
Venezuela	-10.0	-6.0	-2.0	-6.0	-2.0	2.0
	-8.0	-5.0	-2.0	-	-	-
Perú	2.6	3.8	4.6	2.5	3.8	4.7
	2.8	4.0	4.8	-	-	-
Mexico	1.3	2.2	3.0	1.0	2.3	3.5
	1.3	2.2	3.0	-	-	-
Chile	1.5	2.8	3.5	1.0	3.0	4.0
	1.4	2.7	3.4	-	-	-
Trading Partners		2.5			2.6	
	1.5	2.5	3.2	-	-	-
Trading Partners (excluding Venezuela)		2.9			2.7	
	1.8	2.8	3.4	-	-	-

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

18. In January 2018, the value in US dollars of total exports recorded an annual 14.6% growth, explained by increases in the three groups, particularly external sales of

mining goods and those from other exports[1] (Table 2). The contribution of coal with significant increases in both its price and quantities stands out.

19. Exports associated with the group of other exports expanded 22.4%. On the other hand, the group of agricultural items (20.1%) increased, supported mainly by bananas and flowers.

Table 2: Behavior of Exports in US dollars[2]

	Annual Variation [Contribution]	Item	Annual variation of the item	Contribution to annual variation
January 2018				
		Main contributing items to annual variation, in the same direction:		
Total Exports	14.6%			
Agricultural goods	20.1%	Bananas	50.0%	1.0
	[2.7]	Flowers	30.9%	1.0
Mining goods	10.4%	Coal, lignite, and peat	56.9%	8.7
	[6.5]	Ferro-nickel	190.9%	1.0
Other exports*	22.4%	Foods, beverages, and tobacco, excluding coffee	35.8%	1.7
	[5.4]	Chemical products	19.1%	1.3
Accumulated value for January - December 2017				
Total Exports	19.1%			
Agricultural goods	4.0%	Coffee (not roasted)	4.0%	0.3
	[0.6]	Flowers	6.7%	0.3
Mining goods	30.6%	Coal, lignite, and peat	59.3%	8.7
	[16.7]	Oil	25.4%	7.0
Other exports	5.9%	Foods, beverages, and tobacco, excluding coffee	14.9%	0.9
	[1.8]	Non-metal minerals and basic metals	20.3%	0.5

20. For the whole 2017, total exports in US dollars expanded 19.1%. This result is mainly explained by an 18.6% improvement in the price index, while the one for quantities grew 0.8%. This improvement in prices took place in the three groups of goods, although highly concentrated in mining goods with a 28.7% annual variation.

21. By breaking down its components, an increase in external sales of mining goods stand out (30.6%). On the other hand, the group of other exports grew 5.9% on a yearly basis, maintaining its annual variations in positive terrain for the seventh month in a row, after more than three years in negative figures (from January 2014 until May 2017, except for January this year).

22. According to the foreign trade preview by DIAN, in February, exports excluding oil and its derivatives recorded an annual 7.7% increase.

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[1] Excluding oil and its derivatives, coal, nickel, gold, coffee, bananas, and flowers. Includes other mining and agricultural goods. Exports of manufactured goods accounted for 93.8% of this group in January.

[2] There were significant annual growth rates of external sales of this group to the rest of Aladi, Ecuador, and the United States (34.0%, 37.5%, and 8.7%, respectively).

Imports of Goods

23. In 2017, total imports grew 2.6%, supported by increases in capital goods and raw materials. This result was explained by the 1.2% and 1.4% increases in quantities and prices, respectively. This would suggest that, despite the fact that the increase in imports is due to a combined effect, the contribution of prices is more relevant, which concentrates on intermediate goods (Table 3).

Table 3: Behavior of Imports in US dollars

IMPORTS				
	Annual Variation [Contribution]	Main contributing items to annual variation, in the same direction:		
		Item	Annual variation of the item	Contribution to annual variation
Accumulated value for January - December 2017				
Total Imports	2.6%			
Capital Goods	4.6% [1.4]	Fixed Equipment for Industry (others)	11.5%	0.7
		Transport Equipment-parts and accesories	7.1%	0.3
Raw materials	2.9% [1.3]	Mining products	8.1%	0.7
		Chemical and Pharmaceutical Products	4.7%	0.7
Consumer Goods	-0.2% [-0.1]	**Non-durable consumption goods**	**0.8%**	**0.1**
		Clothing and other textiles	17.2%	0.2
		Other non-durable consumption goods	4.1%	0.1
		Durable consumption goods	**-1.4%**	**-0.2**
		Vehicles for Private Use	-6.7%	-0.4
		Weapons and military equipment	-28.1%	0.0
IMPORTS				
January 2018				
Total Imports	10.4%	**Main contributing items to annual variation, in the same direction:**		
Capital Goods	10.5% [3.2]	Fixed Equipment for transportation	70.3%	0.1
		Tools	36.4%	0.2
Raw materials	14.8% [6.7]	For agriculture	27.8%	1.0
		For industry	13.8%	4.2
Consumer Goods	1.8% [0.4]	**Non-durable consumption goods**	**9.0%**	**1.0**
		Beverages	69.7%	0.4
		Durable consumption goods	**-6.2%**	**-0.6**
		Vehicles for Private Use	-24.7%	-1.5

24. In January 2018, the value of CIF imports in US dollars grew 10.4%, *vis-à-vis* the same month in 2017, explained by the annual growth in the three groups. Imports of intermediate goods grew most (14.8%) and contributed this month, when the increase of imports of raw materials for agriculture stands out (27.8%).
25. Regarding consumer goods, in January, external purchases of non-durable consumption goods grew 9.0%, and those of durable consumer goods contracted

6.2% in annual terms. The largest annual contraction was observed once again in imports of vehicles (24.7%), which explains the larger part of the joint result of durable consumer goods. In the group of imports of non-durable consumption goods, the positive variation, in annual terms, in external purchases of clothing and beverages stands out (34.5% and 69.7%, respectively).

26. According to the foreign trade preview by DIAN, CIF imports in February recorded a 0.4% yearly growth.
27. In 2017, the country's current account of the balance of payments registered a USD $10,359 m deficit (3.3% of GDP) (**Table 4**), lower than a year ago, when it reached USD $12,129 m (4.3% of GDP). It must be noted that the value of the current account deficit was lower than had been estimated and presented by the technical staff in the quarterly report three months ago (3.5% of GDP, USD 10,901 m).
28. The lower deficit in 2017 is explained by revenue increase (USD 7,386 m, 13.8%), particularly in exports of goods. This more than offset the increase in expenditures (USD 5,616 m, 8.6%), which was associated with higher profits of companies in the mining and energy sector with foreign direct investment (FDI), the growth of imports of goods and services, and higher interest payments on the country's external debt.
29. With results to December 2017, and with the information available to date for the first quarter, the new estimate for the current account deficit for 2018 is 3.1% of GDP (USD 10,187 m) in the baseline scenario, with a 2.7% deficit for the low-growth scenario, and 3.5% for the high-growth scenario. These results are associated with the international context scenarios presented in the previous section. It is worth noting that this range is determined by the 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 economic activity in general.
30. The current account deficit projected for 2018 (3.1%) is lower than in 2017, (3.3%, USD 10,359 m). The correction is due mainly to the lower trade deficit in goods (**Table 4**). Added to this, higher income from current transfers would continue to contribute positively to the narrowing of the external imbalance. On the contrary, a widening of the deficit of non-factor services and of factor income is expected.
31. As for exports of goods, an annual 9.2% growth in the baseline scenario is estimated. This dynamism would be explained by the expansion of external sales of oil and its derivatives as well as of industrial products, in a context of better prices and higher growth of the country's main trading partners. Regarding imports, a 4.8% growth figure is expected, higher than in 2017.
32. The deficit in services is estimated for 2018 at levels higher than in 2017. On the side of expenses, these would increase as a result of increased traveling expenses

by Colombians abroad, the increase in outflows for freight, and growth of the technical services related to oil given the higher international prices of oil. On the other hand, income would increase mainly due to higher revenues from tourism, in line with the improvement in global growth within a context of a favorable exchange rate for foreigners.

33. Due to factor income, a greater net expenditure is expected *vis-à-vis* 2017, mainly due to the increase in the profit of foreign companies from the oil sector and to higher interest payments on the foreign debt. The profit of companies operating in different sectors of the mining and energy sectors are also expected to improve, consistent with the higher expected growth of the economy.

34. 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	Variation
CURRENT ACCOUNT (A+B+C+D)	**-10,359**	**-10,187**	**173**
Percentage of GDP	**-3.3**	**-3.1**	**0.3**
A. Goods	**-4,766**	**-3,235**	**1,531**
Exports	39,474	43,113	3,638
Main	27,313	30,060	2,747
Other Exports	12,161	13,052	891
Imports	44,241	46,348	2,107
B. Non-factor Services	**-4,111**	**-4,728**	**-617**
Exports	8,326	9,105	779
Imports	12,438	13,833	1,396
C. Factor Income	**-8,167**	**-9,521**	**-1,354**
D. Transfers	**6,685**	**7,298**	**612**

Memo Item:

Mining and oil sector (a-b)[1]	**17,751**	**19,547**	**1,796**
a. Exports	20,798	23,367	2,569
b. Factor Income Revenue	3,047	3,820	773

[1] Including oil and derivatives, coal, and ferronickel

35. In terms of the financing of the current account, for 2018, direct investment is expected to continue to be the main item of inflows of foreign capital. However, the flows of foreign direct investment (FDI) in Colombia would record an annual 9.8% decline (**Table 5**). This would be explained by the base effect of the resources received by companies from the communications industry. It is worth noting that excluding this effect, these would increase 9.6%.

36. Additionally, an increase in loans by the public sector is expected (net disbursements), in contrast to net amortizations in 2017. As for portfolio investment, the baseline scenario for 2018 assumes a lower issuance of bonds by the Government and public institutions, and a less dynamic purchase of TES by foreigners.

Table 5

	2017 (prl.)	2018 (prj.) Baseline	Variation
FINANCIAL ACCOUNT (A+B+C+D+E)	**-9,694**	**-10,187**	**-493**
Percentage of GDP	***-3.1%***	***-3.1%***	***0.1%***
A. Direct Investment (ii-i)	**-10,828**	**-9,100**	**1,728**
i. Foreign Investment in Colombia	14,518	13,094	-1,424
ii. Colombian Investment abroad	3,690	3,994	304
B. Portfolio Investment	**-1,577**	**1,919**	**3,495**
C. Other investment (loans, credits, and other derivatives)	**2,166**	**-3,682**	**-5,849**
D. Reserve Assets	**545**	**677**	**132**
ERRORS AND OMISSIONS	**665**	**0**	

Growth, Domestic Demand, and Credit

37. The economic activity recorded an annual 1.6% growth for the fourth quarter of 2017, somewhat below the forecast by the technical staff of the Central Bank (1.8%). This result meant a 0.3% increase in the GDP between quarters, which corresponds to an annualized 1.1% increase. Although the technical staff forecasted a deceleration due to the high basis for comparison in the same period of 2016, the end result was below the estimate due to unanticipated supply shocks in the transport sector and in agricultural activity, added to a somewhat less dynamic demand than expected. In this context, domestic demand grew 1.3%, a deceleration *vis-à-vis* the growth figure for the third quarter (2.1%).
38. Despite the downward surprise in the data for the fourth quarter of 2017, GDP growth for the whole year (2017) was 1.8%, somewhat higher than the figure forecasted by the technical staff in the previous *Inflation Report* (1.6%). It is worth mentioning that DANE revised the results of previous quarters upwards significantly. With these revisions, the results published still suggest that the slowdown in the Colombian economy bottomed out between 2016 and 2017.
39. The result of GDP growth for 2017 took place in a context of a better performance of external demand, favorable international financial conditions, and better terms of trade, particularly due to higher prices of oil and coal. All this, added to a moderate growth of absorption, allowed for an additional correction of the external imbalance versus that observed in 2016.
40. In fact, when disaggregating by components, domestic demand grew 1.6% on a yearly basis for the aggregate of 2017. This result meant an acceleration versus the

observations from 2016 (**Table 6**), when the absorption rate expanded barely 0.5%. Total consumption exhibited a 1.7% acceleration in 2016, reaching 2.2% in 2017, mainly explained by the performance of public consumption. On the other hand, investment ceased to fall, and imports did not contract as had happened in the past. As for real exports, although there was a slight fall, their performance improved when compared with 2016.

Table 6: GDP growth results on the demand side

	2016	2017				2017
	Whole Year	1st Q	2nd Q	3rd Q	4th Q	Whole Year
Total consumption	**1.7%**	**2.0%**	**2.3%**	**2.9%**	**1.6%**	**2.2%**
Household consumption	1.5%	1.6%	2.0%	2.5%	0.9%	1.7%
Non-durables	2.2%	1.1%	2.0%	2.9%	2.0%	2.0%
Semi-durables	0.8%	-3.6%	-3.3%	-1.5%	-1.0%	-2.4%
Durables	-1.0%	7.1%	-1.7%	6.7%	-8.2%	0.7%
Services	2.6%	2.7%	2.6%	1.9%	1.1%	2.1%
Government final consumption	2.4%	3.8%	3.5%	4.4%	4.2%	4.0%
Net Capital Formation	**-3.3%**	**-0.9%**	**0.7%**	**0.0%**	**0.5%**	**0.1%**
Fixed net capital formation	-2.7%	-1.7%	1.5%	0.3%	0.3%	0.1%
Farming, forestry, hunting and fishing	6.0%	1.9%	-4.9%	-2.2%	3.4%	-0.5%
Machinery and equipment	-8.2%	-0.9%	4.3%	6.7%	4.5%	3.6%
Transport equipment	-31.3%	-3.6%	-2.1%	-0.2%	-13.1%	-5.0%
Construction and building	6.4%	-8.0%	-8.2%	-15.9%	-13.1%	-11.3%
Civil works	-0.4%	3.5%	7.2%	9.1%	8.7%	7.1%
Services	-2.7%	-3.1%	1.4%	0.9%	4.2%	0.8%
Domestic Demand	**0.5%**	**1.4%**	**1.8%**	**2.1%**	**1.3%**	**1.6%**
Total Exports	**-1.2%**	**-5.9%**	**2.6%**	**5.0%**	**-3.8%**	**-0.6%**
Total Imports	**-7.3%**	**-1.1%**	**4.4%**	**1.9%**	**-4.0%**	**0.2%**
GROSS DOMESTIC PRODUCT	**2.0%**	**1.5%**	**1.7%**	**2.3%**	**1.6%**	**1.8%**

Source: DANE, calculations by *Banco de la República*

41. By branches of activity, the sectors that grew most during 2017 were agriculture (4.9%), and financial services (3.8%). On the contrary, the mining industry was the branch that experienced the greatest contraction (-3.6%), followed by industry (-1.0%), construction (-0.7%), and transport (-0.1%) (**Table 7**).
42. Within this environment, the GDP for tradable activities exhibited a 0.5% expansion in 2017, similar to the one recorded a year before (0.4%). However, excluding mining, the GDP for these activities grew 1.3% (compared to 2.2% in 2016). Additionally, the GDP for non-tradable branches also showed a 3.1% slowdown in 2016 to 2.6% in 2017.

Table 7: GDP growth results on the supply side

Real annual GDP growth per economic activity

Branch of activity	2016	2017				2017
	Whole Year	1st Q	2nd Q	3rd Q	4th Q	Whole Year
Farming, forestry, hunting and fishing	**1.6%**	8.6%	4.0%	6.3%	1.0%	4.9%
Mining and quarrying	**-7.0%**	-8.5%	-4.9%	-1.0%	0.5%	-3.6%
Manufacturing	**3.4%**	1.2%	-3.1%	-0.9%	-1.4%	-1.0%
Electricity, gas and water	**-0.8%**	-1.1%	1.4%	2.0%	2.3%	1.1%
Construction	**4.5%**	-1.4%	0.9%	-1.8%	-0.6%	-0.7%
Buildings	**6.0%**	-7.1%	-7.6%	-14.7%	-12.4%	-10.4%
Civil works	**2.6%**	3.4%	7.2%	9.1%	8.7%	7.1%
Retail, repairs, restaurants, and hotels	**2.6%**	0.4%	1.9%	2.2%	0.3%	1.2%
Transportation, warehousing, and communications	**0.6%**	-0.6%	0.8%	0.5%	-1.0%	-0.1%
Financial, real estate, and corporate services	**4.4%**	3.9%	3.9%	4.0%	3.4%	3.8%
Social, community, and personal services	**2.0%**	3.2%	3.3%	3.6%	3.7%	3.4%
Subtotal value added	**2.2%**	1.4%	1.4%	2.0%	1.3%	1.5%
Taxes minus subsidies	**0.6%**	2.5%	3.9%	5.2%	3.9%	3.9%
GROSS DOMESTIC PRODUCT	**2.0%**	1.5%	1.7%	2.3%	1.6%	1.8%

Source: DANE, calculations by *Banco de la República*

43. The information for the first quarter of 2018 is still scarce so as to define a forecast of GDP dynamics for this period. However, recent trends in the available indicators suggest that the growth of economic activity would accelerate, although at rates lower than its potential level.
44. The results of the few short-term indicators supports this. According to the Monthly Survey of Retail Trade (EMCM) by DANE, in January, total retail sales (excluding fuel) increased 6.7% compared to the same period in 2017. This figure represented a significant acceleration *vis-à-vis* the information for the aggregate of the fourth quarter of last year (-2.4%). Excluding vehicle sales and fuels, the remaining aggregate expanded 3.9% on a yearly basis in the same month (vs. 0.2% for Q4 of 2017).
45. On the other hand, the index of retail sales of motor vehicles from the same survey recorded a 26.0% annual expansion in January, which represented an acceleration versus the 15.8% fall of the aggregate for the fourth quarter of 2017. The records of both the level of the series and of the annual growth rate were significantly higher than those observed over the past year.
46. The results of the Monthly Survey of Economic Expectations (EMEE) by *Banco de la República* aim at something similar. With figures to January, the seasonally adjusted sales balance suggests a recovery in the dynamics of private consumption during that month.
47. Regarding the labor market, it began the year with very few changes versus its situation at the close of the previous year. To January, the seasonally adjusted series for the unemployment rate at the national level and of the 13 major metropolitan areas, showed no relevant movements. With this, the urban UR is still showing an increasing trend. Stagnation of employment persists in the latter.

Also for the thirteen areas, with information for the moving quarter ending in January, the seasonally adjusted series show a slight fall in salaried employment and an increase in the number of employed workers and informal workers *vis-à-vis* the figures for the previous month.

48. The latest information available regarding nominal wages for construction, industry, and retail suggest that these continue to adjust to rates above the inflation target. However, the adjustment of nominal wages of retail moderated significantly in January.
49. Regarding gross capital formation, the data to January for imports of capital goods from DANE (carried to constant pesos), and the figures from February for foreign trade by DIAN, allow to foresee a better performance of investment different from construction of buildings and civil works. The recovery would take place both in machinery for industry and transport equipment. The seasonally adjusted series of the investment expectations series of the EMEE in January confirms this, because the balance stopped falling in this month.
50. On the supply side, the indicators available suggest some disparities. While retail, industry, and the oil sector expanded, coffee production recorded a further deterioration.
51. In January, the total industrial production index (IPI) grew 1.0%. Excluding oil refining, the rest of the industry exhibited a 0.2% contraction. Oil refining expanded 5.8%.
52. According to the survey by Fedesarrollo, the indicator of industrial confidence in January showed a significant improvement compared to previous months. The trend also suggests recovery.
53. Oil production in January stood at 860 mbd, resulting in an annual 0.6% increase. However, the level fell versus the average of the fourth quarter of 2017 (862 mdb).
54. The demand for energy recorded an annual 3.5% expansion in January. The trend shows a positive slope. The regulated and non-regulated components increased 3.8% and 3.1%, respectively.
55. In contrast, according to the figures from the Federation of Coffee Growers, coffee production stood at 1,131,000 bags in January, which represents a 11.1% decline. According to the experts in the sector, a fall is expected in the first half of the year close to 3.0%.
56. In this environment, the forecast by the technical staff has remained unchanged for economic growth in 2018. Thus, GDP is estimated to grow 2.7%. This estimate assumes that the international financing conditions, the prices of commodities, and the demand from the country's trading partners will be favorable to the expansion of Colombia's GDP in 2018. Additionally, internal factors such as the decline in inflation, an expansive interest rate, and a labor market without many variations would strengthen the process of convergence toward the growth

potential. Similarly, the projections assume an important dynamism of civil works.

III. Behavior of Inflation and Prices.

57. The annual inflation rate in February 2018 was 3.37%, lower by 31 basis points to the record of January, and 72 bp lower than the figure for December 2017. Thus, three consecutive months of decline were completed (**Table 8**).
58. Monthly variation in February was 0.71%, lower than expected both by the market (0.77%) and the technical staff at *Banco de la República*. The results of the first two months of 2018 were lower than expected in the quarterly December report, which is explained by lower adjustments in the prices of food versus the forecast. Additionally, it also helped to the behavior of tradable goods and services (excluding food and regulated items).
59. The fall of the annual inflation rate between December and February was led by food, although the tradable and non-tradable components also pushed downwards. The only sub main group of the CPI basket which exerted upward pressure was that of regulated items.
60. The core inflation indicator, measured as the average of the four indicators monitored by the Central Bank, fell in the first two months of the year, reaching 3.96% in February (*vis-à-vis* 4.66% in December and 4.36% in January). This indicator resumed the declining trend that had been interrupted in November and December last year.
61. All core inflation indicators exhibited declines in the first two months of this year. The CPI excluding food and regulated items fell the most (from 4.76% in December to 3.91% in February), while the CPI excluding food (from 5.01% to 4.40%) exhibited the highest growth rate. The CPI excluding primary food, fuel, and public utilities moved from 4.02% to 3.26%, and the Core-20 CPI from 4.87% to 4.27%, between December and February, respectively.

Table 8

Description	Weight	Dec 2016	Dec 2017	Jan 2018	Feb 2018	Participation percentage in monthly deceleration	Participation percentage in deceleration of the year to-date
Headline inflation	**100.00**	**5.75**	**4.09**	**3.68**	**3.37**	**100.00**	**100.00**
Non-food inflation	**71.79**	**5.14**	**5.01**	**4.61**	**4.40**	**46.31**	**59.78**
Tradables	26.00	5.31	3.79	3.16	2.50	49.16	42.14
Non-tradables	30.52	4.85	5.49	5.37	4.95	39.13	23.02
Leases	*18.59*	*4.06*	*4.28*	*4.27*	*4.05*	*14.21*	*6.94*
Indexed items	*8.14*	*6.16*	*6.96*	*6.80*	*6.18*	*12.18*	*7.61*
Affected by the exchange rate	*2.29*	*5.66*	*5.72*	*5.45*	*5.65*	*(1.97)*	*0.05*
Others	*1.51*	*5.79*	*10.88*	*9.86*	*7.21*	*14.71*	*8.43*
Regulated items	15.26	5.44	5.86	5.27	6.14	(41.98)	(5.39)
Public utilities	*6.31*	*6.08*	*5.39*	*4.11*	*4.83*	*(15.74)*	*5.99*
Fuel	*2.91*	*1.83*	*9.94*	*7.79*	*9.38*	*(11.14)*	*1.75*
Transportation	*6.04*	*6.06*	*4.92*	*5.69*	*6.46*	*(15.11)*	*(13.13)*
Food inflation	**28.21**	**7.22**	**1.92**	**1.49**	**0.94**	**53.69**	**40.22**
Perishables	3.88	(6.63)	5.84	6.50	5.86	9.12	(1.05)
Processed food	16.26	10.74	(0.91)	(1.27)	(1.81)	28.54	20.37
Eating out	8.07	8.54	5.21	4.05	3.51	16.04	20.90
Core inflation indicators							
Non-food inflation		5.14	5.01	4.61	4.40		
Core 20		6.18	4.87	4.72	4.27		
CPI excluding perishable foods, fuel and utilities		6.03	4.02	3.68	3.26		
CPI excluding food and regulated items		5.05	4.76	4.42	3.91		
Average of core inflation indicators		**5.60**	**4.66**	**4.36**	**3.96**		

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

62. Within the CPI excluding food, the most significant reduction was observed in the CPI for tradables (excluding food and regulated items), moving from 2.35% in December to 1.79% in January, and to 1.39% in February. This reduction, as had been anticipated, is associated with the fading of the shock caused by the increase in the VAT and other indirect taxes at the beginning of last year. Added to this is the performance of domestic demand below its historical average and the appreciation of the exchange rate in the course of the year. Regarding the latter, this time it is likely that the slow growth in demand could have accelerated the pass-through of appreciation to consumer prices. The annual variation of tradables has fallen despite the upward pressures that continued taking place in airline tickets (10.0% in February), which could be the result of several factors, such as the strike which affected the air transport sector in September and October last year, and the increase in the price of the fuels.
63. The annual variation in the non-tradable component excluding food and regulated items also decreased (from 5.49% in December to 4.95% in February), with the group of Others (which includes soccer tickets) the one exhibiting the greatest fall (from 10.88% to 7.21%). On the other hand, the sub group of indexed items moved from 6.96% to 6.18%, and leases from 4.28% to 4.05%. In the case of indexed items, which includes education and health services, the decline was lower than expected (average 2010-2014: 5.06%). It is likely that the increase in the minimum wage of about 6.0% for this year has had an impact on price adjustments such as tuition and school fees, which were adjusted at annual rates above 7.0% in February. The price increases for this and other similar items observed in the first two months will most likely remain during the rest of the

year. For this reason, annual variation in non-tradable inflation should remain significantly above 4.0% throughout the remainder of 2018.

64. In contrast, the annual variation of regulated items increased to 6.14% in February, after standing at 5.86% in December. In the first two months, the CPI variation for urban transport increased the most, reflecting the adjustment in rates that took place in Bogotá. Additionally, in February, increases in fuel prices were reported (9.38% compared to 7.79% one month before), by incorporating a COP $128 increase in the price of a gallon of gasoline decreed by the authorities of the sector in that month.
65. Regarding the food CPI, its annual variation lowered from 1.92% in December to 0.94% in February. The wide food supply in the last few months explains this behavior. The fall of annual food inflation was widespread, but the case of meals outside the home stands out, given that it fell below 4.0% in February, for the first time in several quarters.
66. It should be noted that at present there is a phenomenon known as *La Niña* of low intensity, which may have contributed to maintain an abundant supply of a large number of perishable foods. This phenomenon has already begun to weaken, and the weather should normalize by the second quarter of this year.
67. Non-labor costs, proxied by the PPI for total domestic supply (produced and consumed internally plus imported items), exhibit low adjustments that should not endanger the convergence of inflation to its target. In February, the PPI returned to levels from last December (from 1.86% to 1.85%).
68. Labor costs continued exhibiting mixed behaviors, and continue to adjust to rates above the inflation target. The annual variation in the wages for retail in January was 4.2% (decreasing versus the data from December (5.5%)), while the industry closed down at 5.7% in December. On the other hand, in January, wage adjustments in housing construction (6.1%) tended to increase with regard to December (5.9%). In the case of heavy construction, such adjustments remained stable (4.2%). Given the current slack in the labor market, no upward pressures are expected on wages in the coming months.
69. According to the latest monthly survey to financial analysts by the Central Bank (applied at the beginning of March), inflation expectations to December this year posted at 3.35%, lower than those recorded in February. On the other hand, 12-month inflation expectations lowered, moving from 3.35% in February to 3.29% in March. Something similar happened with expectations to twenty-four months (which moved from 3.29% to 3.28%) On the other hand, in the latest quarterly expectations survey (January 2018), the market expects annual inflation in December 2018 to reach 3.83%, and 3.80% to December 2019.
70. Since the last meeting of the Board of Directors and with information to 14 March, it is noted that Breakeven Inflation embedded in TES denominated in pesos and UVR increased, on average, 2 bp, 1 bp, 3 bp, and 8 bp for the estimate

to 2, 3, 5 and 10 years, respectively. Thus, the average BEI so far in March posts at 3.58%. 3.52%, 3.51%, and 3.67% for 2, 3, 5, and 10 years, respectively.

71. Given that accumulated inflation to February posted at 1.34% and BEI for the remainder of the year at 2.94%, the estimation of inflation for 2018 derived from the FBEI curve is 4.32%, higher than the figure estimated in February (3.92%). The estimates of yearly inflation for 2019, 2020 and 2021 using the FBEI stood at 3.42%, 3.42% and 3.48%, respectively.