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Working Papers from the Board of Directors Banco de la República

Monetary Policy Report

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OFFICE OF THE DEPUTY TECHNICAL GOVERNOR
FEBRUARY 2019

March 2019 Monetary Policy Report

I. External Context

The external context anticipated for 2019 suggests an average growth of the country's trading partners that is expected to be somewhat lower this year than in 2018, with international financial conditions that would be more favorable for emerging economies than those considered in the previous report. Particularly, the information suggests a weaker-than-expected economic performance in the US at the beginning of the year. This, together with the absence of inflationary pressures, would be postponing the increase in the Fed's benchmark interest rate[1]*. For Colombia, this would imply a path of lower risk premia. However, there are still risks of a more pronounced slowdown, both in advanced economies as well as in some emerging economies. The data observed indicate that the country's external imbalance increased in 2018 somewhat more than expected. The lower price of oil anticipated, whose forecast remained unchanged at USD 63 per barrel (Brent) on average for 2019, the external financing conditions in the baseline scenario, and a good performance of domestic demand, suggest that the broadening of the current deficit would continue this year.*

1. In recent months, the external context faced by Colombia has been characterized by better conditions of international liquidity. Recent announcements by the Fed about pausing its process of normalization of monetary policy, along with optimism about a possible trade agreement between the United States and China, have contributed to an improvement in the risk appetite of the international financial markets.

2. This has been reflected by the increase in the main global stock indexes and by a reduction in the financial volatility indicators. Additionally, this has allowed for a recovery of capital flows to emerging economies and a reduction in the sovereign risk premia for these economies.

3. On the other hand, at the beginning of the year, economic results in some countries such as the US and the euro zone have been lower than expected. Given this, a slight downward revision was made to the country's trading partners' growth figures, which are expected to be somewhat lower this year than in 2018. In 2020, the slowdown would continue, in line with lower growth in advanced economies (which in the case of the United States would be closer to its natural output) and with the adjustment process of the Chinese economy. However, there are still significant risks of a more pronounced slowdown, both in advanced economies as well as in some emerging economies.

4. Regarding the Latin American economies, a better performance of the major economies in the region (Brazil and Argentina) is expected for the coming years. For the rest of economies, a slowdown in their growth rates is forecast for 2019, versus the estimate for 2018.

[1] It should be noted that the projection of the path of the external interest rate included in the technical staff's baseline scenario was produced before the press release issued by the members of the Fed's Committee on 20 March 2019.

5. *Vis-à-vis* the previous report, the oil price forecast for 2019 and 2020 was not changed.

Baseline or more likely scenario (Table 1)

6. The forecast for the average growth of the country's trading partners for 2019 and 2020 was revised slightly downwards in this report to 2.27% and 2.19%, respectively (see Table 1). These growth rates represent a slowdown compared to the estimate for 2018 (2.5%), although they remain higher than those observed in 2015 and 2016 (1.85%, on average). These forecasts do not consider the potential positive impacts of the withdrawal of some tariffs by the United States and China. Similarly, it does not consider the imposition of new trade restrictions by the United States to other trading partners.

Table 1: Growth Projections for Trading Partners and Prices of some *Commodities*

Country or Region	2018	2019			2020		
	Baseline	Low	Baseline	High	Low	Baseline	High
USA	2.9	1.4	2.4	3.1	0.7	1.7	2.7
	2.9	1.4	2.5	3.2		1.8	
Euro Zone	1.8	0.7	1.5	2.1	0.5	1.5	2.5
	1.9	0.7	1.6	2.2		1.5	
China	6.6	5.4	6.2	6.7	5.0	6.0	7.0
	6.6	5.4	6.2	6.7		6.0	
Brazil	1.1	1.4	2.3	3.5	1.3	2.4	3.4
	1.3	1.3	2.3	3.4		2.5	
Ecuador	1.1	-0.7	0.6	2.3	0.2	1.2	2.0
	1.1	-0.7	0.6	2.3		1.2	
Venezuela	-14.0	-12.0	-7.0	-3.0	-10.0	-5.0	-1.0
	-14.0	-11.0	-6.0	-1.0		-5.0	
Peru	4.0	2.5	3.8	5.0	2.4	3.7	5.0
	3.8	2.5	3.8	5.0		3.8	
Mexico	2.0	0.7	1.9	3.0	0.6	2.0	3.2
	2.1	0.8	2.0	3.3		2.1	
Chile	4.0	2.3	3.3	4.3	2.1	3.1	4.1
	4.0	2.4	3.4	4.4		3.1	
Total partners (excluding Venezuela)	2.5	1.4	2.27	3.1	1.3	2.19	3.0
Total partners (excluding Venezuela-Dec-18)	2.5	1.4	2.35	3.2		2.24	

Item	2018 Observed	2019			2020		
		Low	Baseline	High	Low	Baseline	High
Oil (Brent)	71.6	52	63	73	50	62	72
		52	63	77		62	
Coal	85.8	70	81	91	62	77	90
		67	81	91		78	
Coffee	1.37	1.20	1.35	1.50	1.20	1.40	1.60
		1.20	1.40	1.60		1.42	
Gold	1,269	1,500	1,300	1,150	1,550	1,350	1,150
		1,500	1,270	1,100		1,300	

The current forecast is shown in black.

The forecast from the January Report is shown in red.

7. The baseline scenario assumes that the Fed will continue with its strategy of increasing rates given the good conditions facing the U.S. labor market and the presence of a positive output gap. However, low levels of inflation and the few pressures anticipated in the future on this front would postpone the increase in the Fed's interest rate to the end of 2019. It is assumed that the balance sheet reduction program continues to be met as announced.

8. However, the projections by the members of the FOMC were disclosed on 20 March 2019, which incorporate no increases in the benchmark rate in 2019, and one increase in 2020. With this news, part of the market would be anticipating a possible rate cut with higher probability in 2020. Additionally, it was announced that the final phase of the reduction of its balance sheet will begin in May and will end in September this year. The effects of this change were not contemplated in the baseline scenario of this report.

9. In the case of the European Central Bank, in accordance with the announcement, no changes in the reference rates are expected before the first half of 2019; also, that the total reinvestment of payments of overdue assets acquired in their asset purchase program (APP) continues for an extended period of time.

10. So far this year, the price of oil has recovered (USD 63.1 per barrel), compared to December 2018 (USD 57.3 per barrel). This increase has been the result, to a large extent, of the cuts by the OPEC and its allies. Added to the above are the additional cuts by Saudi Arabia, the sanctions to the Venezuelan company PDVSA, and the decrease in production in Iran, Canada, and Libya. However, the conditions for global supply and demand for oil do not suggest changes in the oil price forecast for 2019. Particularly, the average of this year is expected to be USD 63 per barrel (Brent) and USD 62 for 2020.

11. Sovereign risk premia in the region have declined in recent months. For Colombia, these premia (measured through five-year CDS) have fallen from 143.4 in December 2018 to 122.8 so far this year, on average. Looking forward, more lax financial conditions than those referred to in the previous report would contribute to a slower convergence of the sovereign risk premia to the long-term levels.

12. The baseline forecast scenario of the country's trading partners' growth continues to face important downside risks. Concerns over the duration of the current expansionary phase of the global economy have increased recently, and there is now a greater possibility of a strong economic slowdown at the turn of a year or more. In addition, this future downcycle could be strengthened by the adoption of protectionist measures in the United States and other countries, and by an eventual traumatic outcome of *Brexit*, among other things. In the medium-term, the high levels of debt recorded by some economies are a risk factor.

13. A positive risk factor for the Colombian economy would be a lower risk premia than the one referred to in the baseline scenario, given the wide conditions of international liquidity.

II. Foreign Trade and Balance of Payments

Exports of Goods

14. In January 2019, total exports in US dollars registered an annual 7.8% reduction rate explained by the fall in the group of mining goods (-12.9%). In this group, sales of coal and crude oil contracted the most. On the other hand, the rest of exports exhibited a slight growth (1.5%). (Table 2).

15. In the month, the value of exports declined mainly due to the fall in prices, reflected on a yearly 8.2% contraction of the price index. As for the index of quantities, it showed a slight increase (0.4%). In annual terms, the decline in prices is explained by the fall in the three groups of goods. The stronger contraction took place in the mining group with 10.5% less than a year ago; those of agricultural origin and other exports fell 4.1% and 3.4%, respectively.

Table 2: Behavior of Exports in US Dollars

	January 2019			
	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	-7.8%			
Mining goods	-12.9% [-8.0]	Coal, Lignite, and Peat	-31.9%	-6.4
		Oil	-15.0%	-5.1
		Ferro-Nickel	48.5%	0.6
Agricultural goods	-1.6% [-0.2]	Flowers	-12.5%	-0.4
		Coffee (not roasted)	2.0%	0.2
		Banana	2.4%	0.1
Other exports*	1.5% [0.4]	Motor Vehicles and other types of Transportation	110.0%	0.9
		Chemical Products	4.4%	0.3

Source: DANE

Imports of Goods

16. The value of imports declared in January grew 10.4% *vis-à-vis* the same month of 2018, explained particularly by intermediate goods and capital goods, which contributed 6.2 pp and 3.1 pp to the total variation, respectively. The increase in external purchases of raw materials for industry stands out, increasing 12.6% in annual terms and contributing 4.5 pp to total growth (Table 3).

Table 3: Behavior of Imports in US Dollars

January 2019				
	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	10.4%			
Capital Goods	10.1% [3.1]	Transport Equipment	21.7%	1.5
		Capital Goods for Industry	4.9%	1.0
Raw materials	13.0% [6.2]	Raw Materials for Industry	12.6%	4.5
		Raw Materials for Agriculture	34.3%	2.3
Consumer Goods	5.4% [1.2]	**Durable consumption goods**	**8.3%**	**0.8**
		Private transport vehicles	16.8%	0.8
		Non-durable consumption goods	**3.2%**	**0.4**
		Food Products	14.5%	0.6

Source: DANE

Balance of Trade for Goods

17. With these results, the trade balance in January showed a USD 1,026 million (FOB) deficit. This means a USD 640 million n increase compared with the previous year.

Balance of Payments

18. With the results observed in 2018 and the external context scenario presented above, the new estimate of the current account deficit for 2019 is 4.3% of GDP (USD 14,341 m) in the baseline scenario. The forecast range for said period would be between 3.9% and 4.7% of GDP, determined by the risks on the terms of trade, the cost, and the availability of external financing, as well as by global growth.

19. The larger current account deficit estimated for 2019 compared to that observed in 2018 (3.8% of GDP), would be explained mainly by the widening of the trade deficit of goods (Table 4). As for the other items, they are expected to contribute less to the widening of the external deficit.

20. The momentum experienced by the value of exports of the main products in 2018 would fade in 2019, in line with the expected setback in the terms of trade (-7.3%). This is due to a lower oil price than in 2018, to a great extent. A lower export price for Colombian coal is also expected. Thus, exports of the main products are expected to decrease 3.5% in 2019. Additionally, moderate growth of foreign sales of industrial goods is expected (4.7%), within a context of a slight slowdown of the main trading partners' growth.

21. On the other hand, the positive growth path of imports is estimated to continue, in line with the higher growth expected in domestic demand. All this explains the significant increase of the trade deficit in goods (Table 4).

22. On the contrary, a lower deficit of non-factor services and of factor income is expected. To a larger extent, the latter is a result of the lower income from exports by oil and mining firms with FDI. Also, the positive contribution of revenues from remittances in line with the economic growth in the countries where they originate would continue.

23. *Vis-à-vis* the previous report, on this occasion, more lax international financial conditions are expected, which would impact on greater flows of foreign capital than had been estimated in January. Thus, in terms of the financing of the current account, for 2019, the flows under "other investment" are expected to continue, resulting both from sales of external assets as well as from contracting new debt. FDI flows are expected to grow driven by the resources allocated to sectors different from the oil and mining sectors; also, the purchase of TES by foreigners is expected to continue, although at a slower pace than in the previous year.

24. The current projection of balance of payments only considers the purchases within the program of accumulation of reserves performed until the second week of March 2019, which amounted to USD 800 million. Additionally, it includes the direct purchase of USD 1,000 m by the Central Bank to the National Treasury.

Table 4: Projection of the Balance of Payments

BALANCE OF PAYMENTS (Millions of US Dollars)	2017 (pr)	2018 (pr)	2019 Baseline
CURRENT ACCOUNT (A+B+C+D)	**-10,296**	**-12,661**	**-14,341**
Percentage of GDP	**-3.3**	**-3.8**	**-4.3**
A. Goods	**-4,571**	**-5,316**	**-9,182**
a. Exports	39,676	44,316	44,021
Main	27,433	30,790	29,547
Other Exports	12,243	13,527	14,475
b. Imports	44,247	49,633	53,204
B. Non-factor Services	**-3,917**	**-3,809**	**-3,050**
a. Exports	8,461	9,457	10,462
b. Imports	12,378	13,266	13,512
C. Factor Income	**-8,405**	**-11,141**	**-10,299**
D. Current Transfers	**6,596**	**7,605**	**8,191**
FINANCIAL ACCOUNT (A+B+C+D)	**-9,644**	**-11,981**	**-14,341**
A. Direct Investment (ii-i)	**-10,147**	**-5,888**	**-6,777**
B. Portfolio Investment	**-1,617**	**1,222**	**-3,571**
C. Other investment (loans, credits, and other derivatives)	**1,606**	**-8,502**	**-6,873**
D. Reserve Assets	**513**	**1,187**	**2,879**
ERRORS AND OMISSIONS	**652**	**679**	**0**

Memo Item:

Mining and oil sector (a-b)[1]	**17,777**	**20,224**	**19,543**
a. Exports	20,917	24,776	23,308
b. Factor Income Revenue	3,141	4,552	3,765

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

III. Growth, Domestic Demand, and Credit

For the fourth quarter, the growth figure was somewhat higher than had been forecast, with a more-dynamic domestic demand than had been expected. This was due to the good performance of public consumption and investment, which grew at a historically high rate for the second consecutive quarter. Contrary to expectations, this was due mainly to a strong accumulation of inventories and an unanticipated acceleration of construction spending, rather than to the performance of investment in machinery and equipment. The better behavior of domestic demand was offset by a net external demand that subtracted from GDP growth, consistent with a higher-than-expected widening of the trade deficit. In this context, for the first quarter 2019 the annual growth rate would increase again, with a dynamic domestic demand and an external demand that would subtract less from GDP. This report projects an annual GDP growth in the first quarter of 2019 of 3.2%, which is a number close to the estimated potential growth of the Colombian economy.

25. The annual GDP growth in the fourth quarter of 2018 was 2.9% on a yearly basis (corrected for seasonality and calendar effects). Between quarters, the corrected series increased 0.6%, which in annualized terms corresponds to 2.4% (Table 5).

26. The results of annual GDP growth were somewhat above the expectations of the technical staff at the Central Bank in the latest *Inflation Report* (2.7% for 2018.Q4 and 2.6% for all of 2018) and by the rest of market analysts (2.6% for 2018). This was due, in part, to strong revisions of the historical series that were observed on this occasion. The one of greatest magnitude took place in the annual GDP growth in 2017, which was 1.8% revised to 1.4%.

27. On the side of expenditure, in the fourth quarter, an acceleration of domestic demand was observed. This behavior was mainly a result of a better performance of gross capital formation. Particularly, the good performance of investment in construction stands out, both for housing, and other buildings and structures. Growth of machinery and equipment fell in annual terms. Total consumption slowed down in the margin, as a product of lower growth rates both in the public and private components. Net exports contributed negatively to GDP growth, on account of a significant increase in imports, which more than offset that of exports (Table 5).

Table 5: GDP Growth Results on the side of Demand

	2017	2018				
	Whole Year	1st Q	2nd Q	3rd Q	4th Q	Whole Year
Total consumption	**2.4%**	**3.9%**	**4.4%**	**3.8%**	**3.6%**	**3.9%**
Household consumption	2.1%	3.4%	3.9%	3.6%	3.3%	3.5%
Non-durables	3.1%	4.4%	5.2%	3.9%	3.6%	4.2%
Semi-durables	0.8%	3.0%	5.1%	5.3%	4.4%	4.4%
Durables	-4.3%	6.4%	8.1%	5.3%	5.6%	6.3%
Services	2.7%	2.8%	2.6%	2.4%	2.5%	2.6%
Government final consumption	3.8%	6.0%	5.9%	6.2%	5.4%	5.9%
Net Capital Formation	**-3.2%**	**-2.3%**	**-1.8%**	**8.7%**	**9.9%**	**3.5%**
Fixed net capital formation	1.9%	-0.9%	-2.8%	2.9%	5.4%	1.1%
Housing	-1.9%	-4.8%	-1.0%	0.9%	5.8%	0.0%
Other buildings and structures	4.6%	-2.2%	-2.6%	1.5%	9.5%	1.5%
Machinery and equipment	1.4%	8.8%	-0.8%	0.2%	-3.8%	1.0%
Cultivated biological resources	0.3%	-2.7%	2.0%	7.6%	-2.6%	0.9%
Intellectual property products	2.5%	4.0%	5.3%	4.7%	4.1%	4.5%
Domestic Demand	**1.2%**	**3.5%**	**3.3%**	**4.0%**	**4.5%**	**3.8%**
Total Exports	**2.5%**	**-0.2%**	**0.4%**	**1.6%**	**3.1%**	**1.2%**
Total Imports	**1.2%**	**0.3%**	**8.3%**	**7.9%**	**15.6%**	**8.0%**
GROSS DOMESTIC PRODUCT	**1.4%**	**2.2%**	**2.6%**	**2.9%**	**2.9%**	**2.7%**

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

28. From the sectoral point of view, the good performance of construction stands out during the fourth quarter of 2018, akin to what it is observed in the demand side, and due mainly to the recovery in civil works. The industry continued to exhibit a favorable behavior, while the branches of retail sales, transport, and housing presented a similar performance to that of the first three quarters (Table 6).

29. For the aggregate of 2018, the figures on the demand side show a recovery of the dynamics of economic growth compared to 2017. That year, domestic demand accelerated hand in hand with an improvement in the performance of total consumption. Investment also contributed to growth after the falls observed in 2017. Consequently, this corresponded to a widening of the trade deficit in constant pesos (which is consistent with the US dollar figures of the balance of payments). On the supply side, in 2018 the dynamism of the sectors related with services was outstanding, as the highest growth rates were recorded by the branches of professional activities and public administration and defense, education and health. The industry also exhibited a good performance.

Table 6: GDP Growth Results on the side of Supply

Branch of activity	2017	2018				
	Whole Year	1st Q	2nd Q	3rd Q	4th Q	Whole Ye
Farming, forestry, hunting and fishing	**5.5%**	**2.2%**	**3.7%**	**1.3%**	**0.8%**	**2.0%**
Mining and quarrying	**-5.7%**	**-3.5%**	**-3.2%**	**2.7%**	**1.0%**	**-0.8%**
Manufacturing	**-1.8%**	**0.1%**	**2.5%**	**2.8%**	**2.6%**	**2.0%**
Electricity, gas and water	**2.9%**	**2.9%**	**2.7%**	**2.6%**	**2.7%**	**2.7%**
Construction	**-2.0%**	**-4.3%**	**-5.2%**	**5.3%**	**5.6%**	**0.3%**
Buildings	-5.2%	0.1%	-5.6%	5.7%	3.9%	1.0%
Civil works	6.5%	-3.7%	-3.8%	-2.9%	7.8%	-0.6%
Specialized construction activities	-4.0%	-1.0%	-5.7%	2.1%	1.0%	-0.9%
Retail, repairs, transport and lodging	**1.9%**	**3.1%**	**3.2%**	**3.2%**	**3.0%**	**3.1%**
Information and communications	**-0.2%**	**0.6%**	**3.1%**	**5.5%**	**3.2%**	**3.1%**
Financial and insurance activities	**5.4%**	**4.7%**	**3.8%**	**1.6%**	**2.3%**	**3.1%**
Real Estate activities	**3.1%**	**2.2%**	**2.0%**	**1.9%**	**1.8%**	**2.0%**
Professional, scientific and technical activities	**1.3%**	**7.2%**	**6.1%**	**3.4%**	**3.4%**	**5.0%**
Public Administration and defense, education and hea	**3.5%**	**5.2%**	**4.2%**	**3.5%**	**3.7%**	**4.1%**
Artistic, entertainment, and leisure activities	**2.2%**	**0.7%**	**1.6%**	**0.9%**	**2.5%**	**1.4%**
Subtotal value added	**1.4%**	**2.4%**	**2.1%**	**2.9%**	**2.5%**	**2.5%**
Taxes minus subsidies	**1.1%**	**2.1%**	**3.1%**	**2.6%**	**2.5%**	**2.6%**
GROSS DOMESTIC PRODUCT	**1.4%**	**2.2%**	**2.6%**	**2.9%**	**2.9%**	**2.7%**

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

30. The information available for the first quarter of 2019 suggests that the Colombian economy would continue to gain momentum, gradually coming closer to its potential long-term growth rate. The projection of the technical staff considers a domestic demand that would maintain a good growth figure, as well as net exports that would subtract less from GDP growth.

31. In this context, private consumption would record a slight slowdown in the margin, on account of the high basis of comparison for the same period in 2018 for durable goods, mainly. However, there would be increases between quarters, and the growing trend exhibited by this component of GDP over the past year would continue. In contrast, public consumption would accelerate in its annual growth rate as a result of the effect of a low basis of comparison in 2018.Q1. Despite this, a quarterly slowdown would be observed.

32. Investment would also contribute to a better performance of GDP. Particularly, the good performance of investment in construction is expected to continue, especially in the segment of civil works. On the side of external demand, an acceleration of exports is expected, and, to a lesser extent, of imports. With this, the trade deficit in real terms would be reduced in the margin, for which net exports would subtract somewhat less from GDP growth.

33. The recent behavior of the situation indicators supports the scenario described (see Table 7). In fact, regarding household consumption, the figures of retail sales grew; also, despite the fact that the sales records and vehicle registration suggest a less-dynamic durable consumption compared to the fourth quarter of 2018, consumer confidence continues to show a recovering trend.

34. Regarding Gross Capital Formation, the series of imports of capital goods (in constant pesos) continues to grow at a good pace, although less than the one recorded toward the end of 2018. In the case of investment in construction (both of housing as of civil works and non-residential buildings), the technical staff anticipates that the positive dynamics observed during the second half of last year will continue.

Table 7: Main Indicators of Demand and Supply

	Indicator	2018Q4		2018		January		February		Year to date	
		Original	SACCE*	Original	SACCE*	Original	SACCE*	Original	SACCE*	Original	SACCE
Demand Indicators	Retail sales excluding fuel (annual variation, %)	9.0%	9.3%	7.0%	6.9%	3.3%	4.5%	N/Avail.	N/Avail.	3.3%	4.5%
	Retail sales excluding fuel and motor vehicles (annual variation, %)	5.8%	6.4%	5.4%	5.5%	4.6%	4.2%	N/Avail.	N/Avail.	4.6%	4.2%
	Retail vehicle sales (annual variation, %)	28.8%	26.7%	16.1%	15.4%	-4.1%	15.1%	N/Avail.	N/Avail.	-4.1%	15.1%
	Records of total enrollments (annual variation, %)	22.1%	20.6%	7.6%	6.5%	-2.8%	-2.8%	0.7%	1.0%	-1.0%	-0.9%
	Records of enrollment, private use (annual variation, %)	19.9%	18.4%	4.2%	3.1%	-7.3%	-7.3%	-4.8%	-4.5%	-6.0%	-5.9%
	Records of enrollment, commercial use (annual variation, %)	24.3%	23.2%	11.4%	10.4%	2.1%	2.1%	6.4%	6.6%	4.4%	4.4%
	Expectations survey - Sales (levels, balance)\†	9.94	4.18	1.19	1.21	N/Avail.	N/Avail.	N/Avail.	N/Avail.	N/Avail.	N/Avail.
	Consumer Confidence Index (CCI, balance, levels)\†	-9.75	N/Applic.	-0.50	N/Applic.	-2.79	N/Applic.	-5.57	N/Applic.	-4.18%	N/Applic.
	Expectations Survey - Investment (levels, balance)\†	5.76	1.67	-0.30	-0.30	N/Avail.	N/Avail.	N/Avail.	N/Avail.	N/Avail.	N/Avail.
	Imports in constant pesos: Capital goods (annual variation, %)	15.4%	14.6%	11.4%	10.8%	15.4%	15.4%	21.1%	20.7%	18.1%	18.1%
Supply Indicators	Industrial Production Index (annual variation, %)	3.1%	2.7%	2.9%	3.0%	3.0%	3.0%	N/Avail.	N/Avail.	3.0%	3.0%
	Coffee Production (annual variation, %)	-6.6%	-6.4%	-4.5%	-4.0%	14.6%	14.9%	-8.7%	-9.1%	2.5%	2.4%
	Oil production (annual variation, %)	2.6%	N/Applic.	1.4%	N/Applic.	4.5%	N/Applic.	8.4%	N/Applic.	6.4%	N/Applic.
	Energy demand (annual variation, %)	3.7%	N/Applic.	3.3%	N/Applic.	3.8%	N/Applic.	5.2%	N/Applic.	4.5%	N/Applic.
	Construction Licenses, total (annual variation, %)	-8.8%	N/Applic.	-6.4%	N/Applic.	-12.5%	N/Applic.	N/Avail.	N/Applic.	-12.5%	N/Applic.
	Construction Licenses, housing (annual variation, %)	-9.8%	N/Applic.	-6.5%	N/Applic.	-9.2%	N/Applic.	N/Avail.	N/Applic.	-9.2%	N/Applic.
	Cement Production (annual variation, %)	5.1%	N/Applic.	1.2%	N/Applic.	2.2%	N/Applic.	N/Avail.	N/Applic.	2.2%	N/Applic.
	Cement dispatches (annual variation, %)	4.1%	N/Applic.	0.2%	N/Applic.	1.0%	N/Applic.	N/Avail.	N/Applic.	1.0%	N/Applic.
MEMI (ISE)	Monthly Economic Monitoring Indicator, Seasonally Adjusted Series, ISE (annual variation, %)	2.8%	2.8%	2.7%	2.7%	N/Avail.	N/Avail.	N/Avail.	N/Avail.	N/Avail.	N/Avail.

* SACCE = Seasonally adjusted and corrected for calendar effects

\† Average for the quarter and year-to-date.

N/Applic. = Not applicable

N/Avail. = Not available

35. On the supply side, the indicators suggest some disparities. While the industry, coffee production, and oil exhibited favorable growth figures, retail sales slowed down significantly, and some indicators related to construction continue to show a weak performance (see Table 7).

36. Considering the above, annual GDP growth for the first quarter of 2019 is projected at 3.2%.

37. Despite better growth figures, some of the labor market results in recent months have been less than satisfactory for reasons that are still to be identified. Although the seasonally adjusted figures for national and urban employment as well as those for formal and salaried employment in the thirteen areas showed a slight recovery to January, the unemployment rates in both domains remain above the levels recorded in the same moving quarter (November to January) in previous years. Global participation and occupation urban rates exhibit a downward trend, with smaller reductions in participation than in occupation, which explains the increase in the unemployment rate in recent months. By branch of activity, retail sales, hotels, and restaurants was the sector that subtracted the most from the national annual employment growth in January, while construction remained as one of the branches of higher positive contributions to employment.

IV. Behavior of Inflation and Prices

In the first months, annual consumer inflation has surprisingly reduced, presenting a decreasing trend that had not been anticipated. The results have been lower than expected in all the subgroups analyzed (tradables, non-tradables, food, and regulated items). As a result, inflation excluding food and regulated items fell to 2.41%, and the average of core inflation indicators fell to 2.81%. The weak pass-through of accumulated depreciation to consumer prices, a possible low impact of the adjustment to the minimum wage, and a negative output gap would explain, among other reasons, this favorable behavior. Additionally, food prices do not appear to be affected by adverse weather factors. However, it cannot be ruled out that part of the forecast errors may obey to the methodological changes introduced by DANE. Analysts' expectations stand between 3.2% and 3.3% to different horizons not over 24 months, and those embedded in public debt bonds stand around 3.3%.

38. Annual consumer inflation in February surprised downwards. The result was 3.01%, i.e., 14 bp lower than the figure for the previous month (Table 8). The monthly variation for February amounted to 0.57%, which is significantly lower than anticipated by the market (0.73%) and by the technical staff of *Banco de la República*. The results were lower than had been forecast for inflation in the four major sub-baskets (food, regulated items, non-tradables, and tradables).

39. Core inflation also exhibited a significant reduction, not entirely anticipated. The average of the four indicators monitored by the Central Bank stood at 2.81% in February, below the 3.0% target

and the records for January (2.99%) and December (3.03%). In February, all core inflation indicators fell except for Core-20; the highest figure was non-food CPI (3.14%), and the lowest was that for inflation excluding food and regulated items (2.41%) (Table 8).

40. In February, the annual adjustments of the large groups of the CPI fell, except for food. The decrease in the annual variation of the CPI excluding food (from 3.46% to 3.14%), was led by non-tradable goods, tradable items, and regulated items, in that order.

41. Within the non-tradables CPI (which moved from 3.87% in January to 3.38% in February), the greatest contraction was observed in the segment of items affected by the exchange rate (especially school transport and network and cable TV subscription and services), followed by indexed items (led by the fall in education items), and lastly, leases.

Table 8: Indicators of Consumer Prices and Inflation

Headline and Core Inflation to February 2019

Description	Weight	Dec 2017	Mar 2018	June 2018	Sept 2018	Dec 2018	Jan 2019	Feb 2019
Headline Inflation	**100.00**	**4.09**	**3.14**	**3.20**	**3.23**	**3.18**	**3.15**	**3.01**
Non-Food Inflation	**76.09**	**5.01**	**4.05**	**3.81**	**3.71**	**3.48**	**3.46**	**3.14**
Tradables	18.69	3.79	1.80	1.83	1.57	1.09	1.02	0.85
Non-Tradables	42.45	5.49	4.76	4.27	4.13	3.79	3.87	3.38
Regulated items	14.95	5.86	6.01	5.82	6.03	6.37	6.03	5.65
Food Inflation	**23.91**	**1.92**	**0.98**	**1.74**	**2.05**	**2.43**	**2.56**	**2.84**
Perishables	3.16	5.84	7.13	8.47	9.51	8.88	8.89	8.32
Processed food	11.93	(0.91)	(2.01)	(0.91)	(0.72)	(0.08)	0.22	0.64
Eating out	8.82	5.21	3.32	3.13	3.32	3.68	3.68	3.97
Core Inflation Indicators								
Non-food inflation		5.01	4.05	3.81	3.71	3.48	3.46	3.14
Core 20		4.87	4.04	3.58	3.56	3.23	3.09	3.13
CPI excluding perishable foods, fuel and utilities		4.02	2.99	2.71	2.81	2.76	2.69	2.57
Inflation excluding food and regulated items		4.76	3.49	3.23	3.04	2.64	2.71	2.41
Average of Core Inflation Indicators		**4.66**	**3.64**	**3.33**	**3.28**	**3.03**	**2.99**	**2.81**

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

42. The performance of non-tradables in February suggests that the 6.0% increase in the minimum wage may be having a smaller-than-anticipated effect, especially regarding the prices of personal services (i.e., CPI items with high content of wages). Additionally, the reduction of inflation in 2018, with a figure that stands very close to the target at the end of that year, has caused the indexation mechanisms in items such as leases and education, among others, to contribute to the decline of inflation. Additionally, in the case of education, the methodological advances in the measurement of monthly allowances for preschool, primary, and secondary education would have also reduced the pace of adjustment of prices in this sector.

43. The annual adjustment in the tradables CPI remained on a downward trend in February, reaching 0.85% this month, somewhat below the level expected by the technical staff. Yet, the pass-through of the depreciation of the exchange rate (which occurred in the second half of 2018) to

the prices in this sub-basket is still to be observed. The recent declines have been concentrated in specific items such as airfares and medication, among others.

44. The CPI for regulated items continued exhibiting significantly higher annual price adjustments than the rest of baskets. However, in February its annual variation reduced (to 5.65%), reaching a lower level than had been anticipated by the technical staff. The fall was led by fuels (from 6.75% to 5.53%), followed by public utilities (from 7.59% to 7.33%), and transport (from 4.13% to 4.01%).

45. Regarding public utilities, energy surprised favorably, whose rates apparently do not yet incorporate the cost overruns by *Hidroituango*, among other factors for upward pressures, which should be taking place in the coming months. Therefore, it is estimated that part of the decline in the annual CPI variation of public utilities in February would be reversed in the rest of the year.

46. In February, the annual variation of the food CPI, which includes meals outside the home (2.84%) continued to increase gradually. The rebound in this segment of the CPI in the last month is explained by processed foods (moving from 0.22% to 0.64%) and meals outside the home (from 3.68% to 3.97%). It should be noted that no significant upward impact of *El Niño* had been observed to February, with a domestic supply of food that seemed normal to that date.

47. The annual inflation of the total Producer Price Index (PPI) for domestic supply, which proxy the performance of non-labor costs, decreased in February (3.35%) *vis-à-vis* that of January (3.42%), but increased compared to December 2018 (3.09%). In the last month, the imported component exerted downward pressures, moving from 4.84% in January to 4.24% in February, while the local PPI increased from 2.82% to 2.98%.

48. Regarding labor costs, they also recorded a mixed performance. In February, the pace of wage adjustments for construction decreased in the segment of heavy construction (from 4.1% to 3.7%), and continued without significant changes for housing construction (3.1%). On the other hand, with data to January, the yearly salary adjustment for retail sales rose from 6.8% in December to 8.4% in January, while that for industry moved from 5.1% to 6.3%[2].

49. With figures to March, inflation expectations also exhibited a mixed performance. Analysts' expectations (collected monthly) fell from 3.41% in February to 3.23% in March, as did those to twelve months from 3.34% to 3.30%. Those to twenty-four months increased (from 3.22% to 3.28%), as well as those to December 2020 (from 3.23% to 3.26%). Those embedded in public debt bonds (*Breakeven Inflation*, BEI) averaged, so far to 19 March, 3.0%, 3.10%, 3.22%, and 3.50% to 2, 3, 5 and 10-year horizons, respectively. Measurements with respect to the latest meeting of the Board of Directors on 22 February varied by -48 bp, -38 bp, -26 bp, and -18 bp, respectively.

[2] The annual adjustments of wages for industry correspond to an estimation made at the Central Bank with the figures of the Monthly Manufacturing Survey (EMM) and the Monthly Manufacturing Survey with a Territorial Approach (EMMETT). Since January 2019, the results of the manufacturing industry are published in the EMMET, which includes information for national total as well as for departments, metropolitan areas, and major cities in the country.

50. Using the *Forward Break-Even Inflation* curve (FBEI), inflation expectations for 2020, 2021, and 2022 correspond to 3.25%, 3.30%, and 3.40%, respectively.