



PUBLIC VERSION

Working Papers from the
Board of Directors
Banco de la República

Monetary Policy Report



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Economic Studies Division

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Monetary Policy Report of April 2015

I. External Context and Foreign Trade

1. So far in May, the international prices of oil continued recovering, and their average was greater than the registers for April and the forecast of *Banco de la República's* technical staff for all of 2015. The depreciation of the US dollar and lower expectations for crude oil production in the United States explained much of this increase. In spite of this, oil prices are still below the average recorded in the past five years.
2. On its part, the prices of nickel and other metals exported by some countries in the region have recovered, while the prices of coffee and some food imported by Colombia have fallen. This behavior in the prices of goods exported and imported by the country indicate that terms of trade in 2015 will be significantly lower than in the previous year, and similar to those registered at the beginning of 2009. This will adversely affect national income.
3. The latest information on global economic activity confirmed that the relevant external demand for Colombia is growing less than in 2014. In the first quarter of 2015, GDP growth in the United States (0.2% t/a) slowed down more than expected, a fact largely attributed to transitory factors. In the same period, the euro zone exhibited low expansion, although somewhat higher than projected. China continues at lower rates of GDP increase, and the major economies of the region exhibit low or even negative growth.
4. In the United States, indicators of real activity available for the second quarter suggest that the recovery would be taking place more slowly than projected. As for the labor market, job creation continues at a favorable pace. In April, the unemployment rate fell to 5.4%, and the alternate indicators monitored by the Federal Reserve such as underemployment and long-term unemployment rates, continued to improve. Regarding inflation, its annual register to March was negative (-0.1%), a fact explained mainly by the sharp fall in the price of fuels. Excluding energy and food, inflation increased from 1.7% in February to 1.8% in March.
5. Within this context, the most recent minutes of the Federal Open Market Committee (FOMC) of the Federal Reserve (Fed) suggest that the benchmark interest rate could be raised towards the end of the year.
6. In the euro zone, GDP growth during the first three months of the year (0.4% quarterly) represented a slight recovery compared to what had been observed by the end of 2014 (0.3%). Additionally, April confidence indicators and industrial surveys suggest that this favorable behavior could continue in the coming months. In April, inflation was 0.0%, mainly as a consequence of lower fuel prices. Excluding food and fuel prices, core inflation slowed marginally to 0.6%. The European Central Bank (ECB) has announced that it would increase its financial assets purchasing program during May, June and September (from

EUR 60 to 70 billion), and that it would reduce it in July and August (from EUR 60 to 40-45 billion).

7. As for China, its growth slowed down from 7.3% in the fourth quarter of 2014 to 7.0% in the first quarter of 2015. The data to April indicate that this slower pace of increase continues. The annual growth rate of industrial production and retail sales remained at their lowest levels since 2008, while investment in fixed assets preserved a clear downward trend. Inflation in April reached 1.5%. In this context, its central bank cut its benchmark interest rate by 25 basis points (bp).
8. In Latin America, the figures for economic growth for the first quarter of the year show some recovery in Chile and Peru with respect to the observations from three months ago, while Mexico's GDP slowed slightly. However, these economies continue expanding at relatively modest rates. On its part, Brazil's index of economic activity in March suggests that the contraction that began in the previous year would have continued during the first quarter.
9. Inflation in Latin American economies continued exhibiting a heterogeneous behavior. Inflation has reduced in Chile, slowly converging to its goal, while in Peru and Mexico it has not changed significantly and is close to 3.0%. In contrast, annual variation of prices in Brazil remains high and with a growing tendency.
10. As for international financial markets, so far in May interest rates on long-term bonds of the major countries of the euro zone and the United States increased. The increase in inflation and oil price expectations, which reduced the deflationary concerns in the euro zone, and the possible over-valuation of the bonds, would explain much of this increase.
11. In Latin America, the average of risk premia reduced in May, but remains at levels higher than the averages observed in 2014. The US dollar, which had depreciated in April and early May vis-à-vis most other currencies, changed this trend in the last week. This recent behavior has been especially pronounced against the Colombian peso.

a. Exports and Imports

12. In March 2015, total exports recorded an annual fall of 22.8%, mainly associated to a decline in prices. Within the main groups, only those of agricultural origin showed an increase (28.8%). Mining and other exports fell 31.6% and 13.2%, respectively. In the case of agricultural goods, an increase was registered in exports of coffee (39%), flowers (18.8%), and banana (24.8%). The fall in the category of mining goods is explained by the lower exports of oil (-44%) and oil derivatives (-50.8%). In this group, the 86% increase in coal exports stands out.
13. Within other exports, the main contributions to the fall were due to chemicals (-15.6%), food and beverages (-20.2%) and non-metallic minerals (-28.5%). Per destinations, there was an increase in this type of exports to Venezuela (9.7%), while falling to other destinations (United States -1.1%, Ecuador -18.5%, and the rest of destinations -18.1%).

14. Total exports fell 30.2% in the first quarter of the year, to which exports of mining goods (-41.8%) and other products (-11.6%) contributed. On the side of agricultural goods there was an increase of 24.5%. Exports of mining goods were affected to a large extent by the 48.4% fall of crude exports and 63.4% of refined goods. Within other exports, significant falls were recorded in chemicals (-5.7%) and food and drinks (-6.8%). Exports of agricultural goods rose thanks to the increases in coffee (50.6%) and flowers (5.5%).
15. On the other hand, CIF imports in March fell 5.5% in annual terms. This is explained by the lower imports of raw materials and intermediate products (-9.6%) and of capital goods and construction materials (-6.1%), which was due to a large extent to the 22.5% decline in the purchase of fuels and lubricants, and of 7.5% in capital goods for the industry, respectively. Imports of consumer goods increased 4.1%, which is explained by the greater purchases of non-durable goods (10.4%), while those of durable goods decreased 1.6%.
16. During the first quarter of the year CIF imports fell 4.4%. This contraction is explained by a decrease in imports of intermediate goods (-15.5%), which was not offset by the 7.4% and 2.3% increases registered in capital and consumption goods, respectively. The fall in intermediate goods is associated to a large degree to the 44.1% reduction in fuels and lubricants. The increase in capital goods is explained by the 44.8% growth in the purchases of transportation equipment, while imports of non-durable consumer goods exhibited a 7.6% increase, partially offset by the 2.7% contraction of durable consumer goods.
17. According to the latest figures for foreign trade by DANE, the trade deficit in goods for the first quarter would be around US \$4,047 m. This figure does not represent an increase from the fourth quarter (US \$4,053 m) according to the methodology of DANE. However, it must be considered that the calculation in the balance of payments and DANE's data varies due to the following: (i) the records of foreign trade of DANE underestimate the exports of the trade balance because they do not include the external sales of gold made from free-trade zones; and, (ii) these records do not incorporate other special trade operations.

II. Growth, Domestic Demand, and Credit

18. The most recent indicators of economic activity for the first quarter of 2015 allow us to maintain the GDP growth forecast range presented in the previous Inflation Report (between 2.0% and 3.5%, with a most likely number of 2.7%).
19. According to the Monthly Survey of retail trade (EMCM) from DANE, the total sales of this sector without fuels grew 4.1% annually in March 2015. This meant a 5.4% growth annually for the accumulated value of the first quarter, a number lower than that of the fourth quarter of 2014 (11.0%). Excluding vehicle sales, the increase was 5.7% during the same month, and 8.0% for the whole quarter, which represented a slow down compared to the record of the last three months of 2014 (9.4%). The behavior of retail sales in March was anticipated by the SGEE and included in the consumption and GDP forecasts presented in the previous quarterly Inflation Report.

20. On its part, vehicle sales reported in the same survey fell 3.2% annually in March, which consequently meant an 8.8% contraction in this line of retail trade during the first quarter of 2015. This figure contrasts with the 19.1% record of annual growth for these sales during the fourth quarter of 2014. It should be noted that by the end of 2014 the 14th edition of the "Salón del Automóvil" took place, which meant a greater volume of vehicle marketing during that period.
21. The behavior of the balance regarding the sales situation as per the Monthly Survey of Economic expectations (EMEE) from the Central Bank aims in the same direction. This item recorded further deterioration in March, which suggests that households consumption (a series with which it is closely correlated) would have slowed down during the first quarter of 2015.
22. In spite of this, labor market indicators continue performing well. With information from the mobile quarter ending in March, new annual declines in the unemployment rate were observed, explained mainly by increments of salaried and formal employment. It should be noted that employment is a macroeconomic variable whose response to the reduction of economic growth is lagged.
23. With respect to investment indicators, the balance of expectations in the EMEE suggests that gross fixed capital formation other than construction of buildings and civil works would have expanded at a slower pace than the one registered one quarter before. This is confirmed by revising the dynamics of imports of capital goods (excluding aircrafts), which have recorded lower levels to February than by the end of 2014.
24. On the supply side for the first quarter, available information continues to show a weak performance of industry. According to DANE, the index of industrial production contracted 0.1% annually in March, a figure lower than the one expected by the SGEE (2.1%). The trend component of the series has a negative slope. When excluding oil refining, the indicator increases 2.3%, but its trend component has a slope of almost zero, which would indicate stagnation. It should be noted that there is high heterogeneity within the branches composing the industry. While there were significant expansions in the production of iron and steel (21.6%), clothing (17.4%), meat and fish processing and preservation (14.3%), and plastic products manufacturing (11.2%), these were partially offset by significant declines in coking, oil refining and fuel mixture (-11.0%), and manufacturing of metal products (-12.1%).
25. Construction, cement production and shipment slowed significantly in March to 1.7% and 3.7%, respectively. The analysis of their behavior during the first three months shows that both items grew vis-a-vis the last quarter of last year. In these periods, cement production increased from 6.0% to 7.8%, while shipments rose from 6.8% to 8.1%. On the contrary, construction licenses exhibited an average contraction of 10.4% in the first quarter of the year.
26. The GDP slowdown forecast for the first quarter is confirmed by the performance of the Economic Activity Index (ISE) published by DANE. In February, its annual growth was

- 2.1%, below the 2.8% of January. For the accumulated two-month period, the figure was 2.4%, lower than the record for the fourth quarter of 2014 (3.2%).
27. Although the information available is limited, regarding the second quarter of 2015 it is possible to foresee that the GDP increase during that period would be low, similar to the one observed for the first three months of the year.
 28. Despite the fact that the consumer confidence index in April (ICC) published by *Fedesarrollo* recovered marginally as compared to that of March, its level remains significantly below its average for the first quarter and that calculated since 2001. The data for April is comparable to that recorded in the second half of 2009. By disaggregating the ICC between economic conditions (ICE) and medium and long-term expectations (IEC), the latter component has the lowest levels.
 29. In April, a slowdown in the growth rate of household credit was recorded. The consumption loan portfolio (in nominal terms) grew 12.9% in the month, a figure slightly lower than the 13.1% in March and 13.4% in December. On its part, household interest rates (in real terms) have remained relatively stable.
 30. On the supply side, with information to April 2015, indicators suggest dissimilar behaviors. Among favorable news, the increase in oil and coffee production stands out, while others such as energy demand have been less favorable.
 31. Oil production reported an annual growth of 9.6% in April, and remained above one-million barrels per day (1025 mbd). So far this year, average production has been 1027 mbd, with results greater than the sector projections presented in the previous quarterly report (1020 mbd). This implies an increase of nearly 4.7% so far this year in this sector. Coffee production increased 11.1% annually in April (924 thousand bags), accumulating 3.8 million bags so far this year (i.e., 8.3% higher than the previous year).
 32. In contrast, in April total energy demand grew 2.1% annually, a figure lower than the 3.3% increase in the first quarter. The regulated component expanded 3.4%, while the non-regulated component fell 0.4%. Its trend component has a positive slope, yet lower than the one observed in previous months.

III. Behavior of Inflation and Prices.

33. Annual consumer inflation increased again in April, standing at 4.64%, i.e., 8 bp more than the record for the previous month, and above analysts' and the Bank's technical staff's forecasts (Table 2). So far this year, the accumulated CPI increase amounted to 2.95%, a number higher than the one recorded in the same period of the previous year (1.98%). The monthly CPI variation in April was 0.54%, as compared to the forecasts by analysts and the SGEE of 0.37% and 0.34%, respectively.
34. The bulk of the acceleration of annual inflation in the last month ran, once more, on account of the CPI for food, whose results exceeded the forecast by the Central Bank's

technical staff. Additionally, in April there were also some upward pressures originated in tradables and non-tradables excluding food and regulated goods (Table 2).

35. In April, core inflation also exhibited acceleration in three of the four indicators, as well as in the average (3.84%, as compared to 3.65% a month before). Thus, seven months of continuous increases have taken place in this indicator. CPI excluding primary food, fuels and utilities presents the highest register (4.3%), and is the first to exceed the ceiling of the target range. This is followed in descending order by core 20, CPI excluding food and regulated goods, and CPI excluding food, which remained stable at 3.4% (Table 2).
36. As was expected, within the CPI excluding food, the greater inflationary pressures were concentrated in tradable goods, whose prices have continued adjusting gradually and with lag versus the depreciation of the peso. Thus, the annual variation of this item passed from 3.46% in March to 3.64% in April (Table 2). The prices of a wide range of products have continued increasing; however, on this occasion they took place especially in household appliances, vehicles and accessories, and medicines.
37. The annual variation of non-tradables CPI increased 11 b.p. between March and April, and stood at 3.67% in the last month. This indicator shows a slight upward trend since December last year, which has not been fully anticipated by the models used by the Central Bank. So far this year, there have been increases mainly in rates for cable TV, tourism, education services, vehicle and health insurance, banking services, mechanical and medical consultation, among others. In April, upward pressures on the annual variation have concentrated on vehicle insurance, other home-occupancy expenses (administration fees), soccer tickets and rentals, the latter breaking the downward trend it had been exhibiting since last year.
38. These increases could be explained by the indexation of several of these prices to inflation at the end of last year and as a result of the 4.6% raise in the minimum wage. An indirect pass-through of depreciation through costs cannot be discarded. According to growth projections and estimates of the output gap (zero in the first quarter), demand pressures should not be playing an important role. Additionally, decreases in the prices of soccer tickets were much lower than expected, and did not offset the increases at the end of last year. The latter also contributed to leaving the annual variation of the entire group of non-tradables at relatively high levels.
39. Once again, a reduction in the annual variation of regulated goods to 2.68% was observed again in April, mainly explained by the behavior of the price of gasoline, which in this month remained relatively stable, while registering an increase in April last year. Something similar happened with public transportation and electric energy. On the contrary, there were increases in water fees (which had been foreseen) and in natural gas. Regarding this last item, it should be noted that the annual adjustment remains high (9.5%).
40. As for food, annual variation in April was 7.70%, increasing 33 bp as compared to data from March. The short-term models of the SGEE foresaw a slight decline in this indicator. So far this year, CPI for food reported a 5.6% cumulative increase.

Table 2
Inflation to April 2015

Description	DEC 2013	MAR 2014	JUN 2014	SEPT 2014	DEC 2014	JAN 2015	FEB 2015	MAR 2015	APR 2015	Participation in monthly acceleration (%)	Participation in acceleration so far this year (%)
Total	1.94	2.51	2.79	2.86	3.66	3.82	4.36	4.56	4.64	100.00	100.00
Non-food Inflation	2.36	2.62	2.66	2.70	3.26	3.20	3.41	3.46	3.44	(20.44)	12.61
Tradables	1.40	1.65	1.94	1.59	2.03	2.28	3.26	3.46	3.64	48.01	38.16
Non-tradables	3.76	3.55	3.45	3.26	3.38	3.47	3.50	3.56	3.67	40.39	9.21
Regulated items	1.05	2.21	2.14	3.25	4.84	4.01	3.47	3.25	2.68	(108.83)	(34.75)
Food Inflation	0.86	2.23	3.11	3.25	4.69	5.41	6.77	7.37	7.70	120.44	87.39
Perishables	(0.16)	3.17	8.92	7.61	16.74	16.78	19.68	21.57	16.99	(176.91)	8.04
Processed food	(0.24)	0.92	1.44	2.14	2.54	3.70	5.62	5.99	7.00	182.91	68.78
Eating out	3.26	4.13	3.52	3.23	3.51	3.60	3.34	3.59	4.68	114.44	10.57
Core Inflation Indicators											
Non-food Inflation	2.36	2.62	2.66	2.70	3.26	3.20	3.41	3.46	3.44		
Core 20	2.72	2.86	3.04	2.89	3.42	3.58	3.62	3.70	3.97		
CPI excluding perishable foods, fuels and utilities	2.19	2.53	2.53	2.39	2.76	3.12	3.69	3.95	4.29		
Inflation excluding foods and regulated items	2.74	2.74	2.81	2.55	2.81	2.97	3.40	3.52	3.65		
Average of Core Inflation Indicators	2.51	2.69	2.76	2.63	3.06	3.22	3.53	3.65	3.84		

Source: DANE. Calculations by BANCO DE LA REPÚBLICA.

41. Unlike previous months, in April the impulse did not come from perishable foods and rice, but from processed foods different from rice, meals outside the home, and beef. Although the price of rice increased this last month, it did so very little (only 0.5%) vis-à-vis the increases in previous months (approximately 33% in the first quarter). On the contrary, there were some considerable increases, higher than in the recent past, in the prices of imported food such as cereals (bread, pasta, etc.) and oils and fats, as well as in export products such as sugar and sweets. It is likely that these cases are presenting a pass-through of depreciation to domestic prices with a greater-than-usual lag. In the case of meals outside the home, after displaying an annual variation around 3.5% for several quarters, April reached 4.7%, which is due both to a very low basis of comparison in April last year as well as to a monthly adjustment higher than that of recent months. Apparently, cost increases due to high food prices were transmitted to this segment of the CPI. Finally, the increase in the price of beef in April would be part of the typical adjustments of the cattle retention phase (the CPI on beef exhibits an annual rate of 4.5%).
42. In April, the prices of perishable food exerted downward pressures after the increases observed in previous months, mainly due to the behavior of the price of potato, which fell after five months of continued increases. Prices of other perishable foods continued increasing, although at a slower pace than in previous months.
43. In April, production costs would have continued to be pressured by the accumulated depreciation of the peso, although they would be offset by downward pressures on farming goods. Indeed, annual variation of the PPI fell from 5.1% in March to 4.3% in April, thanks to the fact that the variation of the PPI for produced and consumed goods declined from 3.5% in March to 2.7% in April due to the result of lower adjustments in the prices of farming goods. On the contrary, the annual variation of the PPI for imported goods remained at very high levels (10.3%).

44. As for labor costs, inflation pressures are still scarce. The two indicators available (construction and retail wages) are adjusted at annual rates of no more than 4.0%, which is compatible with the inflation target.
45. In this context, inflation expectations to December 2015 increased; however, those for twelve months or more tended to remain anchored to the 3.0% goal. In the monthly survey carried out by the Central Bank to market analysts at the beginning of May, the expected inflation for December stood at 3.92%, higher than the figure reported a month ago (3.76%). The expectations obtained from this survey for a twelve-month horizon were around 3.15%, while those to two years continued around 3.0%. At the same time, inflation expectations inferred from the yield curve of TES for 2, 3, and 5-years have declined so far in May 12.3 pb, 14.6 pb, and 11.4 bp, respectively, on average, as compared to the data from April. Thus, *break even inflation* (BEI) to 2, 3 and 5 years registered 3.40%, 3.28%, and 3.29%, respectively.