SUMMARY OF THE MINUTES OF THE MONETARY BOARD, 1971 - 1988

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Abstract

This piece was part of a research on the colombian inflationary experience published as: The Rise and Perpetuation of a Moderate Inflation. Colombia 1970 - 1991. It collects together the summaries of the response of Colombian policy-makers to the shocks identified in that paper. Since 1963 the Monetary Board was responsible for monetary, credit and exchange rate policies in the country. This compilation consists of the opinions and policy measures related with anti-inflationary policy, registered either in the minutes of the meetings of the Monetary Board, the documents of the advisors (two qualified professionals that prepared a technical opinion on the issues at hand), or the actual policy measures undertaken (called "Resoluciones de la Junta Monetaria"). The choice was to report the minutes of sessions from two months before, until two months after every shock. The emphasis relies on those measures directly related to anti-inflationary packages, either of monetary, exchange rate, foreign trade or government financing character. The description is chronological and faithful to the original writing; that is, *this piece contains no interpretation from our part.*

1. THE MINUTES OF THE MONETARY BOARD

This piece collects together the summaries of the response of Colombian policy-makers to the shocks identified throughout the text. As "policy-makers "we will consider the Monetary Board, which since 1963 was responsible for monetary, credit and exchange rate policies in the country. The board was composed by the ministers of Finance (Hacienda y Crédito Público), Development, Agriculture, the Head of the Central Bank, the chief of the department of National Planning, and the Director of the Colombian Institute of Foreign Trade. Additionally, two advisors to the board had voice but not vote, and were responsible for analyzing the macroeconomic situatioin and proposing policy measures to the Board. These professionals were chosen among the best reputed economists of the country, and their tenure did not have to coincide with that of the ministers[1]; every week they prepared documents dealing with the topics the Board has chosen as relevant for discussion; these documents consisted of the most up to date data on the performance of the economy, the analysis of the topic at hand and their policy proposals. Another important institutional feature was that typically the head of the Central bank enjoyed stability of tenure, which in several occasions lasted for

[1]During the 1970s only seven economists were appointed to this post, and during the 1980s, twelve.

more than presidential term[2].

Our compilation consists of the opinions and policy measures related with anti-inflationary policy, registered either in the minutes of the meetings of the Monetary Board, the documents of the advisors and the actual policy measures undertaken (called "Resoluciones de Junta Monetaria"). We focused on the shocks identified in the text, and chose to read the minutes of sessions from two months before until two months after every shock. For instance, for the Sep-1971 : Mar-1972 shock we covered the minutes of the 11 months between Jul-1971 : May-1972 span. Our emphasis will be on those measures directly related to anti-inflationary packages, either of monetary, exchange rate, foreign trade or government financing character.

The description is chronological and faithful to the original writing; that is, *this appendix contains no interpretation from our part*; the summary in the body of the paper has our interpretation of the facts described here. One last remark is due: although we did no include in the paper the Dec-971: Jan-1972 shock, for lack of enough data before 1970, we considered pertinent to summarize the minutes regarding this period, which are the first we deal with.

[2]This is a long lasting tradition in the country: between 1924 and 1970 the average tenure of the Governor of the Central Bank was 8 years; during the period 1970 to1993 the average duration was 6 years.

1.1. DEC-1971 : JAN-1972

1.1.1. Minutes of Monetary Board Meetings (MMBM)

Jan. 12th: M1 is growing less than expected, but the stational effect of January may undo this situation.

Jan. 19th: Measures aimed at controlling credits of commercial banks, justified by the stational increase of liquidity of January. On another front, the Board establishes the range within which the interest rate of the Time Deposits should fluctuate: 18% to 23%.

Feb. 2nd: The identified increase in the CPI is explained by the rapid growth in the price of the tapioca.

Feb. 23rd: One of the advisors proposes the Board to pursue expansionary monetary policy for the whole 1972 year, consisting of reducing the Required Reserve Ration and allowing a higher growth of banking credit. This measure should compensate the lower than expected growth of liquidity.

Measures are undertaken to reduce the "Anticipated Import Deposits" *(AID)*; these instrument forced the importers to freeze in the Central Bank a percentage of the value of the transaction some period before the actual day of the payment to the foreign seller.

On the other hand the Required Reserve ratio was reduced.

Feb. 28th: Facing a fall in M1 and International Reserves, the Board considers monetary expansionary measures for the following two months that guarantee an annual growth rate for M1 of 14%; this opinion defended by one of the advisors is accepted by the Board.

1.2. Sep–1972 : Mar-1973

1.2.1. MMBM (Minutes of Monetary Board Meetings)

Jul. 12th: The annual rate of growth of M1 is considered excessive, and can trigger inflationary pressures; a new favorable situation in the coffee front is identified.

Jul. 14th: [Extraordinary session] Different formulas for computing the interest rate of a newly created savings system, based upon so-called "Units of Constant Purchasing Power" (*UCPP*), are discussed; the system will pay the savers the inflation rate (called "Monetary Correction"), plus a predetermined interest rate; the inflation rate used for computing the Monetary Correction is fixed at 12%, and the interest rate at 5%.

Jul. 19th: Contractionary measures are adopted, including the allowance for more payments to foreign trade and anticipated foreign debt payments; they are oriented to reduce the growth in international reserves.

Jul. 26th: It is identified an excessive growth of outstanding commercial banking credit (1.5% in 15 days).The Board has previously issued a mandate for the banks not to increase this aggregate more than 4% quarterly; a "Marginal Reserve Requirement " (*MRR*) of 100% is imposed to these intermediaries; it means that they will be forced to freeze all deposits surpassing the level reached the day of the imposition of this measure.

The minister of Finance warns the Board regarding the growth of the exchange rate; it should be such that it does not trigger inflationary pressures; it is agreed that it will grow at .03 pesos per US dollar every week; in this way its annual growth will not surpass that of the inflation rate[3].

It is also discussed the alternative of pursuing exchange rate policy by reducing the "Tax-Payment Certificate "(*TPC* ins Spanish) given to some export products; this CAT was (...)

Foreign trade measures are undertaken to contribute with anti-inflationary policy: The AID for imports with positive impact on the CPI is reduced, and exports "sensitive to the domestic market "are suspended.

[3]Since 1967 the country adjusted the nominal value of the exchange rate according to a Crawling-Peg scheme.

Payments abroad are accelerated.

Still it is considered that M1 is growing too fast, and the MRR is emphasized as a key instrument to counteract this tendency.

Aug. 2nd: It is identified a highly favorable current account surplus, explained by good coffee and non-traditional exports sales, which have been offset by higher debt service payments.

The Board specifies the interest rate to be charged by the financial intermediaries in directed subsidized loans of two "funds " in which the Central Bank acts as a second floor bank; the rates are 19%.

Aug. 23rd: The advisors propose to change the MRR by an equivalent increase in the ordinary Reserve Requirement Ratio.

Sep 13th: The advisors warn the Board that the determination of domestic price of coffee, and the financing of inventories accumulation of coffee might lead to further increases of M1.

Oct. 4th: Some anxiety is expressed regarding the growth of M1, International Reserves, foreign loans and total exports. The current budget for imports which is US $ 65 millions is considered low and should be increase; congruently the list of banned imports should be revised, so as to promote purchases abroad.

Oct. 5th: [Extraordinary Meeting] Increases in international Reserves and in domestic loans from the Central Bank are responsible for M1 growth. It is advised to maintain a limit of 3% to the productive assets of the financial intermediaries, to control domestic credits of the Central Bank, and to maintain the MRR, although its effectiveness is more preventive than real. The measure undertaken specifies that the ceiling to the growth of commercial bank's productive assets will be 7% for the second semester, instead of 4% for every quarter.

Oct. 18th: the advisors are preoccupied by the growth International Reserves and the highly positive prospects in coffee and non-traditional exports. It is proposed to limit M1 growth using the Reserve Requirement and imports budget; it is also considered, though not undertaken, to shift the MRR by an increase in ordinary RR.

Oct. 30th: The advisors indicate that at Oct. 21st the annual increase of M1 is 21.1%, which is already bigger than the expected increase for the whole year. Is is expected that its growth at the end of the year will reach 26%; the proposals include an increase in imports budget, to ease the imports licences policy (with more positions to "Free Imports " regime. However they are afraid that the actions taken to contain domestic borrowing, as well as those directed to speed up payments abroad will not be as effective as needed.

The Minister of Finance reveals that the Treasury deficit at the end of the year will be between 600 and 1.600 millions of pesos instead of the amount considered by the advisors: 400 millions of pesos.

The advisors express their opinion according to which "it has been reached a limit of tolerance for the measures of monetary control"; they ask for the creation of a paper that allow the Board to pursue Open Market Operations; there was no statement from the Board regarding this petition,a and the measures issued were an increase of the budget of foreign exchange for imports, and the suspension of the registering of external debt, both of them oriented to accelerate the payments abroad.

Finally, with the argument of long-term export diversification, the advisors express "the necessity of maintaining a increasing speed of growth of the foreign exchange rate... ".

Nov. 8th (4231): AID are reduced for 15 positions of the tariffs There is also a discussion regarding leaks to the outstanding loans ceiling for commercial banks, generated by the exclusion of "development directed credits" from the originally excluded measure.

Nov 22nd. (4254): The outstanding commercial banks loans ceiling has been successful, since it has increased less than the maximum 7% considered in the measure. However M1's growth rate is bigger than expected MRR notwithstanding. The Minister of Finance is pleased with the effectiveness of the contractionary measures. (4261) Measures are taken for accelerating the imports payments abroad. Also in this date the ORR is reduced in 4 percentage points.

(4265) The advisors report that an increase in the interest rates for commercial banks savings deposits, and the reduction of forced investments of these intermediaries led to a substantial rise in outstanding savings.

Nov 29th. (4282): the advisors report the success of the contractionary measures adopted for the second semester of 1972, in particular those of MRR and the limit of growth commercial banks outstanding loans. The minister of finance considers that this situation allows a reduction of the MRR that relieves commercial banks of this burden, ant that can be replaced by an increased in ORR.

Dec. 13th (4305): The advisors propose the use of the "Bonds Tradeable for Exchange Certificates" (TB), as an instrument for OMO. These bonds were denominated in US dollars, and [originally this instrument was designed for allowing importers to purchase the merchandises, and since Mar. Created in May 1970 as a contractionary tool, and as a stabilizing element in the foreign exchange market, in 1971 they were allowed to be traded in the secondary market . The advisors consider that modifying their conditions would make them more attractive in the capital market. Since the exchange rate has been devalued at a rate of 9% annually, the return of these certificates is approximately 14% (e.g. nominal interest rate 5%). Their maturity can be changed, and their interest rate increased to 7%, as well as duplicate their outstanding level; the advisors however are not overoptimistic about this tool, but consider it appropriate taking into account the exhaustion of all other measures taken. The Head of the Planning department expresses concern regarding this measure, since it can compete for resources with the newly created CPPU system. In his words "esta medida no es aconsejable en atención a que podría representar una menor captación de recursos por parte de las Corporaciones de Ahorro y vivienda".

Dec. 20th (4311) Facing a difficult expansionary monetary situation the Board accepts the suggestions of the advisors concerning the increase in the interest rate of the BTEC; the return of this paper is still low compared with other market instruments, making it a "pequeño aliciente adicional que en ningún momento va a constituir un factor de nivelación con otros documentos, pues de todas maneras el rendimiento seguirá siendo más bajo".

Jan. 10th, 1973 (4328-31) M1 grew 24% for the whole year, much higher than the original prediction, 15%, and even than the October prediction of 23.3%, which was made considering primary credit to the public sector and the increase in International reserves. According to the advisors this M1 growth is the highest of the last 22 years. With respect to commercial banks credit, the results for the 1972 year were as expected, showing that the measures imposing a ceiling to the growth of this aggregate were effective as a monetary control instrument. Hence. they recommend its further use for the first quarter of 1973 (4.5%). Additionally, those banks that fulfill this requirement will be relieved of the obligation of the MRR.

Feb. 21st (4381) since the government has pursued a policy of imports increase it is considered the convenience of eliminating the AID, offsetting its expansionary effect.

Feb. 28th (4397) M1 growth for the year 15% - 20%. For controlling the expansionary effects of RI it would be necessary to increase ORR, which could affect negatively the health of financial system; a gradual increase of ORR is advisable. Finally the ORR is increased in 5%: 2% from 12.3.73 on; 1% from 19.3.73; 1% from 26.3.73; 1% from 2.4.73 on. .it is considered the advantages for imports and prices of reducing AID; but the advisors propose to postpone this elimination until the contractionary package is designed. leveling of AID 10% (reducing all those above this level). From April the ORR will be increase to compensate the monetary effects of diminishing the AID. The Finance Minister explains that this measures obey a monetary program designed to face the acute increase in RI, propelled by the rise in the price of coffee. mi is still growing at 24%. they expect the government and the Federación bring money to pay debts and redeem bonds; as well as the pursuing of domestic coffee policy.

Apr 4th (4453) The credit limits is considered the best contractionary policy for its effect on prices. limits are established for the first and second semester of the year

May 2nd (4502) M1 is growing too fast (26.7% annually). It arises the consensual problem regarding what is the ideal rate of growth for M1. taking into consideration the difficulties intrinsic to the measurement of the normal growth of its demand.[4] it is also explicitly recognized that "the problem of establishing a more effective control to inflation may take still some time[5]. As causes of M1 growth the advisors enumerate: higher velocity of circulation of money 9com-

[4]Considera de especial interés para la Junta hacer un amplio análisis spre la situación, sus causas y los medios más adecuados para cambairla. En primer termino estima la junta que debe concretarse a aclarar el problema conceptual acerca de cual ha de ser la tasa ideal de crecimiento de los Medios de Pago, advirtiendose las dificultades que existen para medir el crecimiento normal de la demanda. Se dice que un nivel adecuado seria del 16% para año completo pero que dados los síntomas de expansión que se vienen originando de un tiempo para aca, la autoridad monetaria, desde un punto de vista más real, debería tomar como meta la de alcanzar un nivel de 20%para el mes de junio (en curso) y uno de 18% al finalizar el año, para lograr un aumento moderado de los precios y garantizar un crecimiento adecuado del producto interno.

[5]"...al propio tiempo que se vaya disenando una política coherente para desarrollar en un futuro más inmendiato, pues el problema de establecer un control más efectivo a la inflación puede llevar algun tiempo" (pg. 4502)

patible with higher inflation), the provision of credit to the economy, increases in domestic and international prices of coffee, the credit to the National Coffee Federation, the fiscal situation and the primary credit to the government. Additionally the scarcity of food supply caused either by the climate or the lack of properly allocated credit. the recently created CPPU system is claimed to contribute to the contraction of M1, but there is the fear that it absorbs credit resources from sectors other than building. In sum, the emphasis is on the allocation of credit in three fronts: more irrigation to production, less financing to the Coffee growers Federation and to the government.

May. 30th (4548) M1 is growing 25.5% during the second quarter of 1973, more than in the first quarter, which is a source of concern. The Board stresses the important contractionary effect of the AID; The measures proposed to counteract this phenomenon are a delay in the actual reception of foreign credits, and an increase of the ORR in 1%, are postponed by advice of the Minister of Finance, until the end of June.

1.2.2. Advisors Documents (AD)

Jul. 12th (AD 68/72) The CPI data of June is worrisome, yearly increase reaches 13%; since 1966 prices have not grown that fast. It is the most negative phenomenon of the Colombian economy, and it is alarming. Their diagnosis points out that "always has been considered that credit is the variable with the strongest impact on prices, since this is the factor that determines the demand for goods and services" (p. 15). There is a lag of 3 to 6 months for credit shocks to affect prices; the recent policy measures controlling financial sector credit will contribute to correct this phenomenon.

They express also the opinion that the fiscal situation is currently the one with the highest incidence on prices. Finance either with credit from the CB or with foreign debt, it has expansionary and crowding-out effects. On other front, the evolution of international coffee prices and its incidence on the domestic price and the income of a sector with a high propensity to consume, results also in inflationary pressures. Finally the newly created CPPU system might attract resources from the Housing Bank (BCH), which is an institution that the CB has the mandate to support. This can lead to more expansionary measures.

The advisors consider "explosive" the expansionary potential present at that moment. They propose to accelerate payments abroad, and a reduction in the use of primary credit to the government and the Coffee Growers Federation.

Aug. 2nd (AD 76/72) Worries emerge in M1 growth: 17% yearly. This led to the adoption of the Marginal Reserve Requirement (MRR) of 100%.

1.3. JAN.-1974 : FEB.-1974

1.3.1. Minutes of Monetary Board Meetings (MMBM)

Nov. 7th, 1973 (4858) The advisors consider delicate the monetary situation, since at the actual pace M1 growth can reach 30.8% at the end of the year. The measures proposed include a control to the use of primary credit by he government and the Central Housing Bank; as well as care in discount loans to the banks.

Dec. 5th (4919) Considering that some banks did not fulfill the ORR, sanctions are imposed on those banks that in the future incur in that situation; in particular, the bank must reduce in either 2% or 5% its credit outstanding, during the following month.

Dec. 12th (4945) The advisors propose a revision of the credit policy, consistent with the current monetary policy. (4968) It is decided to simplify the ORR system and to determine a maximum of 15% to the growth of commercial banks credit. Those institutions that during one month exceed these limits will be force to an MRR as follows: if the bank has a rate of growth less than 3% monthly above the limit, it will face a 100% RR on that excess; if the growth is surpasses the limit in more than 3%, the MRR will be 150% of that amount.

Jan. 23rd, 1974 (4998) Considering the monetary situation, the decisions taken were: i. To increase AID from 35% to 40%; ii. to increase from US $ 100 to US $ 120 the monthly imports budget; iii. to move some imported products from "Required Licence Regime " (Licencia Previa) to Free Import Regime, and iv. to discuss a tariff reduction aimed at promoting imports.

It is issued the "Resolución No. 4" (Jan. 24th 1974) creating bonds explicitly aimed at OMO, which will be called "Participation Bonds " (PB, Títulos de Participación). They will be sold to financial intermediaries, and they will be traded in the secondary market. They will be sold at a discount, which will be determined by demand and supply. The term to maturity will be 2, 4 and 6 months, and will be repurchased by the Central Bank at maturity at face value.

It is rejected the presidential suggestion of establishing a 100% MRR, taking into account the MRR dispositions already pending for the banks which exceed the predetermined increase in outstanding loans.

Jan. 30th (5011) The advisors admit that M1 increase was 26.2% during 1973, the highest for the period 1951-1973, indicating that the desired monetary control was not effective. The reasons are, first, the "compensatory character of our monetary policy that, due to the instruments available, limits itself to offsetting expansionary phenomena originated outside its sphere of control; it is the case of the fiscal disequilibrium or the current account surplus. Once the expansion is exogenously created the monetary authority is supposed to counter it; however there is no equivalence between the strength of the expansionary pressure and the possibilities to counter it: the instruments at its disposal, like the ORR or controls to credit growth, affect only the secondary expansion".

Second, the incongruence between the general policies necessary to face such a situation, and the particular demands from specify sectors of the economy that the monetary authorities periodically face.

The advisors consider that an optimal rate of growth for M1 for 1994 is 18%, which presupposes an inflation of 10% and real GDP growth around 8%. Since this increase will be fulfilled by the increase in international reserves, then the government should keep strict control on its expenditures. They also ask for the immendiate issue of Participation Bonds (PB), suitable for OMO, an increase in the ORR of 3 points and the fulfillment on the credit control measures.

Feb. 6th (5019) The increase in ORR (3%) is decided, and the Minister of Finance comments on the analysis made by the advisors in the previous session, showing that he main cause of M1 growth were the international reserves and not government expenditure. According to the government 'as own data the net fiscal effect was contractionary, and the expansionary pressures originated in government's expenditures were inherited from previous years. This topic is left open for further discussion since the advisors disagree with the minister in his consideration of amortization of external debt as a governmental contractionary contribution.

Feb. 20th (5049) The new instrument for OMO (e.g. Participation Bonds) is discussed and a proposal is presented for decree. The interest rates of several government bonds are increased.

Feb. 27th (5065) The Time Deposits Certificates are reformed; banks can issue them and freely determine their interest rate.

Mar. 1st (5079) measures are taken to counteract the expansionary effect of the significant inflow of international reserves; the measures seek to accelerate payments abroad and to extend the AID regime to imports financed by foreign banks; the alternative for these type of imports is either100% of AID or a guarantee for timely payment; whereas for those financed by domestic banks AID is 40%. The interest rate discussed for the PB will be 24% if their return is taxable , and 19% otherwise.

Mar. 13th (5094) meeting in the presidential residence for informing the president about the measures aimed at reducing M1 growth. The president considers that "if this goal has not been reached the situation should be studied again and new measures should be adopted "; however he considers that "it is possible only to reduce the acceleration of the current inflationary process, since certain factors of external character are affecting it "[6]. The president is informed of the policies undertaken which include: higher interest rate for banking credit; higher ORR; harsher access conditions for to discount credits; new structure for AID system; increased budget for imports; reform of the Time Deposits Certificate for banks including a free interest rate to depositors; and authorization to the Central Bank for issuing up to $500 million in Participation Bonds (a new instrument) suitable for OMO.

Apr. 24th (5116) A commission was appointed for gathering all the legislation issued by the Board. The commission suggested that the structure of the interest rates should be more flexible, with which the advisors agreed. The minister however considered that a deeper analysis was necessary, and therefore that any modification should be postponed.

May. 22th (5203) The Governor of the Central Bank remarks that the fact that the OMO are to be sold with an interest rate of 20%, implicitly recognizes that all other interest rates should be close to that level. "Therefore it is also implicit that the monetary authorities will give more flexibility to those interest

[6]"... si bien considera que sólo es posible reducir en su aceleración el actual proceso inflacionario, como quiera que en él estan incidiendo ciertos factores de carácter externo ." (5094-5095).

rates which are below that of intervention; and, as it is widely known, there are many of them".

The governor of the Central Bank says something relevant about the fact that an interest rate of 26.6% [7]was paid for the deposits in the FAVI: "We understand perfectly that in the initial phase of the Corporations [CPPU system] it was sought that they grow and developed, and no aggressive 'Open Market Intervention ' was pursued, at a high price for the monetary policy and the national government [...] ". He then states that this is implies a subsidy for this type of intermediary, and proposes that the interest rate should be equated to the return of the OMO (5205).

1.3.2. Advisors Document (AD)

Dec. 12th, 17th and 19th (AD 128/73) The goal of the revision of credit policies is to simplify the control system

Jan. 15th (AD 6/74) An extraordinary meeting with the president was held on Jan 3rd motivated by the rapid increased in M1. The reasons behind it are the rise in government credit in US $ 12 millions, the Central Bank credits to

[7]The "Resolution No. 12, 1972" (art. 3o.) specified that the interest rate for the bonds to be sold to the corporaciones was 2 percentage points less than the interest rate paid by these intermediaries for their savings certificates.

the banks, to the financial funds (subsidized credit), and to the Coffee Growers Federation. The president proposed three policy measures to the Board: i. to increase the AID from 35% to 50%; ii. to issue and sell Central Bank bonds for pursuing OMO; and iii. a MRR of 100% on increases in current account deposits.

The advisors recognize the contractionary power of the AID since May 1973, and the seemingly normal behavior of imports thereafter. They point out though, the perverse effects in terms of imports demand reduction, increased costs, and probable higher concentration towards importers with access to financing (the bigger ones).

Regarding the issuing of new bonds, it is said that the Board approved of them in Jul. 25th, 1973, but that their actual design was postponed, considering that the contraction reached would be partially offset by a reduction in other papers of the Central Bank (Economic Development Bonds; Financial Corporation Bonds; "Cedulas" of the Central Housing Bank).

The use of the 100% MRR has already been established for those banks that surpass the maximum credit growth, and hence it is not advisable to impose it again.

Jan. 30th (AD 9/74) This document summarizes the policy measures taken since mid-1972 when the expansionary forces initiated; it also shows the disappointment of the advisors regarding the results of these policies, and finally their diagnosis about the this failure. Three topics are dealt with:

A. The policies undertaken during the last year and a half:

1. payment and later elimination of anticipated foreign exchange inflows ("reintegros")..

2. elimination of foreign credit inflow to the private sector

3. acceleration of payments abroad

4. a rigorous budget for the coffee sector that avoided a further expansion, given the important increases of international prices and of quantities exported.

5. increases of 6.5% in the banking sector's ORR

6. reorganization of the Agriculture Products Storage Bonds (Bonos de Prenda) system

7. limit to growth of banking credit

8. changes in the AID

B. The explanation for the "evident lack of success " (p. 16) of these measures; two main causes are argued:

First, the unsatisfactory fulfillment of the government's planed budget; in particular the violation of the self imposed limitations of foreign credit; according to the advisors "the problem of monetary expansion caused by international reserves accumulation is of fiscal nature, and the monetary policy alone cannot correct it; the coordination with the fiscal policy is then necessary for bringing order to the monetary situation. "

Second, the already mentioned compensatory character and lack of instruments of the monetary policy; the instruments were basically the MRR and the limit to banking credit (p. 23; see MBMM Jan. 30th); and the fact that "the policy of monetary stability is not sustained with the rigor and permanence necessary for it to have full effect and a visible impact on the means of payment " (p.20).

C. The analysis of the drastic increase in prices occurred between 1971 and 1973: the advisors blame the basic disequilibrium created by an excess of demand in relation to supply; the former was caused, on the one hand, by an increase in public investment and private consumption, both of them linked to fiscal policy; on the other, by the higher revenues from coffee and non-traditional exports. Domestic supply did not respond because an increase in exportable output and a lagging growth of imports. The advisors also say that once inflation has been accelerated "by other causes " the monetary policy alone is not capable of reaching an inflationary target; in particular they emphasize the necessity of coordination with the fiscal policy.

Feb. 20th (AD 17/74) the advisors propose an increase in the interest rate charged on banking loans; the justification is to promote the market mechanism in the allocation of credit. They explicitly quote R. MacKinnon, who visited the country in this period, when justifying their recommendations. In this vein, the interest rates paid by several government and Central Bank bonds were revised upwards.

(AD 18/74) the characteristics proposed for the PTs (OMO 'instrument) should be: i. taxable return of 24.3 %; ii. sellable to financial intermediaries and to the public; and iii. will be repurchased at maturity; the first issue is for (pesos) $500 millions.

Feb. 27th (AD 21/74) The advisors propose to modify the conditions of Time Deposits Certificates (TDC), created in 1971, whose interest rate (maximum 13%) makes them unattractive to the banks. Disintermediation is a the chief justification for providing financial intermediaries with an instrument with which to compete. Also a more efficient allocation of resources will result if this certificates pay an adequate interest. The advisors propose a completely free interest rate for these deposits, but a regulated rate for the credits given with the resources gathered (e.g. 24%), which will dampen traumatic transferences of funds from other financial instruments.

Regarding its monetary impact, the advisors comment that the ORR could be very low (it was 0,5 % for savings deposits and 5% and remunerated for deposits of Savings and Housing Corporations (SHC). Since the interest rate will be high, the only way to make them profitable for the banks is to impose a low ORR: either 1% if unproductive, or 5% if productive. The Board will determine the economic sectors that will receive credit funded by these deposits.

A brief note on the Financial Reform of 1974-75

According to Jaramillo (1982) and Ortega (1982) the financial reform pursued during this period was oriented to liberalize the financial market and separate the monetary policy from the credit demand. The liberalization was pursued through a reduction in the regulations pending on the financial system and an equalization in the returns of the different financial assets available (e.g. a ceiling on the CPPU was imposed and an increase in the time and savings deposits interest rates was approved). The interest rates paid on deposits were not liberalized on the spot: on the contrary, a gradual approach was chosen, aimed at equalizing market returns first. The credit interest rates of banks were liberalized The access of the financial intermediaries to primary credit was reduced through an increase in the discount rate and the sanctions for negative excess reserves. Finally a new OMO instrument was created, the Economic Emergency Bonds, whose performance though was not entirely successful.

The Financial corporations were authorized to lend in the short run, and the financial instruments of the banks became more attractive; this elements encouraged competition among the financial institutions present ant that money in the market (commercial banks, financial corporations and Savings and Housing Corporations). Foreign owned banks were forced to convert to domestically owned.

The increase in the interest rates led the institutional system to gain dramatically in deposits (which has begun already with the CPOPU system in 1973), at the expense of the non-institutional market which dominated before the reform. Actually, during 1975 the loan interest rate was free to fluctuate below 29%; hence it is not entirely true that this interest rate was completely liberalized; as a matter of fact the actual interest rates during these years were 27.7% for 1974, of 25.4% for 1975 and of 28.1% for 1976

1.4. NOV-1975 : FEB-1976

1.4.1. Minutes of Monetary Board Meetings (MMBM)

Oct. 8th, 1975 (5912) the Board expresses concern over the effect of FER changes on M1. Through the Resolution 56/1975 the ORR is increase from 35% to 36%, and those corresponding to deposits of governmental institutions of the national level, from 20% to 80% (5917). There is some discussion regarding the lack of success of the Economic Emergency Bonds ("Pagarés de Emergencia Económica ", EEB); the board gives instructions to the advisors to make them more attractive, and more effective as OMO instruments (5918). Finally the advisors propose an increase in the discount rate, in order to disencourage banks to seek these funds; the use of them is blamed for the high seasonal increase in liquidity during December.

Oct. 29th (5943)The discount rate is increased from 16% to 20%. Also during this session the advisors warn on the expansionary effects of a reduction of AID percentage, but the Board, considering the recent fall in the demand for imports, approves a reduction from 32% to 25%. The conditions of the EEB are improved: their return is increased to 23.2% for investors and to 26.7% for tax payers, the broker commission is reduced and more advertisement is undertaken.

The Board expresses its concern over the figure of M1's annual increase, 29.8%, and the fact that the contractionary measures taken so far have not been effective. The MRR is reestablished, for all increases in current account and time deposits exceeding the 20.11.1975 level. This measure was to be in pace until the end of January. Additional policies include a rise in the discount rate for SHCs, and the authorization to the CB to issue PB without limit and with return and maturity features that make them attractive in the marketplace (5964).

Jan. 28th, 1976 (6037) the additional issue of PB is considered, taking into account that the original, P/. 500 million issue has been sold.

Jan. 30th (6050) considering the elimination of the MRR, it is approved the ORR to be improved in 3.5 percentage points from Feb. 1st 1976 on.

Feb. 25th (6071) the Board is concerned with the expected increased in International Reserves for the year, and its likely monetary impact.

Mar. 10th (6092) Since M1 is growing 3 points more than expected, the Board decides to reduce the inflow of international reserves, suspending the loans to the private sector.

Mar. 24th (6155) The Board aims at reducing coffee exporters external financing and substitue it for domestic pone.

1.4.2. Advisors Document (AD)

May. 14th (AD 43/75) (Financial Reform) the diagnosis of the advisors regarding the relationship between the credit market and the monetary policy was as follows: traditionally the authorities regulated the interest rate, creating an excess demand for loanable funds; in turn this demand transformed itself into claims to the monetary authorities for more loans to different sectors. Such requests were satisfied with primary sources that ultimately fueled inflation. Therefore, rising the interest rate and letting the credit market progressively determine it would contribute to equilibrate such market, to allocate better the credit resources and to free the monetary policy from constant inflationary pressures. The advisors, facing demands for a fall in the interest rate, warn against such a reduction since it would mean a return to the past in terms of the link between monetary policy and credit demand. They maintain that "the reduction in the time deposits ' interest rate would occur when the inflation expectations change. This has not been evident for the time being " (p. 7).

May. 28th (AD 47/75) the advisors set the target growth for M1 in 15%. The main difficulty to reach this goal is the expected decrease in international reserves of $ 160 millions during the rest 8 months of the year. They foresee a fall in the Monetary Base resulting from this phenomenon.

Sep. 3rd (AD 78/75) July witnessed a dramatic change of sign in M1 growth. The reason for this is partly the reduction of 5% in AID and the reduction if ORR which coincided with the increase in International Reserves since the end of July. Hence, the target of 15% for M1 growth is hardly realist, since for the rest of the year coffee exports will be 7.5 million sacks instead of 6.4 million, and the international price will be $.8 per lb. instead of $ .6 originally planned.

Consequently the new forecast of change in reserves for the end of the year is an increase of \$ 41 millions instead of a decrease of \$ 245 millions. The advisors warn the Board regarding the perverse effects of the expansionary measures taken during the first half of the year, when it was expected that the external sector had a contractionary. The situations has been worsened by a particularly good performance of non-traditional exports, as well as by the rise in foreign financing for the private sector. The policy measures should seek to reduce the anticipated payment of non-traditional exports as well as the mentioned foreign credits. Also the imports budget should be increased and a reduction in primary credit for the government. In particular that the government repays at least the 800 million pesos of EE bonds acquired by the CB that already expired. If none of these measures were adopted the only alternative would be to increase the ORR.

Oct. 29th (AD 94/75) The advisors want to limit the use of the discount loans since they amplify the seasonal jumps of the money supply. Banks have access to inexpensive resources from the CB, which they utilize in particular at the end of the year. Since banks are charging 18% for their credits financed with ordinary deposits (interest rates liberalized by the Resolution 27/1975), the advisors proposed the discount rate to be increased to 20%. This measure would guarantee a more uniform growth of M1! during the year. This is particularly important in the current circumstances when, at Oct. 18th the Means of Payment are growing at an annual rate of 28%.

The other topic presented in this document refers to the AID, which currently is 32%; although on the one hand this instrument can discourage imports, the experience of the last year demonstrated that it is one of the few mechanisms with actual effect on the Monetary Base. However, the AID has been reduced twice during the year from 40% to 35% the first time in July, and then to 32% in October. These measures have resulted in a sensible monetary expansion. In sum the current conditions make advisable not to reduce such rate.

Jan. 27th (AD 9/76) The advisors analyze the events of 1975. The sharp shift in the monetary situation in July took by surprise the monetary authorities; the expansionary measures taken during the first half of the year were oriented to compensate an expected fall in International Reserves. Such situation was completely reversed after July. Additionally, some policies taken during the second half of the year worsened the problem of monetary control i. The government utilized 1000 million pesos of a CB loan ("el cupo ") and 1343 millions of pesos in EEB more which sold to the CB as sources of financing; these two accounted for 21% of total increase in the MB during the year. On top of that the government appropriated the revenues of the Special exchange Accounts ("Cuenta Especial de Cambios "), which also contributed to primary expansion. ii. The reduction in AID from 40% to 25% was responsible for 19% of the increase in BMB. iii. The dramatic rise of International Reserves caused by the jump in international prices, in turn due to the froze in Brazilian coffee crop, and by higher volume of coffee and non-traditional exports explained 41% of the increase in MB. iv. the reduction in the ORR, during the first semester from 37.5% to 34% and reversed during the last quarter to 36%, accompanied by an 80% ORR for deposits of governmental institutions of the national level.

One factor the advisors stress is the wrong policies in terms of government financing and AID reductions, taken during the second semester, when it was already clear that the International Reserves would be highly expansionary. These added to the reduction in ORR led to the biggest increase in M1 in two decades.

1.5. NOV.-1979 : JAN.-1980

1.5.1. Minutes of Monetary Board Meetings

Sep. 12th (7642-7646) the Board authorizes the CB to issue Participation Bonds for P/. 10.000 millions. The new titles will have maturities of 15, 30, 60 and 90 days, will be sold at a discount, and through the financial intermediaries.

Nov. 28th (7690-7693) the advisors analyze the high increment of the means of payment, 29.1% from the beginnig of the yesr to the present. This situation and the fact that the means of payment have a strong seasonal jump at the end of the year lead them to advise the Board to take measures in order to "reduce inflation expectations ". In particular, to issue PB with 15 day maturity with an increase of the interest rate to 28%. Since the high level of the PB's interest rates has been criticized by the financial intermediaries the advisors propose to eliminate the ceiling on the loans and deposits interest rates of banks and financial corporations. They consider that this measures would give the CB a better support and authority to pursue and aggressive policy for capturing liquidity excesses through PB. The Board disagrees with the positive effect of free interest rates, since the rates of the whole market could escalate, something detrimental for the CPPU system.

The advisors also ask the Board to consider a modification of the MRR in place since Feb. 1977 and which has created costly distortions in the financial system. The Board decides to freeze it at the level reached at some date in order to avoid expansionary pressures from this source.

Jan. 16th 1980 (7757-7762) The summary of 1979 is that the Monetary Base grew 30.4%, the ORR policy led to a fall in the money multiplier that yielded an M1 increase of 24%. In spite of what is regarded as a successful monetary policy, prices grew at some point at 29% yearly, something explained by the low supply of some goods and the increase in cost items like wages. Additionally the advisors consider that " the Colombian economy has experienced during the last 8 years a chronic inflation that is only understandable with increases (chronic as well) in the means of payments above national product growth. "

And they continue: "if something can be concluded from the monetary performance in 1979 [...] is that it is possible to achieve gradually control over the monetary aspects of inflation. " They express that there are problems that concern the monetary policy itself, and others that emerge from a conflict between it and the general policy. In particular the fact that there are political reasons to oppose a more effective monetary control, which in their opinion should not have the highest priority. Consequently, it would be advisable to set M1 growth targets for the next two years compatible with reasonable price variation. They suggest 20% for 1980, and 15% for 1981 or 82.

The advisors put forward the measures they consider necessary for 1980: to strenghten the role of the OMO instead of MRR, and of ORR on deposits other than current account. To eliminate ceilings to interest rates and to adjust those of the CPPU system. To freeze the MRR and dismantle the ORR pending on Quasi-money. Finally to accelerate the rhythm of devaluation and to widen the

Exchange Certificates system to all types of registers.

The Board approves an issue of 10 thousand million pesos in PB.

Jan. 30th (7757-7762) The MRR established in 1977 is frozen at the level registered by each intermediary at Jan. 31st 1980. This measure is accompanied with an increase in ORR from 45% to 50% and reductions if forced investments. The ORR pending on Financial Corporations are reduced from 25% to 15%; finally the ceiling on the interest rates of loans made with banks and Financial corporations ' time deposits are removed. The advisors propose to ask the president for an authorization to eliminate the limits on deposits interests rates as well.

Mar. 18th (7825) The International Reserves continue as the main source of monetary increase. The most effective contractionary mechanism are the PB; the monetary policy during the rest of the year should rely on that instrument and the acceleration of drafts as well as on controlling the use of discount loans by financial intermediaries.

1.5.2. Advisors Document (AD)

Nov. 20th (AD 99/79) The growth rate that M1 registered during the Sep.–Nov. span corresponds to an annualized figure of 56%, considered by the advisors as too high. In order to reduce the inflationary expectations they propose to sell PB. In this respect the OMO have arose criticism because of its effects on the interest rates. The advisors have two comments in this regard: first the monetary policy should concentrate on a *permanent* control over the money supply rather than on the interest rates. A rate of growth of M1 close to 30% is clearly incompatible with the goal of price stability. The PB is the only mechanism available, and should be used to target the short run money market with 15 days maturity papers. Second, it is necessary to accept the political cost intrinsic to any OMO. One way to deal with the other leading interest rates of the market would be to increase the "monetary correction "of the CPPU system and to eliminate the ceilings to deposits and loans interest rates of the banking system. Such ceilings were imposed in 1977 when the acceleration of the inflation rendered very low interest rates for the CPPU system. on that occasion instead of improving the return on the CPPU deposits it was chosen to administratively control the leading interest rates of the market. However, such control is undesirable and ineffectual. Undesirable because the government bears all the responsibility for the slow growth of deposits; and ineffectual because the intermediaries can circumvent it through anticipated interest rates and commissions, leading to effective interest rates much higher than the supposedly controlled nominal ones.

Nov. 28th (AD 102/79) The advisors report that all the monetary instruments are operating at its maximum strength; the strength now has to be put on the OMO. The CB has started selling 15 days maturity PB bearing an interest rate of 19% (1 percentage point increase in this return during the week). Another important measure would be to shorten the closing of the financial system at the end of December, in order to diminish the seasonal demand for cash in at the end of the year.

A problem is identified in the MRR, in force since Feb. 1977. This mechanism has induced distortions in the banking system in so far as it has created mechanisms to receive deposits through off-balance items, exempt of the mentioned requirement. Several mechanisms are proposed for dismantling it, avoiding monetary expansion: compensation with ORR, gradual reduction or freezing at some date level.

Jan. 16th (AD 4/80) The summary of 1979 show that although the International Reserves grew a record $ 1621 millions (see Table ##), the increase in the money supply was satisfactory.

Year	INT. RESERVES Variation ($ mill.)	M1 Variation (%)
1975	117	30.2
1976	619	34.9
7977	664	30.4
1978	665	30.3
1979	1621	24.3

Several booming items of the Balance of Payments explain such increase in international assets; their respective change during the year was: i. non-traditional exports: $ 409 m.; ii. returns on IR: $ 119 m.; iii. Services: $ 338 m.; iv. coffee: $ 71 m.; v. Capital account: $ 610 m.; vi. accumulated import drafts: $ 205 m.. The measures taken by the monetary authority responsible for these results were: the reserve requirement policy which reduced the money multiplier, the discipline imposed to the Funds of sectoral promotion administered by the CB, the fiscal policy (in total the domestic credit of the CB fell 30%), the AID and the new issues of PB.

1980 will be a difficult year since a further increase of IR is expected and some instruments like the MRR, the fiscal policy and the OMO will not have the strength displayed during 1979. The policy recommendations stand on the recognitions that "The Colombian economy has experienced a chronic inflation during the last eight years which can be sustained only through increases -equally crhonic- of the Means of Payment above the growth in the National Product " (p. 44). The satisfactory results of 1979 show that it is possible to reach an adequate control of the monetary aspects of inflation.

The inflation of 1979 was 24% and further efforts should guarantee that a reduction to 20% can be achieved in 1980; consequently the goal for M1 increase for 1980 should be 20%, and for 1981-82, 15%. For the future the advisors advance three important points: i. it is incompatible to control money and interest rates at the same time. The administrative controls on the interest rates were imposed in May 1988 when the inflation rate was 15%, with the rationale of allowing the CPPU system more competitiveness. Therefore, the strengthening of the OMO should be accompanied by more flexibility to market interest rates; as regards to the upward pressure of the OMO on the interest rate, everyone has to bear in mind that it is inflation the cause behind high interest rates and not the other way around. ii. it is crucial to avoid additional CB loans to the financial intermediaries, which was a important component of the stabilization policy of 1979. iii. The external sector is the main source of M1 expansion. On this matter they argue that the slow evolution of the drafts abroad was due to a lack of exchange rate risk; a faster pace of devaluation would correct this situation.

Mar. 18th (AD 17/80) during the first two months of 1980s the International reserves continued increasing basically because of coffee exports and the returns of FERs. In the future the foreign loans got by the government and incoming foreign investment will turn the capital account into a source of monetary expansion. Since the MRR was freezed, the best tool of monetary policy are PB, which should be used more aggressively henceforth. These bonds and the drafts of imports are the main pillars of monetary policy for 1980.

1.6. DEC.-1985 : JAN.-1986

1.6.1. Minutes of Monetary Board Meetings

1.6.2. Advisors Document (AD)

Oct. 23rd (AD 121/85) The advisors prepared the forecasts for 1986. The main points mentioned are: the means of payments should increase 23.5%, corresponding to an expected real growth of GDP of 3.5% and inflation of 20%. The so called "Margin of expansion " for the public and private sector during 1986 will depend upon the change in FER. 42% of the non-monetary liabilities of the CB are Exchangeable Bonds and Certificates of Exchange; if there is a rise in FER and a further increase in such liabilities, then the CB domestic credit will be the main item of contraction, which would reduce the ability to lend to the government.

Feb. 26th (AD 35/86) The increase in FER during the last month has accelerated M1's annual growth rate from 28.8% in Nov. to 30.6% in Feb. OMO with EC were crucial during 1985 and its effectiveness was due to the high return granted by the pace of devaluation of the peso/dollar exchange rate. Taking into account the slower expected devaluation for 1986 it is necessary to use the PB as the alternative OMO title. These bonds should be targeted to the short run excesses of liquidity in the financial system. As their colleges of 1979 the advisors think that those resources should be stopped before they are converted into loans. PB of 7, 15 and 30 days, and if necessary other ones of 60 and 90 days, would do the job. its returns should be determined by supply and demand. The cost of these operations should be paid with the proceeds of the SEA ("CEC ").They also propose an increase in ORR, although these new reserves should be remunerated considering the low profitability and capitalization of the financial system. This alternative is less flexible than the OMO, but it would have a milder effect on interest rates. since and the use of EC to postpone the monetization of FER .It is very important to deny further "Cupos de emisión " to the government or to the private sector.

Apr. 9th (AD 41/86) the measures adopted sought on the one hand, an acceleration of imports drafts, through less stringent procedures for obtaining the draft license and the elimination of the "Regime of Minimum Period for Imports Draft". On the other, the avoidance of new "cupos de emisión " (they express the urgency to fully eliminate this source of CB loans) an issue of P/. 30.000 millions in PB (Feb. 27th; the outstanding level at Apr. 4th was P/.46.000 m. since the titles sold to the coffee growers federation was excluded from that maximum). This last operation frozen 74% of the surplus of the Fondo Nacional del Café. The advisors advocate an increase of P/. 20.000 m. more in PB.

Apr. 8th (AD 55/86) The main component of the contractionary policy has been the "Coffee Agreement "which has allowed to create savings precisely in the sector that has excesses of resources. The policy approach is to consider this episode as transitory, since its origin is the sort run evolution of the international price of coffee. Therefore, the goal is to accumulate FER. Alternative measures like a real appreciation or an increase in ORR are ruled out because they would imply a loss of external competitiveness for the country and a loss in profitability for the financial system respectively. On the other hand the OMO with PB are flexible, since they are willingly demanded by private agents, and do not interfere with foreign policy (compared to those with CC and EC). Finally, it is unavoidable that the interest rates rise; a sustainable reduction in the interest rate would be achieve only when the inflation expectations go down.

Apr. 8th (AD 57/86) the forecast of money demand increase for 1986 is based on expected inflation of 22% and real GDP growth of 5%; therefore money supply should rise in 28%. It is necessary to dampen inflationary expectations with a clear signal that the monetary authority will not permit a jump in inflation (p. 26). it is still true that the main instrument is the Coffee Agreement, that allowed savings in this sector, and that a further effort should be done on the part of the government in terms of higher deposits of the treasury on the CB. In this respect it should be clear that they are not asking for a surplus, but just for a reduction on the consolidated government deficit from 4.6% of the GDP to 2.2%. The true effort should would be not to spend the resources created by the Bonanza cafetera.

###. #th (AD 66/86) The increase in FER created an expansion of P/. 313 bn.; the goal of MB growth was P/. 115 bn., hence a contractionary effort of P/. 198 bn. was necessary. The non-monetary liabilities grew in P/. 189 bn. from which P/. 108 were bought by the coffee growers; the domestic credit fell in P/. 11 bn. (which includes 70 th. m. in deposits form the government and 40 bn. from FOGAFIN). The cost of the OMO will be paid by the SEA.

1.7. NOV.-1986 : DEC.-1986

1.7.1. Minutes of Monetary Board Meetings (MMBM)

Oct. 8th (12569) In order to control the seasonal increase in the Means of Payment the advisors propose the ORR of public governmental deposits to be increased from 45% to 65%, which would reduce the multiplier in 2%. This measure will affect oficial banks, responsible for big increases in loans . This requirement was at 80% between 1974 and 1983, and was reduced to give more competitiveness to these banks. The proposal is approved by the Board.

Oct. 22th (12597) The analyses of the advisors and the Research department of the CB deem as favorable the evolution of the monetary policy, considering that the inflation is at a low level[8].

Oct. 29th (12587) One of the main concerns has to do with the access of the Savings and Housing Corporations to discount loans. It is proposed that this intermediaries should have access to the interbank funds market to allow for a better allocation of resources within the financial system, and a less frequent use of CB's discount resources. The proposal is rejected on the grounds that this would distort the function of those institutions as channels of credit to the

[8] Referring to the unattractiveness of CPPU's return, one of the advisors points out that the responsibility lies partly in the low level of inflation.

building industry.

The advisors express their concern regarding the access of the government to resources of the Special Exchange Account (Cuenta Especial de Cambios), which has strong expansionary impact. The minister of Finance recalls that the country faces a high level of unemployment and that closing the access to these resources would force the government to turn to the congress for approval of Loan allocations in the CB (12599).

Nov. 21th (12607) The OMO have been carried out according to the schedule and the Exchangeable Bonds have been sold successfully (Títulos Canjeables por Certificados de Cambio); a new issue of them is authorized. Fearing the effects of a rapid growth in commercial banks credit the Board agrees to persuade the banks with the threat of a limit of loans.

Nov. 28th (12623) The advisors set out the problem of the proliferation of CB loans to the government ("Cupos de Emisión "), which emerge from the Congress with the status of law. They represent a direct and unordered interference of the legislative power in the realm of monetary policy. The proposal of an eventual intervention of the president to avoid this practice is rejected by the Board.

Dec. 15th (12636) The seasonal growth of monetary aggregates is analyzed at the same time with the growth of banking loans at the end of the year. The advisors suggest to rise the cost of discount loans and the sanctions for lack of reserves. The Board decides not to adopt these measures and to pursue moral suasion to the banks for limiting their credit. One of the members mentions that the monetary situation seems to be evolving favorably, so as to make unnecessary more drastic measures. In case that the monetary goals cannot be reached the Board authorizes the use of OMO with Exchangeable Certificates.

Jab. 21st (12687) There is satisfaction regarding the monetary results of 1986.

Mar. 13th (12769) the advisors propose monetary goals for 1987: 24% growth of means of payments corresponding to 20% expected inflation and 4% real GDP growth. The main worries emerge form the FODEX.

1.7.2. Advisors Document (AD)

Dec. 15th (AD 172/86) The recapitulation of the policy implemented to face the "Bonanza Cafetera " is very positive. The policy measures were: aggressive OMO using PB and Exchangeable Bonds which reached unprecedented levels; The elimination of the Gold subsidy; the rise of the ORR of governmental deposits in the banking system. The topic of this document is the rise in the discount rate and the sanctions for lack of reserves, which should help in reducing the strong seasonal increases of the monetary aggregates during December.

Jan. 21st (AD 5/87) The results of 1986 were very positive: annual output growth was higher than 5%, the International reserves surpassed \$ 3000 millions and annual inflation was 20.9%. The measures for controlling the Bonanza Cafetera yielded an increase of M1 of 22.8% and set a clear signal of strict monetary control to the economy.

The monetary situation throughout the year was rather difficult. The means of Payment grew at a rate of 30% during the first quarter, reached 40% in July, and 30% at the end of November. The first PB were sold in February although the fact that the interest rates were controlled during the first semester made difficult the OMO. However, aggressive participation in the market during the second semester led to an increase of PB from P/. 55 bn. in May (14% of the Monetary Base) to P/. 119 bn. in December (29% of MB).

A main part of the diagnosis was that the Bonanza was transitory and therefore the policy should not sacrifice long run goals like the real exchange rate and that it should contribute to accumulate international reserves as a precautionary savings to face future events.

In August the strategy designed to reach the contractionary goals wasto continue with OMO, act on December seasonal behavior of monetary aggregates, and some complementary measures, like moral suasion to achieve a low growth in banking credit at the end of the year, and increases in ORR. The OMO used short run bonds in pesos (PB of 7, 15 30, 60 and 90 days of maturity) and medium run bonds in dollars (EC of 90 and 180 days).

Mar. 13th (AD 27/87) The necessary increment of M1 for 1987 is calculated in 24 percent taking into account that the expected inflation is 20% and the increase in real output is 4%. The argument is that it will "allow the productive activities to develop without resistance ". It is expected that the main source of perturbations will be government investment which facing closed international financial markets will rely heavily on CB's credit . Also it is mentioned the fear that an excess of liquidity may trigger speculative attacks against the peso, similar to those that occurred during the period 1982-84. Finally, the advisors criticize the continuous use of "cupos de emisión "authorized by the congress to give access to the government to credit from the CB.

1.8. JUN.-1988 : JUL.-1988

1.8.1. Minutes of Monetary Board Meetings (MMBM)

1.8.2. Advisors Document (AD)

Apr. 27th (AD 54/88) The goal for M1 growth for 1988 stated in February was 28%, corresponding to expected Inflation rate of 22% (2 points less than 1987) and 5% of real GDP growth. At the end of March inflation reached 26.6%. This was considered a very serious challenge for the monetary policy; they claim explicitly that "... the policy of the government is not to validate the current level of inflation but to correct it gradually."

Another problem that worried the advisors was the allegedly high level of the interest rate, e.g. the deposits rate was 36.88% in April 22, 3.3 points higher than in January. Their diagnosis is that a lack of liquidity pushes up the interest rate. There is also a problem created at the end of 1987 which led the public to demand cash away from current accounts (because these were to be monitored by the government for tax purposes); the banks were left with less inexpensive resources to lend, and forced to compete in the market for loanable funds; this also pushed up the interest rates and worsened banking profitability.

The policy proposed is not to seek so eagerly the monetary goals, reducing the

ORR to achieve the M1 goal but controlling the Monetary Base, since a further reduction in liquidity would have negative effects on the economy[9].

In sum they have three objectives: to reduce inflation, to avoid further increases of the interest rates and not to harm banking profitability. The measure proposed is to introduce more liquidity to the economy (and to the banking system) through a reduction in the ORR. This is not inflationary since the authorities overdid the contraction of the first months of the year.

May. 18th (AD 66/88) The annual inflation rate in April was 28.4%, a peak for the decade. Historically the Colombian inflation had returned to its average level of 22.3% through two channels: i. a strong self-correcting mechanism: the relative prices of food; and ii. "the monetary policy which although indulgent with the *average level of inflation* (their italics), has at least not validated the highest levels of inflation observed at each moment in time ." (p. 2).

[9]"A raíz de la notable expansión de los medios de pago a finbales del año pasado se generó en el mercado monetario un exceso de oferta, cuya principal consecuanecia ha sido la aceleración de la inflación durante los últimos meses. Por tora parte, el efecto combinado de la mayor inflación y de las perturbaciones bancarias del primer trimestre dieron lugar a una notable elevación de las tasas nominales de interés. Las acciones tomadas desde entonces por las autoridades monetarias para contraer los medios de pago, así como la marcha del mismo proceso inflacionario, ha logrado finalmente eliminar en términos reales el exceso inicial de liquidez, hasta el punto de que la situación parece haberse transformado en una de moderado exceso de demanda. Este cambio es, por supuesto, un prerrequisito para poder avanzar hacia la meta de una moderación de la inflación. Sin embargo, una contracción adicional de la liquidez real podría tener efectos indeseables sobre la economía, por lo que se considera viable y conveniente avanzar a partir de este punto en forma más gradual hacia la meta de crecimiento monetario promedio y permitir, via la reducción del encaje, cierta irrigación general de liquidez en la economía. " (p. 16)

"From the several causes of inflation exposed in the domestic literature (e.g. devaluation, real GDP growth, widespread presence of monopolies, wage settlement, unequal income distribution, speculation, high interest rates, etc..), both the economic theory and the available evidence suggest that [...] no other factor explains better the increase in absolute prices than the increase in nominal liquidity ." (p. 5). Their own estimations show that although the effect of monetary policy on inflation is in fact small in the very short run, the accumulated impact of monetary growth is decisive when a whole year or even longer periods are taken into consideration. This finding points out that a temporary lack of care in monetary policy can become very expensive in a longer time span. it would be necessary to bear a certain political cost to make the inflation rate return to a "more normal level " (p. 9).

Since in the short run the inflation depends basically on the behavior of the relative food prices and the recent expansion of monetary liquidity, it cannot be expected that it will drop before two or three months; a clear monetary action added to the seasonal pattern of food production should lead yearly inflation to 24%-25% at the end of the year. The advisors warn that the advice of few weeks ago suggesting that the period of contraction should be ended did not mean that a expansionary turn should be undertaken. The ideas was that there was "... a certain margen of expansion. " (p. 15) Therefore a less expansive policy should be carried out in order to reach the target of inflation (lees than 24%). A relaxation of the monetary control would yield an inflation above 30%. Since the only policy that would render a reduction in prices is one targeted towards food prices, a major issue should be imports of food and the accumulation of inventories. This should be accompanied with a long run reduction of monetary growth.

Jun. 24th (AD 81/88) The current level of inflation of 28.4% is intolerable. An important cause are delayed crops but a clear signal of control should be sent[10]. On top of it is necessary to contemplate other policies like food imports, a reduction of tariffs on some important goods of the CPI whose international prices are increasing (wheat and oleaginous products), and the coordination of the anarchic movement of controlled prices.

They propose a monetary growth compatible with expected GDP growth of 4.5% and target inflation of 24%, which can be reached with a passive activity in the OMO front and a normal provision of funds to the financial funds of the CB.

Jul. 27th (AD 92/88) The results in most of the macroeconomic fronts are satisfactory: the unemployment rate has came down from 12.1% in June 1987 to

[10] [...] that " ... the public know that the monetary question is under control is one of the prerequisites of the anti-inflationary struggle. " (p. 4)

11.7% in June 1988; the non-traditional exports have risen 38% surpassing all expectations. However, the inflation rate at the end of June was 30.3% the highest of the decade. Devaluation has been kept at 28.8% for guaranteeing competitiveness and there has been a noticeable increase in government expenditure during the first semester of 1988.

The sensible increase of liquidity occurred at the beginning of the year was controlled through OMO, a rise in ORR on government deposits and coordination with the Treasury; M1 growth fell from 32.9% in 1987 to 28.1% at the end of June. The pace of the contractionary monetary policy was slowed to moderate the increasing tendency of the interest rates (their level in June was six points above that one year before, although the real interest rates fell), fueled by the increasing inflation, the agent's preference for cash, and a deceleration of financial deposits.

Sep. 14th (AD 114/88) During the last months the following measures have been undertaken: it was established a ceiling to interest rates; expansionary REPOS, OMO[11], and loans to the CPPU system have provided liquidity in order to guarantee the desired annual growth of M1 of 25.2%. in this way the contrac-

[11] The major event on the monetary front in=s the fall in outstanding OMOs; currently these operations are practically suspended. Appart from the monetary reasons for this, there are limitations in the market arising from the ceiling to interest rates. (p. 2).

tion of the last 8 months would be fully compensated. Unless some additional measures are undertaken it is probable that during September and October the rate of growth of the money supply remain below the goals set by the Board. The advisors propose an expansionary policy during th next two months (Oct. - Nov.) and a contractionary one for the last two months of the year. For these operations they propose the issue of a special PB replaceable for some points of ORR on current accounts, aimed at providing liquidity to the banks during the following months.

Oct. 12th (AD 128/88) The ORR were reduced 2 points permanently and 4 transitorily. "The observed events regarding the reductions of ORR, REPOS and OMO show that it has not been the goal of the authorities to produce a monetary contraction and on the contrary measures have been firmly taken to fulfill the monetary goals. [...]. We do not remember another period of recent monetary history when a monetary expansion would have been so decidedly sought. " (p.14). The advisors explain how the slow growth of the money supply occurred in spite of many expansionary efforts; the most worrisome element for the performance of the financial system and the level reached by the interest rates and was the slow growth of savings, reflected in almost all types of deposits available. In the final analysis this was responsible for the lack of loanable funds, no matter how strongly the monetary policy aimed to compensate the lack of savings in the economy.

Oct. 24th (AD 134/88)The whole year was marked by the high preference for cash on the part of the public. this fact reduced the multiplier and the Means of Payment. Other elements also affected the MB, and the monetary policy was designed to compensate them in order to reach the monetary targets stated by the Board. However the weak demand for current accounts, reinforced by the high level of the interest rates partially offset these efforts. These facts explain why the monetary forecasts of the advisors proved too high during the last quarter. Currently there is a lack of financial savings agravated by the administrative control on the interest rate. This lack of financial savings, which is not due to the monetary policy, is the cause of the strong lack of liquidity and the reduction in the outstanding loans of the financial system. the advisors propose a reduction of the ORR in two points which can lead to new loans and an immediate expansionary effect.