

MONETARY POLICY IN COLOMBIA: MAIN CHALLENGES 2016 - 2017*

**Bank of America
Merrill Lynch**

Small Talks Symposium

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***Personal Opinions**

The independence of the Central Bank of Colombia

- The CB was granted independence from the Government in 1991. The Board is made up of five full-time members, plus the Minister of Finance and the Governor.
- Following our Constitutional mandate, “the primary goal of monetary policy is price stability, in coordination with the objectives of general economic policy.”
- Since 1999, the CB has used a flexible Inflation Targeting strategy and an exchange rate floating regimen to handle monetary policy. The policy objectives of this strategy are:
 - (i) maintaining a low and stable inflation (3.0% +/- 1.0%);
 - (ii) smoothing output fluctuations around a sustainable growth path; and
 - (iii) contributing to financial stability.

Recent economic performance as a driver of monetary policy.

- Between 2005 and 2014, the Colombian economy performed relatively well compared to the region.
- Average GDP growth during that decade was 4.7%, close to its potential.
- The strength of the Colombian economy contrasted with slow growth in other economies of the region and the rest of the emerging world.



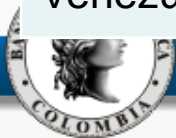
2016 - 2017: dilemma triggered by the fall of oil prices, its adverse impact on terms of trade and domestic income, and, as a result, the shrinking of potential GDP

- The CB now faces a dilemma: while the economy is decelerating (2%) and below potential GDP growth (which now could be near just 3%), inflation (7.3%) has remained above the upper limit of the target range (3% +/- 1%) during the last twenty months.
- The problem is no longer originated in food inflation. Even excluding food, inflation surpasses the target range upper limit. 'Core' inflation has also been persistently above the upper limit of the target range.



GDP and inflation performance (in annual %) of Colombia and partners in LatAm. In GDP growth, Peru ahead. Whereas in inflation and expectations, Brazil and Colombia lagging (excluding Venezuela, obviously).

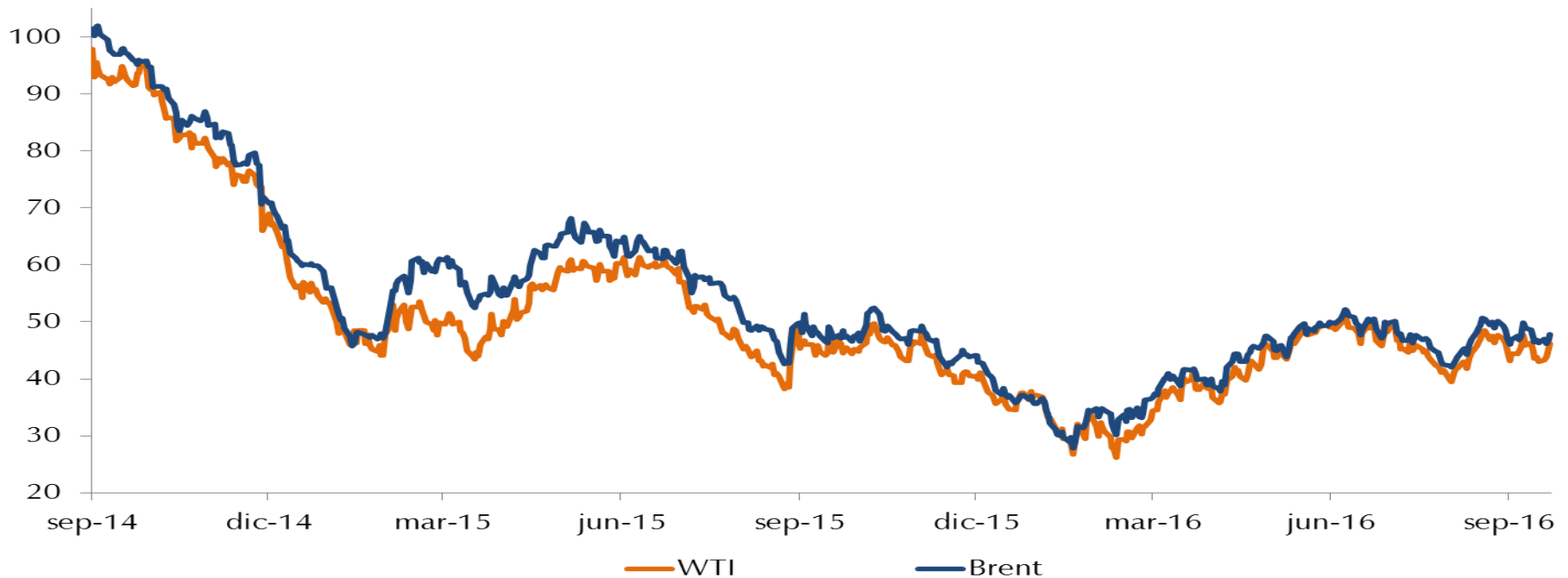
Country	GDP growth 2015	GDP growth 2016 (p)	GDP growth PIB 2017 (p)	Actual inflation Sep 30 th	Expect. for 2016 Bloomberg Sep 30 th
Brazil	- 3.8	- 3.1	0.7	9.0	8.8
Colombia	3.1	2.0*	3.0*	7.3	6.0*
Chile	2.1	1.6	2.5	3.4	4.0
Ecuador	- 0.5	- 2.8	- 1.0	1.4	2.9 (CB)
Mexico	2.5	2.2	2.7	2.7	2.8
Peru	3.3	3.8	4.2	3.1	3.5
Venezuela	- 10.0	- 7.0	- 4.0	181 (Gob)	720 (FMI)



The end of the ‘bonanza’. The collapse of oil prices seriously hurt the national government’s finances. In 2013, 20% of total government revenues came from the oil industry, equivalent to 3.3% of GDP. In 2016, that source disappeared. By the end of this year the fiscal deficit could reach 3.9% of GDP.

(dólares/barril)

Precio internacional del petróleo



Even reducing public expenses and investment substantially, it would not be possible to meet the Fiscal Rule under an scenario of no structural fiscal reform. By 2020, the deficit would reach 5.5% of GDP, versus a legal maximum limit of 1.4%. Avoidance of ‘fiscal dominance’ of monetary policy must be a top macroeconomic priority.

Balance fiscal del GNC

	2014	2015	2016	2017	2018	2019	2020
Ingresos totales	16.7	16.1	14.9	14.2	14.0	13.3	13.2
Renta petrolera	2.6	1.2	0.1	0.0	0.1	0.2	0.3
Tributarios no petroleros	13.1	13.8	13.9	13.6	13.3	12.4	12.3
Otros ingresos*	0.9	1.2	0.8	0.6	0.6	0.7	0.6
Gastos totales	19.1	19.1	18.9	19.2	18.9	18.6	18.7
Inversión	3.0	2.7	1.9	1.8	1.8	1.9	1.9
Intereses	2.2	2.6	3.0	3.1	3.3	3.4	3.6
Funcionamiento	13.9	13.8	14.0	14.3	13.8	13.3	13.3
Déficit total	2.4	3.0	4.0	5.0	4.9	5.3	5.5
Deficit estructural Regla Fiscal	2.3	2.2	2.1	2.0	1.9	1.6	1.4



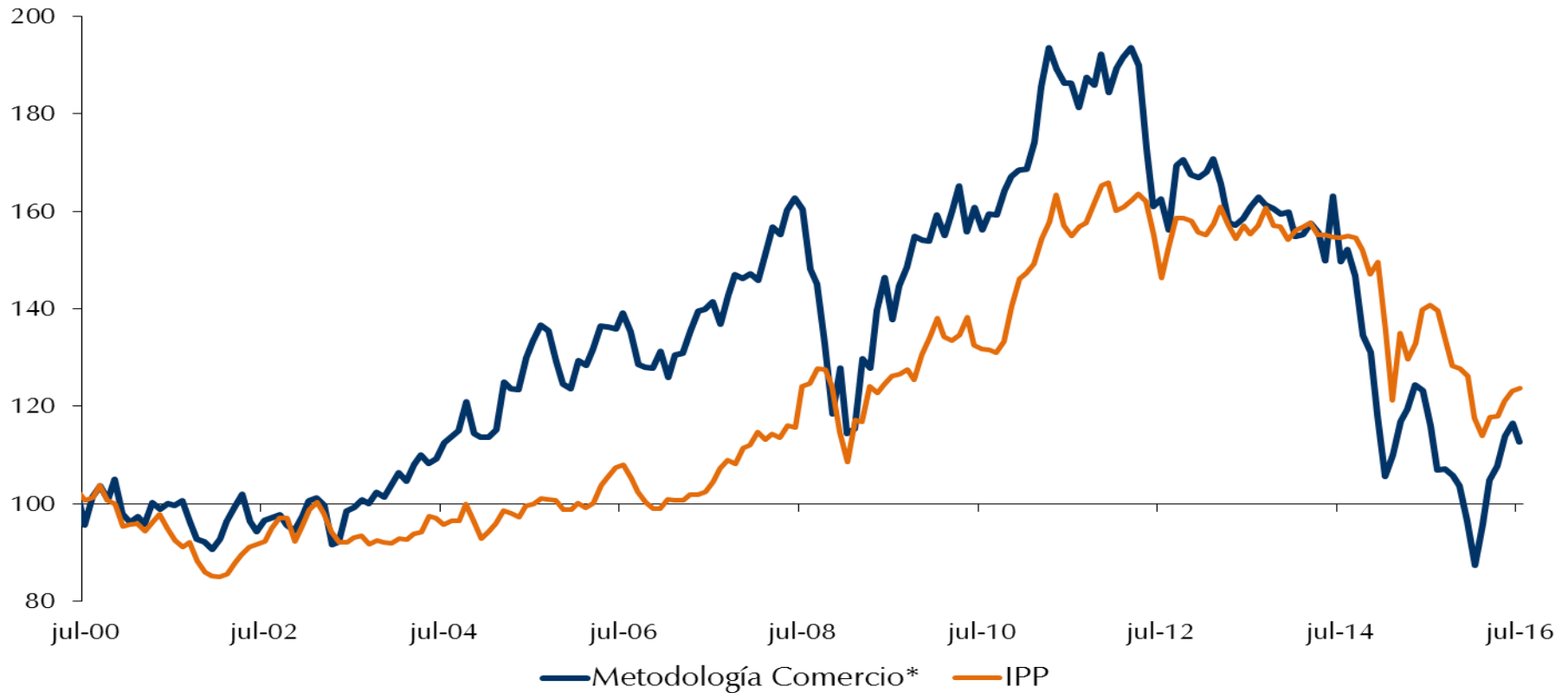
Nota: Cifras a diciembre de 2015.

Fuente: Ministerio de Hacienda y Crédito Público. proyecciones Fedesarrollo.

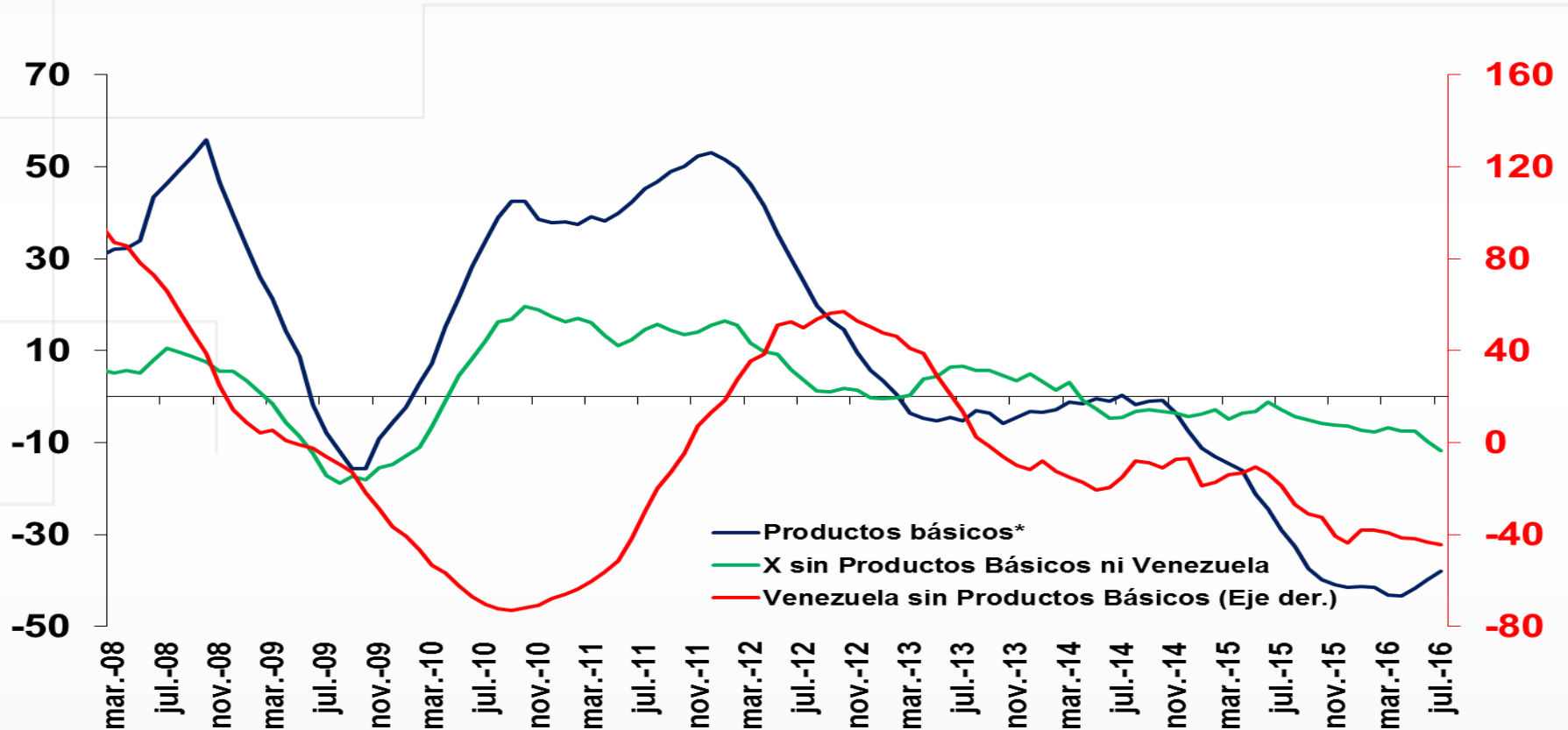
Negative shock to the terms of trade. Deep imbalances that require adjusting the total expenditure of the economy. The fall (9.0% in 2014 and 24.0% in 2015) contracted domestic income. But recently, due to the recovery of oil prices, the terms of trade have improved.

Términos de Intercambio

(Índice 2000=100)



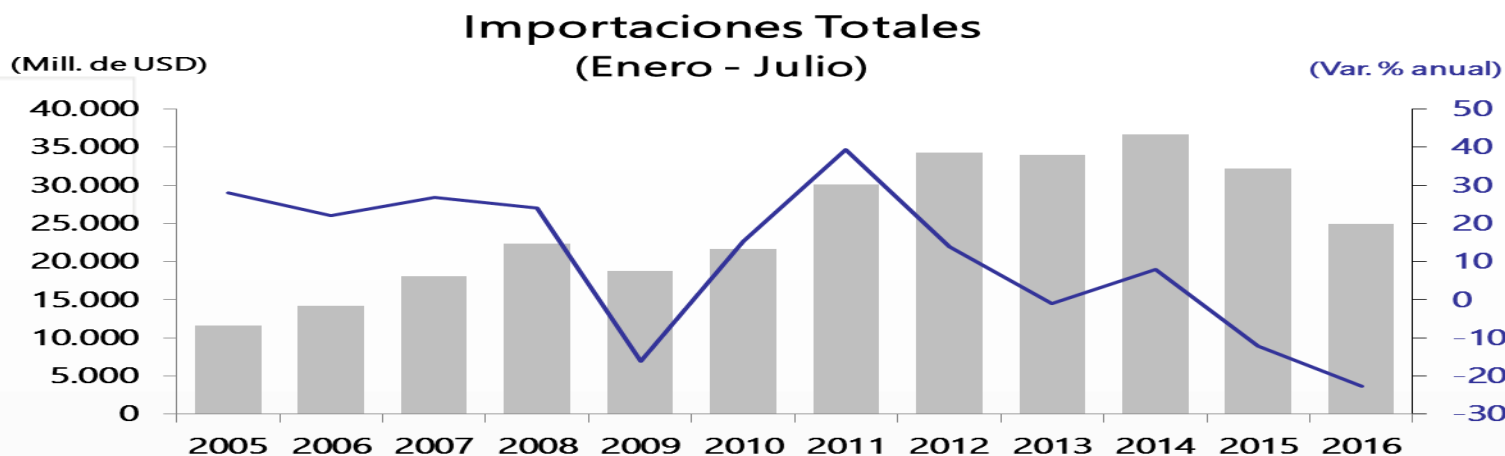
Exports (USD) Growth (12-month aggregate %). All categories in negative terrain. January-August dropped 22.2% vs. same period 2105.



* Considera Petróleo y derivados, Carbón, ferróniquel, oro, café, banano y flores



Imports (USD) Growth (12-month aggregate %): also falling (-22.7%), a bit more than exports. As a result, the Current Account deficit (% of GDP) reached 4.8% the first semester 2016. Lower than a year ago (6.3%). But still one of the highest among economies of similar size, or bigger.



	US\$ Millones	Var. % anual
Jan-Jul 2016	24.902	-22,7%
Jan-Jul 2015	32.303	-12,1%



Source: DANE.

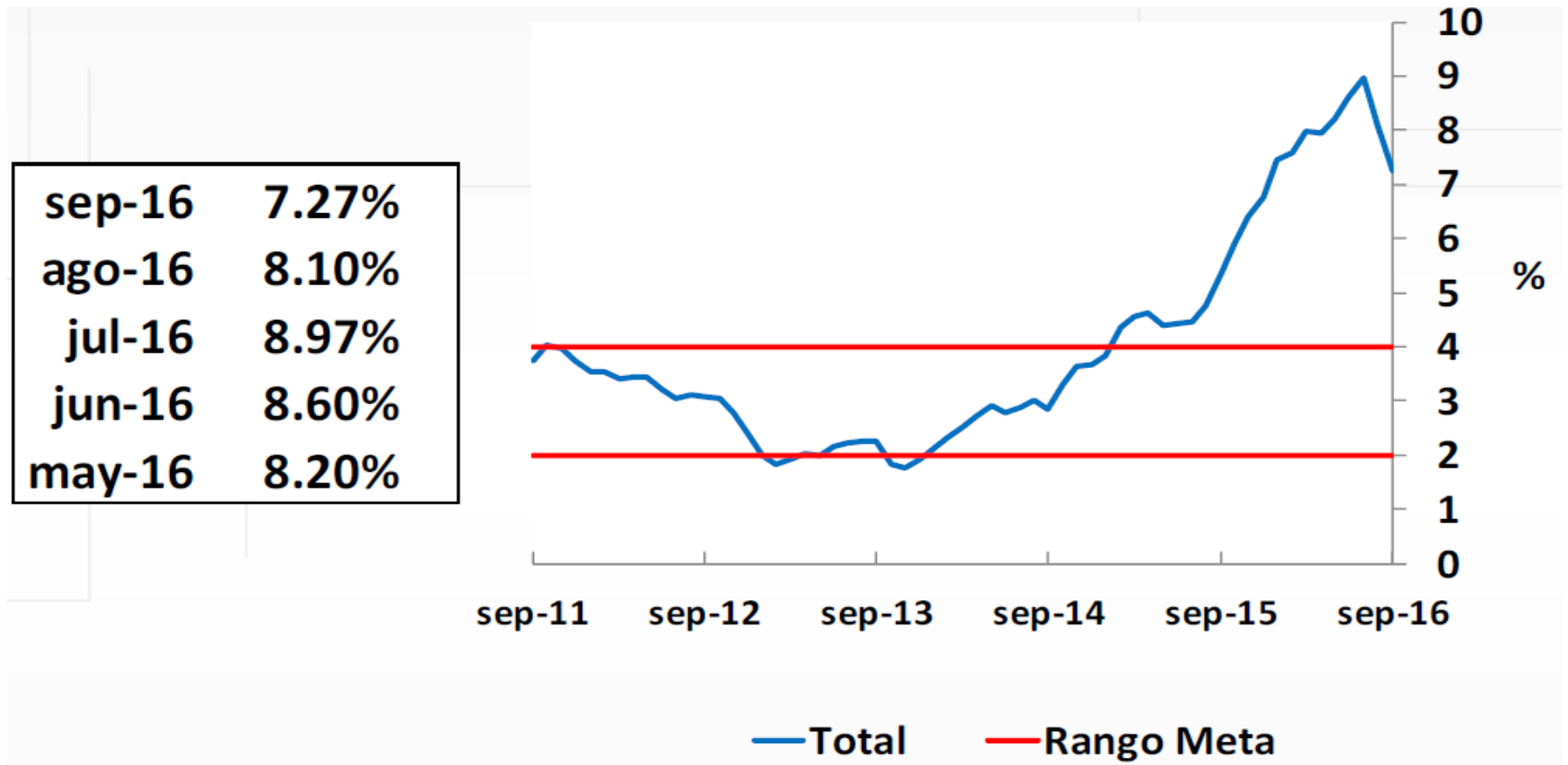
Currencies appreciation (yellow)

Currencies Depreciation (green)

LATAM								
	day	week	month	current year	6 months	1 year	2 years	3 years
Colombia Average Exchange Rate at 13:00:00	1,15%	1,21%	-4,79%	-7,88%	-9,44%	-4,93%	52,26%	51,28%
Colombia Last Rate at 13:00:00	-0,78%	0,45%	1,59%	-8,45%	-5,94%	0,23%	41,95%	53,62%
Brasil	0,04%	-1,14%	0,82%	-18,64%	-10,25%	-16,36%	34,46%	46,26%
México	0,15%	-1,43%	4,70%	11,83%	8,25%	15,54%	42,80%	48,40%
Argentina	0,20%	-0,96%	1,11%	17,68%	5,11%	61,09%	79,97%	159,30%
Peru	0,19%	0,38%	1,36%	-0,16%	1,18%	5,74%	17,27%	23,43%
Uruguay	-0,01%	-0,66%	-2,87%	-5,19%	-9,49%	-2,73%	16,77%	31,46%
Chile	0,27%	1,38%	0,80%	-5,89%	-2,37%	-2,04%	11,93%	32,42%



Annual inflation to September: 7.3%. It has remained above the upper limit of the target range (3% +/- 1%) during the last twenty months. But now it is rapidly descending. Good news.



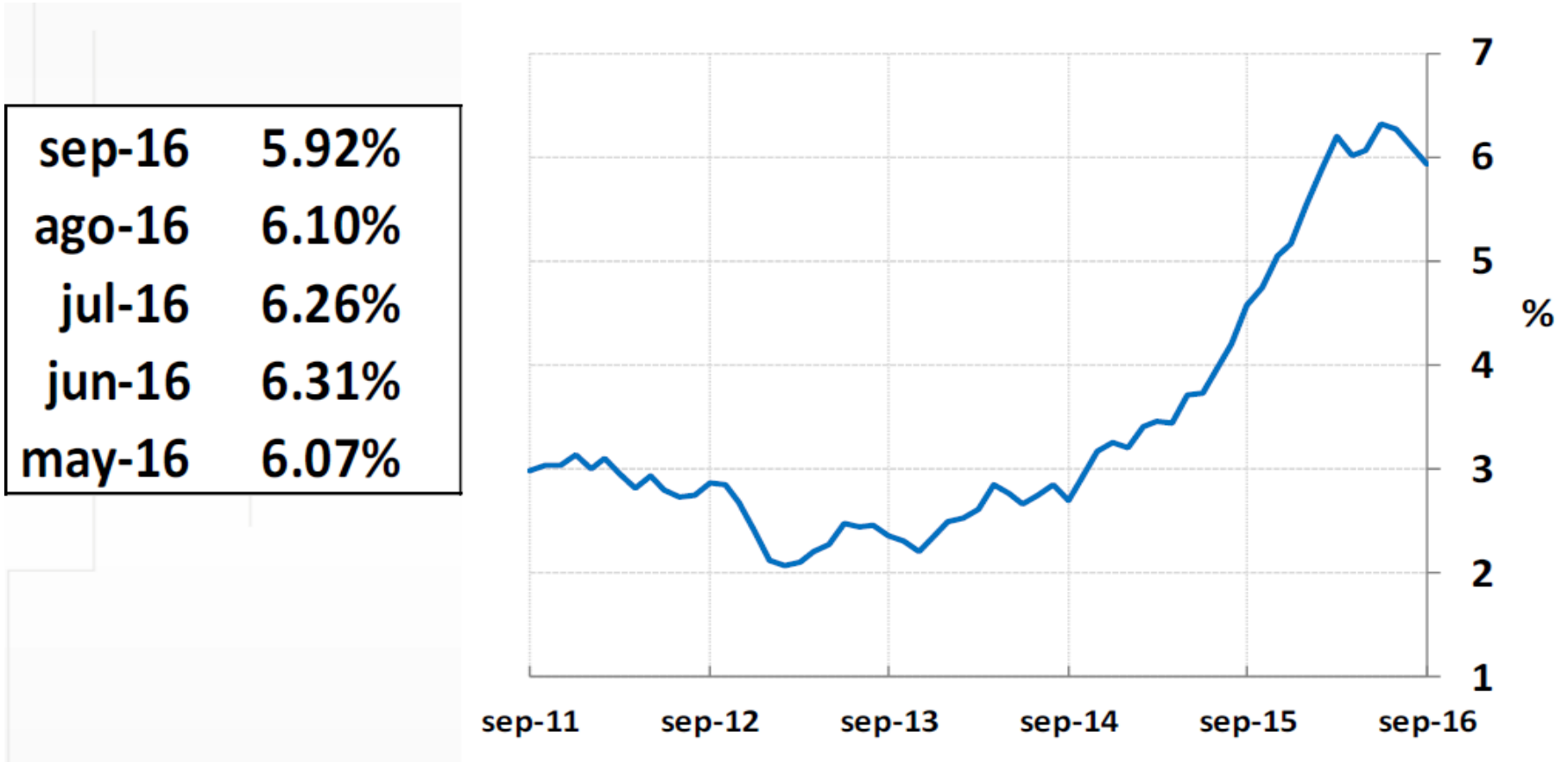
Food inflation (10.6%) -pushed by climate conditions such as *El Niño*- has been dominating total inflation. But, as expected, it is now receding. As it represents a typical supply shock, in principle, monetary policy should not react, unless expectations become affected.

Food inflation



But even excluding food, inflation remains close to 6.0%.

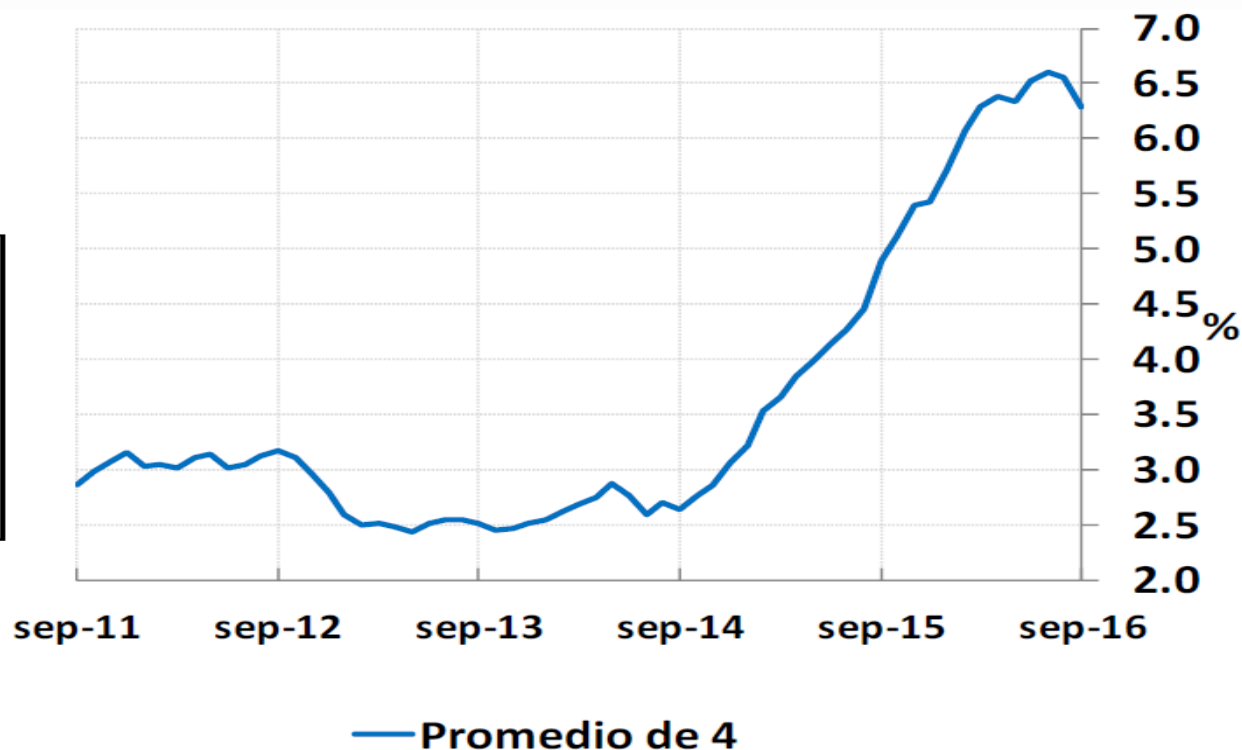
Yearly Inflation excluding Food



Whereas core inflation in September remained above 6%.

Core Inflation Indicators

sep-16	6.29%
ago-16	6.56%
jul-16	6.61%
jun-16	6.52%
may-16	6.33%



All relevant inflation indicators still notably high.

(Data in % annual terms at the end of September of each year)

Type of inflation	2014	2015	2016
CPI	2.9	5.3	7.3
Excluding food	2.7	4.6	5.9
Excluding food and utilities	2.6	4.9	5.8
Non tradables	3.9	4.7	7.2
Non tradables excluding food and utilities	3.3	4.3	4.8
Core	2.6	4.9	6.3

How should the monetary authority respond?

- It depends on inflation expectations, the key measure of the credibility in the monetary policy.
- “Not only do expectations about policy matter, but, at least under current conditions, very little else matters.”
(Michael Woodford)
- The main challenge for the Colombian monetary authority consists in ensuring that expectations become well anchored to the target for December 2017.



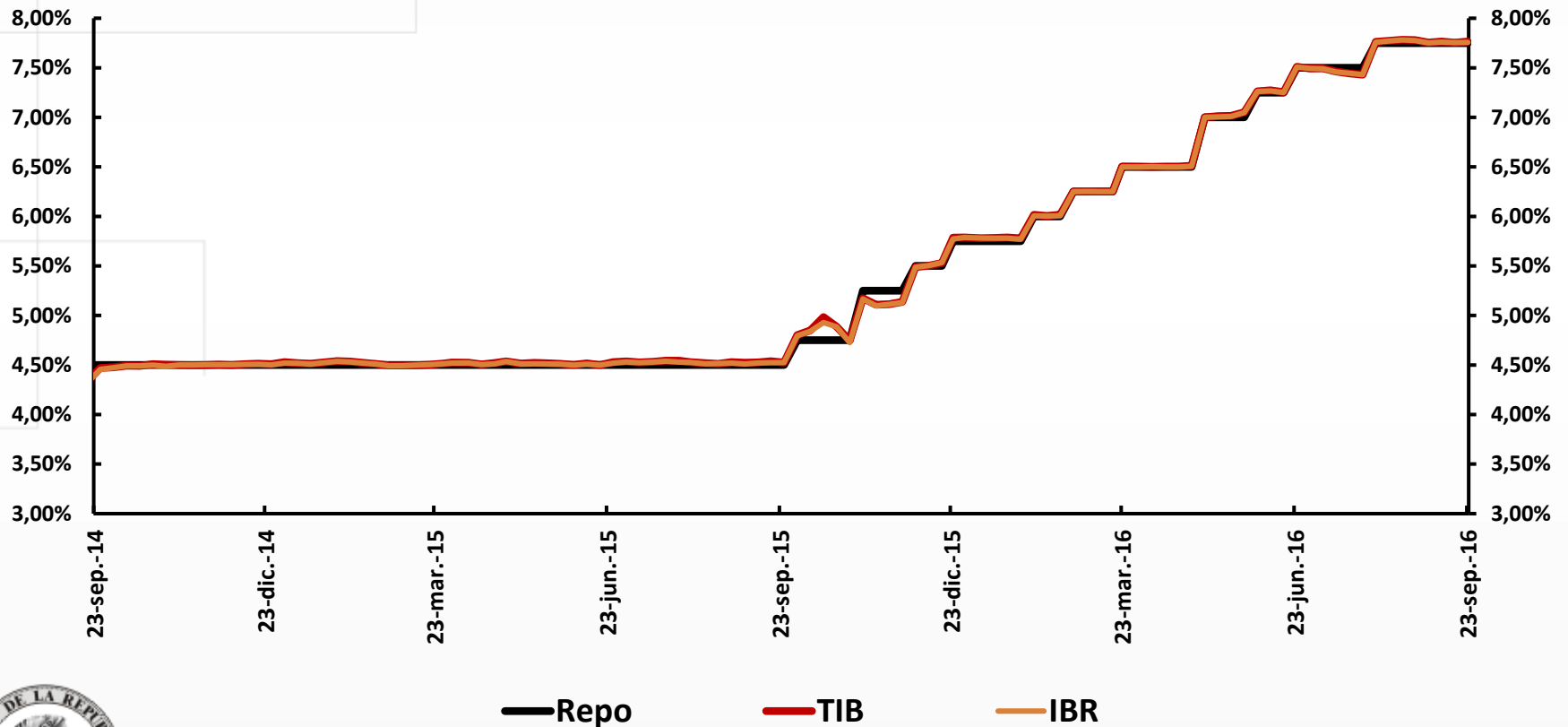
Policy Response

The Board of Directors raised the policy interest rate 325 basic points from September last year until July 2016: from 4.5% to 7.75%. Since then the rate has remained unchanged.



Monetary policy path since September 2014

Tasa de Política , TIB e IBR
Semanales



Thank you.

