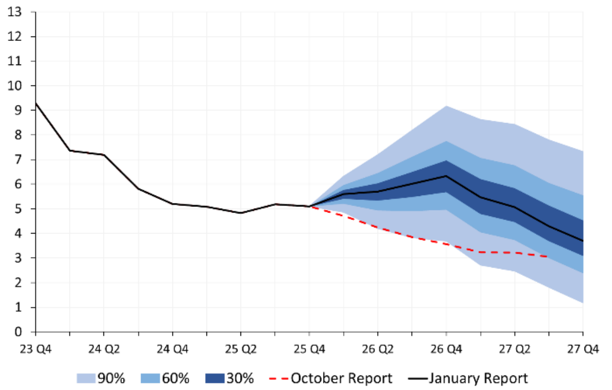
1. Summary

1.1 Macroeconomic Summary

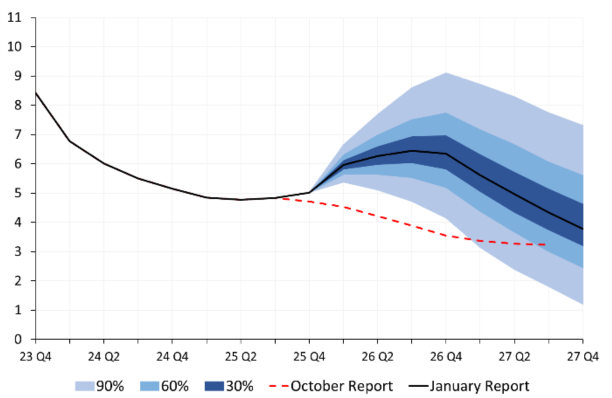
In the fourth quarter of 2025, headline inflation eased slightly to 5.1%, in line with the October forecast. However, and against expectations, core inflation—which excludes food and regulated items—rose to 5.0%. Consequently, the revised forecast, which incorporates the price effects of the substantial minimum wage increase, suggests that inflation will rise in 2026 and then converge more slowly toward the 3% target. Compared to October projections, prices in the food group and, to a lesser extent, regulated prices surprised on the downside in December, a behavior explained by a high supply of perishable foods, a stronger-than-expected appreciation of the peso and its pass-through to processed food prices, and unanticipated reductions in public gas and electricity services. Many of the above downward surprises were offset by an increase in core inflation that exceeded expectations, amid strong domestic demand likely to exceed the economy's productive capacity, labor costs that could exert greater upward pressure on prices, and greater indexation of rents to past inflation. Incorporating these surprises into the forecasts, along with the sharp 23.2% increase in the minimum wage, the projected price effects of the economic emergency, and larger-than-expected increases in gas prices relative to October, both headline and core inflation projections for 2026 were revised upward, implying a slower convergence to the 3% target. The forecast horizon assumes a more negative real exchange rate gap, greater downward pressure on prices of imports, no significant supply shocks in food production, and a reactive monetary policy aimed at bringing inflation back to the 3% target. Accordingly, headline and core inflation are now expected to reach 6.3% by December 2026, up from the previous projections of 3.6% and 3.5%, respectively, and to decline to 3.7% and 3.8% by year-end 2027 (previously projected at 3%) (Graphs 1.1 and 1.2). These forecasts remain subject to considerable uncertainty and could deviate from current estimates, mainly due to the effects of the unusually large minimum wage increase, the future path of the exchange rate, supply shocks affecting international and domestic food prices, and provisions related to adjustments in regulated goods and services prices.

Graph 1.1
Consumer Price Index a/b/
(annual change; end-of-period)
(percentage)



a/ This graph presents the forecast probability distribution on an eight-quarter time horizon. Density characterizes the prospective balance of risks with areas of 30%, 60%, and 90% probability surrounding the central forecast (mode), through a combination of densities from the Patacon and the 4GM-LM monetary policy models.
b/ The probability distribution corresponds to the forecast exercise from the October report.
Source: DANE – calculations and projections by Banco de la República

Graph 1.2
CPI excluding food and regulated items a/b/
(annual change; end-of-period)
(percentage)



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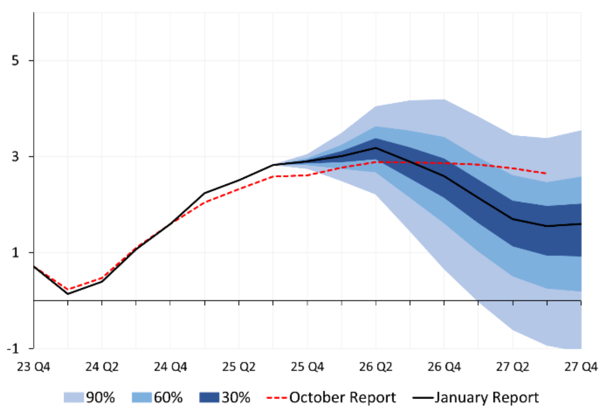
b/ The probability distribution corresponds to the forecast exercise from the October report.
Source: DANE – calculations and projections by Banco de la República

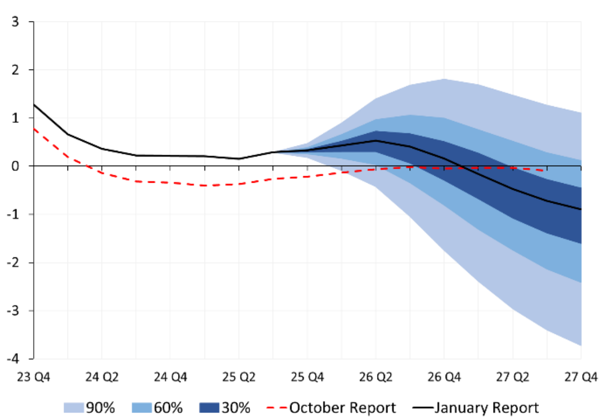
DANE revised the cumulative output level for 2025 year-to-date upwards, reporting higher economic growth for the third quarter (3.4%) than previously estimated (3.0%), as domestic demand (5.0%) recorded five consecutive quarters of significant increases, exceeding domestic output. The latter, coupled with the inflation and labor market results, suggests a positive output gap that could persist throughout 2026. In the third quarter, domestic demand surpassed expectations, driven mainly by private (4.0%) and public consumption (15.2%). Gross fixed capital formation also displayed high annual growth (4.7%), especially in machinery and equipment, although it remains below pre-COVID-19 pandemic levels. In contrast,

Graph 1.3
Gross Domestic Product, four quarter accumulation [a/b/c/]
(annual change)
(percentage)



a/ Seasonally adjusted and corrected for calendar effects.
b/ This graph presents the forecast probability distribution on an eight-quarter time horizon. Density characterizes the prospective balance of risks with areas of 30%, 60%, and 90% probability surrounding the central forecast (mode), through a combination of densities from the Patacon and the 4GM-LM monetary policy models.
c/ The probability distribution corresponds to the forecast exercise from the October report.
Source: Banco de la República

Graph 1.4
Output gap [a/b/c/] - Predictive Densities
(four-quarter accumulation)
(percentage)



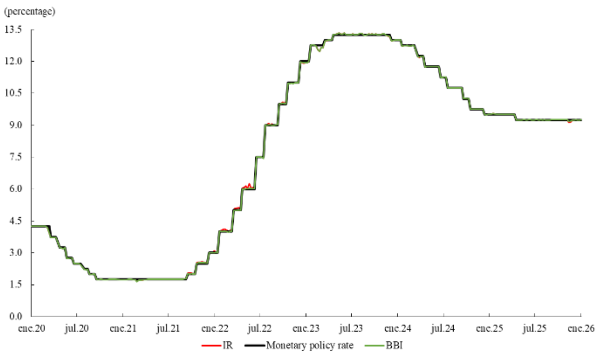
a/ The historical output gap estimate is calculated as the difference between observed GDP (four-quarter accumulation) and potential GDP (trend; four-quarter accumulation) based on the 4GM-LM model.
b/ This graph presents the forecast probability distribution on an eight-quarter time horizon. Density characterizes the prospective balance of risks with areas of 30%, 60%, and 90% probability surrounding the central forecast (mode), through a combination of densities from the Patacon and the 4GM-LM monetary policy models.
c/ The probability distribution corresponds to the forecast exercise from the October report.
Source: Banco de la República

net external demand was a negative contributor to GDP growth, as the year-on-year increase in imports (10.1%) exceeded that of exports (2.4%), a trend that also reflects the strength of domestic demand. The data available for the fourth quarter suggest an annual GDP growth of 3%, as domestic demand continues strong (4.8%), explained by the vitality of both private and public consumption (4.3% and 5.8% respectively), along with the recovery of gross fixed capital formation (3.2%) from its lower post-pandemic levels. The trade deficit is expected to widen further, as imports continue to grow annually (9.2%) while exports remain stagnant (0%), mainly due to the ongoing decline in foreign sales of coal and oil. In 2026, multiple factors would continue to encourage consumption, including the high and persistent primary fiscal deficit, the high flow of remittances, the vitality of foreign tourism, the still-high coffee prices, and - in the short term- the increase in real wages. Upward surprises in output levels and core inflation, strong absorption dynamics, positive labor market indicators, a growing trade deficit, and economic growth forecasts suggest that demand will exceed the economy's productive capacity, thus foreseeing a positive output gap throughout 2026. Against this backdrop, the economic growth estimate increased to 2.9% for 2025 and decreased to 2.6% for 2026 (previously 2.6% and 2.8%, respectively). By 2027, economic activity would continue to slow, as the output gap turns negative (Graph 1.3). These circumstances would occur in a context of active monetary policy that adapts in step with the convergence of inflation toward the 3% target in 2027, and the decrease in excess demand (Graph 1.4). However, these forecasts are subject to a high level of uncertainty, owing to external factors - including global political and trade tensions, along with the response of financial markets to monetary policy in advanced economies - and internal factors, particularly uncertainty surrounding fiscal policy.

Relative to the October *Report*, the country's external financing conditions have eased, reflecting the lowering of U.S. policy interest rates, stronger demand for risk assets, and diminished global trade tensions, although global uncertainty surrounding geopolitical conflicts remains high. Colombia's external demand has exceeded growth expectations and is expected to continue expanding at a somewhat slower pace during the forecast horizon. Terms of trade have improved as a result of falling prices for intermediate and capital goods imports, along with continued high prices for commodities such as coffee and gold, which have more than offset the decline in mining and energy prices. Meanwhile, as anticipated, in December the U.S. Federal Reserve (Fed) reduced its benchmark rate by 25 basis points (bp) to a range of 3.50% to 3.75%, reflecting signs of moderating economic activity, reduced hiring, and limited available data due to delays in government statistical releases. Following this decision, December inflation edged down slightly relative to previous months. Consequently, this *Report* forecasts a slightly lower monetary policy rate for 2026, with two 25-bp decreases expected to bring the benchmark rate to between 3.0% and 3.25% by year-end, maintaining this range throughout 2027. This situation has reinforced the buoyancy of global stock markets and the decline of risk premiums in emerging economies. Nevertheless, Colombia's fiscal deterioration has increased its country risk premium in recent months, a trend expected to continue during the forecast horizon. It is important to underscore that external uncertainty remains elevated, as trade tensions, U.S. immigration policies, geopolitical conflicts, fluctuations in global financial conditions, and perceptions of Colombia's sovereign risk persist.

A strong domestic demand that surpasses the economy's productive capacity, as well as headline and core inflation that are expected to rise and continue exceeding the 3% target, coupled with a significant increase in inflation expectations that has reduced the *ex ante* real interest rate of monetary policy, indicate that monetary policy should be adjusted to levels compatible with a decrease in inflation and its convergence to the 3% target. Economic activity indicators for the fourth quarter suggest that GDP has completed two full years of quarterly increases, with annual domestic demand far outpacing GDP growth. This has been reflected in a broadening external deficit as a percentage of GDP, after the adjustment noted in the previous two years. In the labor market, the unemployment rate continues at historically low levels, with employment trending upward. Core inflation has surprised on the upside and, like headline inflation, remains well above target. These developments in the country´s economic activity, labor market, and prices indicate a positive output gap. Fiscal deterioration increases the country's vulnerability to adverse external financing shocks. The sharp increase in the minimum wage led to significant upward revisions in the inflation forecasts of the Bank's technical staff and in economic agents' inflation expectations, reducing the real policy interest rate. In addition, there are significant inflationary risks stemming from changing external financial conditions, local fiscal deterioration, and pressures on natural gas prices. The prospect of higher inflation in 2026, the presence of aggregate demand that exceeds the economy's productive capacity, and significant upside risks to inflation, require an adjustment in the monetary policy stance to resume convergence of inflation toward the target over the forecast horizon, consistent with the commitment of *Banco de la Republica* to the constitutional mandate to maintain a low and stable inflation and achieve the maximum sustainable level of output and employment.

Graph 1.5
Monetary policy interest rate, interbank rate and BBI/
(weekly data)



Sources: Superintendencia Financiera de Colombia and Banco de la República.
1/ IR: interbank rate. BBI: benchmark banking indicator.

1.2 Monetary Policy Decision

At its December 2025 meeting, the Board of Directors of the *Banco de la República* (BDBR) decided by majority vote to maintain the monetary policy interest rate unchanged and to increase it by 100 basis points (bps) at its meeting in January of this year, bringing it to 10.25% (Graph 1.5).