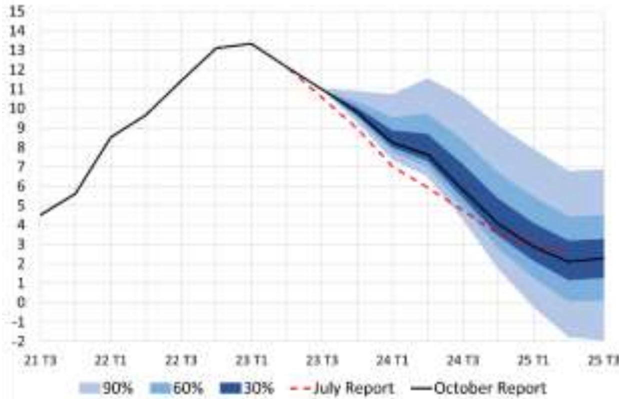
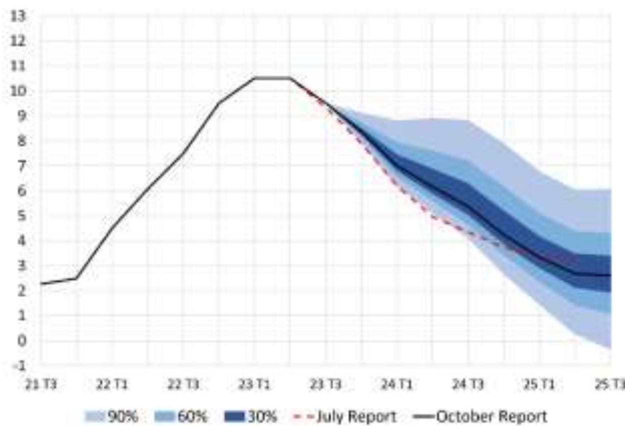
1. Summary

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 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.

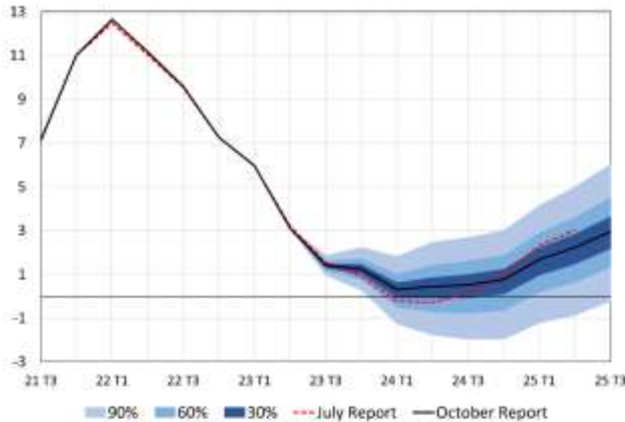
1.1 Macroeconomic Summary

In September, both headline (11.0%) and core (9.5%) inflation continued to decline, although by less than anticipated, remaining well above the target. Going forward, the cumulative impact of monetary policy actions and the unwinding of various shocks that affected prices will continue to help inflation converge towards the 3 percent target over the forecast horizon. In the third quarter, annual price variances in the food and goods sub-baskets lessened and took on a downward trajectory, while the prices of services and regulated items remained relatively stable; all sub-baskets showed annual changes well above the inflation target of 3 percent. This slower inflation decline was explained by the behavior of food prices, primarily the pricing rebound in perishables. Moreover, price indexation mechanisms have transferred transitory increases in specific sub-baskets (e.g., food) to other consumer price index (CPI) items, thus enhancing inflation's persistence. This fact has proved significant for the price behavior of certain services indexed to headline inflation (e.g., rents and utilities) or to the minimum wage (e.g., higher education and building management fees), which continue to show an upward trend. For 2024, the forecast for all CPI sub-baskets increased compared to the July Report. This increase is partly explained by the assimilation of the El Niño phenomenon effects, which assumes a moderate upward pressure on food and energy prices for the first half of 2024. This is compounded by a slower-than-expected reduction of excess demand and an indexation of prices and wages to higher inflation by yearend 2024. Food costs and international prices of some foods would continue to ease, thus lessening some of their earlier upward inflationary pressures. Overall, the forecast for headline inflation stands at 9.8% (previously 9.0%) for yearend 2023. By the end of 2024, assuming a solid contractionary monetary policy stance over the forecast horizon, this Report places the probability of inflation falling below 4.0%, which is the central scenario, at 28% (Graph 1.1). However, inflation would continue to fall during the first half of 2025 and stand slightly below the 3% target by the third quarter of that year, with a 74% probability of reaching values below 4%. Relative to the previous Report, the core inflation estimate increased from 7.9% to 8.4% and from 3.7% to 4.2% for yearend 2023 and yearned 2024, respectively (Graph 1.2). As with the behavior of headline inflation,

core inflation would fall slightly below the 3% target by the first half of 2025. These projections are subject to high uncertainty and involve significant upside risks. The latter includes the possibility of a more substantial impact from the El Niño phenomenon on food and energy prices than foreseen in this Report; increases in the real minimum wage in 2024 that surpass the increase in the economy's productivity levels, accentuating indexation mechanisms and generating stickier inflation thus limiting its expected decline; and oil prices that, should their current high levels persist, could place additional pressures on the Fuel Price Stabilization Fund (*Fondo de Estabilización de los Precios de los Combustibles*, FEPC) and require more significant adjustments to the internal prices of this basket.

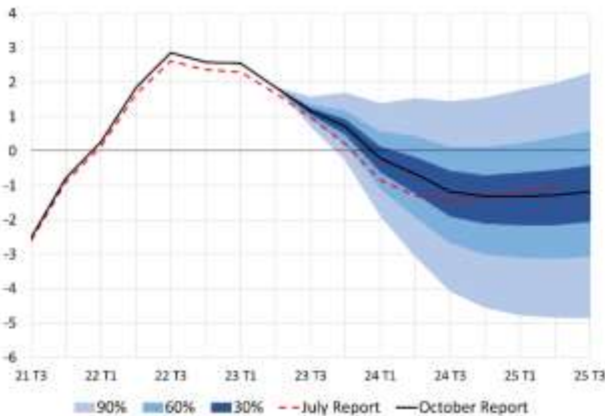
Economic activity continues to display low growth rates, although somewhat higher than anticipated in the July Report. The adjustment in domestic demand is expected to continue and regulate towards a more compatible level with the economy's productive capacity. The seasonally adjusted and corrected for calendar effects gross domestic product (GDP) grew by 0.3% annually in the second quarter. Domestic demand fell from the high levels recorded the previous year owing to the decline in investment and a fall in the consumption of durable and semi-durable goods. The dynamics of services consumption continued to moderate, although still displaying high levels, while public consumption recovered significantly. The significant drop in imports echoed the performance of domestic demand that, together with the growth of exports, explains a decline in the real external deficit. The available economic indicators suggest an annual GDP growth of 0.4% for the third quarter, with a slight recovery between quarters. In yearly terms, investment would continue on a downward path. At the same time, total consumption would remain at high levels similar to those observed a year ago, with a reconfiguration towards greater consumption spending on services instead of goods. The lower pace of domestic demand would be reflected in a further drop in imports that, combined with a stable level of exports, would result in a further decrease in the external deficit. Weak external demand is expected during the remainder of 2023 amid a backdrop of tight global financial conditions and lower terms of trade than those observed in 2022. Domestic demand would continue to adjust toward more sustainable values in a context of low consumer and business confidence levels, high household indebtedness, a reduced credit supply, and a

Graph 1.3
Gross Domestic Product, four quarter accumulation [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 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 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 monetary policy models.
c/ The probability distribution corresponds to the forecast exercise from the *October report.*
Source: Banco de la República

contractionary monetary policy stance aimed at bringing inflation closer to its target. Consequently, annual GDP growth would continue at 1.2% for 2023, a figure above that of the July Report (0.9%), yet similar to that forecast by the technical staff since mid-2022 (Graph 1.3). By 2024, growth would reach 0.8% (formerly 1.0%), with investment recovering from the record lows estimated for 2023 and consumption continuing at similar levels to those projected for the current year in a contractionary stance regarding the General Government's fiscal deficit coupled with a restrictive monetary policy course. Net external demand would also contribute to growth. Excess demand (measured by the output gap) would diminish towards the end of 2023, but at a more gradual pace than foreseen in the previous Report and turn negative by 2024 (Graph 1.4). These estimates continue to be subject to a high degree of uncertainty due to external factors (e.g., global political tensions and monetary policy in advanced countries) and domestic factors (e.g., uncertainty surrounding the development and impact of the reforms submitted to Congress and the response of domestic demand to local financial conditions).

In 2023 and 2024, the country's external imbalance would narrow and show a significant adjustment, mainly reflecting the correction in domestic demand. Lower domestic demand, compatible with longer-term sustainable output levels and the convergence of inflation to the target, has contributed to a fall in the external imbalance that will continue for the remainder of the year and through 2024. The latter would bring about a decline in the current account deficit as a share of GDP from 6.2% in 2022 to 3.4% in 2023 and 3.2% in 2024. This adjustment principally reflects a fall in imports from the elevated levels seen in 2022, lower profits remitted abroad by companies with foreign direct investment (FDI), and a rebound in service-related exports associated with tourism. The decrease in the current account deficit improves the country's external position and reduces the economy's vulnerability to significant worldwide deteriorations.

External financial conditions are projected to remain tight in an environment of global inflation that has decelerated but continues above the target in several countries, along with a weaker-than-expected global economy slowdown. In the United States, the Federal Reserve (Fed) kept the interest rate unchanged in the 5.25% to 5.50% range and given the persistence

of high core inflation and a tight labor market, it could raise rates yet again during the remainder of the year. Furthermore, the Fed's recent announcements indicate that it will maintain high interest rates for a more extended term, considering additional pressures from recent oil and fuel price increases and an economy that has proven more resilient than anticipated. Long-term interest rates in the United States have risen significantly amid a backdrop of growing fiscal deficits, uncertainty about future monetary policy, and the neutral interest rate in that country. In this context, Colombia's sovereign risk premium and exchange rate increased, returning to similar levels as those observed in June. The higher cost of external financing and the increased uncertainty partly derived from geopolitical tensions and conflicts, among other factors, would continue to impact the world economy and suggest a relevant slowdown in external demand for the country. The latter, together with lower terms of trade, would generate a year-on-year decline in the national income versus the previous year. Uncertainty regarding external forecasts and their effect on the country remains high, given the unpredictable evolution of global conflicts (Ukraine and the Middle East), ongoing geopolitical tensions, external financial conditions, and the perception of Colombia's sovereign risk, among other factors.

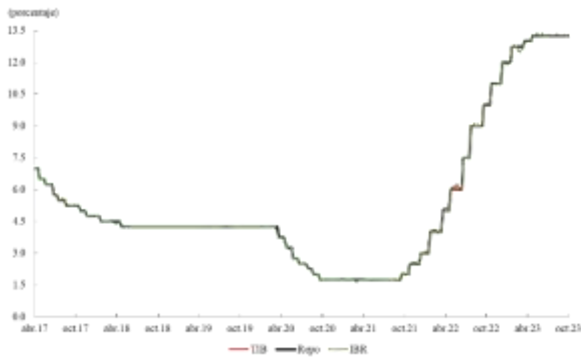
The macroeconomic context, characterized by receding inflation, yet whose forecasts and expectations continue to surpass the target and the prevailing excess demand, indicates the need to maintain a contractionary monetary policy stance. This posture is necessary to ensure the convergence of inflation towards the target, the correction of aggregate demand to levels more compatible with the economy's productive capacity, and to solidify a sustainable external position. Economic activity indicators for the third quarter continue to point to a low economic growth rate. However, this adjustment is occurring at a slower pace than projected. The estimated excess demand remains, reflected in an output level that surpasses the economy's productive capacity and a labor market exhibiting unemployment rates at the lowest level of the past six years and employment levels (especially salaried) continuing to grow in most sectors of the economy. Credit risk has increased, but the Colombian financial system maintains provisions, solvency, and liquidity levels that would allow it to face significant macroeconomic deteriorations. Headline and core inflation fell, but by less than forecast, and remain at high levels well above the target.

Going forward, inflation's deceleration is expected to continue, albeit slower than estimated in July. Inflation expectations increased and continued above the target. This macroeconomic environment, characterized by high inflation, above-target inflation forecasts and expectations, and enduring excess demand, together with the inflationary risks mentioned above, requires maintaining a contractionary monetary policy stance to bring inflation to the target and achieve sustainable output levels. The recent solid financial system indicators indicate no trade-off between monetary policy and financial stability.

1.2 Monetary Policy Decision

At its September and October 2023 meetings, the Board of Directors of *Banco de la República* (BDBR) decided by a majority to maintain the monetary policy interest rate unchanged at 13.25% (Graph 1.5).

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.