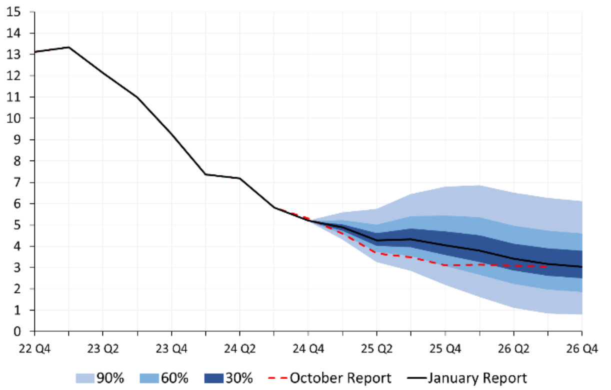
1. Summary

1.1 Macroeconomic Summary

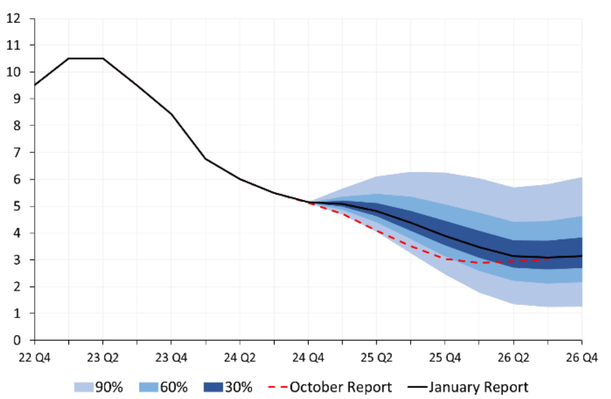
In December, the decrease in headline inflation (5.2%) exceeded the projections of the previous Report, while core inflation (5.2%) fell in line with expectations. Looking ahead, it is anticipated that inflation will continue to converge towards the 3% target, albeit at a slower pace than projected in the previous Report, mainly due to the anticipated consequences of the minimum wage increase. Compared to the October forecasts, the more significant inflation reduction seen at the end of 2024 was driven by food prices (3.3%), which rose less than projected due to a better supply of perishable goods. The CPI for regulated items (7.3%) showed a significant slowdown, although less than forecast due to higher-than-expected gas and electricity service prices. Inflation excluding food and regulated items (5.2%) decreased in keeping with projections, reflecting the behavior of the services group, which recorded decreases in the annual price variations of rents and education. However, these were partially offset by increased tourism service prices and building management fees. The prices of goods registered a low and relatively stable annual growth of around 0.6% in the final months of the year in an environment of lower international prices and upward pressure on the exchange rate. In 2025 and 2026, headline inflation is expected to continue its convergence toward the target but at a slower pace than foreseen in October forecasts. The latter is primarily due to the real increase in the minimum wage, which is significantly higher than the labor's productivity growth. Additionally, the external and fiscal context is likely to generate greater upward pressure on the exchange rate and its pass-through to prices. The projected path of expected increases in food and regulated items was revised slightly upward. In the case of food, this rise is due to an upward trend in the prices of perishable goods, whose seasonality could have shifted. For regulated items, the revision reflects upward surprises in some public services noted at the end of 2024. However, the indexation of certain CPI groups to lower inflation and the cumulative effects of local monetary policy—reflected in an output gap still estimated in negative territory for the coming year—are anticipated to continue aiding the convergence of inflation towards the target. Considering these factors, it is anticipated that headline inflation will reach 4.1% (up from 3.1%) and core inflation 3.9% (up from 3.0%) by the end of 2025 (Graphs 1.1 and 1.2). These figures align closely with those assumed by the median of market analysts.[1] These projections continue to face high uncertainty, primarily related to the future behavior of the exchange rate, potential increases in global trade tariffs, supply shocks affecting food prices, changes in the prices of some regulated goods and services, and the increase in the minimum wage for the coming year, among other factors.

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 January report.
Source: DANE – calculations and projections by Banco de la República

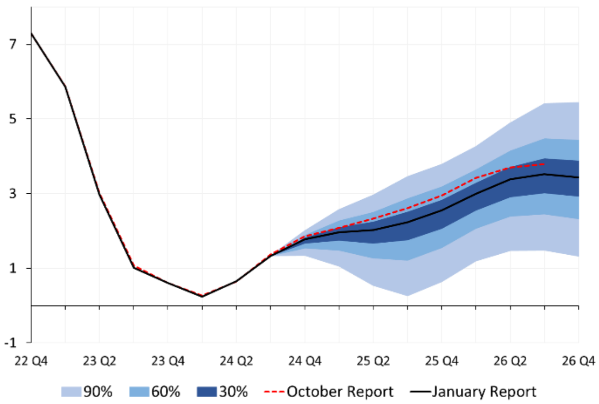
Graph 1.2
CPI excluding food and regulated items [a/b/]
(annual change; end-of-period)
(percentage)



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 January report.
Source: DANE – calculations and projections by Banco de la República

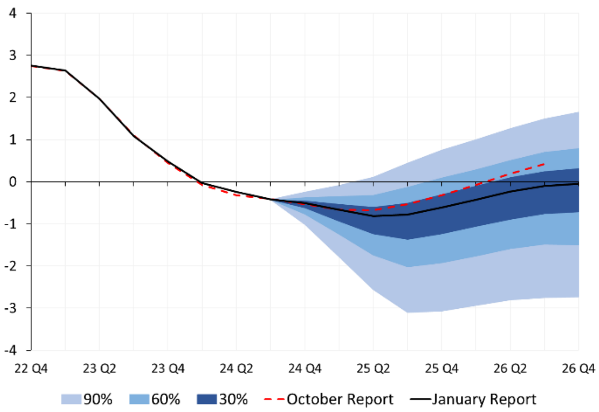
[1] According to the results of the Monthly Expectations Survey conducted by *Banco de la República* among market analysts in January 2025.

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 monetary policy models.
c/ The probability distribution corresponds to the forecast exercise from the January 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 January report.
Source: Banco de la República

Economic activity would continue to pick up over the forecast horizon, although at a more gradual pace than projected in the October Report. Compared to October estimates, annual GDP growth for the third quarter was lower than expected (2.0% versus 2.4%), primarily due to a more negative contribution from the external trade balance, mainly associated with stronger import dynamics. Growth in domestic demand was higher than projected (3.9% versus 3.3%), marking the fourth consecutive quarter of increases, driven by private consumption and, to a lesser extent, by gross fixed capital formation (GFCF). In contrast, the weak performance of public consumption was primarily attributed to lower government subsidies for electricity consumption, associated with reduced household demand. Available figures for economic activity in the fourth quarter suggest that the economy grew at an annual rate of 2.3%. This forecast indicates that, by the end of the year, domestic demand would have continued to accelerate (4.1%), driven by the strong growth in GFCF (5.7%) spurred by an uptick in machinery, equipment, and civil construction spending, as opposed to the low levels observed a year ago. Nonetheless, consumption growth remained modest (1.4%). External demand continued to contribute negatively to growth due to increased imports (9.0%) that outpaced exports (1.4%). As a result, the 2024 economic growth forecast has been revised to 1.8%, compared to the 1.9% stated in the previous Report. In 2025 and 2026, economic activity is expected to continue on its recovery path within a less contractionary external and domestic monetary policy context, but the latter is consistent with inflation converging towards the 3% target. Economic activity would expand by 2.6% in 2025 (down from the 2.9% estimated in October) and accelerate further in 2026 to 3.4% (Graph 1.3). The downward revision for 2025 is attributed to monetary policy response in the face of increased inflationary pressures, the slight downward revision in private consumption dynamics in the figures published by DANE, and the weak performance of public consumption observed and expected for this year. Excess production capacity is anticipated to increase slightly until the second quarter of 2025 and gradually diminish over the forecast period (Graph 1.4). These estimates continue to be subject to high uncertainty, influenced by external factors such as global political and trade tensions and monetary policy in advanced economies, as well as internal factors such as uncertainty surrounding fiscal policy and domestic demand response to local financial conditions.

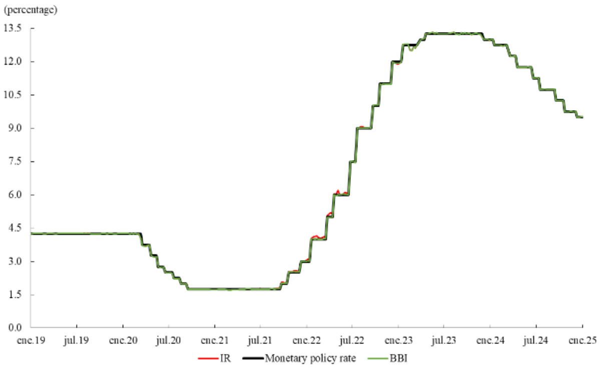
It is foreseen that the country's external financing conditions will be more restrictive than anticipated in October due to a slower normalization of monetary policy in the United States and upward pressures on the risk premium. In December, the Federal Reserve (Fed) lowered the monetary policy interest rate by 25 basis points (bp), which was in line with market expectations and those of the Bank's technical staff. However, the strong performance of the labor market, favorable economic activity results, inflation above the target, uncertainty regarding the neutral interest rate, announcements of potential increases in import tariffs, and the Fed's meeting minutes, among other factors, tempered expectations of further rate reductions. Consequently, this Report assumes that the Fed will further decrease interest rates by 50 bp in 2025 and 50 bp in 2026, reaching a range of 3.75% to 4.0% and 3.25% to 3.5%, respectively. Additionally, the external neutral real interest rate (NRIR) has increased, reflecting revisions made by the Federal Open Market Committee (FOMC) in the United States. In tandem, the decline in international prices for some key exported raw materials, notably oil, coal, and nickel, has furthered the worsening of the terms of trade, a trend expected to roll into 2025. These external conditions, coupled with the observed fiscal deterioration in the country, are likely to exert upward pressure on the risk premium and its trend behavior. In 2024, the relevant external demand for the country is expected to have slowed less than anticipated in the October Report, maintaining low but relatively stable growth over the forecast horizon. The uncertainty surrounding external forecasts and their impact on Colombia’s economy remains significant, given the ongoing conflicts in various regions, rising tensions in foreign trade, potential migration, tariff and fiscal measures in the United States, and concerns about Colombia's sovereign risk, among other factors.

The contractionary monetary policy stance continues to support the convergence of inflation toward the target. However, observed inflation and most measures of inflation expectations remain above 3%. Economic activity indicators for the end of the year suggest that output has completed five consecutive quarters of growth, with domestic demand returning to an annual expansion behavior. The economy is still projected to have excess production capacity, contributing to disinflationary pressures. In the labor market, the unemployment rate remains at historically low levels, employment has remained relatively stable, and the real increase in the minimum wage has significantly exceeded productivity growth. Credit dynamics remain weak but have begun to recover. In 2024, the external position is expected to complete two consecutive years of current account deficit reduction as a percentage of GDP, contributing to lower external vulnerability. Nonetheless, the upward revision of the relevant external NRIR and the trend risk premium have increased the estimated local NRIR. The prospect of declining inflation, combined with a negative output gap, has allowed for a gradual easing of monetary policy, as reflected in the Board of Directors' decisions to lower the policy interest rate. Looking ahead, inflation is expected to continue declining and converge toward 3%, but at a more gradual pace than that projected in the October Report. However, inflation expectations for December 2025 and 2026 remain above 3%. It is foreseen that excess production capacity will moderate by the end of 2026. These projected inflation and output gap dynamics are consistent with a contractionary monetary policy stance supporting the expected inflation convergence toward the target by 2026.

1.2 Monetary Policy Decision

At its December 2024 meeting, the Board of Directors of *Banco de la República* (BDBR) determined by majority vote to reduce the benchmark interest rate by 25 basis points and keep it unchanged at 9.5% at its meeting in January of this year (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.