Presentation, summary and conclusions

Review of inflation to june 2001

✠ Annual consumer inflation remained stable over much of the first half of the year (February to June) at a level very close to the 8.0% target for 2001. Specifically, annual inflation in June ran at 7.9%, slightly higher than three months earlier (7.8%) but 1.8 percentage points lower than in June 2000. Accumulated inflation in the first half of 2001 was 6.2%, lower than in the same period last year (7.0%).

✠ The Consumer Price Index rose by 1.6% in the second quarter, slightly more than in the same quarter last year (1.5%). The particular CPI items exerting the greatest inflationary pressure over the quarter included some foodstuffs (particularly beef), utilities, and banking services.

✠ The annual price rise was higher in June than in March for the following major CPI groups: food, education, clothing, culture and entertainment, and diverse expenses, and lower for the remaining groups: housing, transport, and health.

✠ The case of beef deserves special attention, in view of its large share (4%) in the CPI basket. Beef prices registered an accumulated second-quarter rise of 16.6%, accounting for over a third of consumer inflation in the quarter. The growth in beef prices, anticipated in the previous Inflation Report, is associated with the retention stage of the cattle-breeding cycle coming into full swing and thereby reducing the supply of beef. This stage was intensified in the first half 2001 by scanty rainfall and is expected to continue over the rest of the year. It should however be accompanied by an easing of price variations, if these follow their typical seasonal pattern of decreasing in the second half of every year.

✠ Education prices registered a greater annual rise in June (10.6%) than twelve months earlier (9.7%), largely because of higher enrollment and tuition fees. By the end of the year, therefore, inflation in this group is very likely to be higher than in 2000.

✠ The sectors with lower annual price growth in the second quarter included notably transport. The transport sector drove consumer inflation during last year and the first quarter of 2001, by steep rises in the domestic price of fuel. Fuel prices are is expected to become relatively stable in the second half of this year.

✠ At annual rate, the prices of nontradable goods and services rose faster in the second quarter than in the first, largely because of rising food prices. In contrast, inflation in tradables fell for the first time to under 10%, though, at 9.5%, it was still higher than headline inflation, suggesting moderate inflationary pressures from devaluation.

✠ In June, the non-food CPI and inflation nucleus, the two most reliable measures of core inflation calculated by the Banco de la República's, stood at 7.7% and 8.2% respectively, both lower than in March, and their 7.9% average was five percentage points below the March figure.

✠ Annual producer inflation ran at 10.2% in June, down by 0.7 percentage points on March and by 5.4 points on a year earlier (15.6%). Breakdown of the PPI by origin shows the second-quarter fall in producer inflation to have been a direct outcome of slower price growth in imported goods: 7.6%, down from 12.5% in March, at annual rate. In contrast, the prices of domestically produced and consumed goods grew at a faster annual rate over the second quarter: 11.1%. The breakdown by industrial activity attributes the fall in producer inflation between March and June to a fall in the mining sector's price growth: from 27.0% to 23.5% over that period, at annual rate. Beef and cattle prices were among the individual product prices most accountable for second-quarter producer inflation.

✠ The latest inflation forecasts from the Bank's transmission-mechanism model are lower than the first quarter's on all time horizons. The central path of the forecast currently shows inflation averaging 7.3% by the fourth quarter of this year (0.6 percentage points below the previous forecast) and 5.3% by the end of 2002 (0.9 points below the previous forecast). It should be noted however that these central forecast come with an upward biased risk balance that tries to capture, among other things, the risks associated with a possible intensification of the crisis in Argentina and its potential effect on devaluation and inflation rates in Colombia. That is to say, inflation is quite likely to end up a little higher than the central forecast.

✠ Core inflation as the average of the two most reliable indicators (the nucleus and non-food CPI) is forecast to run at 7.1% by December 2001, down from 7.3% predicted in March.

✠ To judge by various indicators of real activity for part of the second quarter, the economy seems to have grown slowly in this quarter, much as it had in the previous two. And slow growth has continued to be attended by weak domestic demand. Circumstances such as today's high rate of unemployment, lower coffee and oil prices, and an uncertain business climate-as evidenced by several expectations surveys-make a reversal of this situation unlikely in the coming months. But that is not to rule out a pick-up in growth in the second half of the year compared with the first, since some of the supply shocks identified in previous Reports have now been overcome, as indicated by an acceleration of industrial growth. Even so, the economy is unlikely to become sufficiently dynamic over the rest of the year to meet the government's initial growth target. Nor is demand expected to generate any strong inflationary pressure in the coming months.

✠ In June the Board of Directors approved a new reference line for the monetary base. At the end of the second quarter, the monetary base's 20- and 45-month moving averages stood 1.0% and 0.5% below the new reference line's respective averages, because cash holdings were lower than the level envisaged for them in the new line. The financial system's portfolio shrank more slowly between March and June, in both nominal and real terms, largely as a result of real growth in non-mortgage loans from March on.

✠ Deposit and lending rates edged down over the second quarter in both nominal and real terms. In June the nominal deposit rate was12.7%, down by 0,3 percentage points on March, while the overall nominal lending rate calculated by the Banco de la República was 18.6%, also 0,3 points lower than in March. In real terms, the deposit rate fell from 4.8% in March to 4.4% in June, and the lending rate calculated by the Bank from 10.4% to 9.9%. The nominal interbank rate hovered around 11.0% during the second quarter, but ended up with a slightly higher average (11.4%) than in March (10.8%).

✠ On price information to June, most inflation forecasts indicate a greater likelihood of inflation for 2001 running lower than the 8.0% target. The transmission-mechanism model suggests that in 2002, too, inflation will undershoot the respective target of 6.0%. In addition to these forecasts, there is the fact that the economy is still growing slowly, mainly because of weak domestic demand. Moreover, with the monetary base standing slightly below the reference line, analysis of the economy's domestic conditions points to the possibility of a more relaxed monetary-policy stance.

✠ In contrast, analysis of the international situation reveals a disturbing climate of uncertainty in Latin America, which worsened in early July. This situation has led to sharply rising spreads on the foreign debts of countries such as Argentina and Brazil and to a large devaluation in Brazil. Although Colombia has not been adversely affected by the Southern-Cone crisis thanks to macroeconomic-adjustment efforts, constitutional and legislative reforms and external pre-financing, it is not immune to contagion effect. In that event, an interest-rate cut by the Bank's Board of Directors might produce significant capital outflows, which could hold back economic recovery and make it difficult to meet the inflation targets.

✠ Since the Board's monetary-policy strategy takes into account inflation and growth risks arising from the international context, the Board has decided to leave the Bank's intervention rates unchanged. Accordingly, the Lombard expansion and contraction rates remain at 15.5% and 8.0% and the auction expansion and contraction rates at 11.5% and 10.5%, respectively.

The Board of Directors,

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