Presentation, summary and conclusions

Review of inflation to march 2001

✠ Annual inflation in the Consumer Price Index was 7.8% at the end of the first quarter of 2001, down by 0.3 percentage points on February (8.1%), and by 1.9 points on March 2000 (9.7%). It was the lowest annual rate in any March since 1969 (6.2%), inflation having fallen steadily from 9.0% last October.

✠ Lower annual inflation in March resulted from slower price increases in food, housing, education, and diverse expenditures. The housing group included, notably, a slower rise in utility charges in March than in February, and a minimal increase (0.7%) in housing occupation expenses. In contrast, inflation accelerated in health care, entertainment, and transport but remained relatively steady in clothing.

✠ The Consumer Price Index rose by 1.5% in March, driven mainly, as in recent months, by meat and dairy products and fuel prices. Bus fares and gas and fuel prices together accounted for more than 20% of inflation in March, while beef and milk contributed a little over 9%. The price of meat is expected to keep on rising in real terms all year long because the cattle-raising cycle is currently going through a holding-back stage that is sure to reduce supply. Lastly, potato prices, which usually rise in March, fell this year.

✠ Economic classification of the CPI basket shows tradables continuing to register a higher annual price rise (8.2%) than nontradables (7.4%), partly because of a relatively high devaluation in the previous 12 months. Lower inflation in nontradables was largely caused by slower growth in housing rents. In March, however, tradables as well as nontradables registered decreasing price growth.

✠ The four measures of core inflation (non-food CPI, inflation nucleus, trimmed mean, and asymmetric mean) averaged 7.8% at the end of the first quarter, 0.4 percentage points lower than in February. Leaving out the most volatile indicator (asymmetric mean) gives an average core inflation of 8.3%, much the same as in February (8.2%). Out of the four indicators, only the inflation nucleus ran higher in March than in February.

✠ Producer inflation, measured as annual rise in the Producer Price Index, stood at 10.9% in March, 0.4 percentage points lower than in February (11.4%) and 2.8 points lower than a year earlier (13.7%). The breakdown by origin attributes this 12-month fall in producer inflation to imports, their price growth having declined from 18.7% in March 2000 to 12.5% a year later. The breakdown by industrial activity attributes it essentially to slower growth in agricultural prices: from 18.4% in March 2000 to 4.2% a year later.

✠ This Report presents for the first time the results of a standard model of transmission mechanisms, capable of forecasting inflation and growth simultaneously and also incorporating a policy rule. On information to March, the model forecasts an annual inflation of 8.2% by the fourth quarter of this year and of 4.2% by the end of 2002. This forecasting assumes that interbank interest rates in the second quarter will be much the same as the Banco de la República's current intervention rates. The main forecasts are accompanied by a risk balance with an upward bias resulting from the expected distribution of shocks in food prices and in devaluation. In this connection, lower-than-expected oil prices and oil-export volumes might produce current-account shocks in the course of the year, which could accelerate devaluation and hence adversely affect prices.

✠ Core inflation, as the average of the three more reliable indicators, is forecast to be 7.2% by December 2001, some 0.7 percentage points higher than was forecast last December. As the average of all four indicators, however, it is expected to be 6.7%, or 0.3 percentage points lower than forecast in the previous Report.

✠ Available indicators of real activity do not provide a clear picture of the present state of the economy. It is true that key indicators such as industrial output or retail sales slowed in the first quarter of this year relative to a year earlier. But it is also true that slower growth was in good measure caused by supply factors, such as the strike at Bavaria (a beverage producer) and reduced oil production. Moreover, imports, nontraditional exports, and other variables continued to improve in the first quarter, as did overall employment and, to a lesser extent, industrial employment, power consumption, and a number of variables connected with construction. Likewise, Fedesarrollo's survey figures to February reveal no significant trend breaks in such indicators as stocks and orders. So, if the effects of the above supply shocks are excluded, there is as yet no conclusive evidence of an actual slowdown in the first quarter or of an impending one in the coming months. Growth over the first half of the year can therefore still be expected to be consistent with an annual rate not much below the government's forecast. Since production levels are still low in several sectors and the estimated GDP gap is large, such growth should not generate any major inflationary pressures from demand over the next few months.

✠ At the end of March the monetary base's 20-month and 45-month averages exceeded the reference line's corresponding averages by 5.3% and 5.4% respectively. Deviation by the monetary base from its reference line over the first quarter is explained by a greater demand for cash than is envisaged in the reference line; this cash growth resulted from the transaction levy being raised and has produced no inflationary impact[*]. The Banco de la República's Board of Directors is presently considering necessary corrections to the monetary base's reference line. The financial system's overall loan portfolio continued to shrink up to March in both real and nominal terms, exclusively because of mortgage-loan behavior, for the non-mortgage portfolio continued to grow to March, showing an expansion in real terms for the first time since November 1998.

✠ As regards interest rates, the nominal deposit rate fell in March for the second month in a row, to 13.0%, down by 0.3 percentage points on February. Lending rates for common, preferential, and Treasury loans changed little from December 2000 to March, remaining far

[*] A preliminary reference line was submitted for consideration by the Board of Directors on March 9th. By the end of the month the monetary base's 20-month and 45-month moving averages were both slightly under this new line (1.0% and 0.5% respectively).

below rates for consumer loans and credit cards. At the end of March, the average lending rate including preferential loans was 19.0%, the same as in December. Over the same period the real deposit rate rose by 0.6 percentage points, to 4.8%, and the real lending rate (including preferential loans) edged up by 1.1 points, to 10.4%. The nominal interbank rate averaged 10.8% in March, 1.4 percentage points lower than in December 2000 and 0.5 points lower than in February. The interbank rate's March decline corresponded to a mid-month cut of 50 basis points in intervention rates.

✠ In early March the Board of Directors, taking into account satisfactory price-index behavior in the first two months of the year and forecasts for 2001 and 2002, and in view of the aim to promote growth in output and employment, decided to cut all the Banco de la República's intervention rates by 50 basis points. Accordingly, the Lombard expansion and contraction rates were set at 15.5% and 8.0% respectively, and the auction expansion and contraction rates at 11.5% and 10.5% respectively.

✠ Figures for March showed inflation continuing on a downward trend. Review of forecasts regarding inflation behavior during this year and next suggests that the 8% target for 20001 and the 6% target for 2002 can be reached with the current monetary stance, provided that the exchange rate remains reasonably stable. Technical analyses also indicate that the Banco de la República's present structure of intervention interest rates will be conducive to strengthening the economy's recovery. The Board of Directors did not therefore feel any further changes needed to be made to the Bank's structure of intervention rates. This decision should also help to contain capital flight from Colombia, such flight being particularly detrimental in today's situation of international turbulence. As stated in the Board of Directors' Report to Congress, the country's economy requires a strong injection of investment to stimulate aggregate demand, expand production capacity, and boost economic recovery.

The Board of Directors,

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Juan Manuel Santos Calderón
Minister of Finance and Public Credit

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Sergio Clavijo Vergara
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