Minutes of the Meeting of the Board of Directors of *Banco de la República* on 27 October 2017

A regular meeting of the Board of Directors of *Banco de la República* took place in the city of Bogotá D.C. on Friday, October 27, 2017. In attendance were Mauricio Cárdenas Santamaría, Minister of Finance and Public Credit; Juan José Echavarría, Governor of the Central Bank; and Board Members Gerardo Hernández Correa, Ana Fernanda Maiguashca Olano, Adolfo Meisel Roca, José Antonio Ocampo Gaviria, and Juan Pablo Zárate Perdomo.

These minutes contain a summary of the outlook on the macroeconomic situation by the technical staff of the Central Bank (section 1), followed by a review of the main discussion regarding monetary policy by the Board of Directors (section 2).

Further detail on the macroeconomic situation prepared by the technical staff from the Central Bank will be presented in the monthly Monetary Policy Report for September 2017 and in the statistical annex.

1. MACROECONOMIC CONTEXT

a. The average growth forecast for Colombia's main trading partners for 2017 and 2018 was revised slightly upwards in this report. Thus, the Colombian economy would receive an additional boost next year generated by a stronger external demand.

b. Consistent with a greater global demand and a lower growth of global production of crude oil, the price of oil is expected to remain at current levels, which would continue driving the recovery in the country's terms of trade for the rest of the year. This trend would continue in 2018, when a slight increase in the international prices of some of the main export products is also expected.

c. The most recent information on capital flows to emerging economies and the behavior of risk premia suggest that external financing would not exhibit significant changes in the rest of the year. However, in recent months, the expectations of a less expansionary monetary policy in developed economies has increased; consequently, it is estimated that external financing conditions for 2018 will be less generous than in previous years. This report assumes an increase in the FED's policy rate in December 2017 and two more increases next year.

d. Forecasts suggest that the country's external deficit should continue correcting in the remainder of the year as a result of a better dynamics of exports of goods and the good performance of current transfers. Thus, a current account deficit close to 3.7% of GDP is estimated in 2017. A deficit of around 3.6% of GDP is forecast for the coming year, still above the country's historical average.

e. The information available on real activity in Colombia allows to confirm that the slowdown would have bottomed out during the first half of 2017. The indicators for the third quarter suggest an acceleration of the pace of GDP growth, mainly driven by investment and, to a lesser extent, by public consumption, as well as by a low basis for comparison in the same period last year.

f. As for credit, total indebtedness since March shows a relatively stable nominal growth (close to 6.0%). Household credit continues to slow down, although it still exhibits increases at rates that exceed inflation and nominal GDP growth. Commercial indebtedness grows at a low rate, close to inflation. Interest rates on commercial loans (except for construction) have registered falls higher than the those of the policy rate. Transmission towards households' interest rates on loans has been lower.

g. With all this, growth in the second half of this year is expected to be low, but higher than in the first half of 2017. This comes as a result of a more dynamic external demand, of a good performance of public consumption, and a significant increase of civil works. Thus, for 2017, the technical staff maintained its estimation for GDP growth close to 1.6%, within a range between 1.3% and 1.9%.

h. For 2018, the technical staff increased its growth forecast from 2.4% to 2.7%, within a range between 1.5% and 3.5%.

i. In line with the expectations from the technical staff and the market, inflation increased in September, although less than expected, standing at 3.97% on a yearly basis. This acceleration is explained by the behavior of the groups of perishable food and regulated items. Contrastingly, the tradable sector, together with processed foods and meals outside the home, contributed to lower inflation. The average of core inflation indicators continued its downward trend, as observed in recent months.

j. Inflation expectations to December 2017 obtained from the monthly survey to financial analysts decreased slightly, posting at 4.07%. Analysts' expectations and those embedded in public debt bonds to horizons greater than or equal to one year remain stable, standing between 3.4% and 3.6%.

In summary, to December 2017, inflation is expected to stand near 4.0% and decline in the first quarter next year, partly as a result of the reversal of the transitory shocks that have diverted it from its target. This takes place in an environment of economic activity that would recover, but still with an excess of installed capacity. Monetary policy actions undertaken so far, which consider these effects, should strengthen convergence of inflation to its target.

2. DISCUSSION AND POLICY OPTIONS

The members of the Board highlighted the good performance of inflation in the last months and the reduction of its forecast at different deadlines. This is based on the following considerations: (i) the figures for inflation in the last quarter have been lower than expected by the market and by the Central Bank's technical staff; (ii) the staff's forecasts on this variable have declined, suggesting that it will be close to 4.0% by the end of 2017. Similarly, forecasts suggest that achieving the 3.0% target in 2018 is highly probable; and (iii) core inflation has continued to fall.

Five Board Members voted in favor of a 25 bp reduction to the benchmark interest rate. This group stressed the fact that the economy has been operating with excess capacity. Should the growth forecasts by the technical staff come to reality, this phenomenon will deepen in 2018. In the view of these members, in this environment, with a widening of the excesses of installed capacity and good anchorage of the forecasts and inflation expectations, a reduction in the intervention interest rates is suitable.

Some members from the majoritarian group pointed out that external risks persist that limit the possibilities of carrying out a more expansionary monetary policy. They highlighted the still relatively high level of the current account deficit, and possible unexpected effects of the normalization process of monetary policy in the United States. For this reason, they pointed out that a reduction in the benchmark interest rate should not be understood as the beginning of a path of cuts.

Other members within the same group underlined that much of the recent information on economic activity continues to show a low dynamics, which has begun to affect labor market variables. These factors, added to the previous excesses of installed capacity, deserve a more countercyclical and less contractive monetary policy.

Two Board Members voted to keep the benchmark interest rate unaltered. These members stressed that, should the risks still posed by inflation forecasts materialize, they could hinder the convergence of inflation to the target in the policy horizon. For this reason, they emphasized the desirability of maintaining the monetary policy stance while gaining certainty about such convergence, which in turn increases the credibility of the economic agents in this process. They also stated that keeping the benchmark interest rate unaltered was in line with market expectations, which would consolidate the predictability of the policy, thus enhancing its credibility and efficacy.

3. POLICY DECISION

The Board of Directors of the Central Bank of Colombia, at today’s meeting, by majority, decided to reduce the benchmark interest rate by 25 bp to 5.0%.

The decision to reduce the benchmark interest rate was approved by five (5) members of the Board. The two (2) remaining Board Members voted to maintain the policy rate unaltered.

Bogotá D.C., 10 November 2017