

## PRESENTATION, SUMMARY AND CONCLUSIONS

✚ Annual consumer inflation rate for September 1999 was 9.3%, 0.3 percentage points higher than at the end of the second quarter (9.0%) but 8.5 percentage points lower than in September 1998. The annual producer inflation rate was 10.9%, about five percentage points higher than at the end of the second quarter.

✚ Since February 1999, inflation has presented a significant decline of 8.5 percentage points, bringing the annual rate down to one-digit levels for five consecutive months. This reduction was the outcome of lower price increases across all groups in the CPI basket of goods and services. The largest declines were in food (with the annual rate of price increase falling from 20.3% in September 1998 to 4.2% a year later), education (from 18.4% to 8.9%), and housing (from 15.6% to 8.6%). As in the previous quarter, all groups of the alternate classification (tradable, indexed, flexible and cyclical items) contributed to lower inflation. The greatest downward pressure on prices came from nontradable component's, accounting for 70% of the fall. This performance resulted from slower growth in demand, a favorable cycle of meat prices, lower dwelling rents, and an abundant supply of root crops.

✚ On an annual basis, higher-than-average price increases were registered in sundry expenditures (18.9%), transport (18.9%), and health care (15.7%). These groups were particularly affected by the imposition of VAT, in the case of sundry expenditures (toiletries); higher world oil prices, in the case of transport; and devaluation, in the case of health care (drugs). Lower-than-average growth was seen in food (4.2%), clothing (4.4%), housing (8.6%), and education (8.9%). In the alternate Consumer Price Index classification, higher-than-average inflation was displayed only by tradables (10.2%) and indexed items (11.7%).

✚ According to the recent performance of core-inflation indicators, the small increase in headline inflation since the beginning of the third quarter (from 8.8% in July to 9.3% in September) was not the result of demand pressures. In fact, the average of the four underlying-inflation indicators continued to fall, from 11.5% in June to 10.0% in September.

✚ Industrial-wage increases averaged 16.3% in July, slightly under the average registered three months earlier (17.2%) and nearly three percentage points lower than in December 1998. It should be pointed out, however, that in the past two months the rate of wage increases has

remained steady at around 15.5%, not far from the rates set in collective bargaining agreements at the end of 1998. This is likely due to the relative downward inflexibility of industrial-pay adjustments in Colombia in the medium term, a factor that has resulted in considerable growth in real wages during 1999.

✚ According to Banco de la República's expectations survey, inflationary expectations continued to decline over the past quarter, following the trend started at the beginning of the year. Expectations for December were 1.3 percentage points lower than in June. Agents currently expect an average inflation of 12.2% by the end of 1999. For December 2000 they expect an inflation of 11.3%, in contrast to the March survey's figure of 12.2%. It is necessary to bear in mind, however, that the Banco de la República's expectations surveys have systematically overestimated future inflation by about 2 percentage points.

✚ Indicators such as electricity consumption (to September), the financial sector's nominal and real portfolio performance (to September), and credit cards sales (to August) show no clear reversal in the economy's declining trends. Moreover, uncertainty in recent months about the legal basis of housing financing schemes is likely to delay recovery in the critical construction sector.

✚ However, some signs of potential recovery continue to surface, such as increased orders in industry and reductions in stocks of finished goods. In addition, there have been indications lately, particularly in July and August, that nontraditional exports might present a more promising performance towards the end of the year, benefiting especially from the peso's real devaluation in recent years and from faster growth in external demand. Based on this evidence, the economy should show some signs of recovery by the end of the year. Never the less, demand is hardly likely to cause any serious inflationary pressures.

✚ Forecasts derived from ARIMA models indicate that by December 1999 inflation will be between 8.1% and 12%. The point forecast made with figures to September is lower than the one registered a month earlier (10.8%). In addition, underlying inflation is expected to run between 8.2% and 10.2% in December, below the 1999 inflation target.

✚ Forecasts derived from structural models confirm that inflation will remain at low levels until the end of the year. The combination of forecasts yields an inflation of 9.8% for 1999, 10.4% for June 2000, and 9.8% for September 2000. These results bear out the conclusions of a projection-run based on the historical behavior of food prices, which predicts an inflation range of 7.3% to 10.7% by the end of 1999.

✚ The money supply's 20-month moving average remained close to the midpoint of its corridor, whereas M3 continued below its lower limit. In addition, nominal and real loan portfolios displayed a new decline. Lastly, the real deposit rate in September was almost one percentage point lower than in August, while the lending rate fell by 0.5 percentage points.

✚ The inflation results and trends discussed in this report have led the Bank's Board of Directors to conclude that inflation for 1999 will not surpass 11% and that the 10% target for the year 2000 will be met. Moreover, since the money supply remains within its corridor, the Board has decided that there is scope for reducing the Bank's intervention rates by 100 basis points. Accordingly, the basic rate for REPO auctions now stands at 15%, and the Lombard rate (the rate for the unlimited REPO window) at 21%. The reverse REPO rate stays at 11%.

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