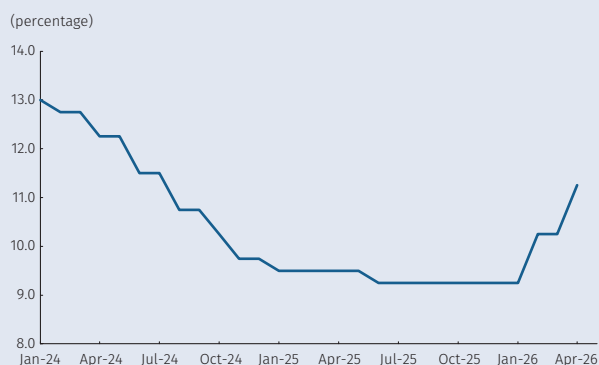


Box 1

A 200-Basis-Point Increase in the Monetary Policy Interest Rate Between January and March 2026

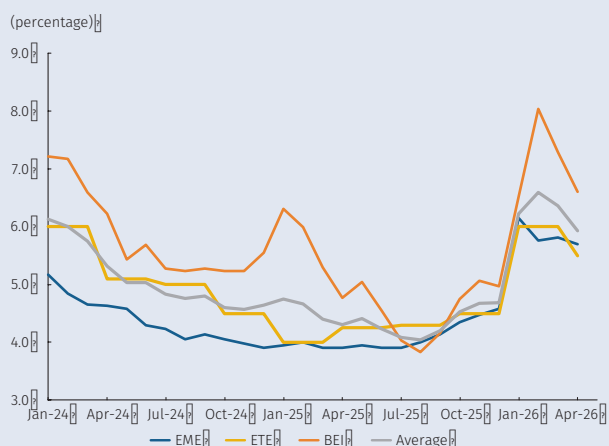
Juan José Ospina*

Graph B1.1
Monetary policy interest rate (MPR)



Source: Banco de la República.

Graph B1.2
Measures of inflation expectations (to 12 months)



EME: Monthly survey of economic analysts' inflation expectation—median
ETE: Quarterly survey of economic expectations (businesspeople, unions, and academia) – median
BEI: Breakeven inflation expectations
Source: Banco de la República.

During January and March 2026, the Board of Directors of *Banco de la República* (BDBR) increased the monetary policy interest rate from 9.25% to 11.25% (Graph B1.1). The pace of this increase was faster than that of typical benchmark-rate adjustments. It was adopted in a context where many individuals, companies, and economic analysts began to expect inflation to exceed previous estimates due to the sharp rise in companies' labor costs early in the year. This relatively swift rise in policy rates was intended to curb inflation's impact on prices and safeguard households' purchasing power, particularly that of the most vulnerable populations. An illustrative explanation of this monetary policy interest rate adjustment is provided below.

During January 2026, inflation expectations across all measures monitored by *Banco de la República* rose significantly, reaching levels above 6% (Graph B1.2), continuing to increase on average through February. By January, the various economic agents whose inflation expectations are surveyed—including businesspeople, unions, academia, financial analysts, and buyers and sellers of public debt—revised their 2026 outlooks relative to their earlier responses, indicating they expected prices to escalate further in the year than they previously forecast, and thus inflation would deviate further from its target. Simply put, in January, they expected a larger overall increase in prices, meaning households' purchasing power would decline.

Notably, this increase in inflation expectations was quite abrupt. For all measures of inflation expectations monitored by the Bank, this single-month jump was the largest in its tracked history (Graph B1.3). In light of this scenario, *Banco de la República* sought to neutralize the effect of this increase in expectations on the real borrowing and savings conditions. The example presented below illustrates why this was necessary, what variables could influence the decision, and how the mechanism functions.

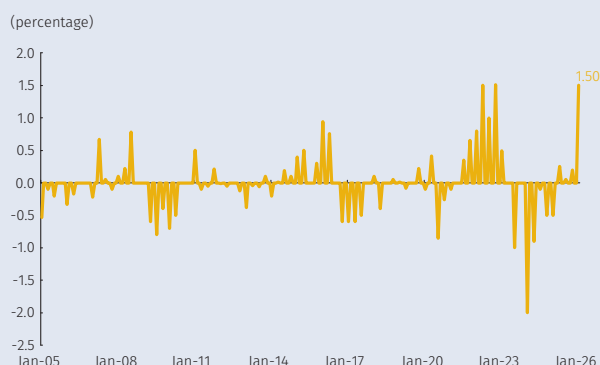
1. What is the real *ex ante* interest rate, and why is it so important?

When *Banco de la República* raises its policy rate, it is not always seeking to make credit more expensive or make savings more affordable

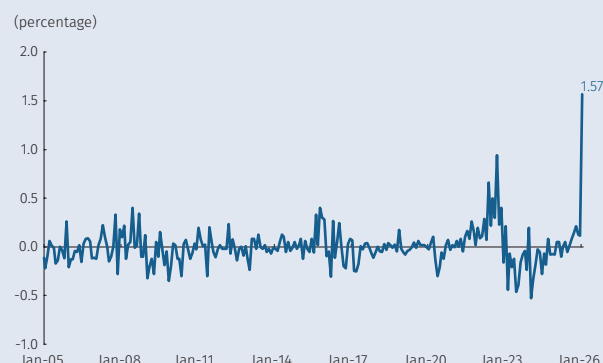
* The author is the Chief Officer of Monetary Policy and Economic Information. The opinions herein expressed are solely the responsibility of the author and do not necessarily reflect those of the Bank nor its Board of Directors.

Graph B1.3
Changes in inflation expectations

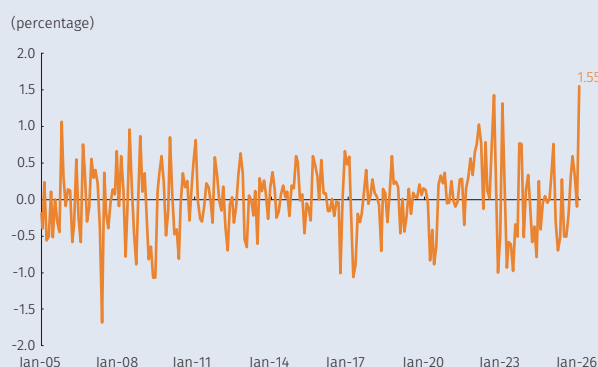
A. Quarterly survey of inflation expectations—
businesspeople, unions, and academia
(ETE for its Spanish acronym)



B. Monthly survey of economic analysts' expectations (EME for its Spanish acronym)



C. Inflation expectations derived from
the public securities market (BEI)



Sources: *Banco de la República*, author's own calculations.

in real terms. To understand why the benchmark rate is increased, a key concept must be understood: the real *ex ante* interest rate.

This rate refers to the difference between the nominal interest rate—such as that set by *Banco de la República* or other rates, such as those on public debt securities or CDTs—and the inflation expected by economic agents in the future. Namely:

$$\text{Real } ex \text{ ante interest rate} = \text{nominal interest rate} - \text{expected inflation}$$

What really matters when deciding whether to spend, save, or borrow is not the nominal interest rate but the real interest rate. The following example illustrates this concept:

In January, a merchant orders 1,000 T-shirts, costing \$10,000 each, to sell in December. The current market price for these T-shirts is \$12,000, but since he must wait a year to sell them, the price at which he can sell them will depend on how much prices increase over that year, which reflects inflation. To finance the purchase, he takes out a loan of \$10,000,000 at a 10% nominal interest rate.

To understand why the real interest rate is the key variable, let's compare two merchants who have identical operations, credit conditions, and a 10% nominal interest rate, but differ in their inflation expectations.

Merchant 1 believes prices will rise by 3% over the year, so he expects to sell each T-shirt for \$12,360. His expected income is \$12,360,000, and after paying the \$10,000,000 product cost

and \$1,000,000 of interest on the loan, he expects a profit of \$1,360,000. Thus, for merchant 1, the real interest rate is 7% (10% – 3%).

Merchant 2 believes that prices will rise by 13% over the year. Therefore, he expects to sell each T-shirt for \$13,560, his expected income is \$13,560,000, and, after paying the same interest costs, his expected profit is \$2,560,000. For this merchant, the real interest rate is –3% (10% – 13%).

The conclusion is clear: at the same nominal interest rate, merchant 2 expects to earn nearly twice as much as merchant 1, making him more willing to take on the loan. The key difference lies not in the nominal interest rate itself but in the inflation each merchant expects. Therefore, the real interest rate, rather than the nominal rate, primarily influences economic decisions. This reasoning can also be applied to savings, consumption, and credit choices.

2. What happens when the components of the real ex ante interest rate change?

	Merchant 1	Merchant 2
Nominal interest rate	10 %	10 %
Expected inflation	3 %	13 %
Real interest rate	+7 %	–3 %
Expected sale price	\$12,360	\$13,560
Expected profit	\$1,360,000	\$2,560,000

Using Merchant 1 as a benchmark (nominal interest rate of 10%, expected inflation of 3%, real interest rate of +7%, and expected profit of \$1,360,000), let's observe what happens when inflation expectations increase, and the central bank raises or keeps the nominal interest rate unchanged. In this example, we assume the interest rate applicable to the merchant changes in lockstep with the monetary policy interest rate. In reality, interest rates can also fluctuate due to increases in country risk, increases in other benchmark interest rates, such as those on public debt bonds (see Box 5 of this *Report*), or factors related to the person applying for the loan.

Scenario 1: inflation expectations rise by 200 bps, and *Banrep* does not adjust the policy rate

Expected inflation increases from 3% to 5%, but the nominal interest rate remains at 10%. The real rate falls from +7% to +5%. The expected sale price rises to \$12,600, loan interest remains at \$1,000,000, and the expected profit totals \$1,600,000. The transaction becomes more attractive: real borrowing costs have declined, and the merchant has greater incentives to borrow and spend.

Scenario 2: inflation expectations rise by 200 bps, and *Banrep* reacts by raising the interest rate by 200 bps

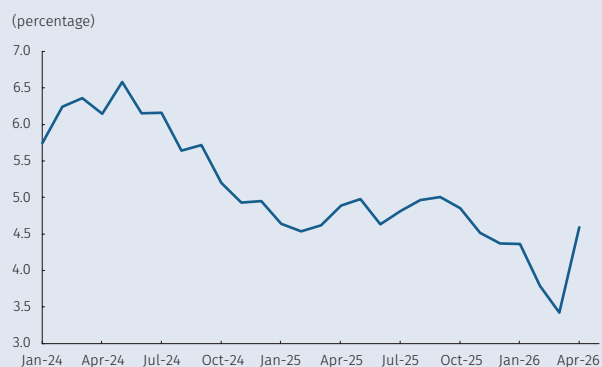
Expected inflation increases from 3% to 5%, and the nominal interest rate rises from 10% to 12%. The real rate remains at +7%. The expected sale price rises to \$12,600, the loan interest rises to \$1,200,000, and the expected profit is \$1,400,000. The business remains practically the same as in the benchmark situation (profit of \$1,360,000) because the Bank neutralized the effect of the increase in inflation expectations.

Scenario 2 mirrors *Banco de la República's* actions during January and March 2026: by raising its nominal interest rate by an amount similar to the increase in inflation expectations in the first two months of the year, it prevented credit from becoming cheaper in real terms and from generating additional incentives to spend and borrow at a time when inflation was already high and expected to rise. In other words, the Bank did not seek to restrain economic activity; it simply avoided overstimulating it in an environment of rising inflation.

Scenario	Nominal interest rate	Expected inflation	Real interest rate	Expected profit
Base	10%	3%	+7%	\$1,360,000
1. Inflation increases, the Bank does not react	10%	5%	+5%	\$1,600,000
2. Both inflation & MPR increase	12%	5%	+7%	\$1,400,000

Graph B1.4

Ex ante benchmark rate (12-month average inflation expectations)



Note: The calculation uses the 12-month average inflation expectations (ETE, EME, BEI) available at the time of the monetary policy decision.

Sources: Banco de la República; author's calculations.

3. So, what actually happened to the real benchmark interest rate?

Graph B1.4 shows *Banco de la República's* real *ex ante* interest rate calculated as the difference between the nominal monetary policy interest rate and the average of the different measures of inflation expectations presented (Graph B1.2). As observed, despite the 200 bps increase in the nominal interest rate between January and March 2026, the real *ex ante* interest rate is similar to that recorded in December. In January, it fell sharply due to an increase in inflation expectations, a decline that was then corrected by an increase in the monetary policy interest rate, leaving it at levels comparable to those in December. Thus, the BDBR's decisions sought to offset the effects of the rise in inflation expectations without tightening monetary conditions, thereby continuing to reduce inflation and protect the purchasing power of all Colombians.