Presentation, summary and conclusions

- Annual consumer inflation stood at 9.7% in June, identical to the first quarter but above inflation in June 1999 (9.0%). The new feature in the second quarter was negative monthly inflation in June (-0.02%), the first since August 1988. Current- year inflation in June was 7.0%, which is slightly above price growth during the first half of 1999 (6.5%) but below accumulated inflation in the first half of 1998 (14.1%). In the second quarter, unlike the first, inflation was not pulled up by food prices. On the contrary, in May and June, a seasonal recovery in food supply helped to slow price growth. The other item determining the behavior of consumer inflation in the first quarter; that is, services, remained an accelerating factor between March and June.

- In the year as a whole, four market-basket components registered annual price adjustments in excess of average inflation: transport (18.4%), sundry expenditures (17.4%), health care (11.2%) and food (9.9%). These above-average increases in Consumer Price Index (CPI) groups are explained by higher prices for fuel (transport) and banking services (sundry expenditures), and by devaluation, which made items such as medicine (health) more expensive. Seasonal food shortages (foodstuffs) during the first four months of the year were also a factor. The only groups to experience price changes below total inflation were education (8.3%), housing (5.2%) and clothing (2.8%).

- According to the alternate classification, the rise in inflation over the past twelve months is due to non-tradables. As a whole, they increased inflation by 2.2 percentage points. The 25.5% price rise in flexible goods (root crops, fruits and vegetables) was important and added 3.8 percentage points to the acceleration in overall inflation for the period. With an annual price variation of 9.4%, tradables had the opposite effect.

- Annual producer inflation in June was 15.6%; that is, 1.9 percentage points higher than in March (13.7%) and 9.5 percentage points above the rate in June 1999 (6.1%). As with consumer inflation, prices for farm products in the second quarter, especially foods, ceased to exert upward pressure on producer inflation. The rise in producer inflation during the last three months is, therefore, explained mainly by added growth in the price of industrial goods. This is consistent with greater devaluation and the substantial rise in domestic gasoline prices.

- With data to June, core inflation calculated by the Banco de la República, using the four traditional indicators, is 9% or 0.6 percentage points higher than inflation calculated with data to March. This increase is the result of an upsurge in core inflation calculated by the trimmed mean and particularly by the asymmetric mean. With respect to the other two indicators, inflation excluding food dropped in the second quarter, while the inflation nucleus remained stable. As explained in this report, the rise in average core inflation in June does not necessarily reflect emergence of demand pressure; it is more a question of the temporary inability of asymmetric and trimmed mean indicators to measure this type of pressure accurately. In effect, the statistical procedures used to calculate these two indicators in June led to the exclusion of rental prices. Thanks to an extremely low annual increase, rental prices helped to temper core inflation measured in this way. The same problem did not occur with the inflation nucleus or inflation excluding food, which seems to suggest these indicators should be used to assess the actual behavior of demand-pull inflation. An average of the last two indexes shows core inflation may have dropped in the second quarter by about 0.2 percentage points.

✠ At the end of June, the monetary base 20-month moving average was 3.4% above the original corridor ceiling. As analyzed in this report, greater growth in more liquid monetary aggregates -monetary base and M1- is due to growth in the demand for cash, thanks to factors such as low interest rates and the "two per thousand" tax on banking operations. The increase, therefore, should not affect prices due to growth in aggregate demand beyond what is expected.

✠ During the month in question, the financial system's nominal and real loan portfolio continued to drop at rate similar to that of the previous month. The exception in the financial system is still the nominal loan portfolio of private financial institutions, excluding savings and loan corporations (CAVs) and mortgage banks; it continues to exhibit positive annual growth of around 4.5%. On the other hand, the nominal lending rate was 24.0% in June, similar to the rate in March (23.7%), while the nominal deposit rate edged up from 10.9% in March to 12.0% in June. In terms of real interest rates, this implies a second-quarter rise of 1.0 percentage points in the deposit rate during the last month and 0.4 percentage points in the lending rate. At June, these rates were 2.1% and 13.1%, respectively.

✠ The latest figures on the productive sector suggest the economy continued to expand in the second quarter of the year. This claim is based on the recent trend in indicators such as electrical power consumption, automobile sales, credit-card consumption, and temporary employment and overtime. Growth trends in industrial production and exports at May were also a factor. However, use of installed capacity remains low, as demonstrated by the Fedesarrollo and ANDI indicators, and no great demand pressure is anticipated in the coming months.

✠ In view of the statistical problems involved in calculating the asymmetric and trimmed means, core inflation forecasts for the rest of the year should eliminate fears of a possible upsurge in demand-pull inflation. With data to June, the forecasts for all four core-inflation indicators remain below the target of 10%.

✠ First-semester inflation is compatible with the target of 10% for the current year. To date, there are clear indications that the upsurge in inflation at the beginning of the year was a temporary phenomenon, as foreseen by the Board of the Banco de la República, and was due largely to the food price cycle. As has been the case since May, these factors will have much less influence in the second half of the year.

✠ The slowdown in inflation during the last two months is particularly significant, as it occurred at a time of economic recovery. This reaffirms the possibility of economic recovery without sacrificing progress towards price stability, which is a fundamental goal of the current macroeconomic program.

✠ Although it is optimistic about meeting this year's inflation target, the Board has its eye out for possible inflationary pressures in 2001. Some have been identified already. One is the growing pace of devaluation in recent months. By making imported goods more expensive, this could alter prices to the extent permitted by recovery in aggregate demand. Furthermore, rapid growth in certain monetary aggregates, as with the monetary base and money supply (M1), could also exert pressure on prices in the medium term.

✠ Recognizing these and other factors in due time and technically assessing their possible effects through the use of forecast models has enabled the Board to take steps to prevent pressures of this sort from having an effect. It intends to do all possible to ensure that inflation in the year 2001 does not exceed 8% and to consolidate what is now being accomplished; that is, economic recovery in an atmosphere of price stability.

The Board of Directors,

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Juan Camilo Restrepo Salazar
Minister of Finance and Public Credit

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