Minutes of a Meeting of the Board of Directors of the Central Bank of Colombia on November 21, 2008

A regular meeting of the Board of Directors of the Central Bank of Colombia was held in the city of Bogotá on November 21, 2008.

Present:

Mr. Óscar Iván Zuluaga, Minister of Finance and Public Credit

Mr. José Darío Uribe, Governor, Central Bank of Colombia

Permanent Board Members:
Mr. Carlos Gustavo Cano
Mr. Juan José Echavarría
Mr. Juan Mario Laserna
Mr. Fernando Tenjo
Mr. Leonardo Villar

The situation and prospects with respect to inflation and economic growth were discussed and decisions on monetary policy were reached. The following is a summary of the main topics addressed at the meeting.

1. BACKGROUND

a. Recent inflation developments

The yearly inflation for consumers in the month of October was of 7.94%, increasing 37 bp as compared to September, time in which it had decreased. The accumulated inflation during the first ten months of the year reaches 6.9%, and the different indicators of basic inflation increased during the last month.

The inflation of non tradable goods, except food and regulated prices, was of 5.7%, as compared to 5.1% in September. This increase was concentrated in rentals and banking services and those related to entertainment. On the other hand, the inflation of tradable goods except food and regulated prices increased from 2.2% in September to 2.3% in October.

Inflation of food in October increased by 38 bp as compared to the previous month, reaching 13.2%. The upward pressures were originated by the prices of beef meat and its substitutes and by those of cereals (particularly rice and corn), oils, and others. In this way, the increase in the prices of food explains the 67.97% in the acceleration of inflation during the course of the present year.

The prices for regulated goods presented an annual increase of 10.8% in October, 33 bp higher than in the previous month, with the prices of gas and fuels standing out.

The different measurements for the inflation expectations resulting from public debt bonds (to 1, 5, and 10 years) are still over the targets set by the Board.

The annual variation of the producer prices (PPI) increased from 9.8% in September to 11.8% in October.

b. Internal Growth

The information available shows that:

- Industrial production according to the DANE contracted to an annual rate of 3.3% in September, which produces a result of -1.1% to this date. With this new number, the industrial growth in the third trimester was of -3.4%. The industrial confidence indexes and the level of stock and demand provided by Fedesarrollo to September corroborate this trend.

- Retail sales contracted to a yearly rate of 2.5% in September, with which the growth in the trimester would have been null. The information from surveys by Fenalco until October confirms the loss of momentum in sales during the last six months. Something similar is suggested by the indicators produced by Fedesarrollo for the sector, such as the current economic situation and the expectations of economic situation six months from now.

- The numbers on energy demand to September and October showed improvement after a low registry in August. For example, in October the annual growth was of 3.8%, higher than the one observed along the year until September (2.1%). However, this increase could be due to the high demand from the mining sector instead of to a generalized recovery of the economy.

- For the fourth trimester, situations such as the strike of sugarcane collectors and the paralysis of the sugar refineries add up to the weak performance of the demand. Additionally, the possible consequences that the fall of the pyramids may bring on the consumption indicators in several regions must be considered.

- Regarding labor market, hired employment is falling, whereas the so-called self-employment continues to rise.

c. External Context

The financial crisis has had consequences on the activity of the real sector. In the USA, the growth of the GNP during the third trimester entered a negative terrain with -0.3% (t/t) (according to the preliminary data), while the Euro zone completed two consecutive trimesters falling (each of -0.2% t/t), with which said economy could be technically in recession. Something similar happens in the UK and Japan, where growth has been null or negative in two trimesters. In China, although the expansion continues to be important, a significant deceleration has been observed in the last months.

Facing this scenario, the economic authorities in the USA reformulated their salvage plan, emphasizing the recapitalization of the financial system and the creation of mechanisms to encourage credit. In Europe, although a joint economic program is expected, several countries such as Germany and Spain have decided to act individually. On the other hand, China announced a plan to strengthen its economy which reaches up to 17% of the GNP for 2007 (4 trillion Yuan), which would be performed during the following three years.

The policies established by the economic authorities in the USA and in Europe have allowed the reduction of liquidity problems, although the situation has not yet returned to its full normality. At the same time, aversion to risk is still high and investors continue to seek refuge in more secure assets.

During the first two weeks of November, the risk premiums of emerging economies decreased from the high levels reached by mid-October, but they remain high as compared to the observations made two or three months ago. These premiums could be affected by the particularly vulnerable situation in several countries of the Eastern Europe.

The prices of the basic products have decreased rapidly. In the case of petroleum, the fall from July to the second week of November has been of 60%, leaving the price at about $55 dollars per barrel, a level that had not been experienced since 2005.

For developed economies as well as for many countries which are importers of raw materials, these lower prices must result in a decrease in their inflation in the short term. However, for the countries which are exporters of raw materials such as those in the region, the inflationary situation is more complex since the fall in the prices will tend to be accompanied by a depreciation of their currencies. A reduction in inflation has not yet been observed in Latin America, while several currencies in the region have depreciated during the last months.

Given the aforesaid, the panorama of the monetary policy is very diverse. On the one hand, the central banks of major economies (USA, Euro Zone, China) have reduced their rates upon perceiving lower inflationary risks and due to the existing preoccupation regarding growth. On the other hand, some emerging economies from Eastern Europe have increased their rates, while in Latin America they remain unaltered.

d. Financial variables

The main monetary aggregates maintained expansion rates similar to those observed in previous months. The M3 and the liabilities under statutory reserve requirements grew at annual rates of 15.5% and 16.4%, respectively.

In October, the dynamics of liability portfolios continued on its path of moderation. The total liabilities in legal tender of the financial system showed an annual growth of 18.5%, as compared to a 19.1% one month before. Commercial liabilities grew 20.6% compared to 19.8% in September, while consumption liabilities grew at a rate of 14.9%, less than that of the previous month (17.6%). Mortgage liabilities also decelerated slightly.

The majority of asset and liability rates diminished in October, in nominal as well as in real terms. In October, the average rate for customer acquisition for limited term deposit certificates descended 16 bp, reaching 10.3%. The DTF and savings rates increased slightly (10pb and 4bp respectively) reaching 10% and 5%. On the other hand, the active average rate calculated by Central Bank of Colombia reduced in 26pb as compared to the previous month, reaching 17.1%. Similarly, the interest rates of household credits diminished: consumption rates by 29 bp and credit card rates by 24 bp. This movement was accompanied by a fall in the usury rate of 73bp. The rates for commercial liabilities presented a mixed behavior, descending (51 bp) for ordinary credit, and increasing (24 bp) for treasury credit, and remaining stable in the case of the preferential rate.

The Colombian Peso remained stable before the US Dollar since the last meeting of the Board of Directors.

2. DISCUSSION AND POLICY OPTIONS

In the development of the discussion the following issues were highlighted: (i) the rhythm of increase in prices continues to be above the targets established; (ii) the increase presented in the last month due mainly to the prices of non tradable goods; (iii) the international prices of food, raw materials, and petroleum continue to decrease, which might have an important effect on the total inflation within a few months, depending on the behavior of the exchange rate; (iv) the prices of regulated goods continued to increase, given the indexation mechanisms incorporated in the determination of the price lists and the inflation of non tradable goods; (v) the economic activity continues to weaken; (vi) the production costs of the companies show important increases, as is reflected by the increase in the growth rhythm of the PPI; the greatest depreciation of the Peso observed could be expressed in additional pressures; (vii) uncertainty over the future behavior of the world's economy and of our main exportation markets, particularly those of Venezuela and Ecuador; viii) the effect of the exchange rate on the inflation and the growth of the tradable sectors; and ix) the behavior of the expectations of inflation for the medium and long terms, which continue to be higher than the targets set by the Board.

The main issues discussed among the members of the Board were: i) the effect of the measures of monetary policy given their lag; ii) the elements that affect the projections of inflation for 2009 and 2010; iii) the behavior of inflation of the non tradable goods except food and regulated prices; iv) the effect that the short-term behavior of inflation may have over the formation of prices and salaries in 2009; v) the implications regarding the inflation observed as well as the expectations of inflation of the current policy of restriction to the importation of some agricultural products, whose impact on the basic food supply is significant; vi) the projections of deficit in the current account; vii) the effects of volatility in the exchange rate and the devaluation observed during the last months; viii) the uncertainty generated by the financial crisis around the world on international markets and their incidence on the Colombian economy; ix) the difficulty to evaluate the available information in a juncture in which there has been a rupture in the growth cycle; x) the balance of risks between growth and inflation in a context in which expectations of growth are maintained over the targets and the necessity of deceleration of the economy; and xi) the need to strengthen the credibility of the monetary authorities and anchor the expectations of inflation.

The members of the Board emphasized the goodness and efficacy of the decisions on monetary policy adopted since April 2006, addressed to eliminating the excess of demand and the growth of credit, controlling the entrance of foreign speculative capital, strengthening the position of international reserves, and mitigating the effects over the inflation expectations of the highest international prices of basic products.

They highlighted that the international deterioration still continues, which has caused restrictions on credit worldwide and a lower growth of our main commercial partners. Additionally, the information available shows that the productive sector in Colombia continues feeling the negative effects of the increase in costs and the fall in the demand, which is reflected in a lower growth dynamics of the GNP.

The international crisis has also led the prices of assets to continue showing great volatility as well as to the increase in risk premiums and external interest rates for all emerging economies.

The prices of food, the devaluation of the Peso, and eventually the higher salary costs could maintain total inflation high in the following months. However, it is expected that the weakness in the demand and the recent reduction in the international prices of the main basic products will turn out into less inflationary pressures in the future.

Some directors highlighted from the aforesaid that it is not yet opportune to revise the approach of the monetary policy by reducing the interest rates for intervention. Even if some inflationary pressures have been reduced, there is as yet no evidence that they may be sufficiently under control. The same happens with the inflation expectations which remain in high levels. There is uncertainty especially on the behavior of the Exchange rate and its effects over the prices and the perspectives of salary increases to be decided in the coming months. The risks of the international crisis over the financing of the balance of payments constitute an additional argument to be cautious in the adoption of the monetary policy.

Additionally, these directors considered that the commitment of the monetary authority with the long-term inflation targets promotes the conditions for a sustained growth of production and employment. Similarly, that in the present juncture, a premature change on the monetary policy could lead to an increase in the inflation expectations, which would raise the medium and long-term interest rates, bringing negative effects on the economic activity and the price of the titles in public debt. Acting without the necessary precaution would reduce the capacity of the monetary policy to operate in an anti-cyclic manner in the future.

Another position within the Board considered that given the worldwide deterioration of economy and the fall of prices in basic products, as well as the subsequent reduction of inflationary pressures and expectations, a change in the monetary policy is opportune. Besides, they indicated that, in the internal scope, the new information continues showing that there is a pronounced fall in the growth of product. The negative behavior of the industry and commerce, the increase of its stock, and the reduction in the level of its orders, as well as the deterioration of the confidence indexes, the wilting of investment expectations and the feeling of consumers confirm the aforesaid. This reduction in the productive dynamics continues to be reflected in the increase of the national unemployment rate and the fall of hired employment. This group of directors indicated that the situation could become acute, depending on how the international crisis affects our main commercial partners. Considering that the monetary policy has to look ahead into a horizon of time of no less than one to two years, Central Bank of Colombia must begin a process to reduce the interest rate of intervention. On this matter, within this group there were two opinions: the first one stating that the aforesaid reduction should be of 25 basis point, and the second one stating that it should be at least of 50 basis point.

On the other hand, the Board unanimously set the inflation target for 2009 within the range of 4.5% and 5.5%, with 5% as a punctual target for legal effects. Similarly, it set the medium term for the range of the inflation target for 2010 on 4%, and the members expressed their trust in that inflation will be in the range-long-term target of (3% +/- 1 percent point) in 2011.

The new path for inflation considers the effects of the strong increase in the prices of food and regulated goods and services observed this year. This clash in prices, which took place in all world economies, produced a substantial increase in inflation and led to the non-fulfillment of the targets.

The decisions on monetary policy are headed towards retaking a convergent path of inflation towards the long-term target. In 2009 it is expected that the reversion or moderation of these clashes in relative prices, as well as the accumulated effect of the adjustments in monetary policy carried out since 2006, will produce a meaningful reduction of annual inflation on consumers. The announcement of the new targets shows the commitment of the Board to achieve the long-term target. It is also a fundamental criterion to guide the decisions on prices and salaries in economy.

Finally, the Board reiterated its commitment to providing the liquidity required by the economy by the end of the year and the need to continue tracking the international financial situation with the purpose of adopting measures of monetary policy which may be necessary to face its effects opportunely.

3. DECISION ON THE POLICY

The Board of Directors agreed, by majority, to leave the interest intervention rates of the Central Bank of Colombia unaltered.

On the other hand, the Board unanimously fixed the inflation target for 2009 within 4.5% and 5.5%, with 5% as a punctual target for legal effects and in 4% the medium term for the range of the inflation target for 2010.

Bogotá D.C., December 05, 2008