MINUTES OF THE MEETING OF THE BOARD OF DIRECTORS OF BANCO DE LA REPÚBLICA HELD ON 30TH SEPTEMBER 2011

On 30th September 2011, the ordinary meeting of Banco de la República's Board of Directors was held in the city of Bogota, attended by the Minister of Finance and Public Credit Mr. Juan Carlos Echeverry, the General Manager Mr. José Dario Uribe, and the exclusive full-time dedicated directors, Messrs. Carlos Gustavo Cano, Juan Jose Echavarria, Fernando Tenjo, Juan Pablo Zarate, and Cesar Vallejo, at which inflation and economic growth, and the perspectives for both situations were discussed, and decisions relating to the monetary policy were adopted. The following is a summary of the major topics addressed at the meeting.

1. BACKGROUND

a. Recent Developments in Inflation

Annual consumer inflation in August was 3.27% (-0.03% monthly), which means 15 basis points (bp) less than in July. This figure was lower than the projection of the Bank's technical team and what was expected for the market's average. For the year elapsed as of August, the CPI accumulated a 2.64% increase, this being a little higher than the one recorded in the same period of the previous year.

Food prices recorded a favorable behavior in August, which was translated into decrease in the annual variation of the respective CPI down to 4.6% from the previous month's 4.8%.

Regarding inflation without foods, the result in August was 2.76% as compared with 2.90% in July. This decline was due to a decrease in the annual variation of the regulated and non-tradable basket without foods or regulated items. In the case of non-tradable without foods or regulated, a significant 40 bp was seen as compared with the July record. This fall is in great part related to the reversion of the June increase. Notwithstanding, even discarding this phenomenon, some decline in the non-tradable adjustment rate occurred.

In the case of the regulated items basket, the price variation was 5.6% (7 bp less than in July). The variation of the annual regulated CPI has decreased gradually since March in the current year, due to the low adjustments, or even reductions, taking place in the electric energy charges. This may be added to fuel price adjustments, slightly lower than those observed last year.

In the CPI without food, upward pressures came this time from the tradable without food or regulated. The annual indicator variation was placed in a positive terrain (0.12%) for the first time since the beginning of the previous year. Items such as automobiles, electro domestic appliances, and electronic and communication apparatuses, continued to show falls in their prices, but of less magnitude than in the past year. Likewise, other categories relating to house cleaning, hygiene and wardrobe have started showing some rises. This behavior is likely due to the fact that the cumulative appreciation of the peso gave way in the previous months.

All basic inflation measurements showed reductions in August. For this reason, the growing trend exhibited by these indicators since the end of 2010 was interrupted.

Inflation expectations measured through surveys did not show important changes. They exhibit a result close to 3.2% for the end of the year and the next twelve months. On the other hand, the TES derivates at different terms continued to decrease and remained within the target range.

The variation of the producer price index (PPI) experienced a recovery in August and was adjusted at an annual 5.2% rate versus 4.8% in July. Increases were concentrated in the imported component of the indicator.

b. Growth

In the second quarter of 2011, the Colombian GDP grew at a 5.2% annual rate. Household consumption was the most contributing aggregate for GDP expansion in this period as mainly propelled by the purchases of durable and semi-durable goods.

Investment in fixed capital was as well accelerated during this period with the highest expansion rate in four years, and a growth average higher than that the past decade's. By components, the strong dynamism of investment in machinery and transportation equipment stands out. Construction has contributed negatively due to the fall of investment in civil works, not offset by the expansion in buildings. Simultaneously, in the second semester, a strong inventory accumulation was recorded, thus taking up to 21.1% the annual growth of total investment.

Internal demand in the second quarter grew 9.1% per annum and it remains as the main support of Colombian economy's growth. The annual growth rate of private demand was 11.7%. On the other hand, net exports contributed negatively to GDP growth. This was due to imports growing threefold over exports.

On the supply side, annual growths higher than 7% recorded by the mining, commerce and transport sectors were highlighted. However, due to its heavier weight in GDP, the branch of financial and real estate services was the best contributor to GDP growth. The industry's GDP grew 2.1% in annual terms, and contracted vis-à-vis the first quarter. The construction sector, due to the civil works fall, was the only one to register an annual backward movement.

Total exports in dollars grew at a 55% annual rate. This increase was propelled by both higher prices and the amounts of crude oil and by-products produced and, in lesser degree, by exports of coal and some industrial products. As per exports of basic agricultural products (like coffee, bananas, and flowers), an annual 6.6% fall was recorded. In the case of industrial exports (without oil derivatives, ferronickel, gold and coffee) during the month of July, a recovery was seen in both prices (20% per annum) and amounts (20% per annum).

Total imports in dollars showed an annual 33% variation in July. Major contributions to the annual growth of external purchases during July were concentrated in goods for industry, transport equipment, fuels, and non-durable consumption goods. Particularly, annual growth for consumption goods imports was 21%, for intermediate goods was 29%, and for capital goods was 46%.

With respect to the third quarter of 2011, most activity indicators available suggest that the economy would have maintained a good performance. By type of expenditure, growth in the third quarter would have continued to be propelled by household consumption as inferred from the behavior of consumer’s trust, consumption credit as of August, and the good dynamism of consumer goods imports as well as of retail sales as of July continuing to show a positive trend.

The recent evolution of the labor market would also support the favorable dynamics of private consumption. In the moving quarter as of July, the higher growth of the occupation rate with respect to global participation allowed the unemployment rate to keep its decreasing tendency. Notwithstanding employment creation being more concentrated on non-salaried than salaried workers, underemployment continued to decrease with no apparent deterioration of employment quality, for this reason. The labor market is expected to persist on behaving favorably during the rest of the year.

On the supply side, some variables associated with the manufacturing industry such as the DANE’ industrial production index as well as the Fedesarrollo’s orders indicator (both as of July), and the sector’s energy demand (as of August) suggest a relative stagnation of the productive activity. However, predicting sector’s deterioration is still premature if we consider that the indicator of the industrialists’ expectations on their three-month production has been kept at considerably high levels. Other sectoral indicators suggest that commerce, construction, mining, and services shall be the activities that will contribute most to GDP growth in the third quarter. Hence, the expansion rhythm of the third quarter is likely to be higher than the second quarter’s.

Based on the above, it is probable for economy to accelerate its growth. In addition, it is feasible that the Colombian economy will not be hit in an important manner by the less favorable international conjuncture in the third quarter.

Towards the fourth quarter, an adverse effect on internal economy may be seen if the deterioration of the external situation is confirmed. Under the presupposition that the fourth quarter may not growth with respect to the third, the full year's GDP would grow about 5.2%, this figure being within the (4.5 to 6.5%) prediction range set forth in the June quarterly report.

c. Financial variables

Total credit in national currency ["*moneda nacional*"] (MN) and foreign currency ["*moneda extranjera*"] (ME) was stabilized at high growth rates. As of August, all credit modalities, for households and enterprises, are recording growths extremely higher than the 2011 estimated GDP growth. This has taken place in a context of historically low real interest rates.

In July and August, (MN and ME) bank credit was stabilized at an average growth rate of 23.2% per annum. Likewise, by portfolio modalities in these two months, the average annual growth was: 2.5% for consumption, 23.1 for commercial, and 17.3% for mortgage portfolios.

In July, the real interest rates (with the exception of GDP without food) for consumer, mortgage and ordinary commercial credits were placed at 15.5%, 10.0% and 8.0%, this figures being lower than the averages seen since 1998.

With respect to portfolio, the annual growth rates are sustained by indebtedness in pesos, since annual growth in foreign currency is decreasing because the balance since May has been maintained around US$ 6,850 billion [in US figure representation], 6,850 million [in English and European figure representation].

d. External context

In the few past weeks, the international context has continued to deteriorate. Fears relating to the sovereign debt problems in Europe are increasing, and growth forecasts for the United States and Europe in 2012 have been revised downwards.

Considerable volatility and strong losses in the equity markets have been associated, in large part, with high uncertainty about the fiscal situation of some developed economies; markets are more and more skeptic with respect to the abilities of those affected by fiscal problems to stabilize their public debt.

In the Eurozone case, doubts were increasing about the solvency of some commercial banks in the region having high investments in sovereign bonds of countries with fiscal problems. In fact, during the last two months, signs indicating a likely increase in developed economies' liquidity emerged, particularly in Europe. In this continent, the differential between the Libor and the interbank rates continues to rise. In addition, restrictions are being seen for the mid-term founding, likely to limit the granting of credit. The risk perception with respect to the banking business in these economies is increasing again and reaching the 2008 and 2009 levels.

The most recent announcements and measures introduced by governments and economic authorities in these countries to confront the fiscal problems have not been effective to enhance agents' confidence. Global securities/stock markets have experienced drastic falls not limited to bank actions only. The absence of decisions addressing the problem of the sovereign debt in Europe imposes more and more serious risks on the international financial stability. Adding to the above is fiscal uncertainty in the United States, for lack of agreement between the political parties on the necessary measures required to reach a sustainable debt.

Face to this general overlook, the recovery of internal demand in developed economies may get even more complicated as, in fact, some real activity indicators in both Europe and the United States already suggest.

In the Eurozone, a contraction of the manufacturing activity was observed. In Germany and France, the two growth engines in the region, a deceleration of exports has been witnessed. And this has been the most dynamic demand component in the past two years. The labor market is neither showing recovery signs, this making a very weak consumption foreseeable for the third quarter of the year. In the European periphery economies, fiscal adjustment programs will continue to depress the internal demand's recovery perspectives in the short term. In this manner, growth forecasts for the Eurozone are diminishing. For instance, for 2011 and 2012 they were reduced by the IMF from 2.0% and 1.7% to 1.6% and 1.1%

In the United States, during the past two months, several indicators of real activity have deteriorated. Since April, both personal consumption like retail sales show very little growth, this being in part explained by the conditions of the labor market and consumers' impaired confidence. The high levels of household indebtedness have not been significantly reduced, this fact being a negative factor in the reactivation of their internal demand. Moreover, the deterioration of the economic and financial situation in Europe, as well as its effects likely to affect world demand, may limit its exports Hence, the IMF reducing growth forecast for 2011 and 2012 from 2.5% and 7% to 1.6%, and 1.9% respectively. All the projections of analysts consulted by the technical team were as well revised downwards.

In the emerging economies, some moderation has occurred in the observed and expected growth. This can be explained in part by more restrictive monetary policies, the elimination of fiscal incentives, and the world demand deceleration. Particularly, markets are closely following China and India where some indicators point out at some deceleration, and Brazil where this trend is more evident.

As per basic product prices, industrial activity deceleration worldwide has slowed down the demand for these goods in such a way, that in the past few weeks a decrease has been seen in the international quotation of prices for some, particularly oil, copper and coal.
The prices of other basic products of agricultural origin such as cereals and oils, suspended their upward rend and got stabilized at high levels.

Turbulence in the international financial markets is beginning to be strongly felt in Latin America, especially in the exchange and the security/stock marketplaces. Risk premiums in the region countries are increasing and currencies have been depreciated against the US dollar, in this way attaining levels unseen since the end of 2009.

Likely, if the situation in the United States and Europe gets complicated, growth in the region's countries may be negatively affected trough different channels. One of them would by the loss of confidence, this being a variable having played an important role in the previous crisis. Another channel would be the lessened national income, since a depressed external demand may generate addition decreases in the prices of basic goods, as well as falls in exports and high volatility in capital flows. Nevertheless, the major Latin American economies may have a larger space than developed economies to cushion a likely fall by means of (fiscal and monetary) counter-cycle policies.

Growth predictions in emerging economies have began to diminish, but in a less pronounced manner than those of the developed economies. In the case of China, the IMF revised its forecasts for 2011 from 9.6% to 9.5%, and for 2012 from 9.5% to 9%.
Anyway, emerging economies are expected to continue to foster world growth; and, among other reasons, because household consumption in these countries will be more dynamic than in the developed economies.

2. DISCUSSION AND POLICY OPTIONS

The Board members highlighted the following issues:

i) the growing uncertainty at the international financial markets; ii) GDP growth in the second quarter; iii) the dynamic performance of the internal demand, as reflected on both consumption increase and private investment; iv) the best indicators of employment quality in the labor market; v) the stabilization of the credit growth rate at high levels for both homes and enterprises; vi) the context of low real interest rates that, even having become higher, they show lower levels than their historical averages, and their likely future effect on the economy's risk taking if they are kept for an excessive prolonged period: vii) the high level of exchange terms, despite the fall of some prices for exports, like oil; viii) the annual August inflation decreasing more than foreseen (3.27%), particularly for the non-tradable and regulated prices behavior. On its side, the average of basic inflation measurements are within the target range (3% +/- 1 percentage point); ix) the different-term basic inflation expectations being reduced, and inflation projections maintained at the end of 2011 and 2012; x) other countries' monetary policy, and xi) the exchange rate behavior.

The Board of Directors of Banco de la República has decided to keep the intervention interest rate unaltered at 4.5%, based on the following main considerations:

The international context has deteriorated in the weeks subsequent to the past meeting of the Board. Fears regarding the sovereign debt have been growing, and growth predictions in the United States and Europe in 2011 and 20012 have been revised downward. In certain Asian and Latin American economies, the new information points out to some moderation in growth. Although International prizes for basic products have gone down, they still remain at high levels. Besides the volatility of financial markets has increased.

As for Colombia, it was highlighted that : (i) data for the first semester showed economic activity expanding at a good (5%) rhythm similar to that previously projected. Growth has been propelled by the strong dynamism of internal demand, particularly from the private sector with an annual rate of 11.7% in the second quarter. For the third quarter, the new information currently available suggests that growth may be higher than recorded in the first semester. Thus, the probability of the growth-prediction range (between 4.5% - 6.5%) for 2011 is still high. (ii) The annual growth of bank credit became stabilized at a high rate in an environment of real interest rates on loans that, in spite of their increases, are still below their historical averages. Consumption remains being the most dynamic portfolio, with increases almost threefold the nominal GDP growth estimated for 2011; and (iii) the new housing price index continued to increase and reached in July the maximum record of the series, as calculated since 1997.

In this context, the risk balance was not substantially modified vis-à-vis the previous month. While external factors were reflecting more risks and uncertainty, Colombian economy is maintaining a strong dynamics.

3. POLICY DECISION

The Board of Directors has unanimously agreed to keep the intervention interest rate unaltered at 4.5%. Likewise, it considers that the current level keeps the rate in a good position to answer to the new information regarding global and national economy.

The Board will continue to carefully monitor the international situation, together with inflation behavior and forecasts, growth, active markets behavior, and it reiterates that future monetary policy will depend on the new information available.

Bogotá D. C., October 14 2011.