Minutes of a Meeting of the Board of Directors of Banco de la República on September 24, 2010

A regular meeting of the Board of Directors of Banco de la República was held in the city of Bogotá on September 24, 2010.

Present:
Mr. Juan Carlos Echeverry, Minister of Finance and Public Credit
Mr. José Darío Uribe, Governor of Banco de la República

Full-time Board Members in Attendance:
Mr. Carlos Gustavo Cano
Mr. Juan José Echavarría
Mr. Fernando Tenjo
Mr. Cesar Vallejo
Mr. Juan Pablo Zárate

Inflation and the economic situation were discussed with respect to growth and prospects for the future, and monetary-policy decisions were reached. The following is a summary of the main topics addressed during the meeting.

1. BACKGROUND

a. Recent Developments in Inflation

Annual consumer inflation was 2.31% in August (0.11% for the month) compared to 2.24% in July. As a result, accumulated inflation is now 2.54%.

As has been the case for several months, the main upward pressure on annual inflation comes from prices for regulated items and food. The annual increase in prices for regulated items went from 5.23% in July to 5.69% in August, due to adjustments in utility rates, specifically for water and residential natural gas. The annual variation in the food CPI was 1.80% in August, as opposed to 1.71% the month before.

The annual variation in prices for non-tradables, excluding food and regulated items, decline from 3.78% in July to 3.69% in August. The annual increase in prices for tradable goods, excluding food and regulated items, remained constant at -0.77% between July and August.

The core inflation indicators remained virtually stable during the past month and were below 3%. The lowest continued to be the CPI excluding food and regulated prices, with an annual increase of 1.7%.

Given the preliminary figures for September to date, inflation expectations derived from trading in government bonds at one, five and 10 years came to 2.43%, 3.67% and 3.98%, with respective variations of +74 bp, -2 bp and -9 bp compared to the average the month before.

Inflation expectations detected in the monthly survey conducted by Banco de la República at the start of September continue to show reductions and are within the long-term target range set by the Board of Directors.

As to pressure from non-wage costs, it is important to note that PPI performance to date suggests these costs are not significant. The annual variation in the PPI by August was only 2.0%, with a slight increase due to an extremely low base of comparison.

b. Growth

DANE says GDP grew at an annual rate of 4.5% during the second quarter. With the new figures, household consumption continued to recover, bolstered by low interest rates, high levels of confidence and low inflation. Its annual growth went from 3.5% in the first quarter to 3.9% in the second.

The decline in the unemployment rate came to a halt in July due to an increase in the supply of labor (12.6% total unemployment nationwide and 13.3% in the thirteen major cities). The employment rate for household heads remains at levels above 74%.

In general, the economy is still being bolstered by internal demand, including total investment and government consumption. The negative contribution from net external demand was more pronounced in the second quarter than in the first, given the momentum gained by imports and the slow growth in exports.

Growth during the first quarter of 2010 was revised downward to 4.2% as opposed to the initial estimate of 4.4%. This figure brought the average annual increase in GDP during the first half of the year to 4.3%.

As for the third quarter, the supply indicators at hand show mixed performance and suggest that economic growth could slow in a number of branches such as transportation, energy, gas and water, and industry. In the case of the latter, this is according to the ANDI and Fedesarrollo surveys and the DANE data at July.

The figures on demand are more favorable, particularly with respect to household consumption. According to the opinion polls in August and the latest figures on commerce, household consumption is growing at a good pace.

A number of indicators, such as foreign investment, imports of capital goods for industry and the local manufacture of machinery and equipment, suggest that corporate investment is gaining strength. The increase in building permits and good performance with respect to mortgage lending also imply some recovery in building construction.

c. The External Context

The latest available data on the external front suggests less growth in the United States and Japan. In the United States, which is Colombia's major trading partner, GDP during the second quarter of 2010 was revised downward from 2.4% (a/q) to 1.6% (a/q), primarily because of slower growth in investments and exports. For the third quarter, the new figures on the job market, industrial sentiment, retail sales, consumer lending and housing starts suggest that growth during the second half of 2010 could be less than what analysts had estimated previously.

The latest information on GDP in Europe was better than expected, causing the market to raise its forecasts for 2010 as a whole. However, the new data for the third quarter show this momentum is losing force. In July, industrial production in the Euro Zone rose 7.1% (the forecast was for 8%); a month earlier, it increased by 8.3%. In Germany, the country in the Euro Zone that has grown the most, the indicator of economic sentiment among analysts (ZEW) entered negative terrain in September , (-4.3 points; 14 points were expected) and reached its lowest level in 19 months.

With the exception of Venezuela, our major trading partners in Latin America experienced high growth rates during the second quarter of 2010, although those rates are expected to be more moderate during the remainder of the year.

In the case of Venezuela, GDP growth during the second quarter of 2010 (-1.9% annual) showed that country's economy is still in a recession; however, it is less pronounced than analysts had predicted. Internal demand in Venezuela declined at an annual rate of 0.9% during the same period, primarily because of the drop in household consumption (-2.5% annual).

d. Financial Variables

In August, the nominal rates on consumer and ordinary lending averaged 17.6% and 9.8% respectively, having dropped by 32 bp and 6 bp, in that order, compared to the month before. The rates on mortgage lending remained stable at 12.9%. Accordingly, the interest rates on loans to households and companies are at historically low levels.

The average annual increase in the total gross loan portfolio came to 6.6% in August, having been 4.4% the month before. The mortgage and consumer loan portfolios continued to be the most dynamic, with 19.3% and 10.6% annual growth, in that order. These figures exceed those in July by 50 bp and 130 bp, respectively. In August, annual growth in the consumer loan portfolio was up by 110 bp compared to July and came to 2.5%.

The rates on one-year and five-year government bonds dropped by 10 bp and 15 bp, respectively, between the end of August and September 17, 2010. On the same date, 10-year bonds were at 7.79%, which is 4 bp more than the rate posted at the end of the previous month.

2. DISCUSSION AND POLICY OPTIONS

The following points were emphasized by the Board during its deliberations:

i. Inflation at August
ii. Core inflation indicators
iii. Inflation expectations
iv. The available data on economic growth
v. Producer and consumer confidence indicators
vi. Development of the peso-denominated loan portfolio in the financial system
vii. The performance of market interest rates in response to the Bank's benchmark rate cuts.
viii. The impact of the exchange rate on inflation and prices in the tradable sectors
ix. The performance of government bonds
x. Data on world economic growth, especially the figures on economic growth in the United States

The main points analyzed by the Board members centered on the following aspects: (i) the inflation forecasts for 2010 and 2011; (ii) the decline in the variation in prices for tradables due to peso appreciation with respect to the dollar; (iii) the delayed effect of monetary policy measures on production and prices; (iv) the forecasts for economic growth in 2010, which suggest recovery will be slower than expected (v) investment performance and the increase in consumer confidence (vi) the recent momentum in the portfolio of the financial system; (vii) the rise in prices for financial assets and housing; (viii) the drop in inflation expectations; (ix) the recent developments in capital flows; (x) the performance of government bonds, which shows valuation at the short end of the curve and depreciation at the long end; (xi) the risk balance between growth and inflation in a context where the economy is recovering and inflation is within the long-term target range; and (xii) the need to maintain the monetary authority's credibility and to anchor inflation expectations to the long-term target.

The Board of Directors highlighted the following aspects with respect to inflation during the month: (i) Annual consumer inflation in August was 2.31%, which is slightly more than was anticipated by the market and by Banco de la República's technical team. (ii) The core inflation indicators declined once again. (iii) Inflation expectations remain low. (iv) The outcome for inflation in August is consistent with the technical team's forecasts. These suggest - with a high degree of confidence - that inflation will be within the long-term target range in 2010 and 2011.

The Board emphasized that the information at hand indicates the Colombian economy is growing at the anticipated rate, without bringing inflationary pressure to bear. The economy still is being bolstered by internal demand, including total investment and government consumption.

The world economy continued to grow, although more slowly than during the first half of the year. Nevertheless, the Asian economies are growing at a good pace and the Latin American economies have shown an increasing amount of recovery.

As for the rest of the year and early 2011, the Board expects the Colombian economy to see favorable terms of trade, larger capital flows, low international interest rates and a weak recovery in external demand.

The Board believes its expansive monetary policy has contributed to economic growth, without jeopardizing the inflation targets.

3. POLICY DECISION

The Board of Directors agreed to hold Banco de la República's intervention rate steady at 3%.

Bogotá, Colombia
October 8, 2010