MINUTES OF THE BANCO DE LA REPUBLICA BOARD OF DIRECTOR'S MEETING ON DECEMBER 18, 2009

On December 18, 2009 the regular meeting of the Board of Directors of the Banco de la Republica was held in the city of Bogota.

Present were:
Oscar Ivan Zuluaga, Minister of the Treasury and Public Credit
Jose Dario Uribe, the general director

Full-time Board members present:
Carlos Gustavo Cano
Juan Jose Echavarria,
Fernando Tenjo,
Cesar Vallejo
Juan Pablo Zarate.

The inflationary situation and economic growth as well as the outlook for both were discussed and decisions were made in relation to monetary policy. Below is a summary of the main topics dealt with in this meeting.

1. BACKGROUND

a. Recent developments in inflation

Annual consumer inflation in November was 2.37% which was a reduction of 35 basic points (bp) with respect to October. As of November, the accumulated inflation for the year was 1.92% which was well below that recorded for last year (7.2%). The core inflation indicators continued dropping.

The annual change in food prices fell from 1.6% in October to 0.7% in November.

The annual rise in regulated prices declined from 1.7% in October to 1.5% in November with the drop in public transportation being prominent.

The annual change in prices for non-tradables excluding food and regulated goods went from 4.6% in October to 4.5% in November. The drop in rental rates which went from 4.4% to 4.2%

stands out. The annual change in prices for items with high indexing declined to 6.8% while that for the ones that are less indexed went from 3.6% in October to 3.8% in November.

The annual rise in prices for tradables excluding food and regulated goods fell from 2.1% in October to 1.94% in November.

Inflation expectations for December derived from public debt negotiations for 1, 5 and 10 years showed variations of -1 bp, -23 bp, and -32 bp compared to the average data for November and stood at 2.57%, 3.17% and 3.67% respectively.

The annual change for producer prices (PPI) was -3.9% which is slightly higher than that of the month before (-4.1%).

b. Growth

The information available as of November shows that the quarterly GDP levels are continuing their recovery although with low annual growth rates.

- The information from the third quarter shows that the sectors such as mining and public works continue to drive economic growth. However, other important activities such as industry, construction, trade and transportation continue at a lower momentum but with signs of recovery.

- Industrial production measured by ANDI for the year up to October was -6.9% compared to that recorded for the year, January to September (-7.3%).

- The industrial inventory indicator from the Fedesarrollo Business Opinion Survey (EOE) for October shows a slight reduction with respect to the level that has been seen while the order indicator from the same survey showed a recovery in comparison to what had happened months before.

- The annual growth in the demand for electricity for November was 3.3% which is higher than that of October and of the average for the third quarter (1.2% and 2.2% respectively).

- Fedesarrollo's consumer confidence indicator grew significantly in November and was at its highest level since September, 2008 when Lehman Brothers went bankrupt. The upswing in this index is mainly due to the better view households have of current economic conditions. When the October and November records are averaged, a rise in the fourth quarter indicator in comparison to that of the third quarter can be seen.

- According to the Colombian Automotive Industry Committee, the annual fall in sales of private cars, utility vehicles and pick ups declined in the last two months and, in levels, show a slight recovery.

- Imports of capital goods continued declining in the fourth quarter in constant pesos.

On the monthly level, the trade balance in October (FOB) showed a surplus of US$134 m. From January to October, it still showed a positive balance of US$1.188 m, a level that is similar to that from the same period last year.

In October total exports continued to register a fall with respect to the same month for the previous year (-5.5%), especially industrial exports. Over the year –January to October– total exports dropped 17.3% with respect to the same period last year. Nevertheless, the levels for 2009 are close to those for 2007 with the exception of the mining sector which has had a higher value. For the same period, all of the sectors showed declines in value while in volume only the industrial sector showed a reduction.

Over the course of 2009 (January to October), exports to the United States were the ones that have fallen the most in absolute value (US$2.089 million). However, in terms of percentage the largest falls were recorded in sales to Venezuela. In October, 73.3% compared to the same month last year and between January and October, 22% annually.

In October the value of CIF imports was 20% lower than it was during the same month last year with the fall in imports of intermediate goods highlighted. Over the course of the year total imports plunged 18.9%.

c. Foreign context

The majority of developed economies saw an economic expansion in the third quarter compared to the second with the exception of the United Kingdom where the GDP shrank again. Add to this the positive result in the US labor market which, according to various analysts, could mark a break in the trend. However, other available indicators for the fourth quarter suggest a slow growth for the end of the year in various industrialized countries that is even slower than that of the third quarter. Some production and sales indicators that have been growing showed some reverses.

During the last month and a half, the risk premiums for the sovereign debt of these countries rose, especially in the case of the United States and Japan. This could be related to the sharp increase in the public debt for many of these economies in an environment of low growth.

With respect to the economies of Latin America, the third quarter GDP results show a lower annual contraction than those of the second quarter in countries such as Brazil, Peru, Chile and Mexico. One exception is Venezuela where the growth was -4.5% compared to -2.4% in the second quarter. The currencies in the region did not show relevant changes in comparison to the dollar and tended to stabilize in November and up to now in December. The same thing happened with risk premiums, which have stabilized at pre-crisis levels though it should be emphasized that the impact of Dubai’s declaration of moratorium was minimal. With regards to prices, the decline in inflation has continued to be significant, especially in the cases of Chile, Peru and Colombia.

d. Financial variables

The annual growth of M3, which has been slowing down since mid-August, stabilized in November at an average rate of close to 9.4%. Liabilities subject to reserve requirement (PSE), which grew an average of 10.2% in the same month, showed the same trend. In real terms (discounting inflation excluding food), the PSE rose 7% annually in November.

The gross loan portfolio in national currency (M/N) continued slowing down mainly due to trade. Between the end of October and end of November, the annual change in the total gross portfolio (M/N) went from 6.7% growth to 5.3% growth. During the same period, the commercial loan portfolio went from 6.1% to 4.8% while the mortgage portfolio climbed from 13.9% to 14.5%. In regards to the consumer loan portfolio, since the last quarter of 2008, it has remained at a level of around COL$40 t and as of November 27, 2009, it showed an annual growth of 0.8%. In real terms, the annual growth rates in November for the portfolio were: total, 2.7%; commercial (including *leasing*), 3.0%; consumption, -2.9%; adjusted mortgage, 11.0% and micro-loan, 33.1%.

The productive sector continued increasing its financing by issuing debt securities. Estimates made by the Bank's technical team using information from the Financial Superintendency show that the commercial loan portfolio plus real sector bonds were at levels close to COL$100.5 t.

Regarding interest rates, the last reduction in the policy rate was transmitted to the money market rates and the commercial and consumer loan rates more intensely. The Banco de la Republica's net debtor position with respect to the financial system, which has existed since the end of November, contributed to keeping the money market rates (TIB and IBR) at levels below (15 bp on average) that of the Banco de la Republica's expansion.

Between October 30 and December 4, the DTF rate declined 10 bp and had an average of 4.4%. During the same period, the total CD rate dropped 44 bp and, at the beginning of December, stood at 4.42%. With the exception of the interest rates for construction, home buying, and credit cards, the rest of the rates continue to receive the full transmission of the reduction of the policy rate. Between October 30 and November 27, the rates for ordinary, preferential, Treasury and consumption loans declined (following the same order) 90 bp, 75 bp, 33 bp and 46 bp. Between the same dates, the interest rates for construction rose 45 bp and those for buying a house declined 8 bp. Card rates continue to be limited by the usury rate.

In real terms, the average lending rate as of November (BR methodology) stood at 7.12%, the lowest level since June, 2000 and below its historical average, calculated since 1986.

The curve for the TES between November 24 and September 11 registered drops of 26 bp and 11 bp in the short and medium tranche respectively. The long tranche rose 14 bp thus bringing about a steepening of the curve.

2. *DISCUSSION AND POLICY OPTIONS*

As the discussion developed the following points stood out:

i) the fall in the pace of price growth over the month which was more than what the market and the Bank's technical work expected;
ii) the continuous decline in core inflation indicators and in inflation expectations that are in the target range fixed by the Board of Directors for the upcoming year;
iii) the reduction in price growth was generalized again;
iv) the transitory effect the "El Niño" phenomenon could have on price growth;
v) the improvement in the growth of producer and consumer confidence indicators;
vi) the recovery of M3 and especially, liabilities subject to reserve requirement;
vii) the financial system portfolio in legal currency which, although it continues to fall, is growing more than the nominal GDP;
viii) the issuing of bonds that has complemented the productive sector's financing;
ix) the behavior of the market interest rates in response to the lowering of the Bank's benchmark rate;
x) the slowdown in the growth of the Venezuelan economy this year and the outlook for 2010;
xi) the effect of the exchange rate on inflation and the growth of the product of the tradable sectors;
xii) the performance of the interest rates for public debt securities.

The main points of analysis for the members of the Board were focused on the following aspects:

i) the elements that affect inflation projections for 2009 and 2010, especially a possible rise in regulated prices and food due to the "El Niño" phenomenon;
ii) the lagged effect of monetary policy measures on production and prices;
iii) the growth projections for the economy for the rest of the year and 2010 with a domestic demand that is weaker than what was projected though it is recovering and a lesser fiscal drive in the upcoming year;
iv) the sharp drop that occurred in exports to Venezuela in the last few months and in that country's product;
v) the performance of the monetary aggregates and their possible effects on economic reactivation;
vi) the recent momentum in the financial system's commercial loan portfolio;
vii) the balance of risk between growth and inflation in a context of economic slowdown and falling inflation; and
viii) the need to strengthen the credibility of the monetary authority and anchor inflation expectations around the long term target.

The Board of Directors highlighted the following regarding the performance of inflation during the month:

i) annual consumer inflation in the month of November maintained the descending trend that has been seen over the course of the year;

ii) the core inflation indicators and inflation expectations continued to fall;
iii) the general drop in prices for the different items that the basket is made up of thus covering a broad variety of goods and services;
iv) end of the year inflation will be below the mid-point of the long term target range (3%) and close to 2%.

Even if the foreign context has improved in the last few months, the economic recovery of developed countries continues to be slow. The medium and long term outlook for the region's economies and for other emerging countries are more favorable. Nevertheless, the growth projections for Venezuela show a significant drop in the GDP for this year as well as for 2010.

The available information shows that the quarterly levels of the GDP continue to recover with annual rates of low growth. It should be emphasized that the Fedesarrollo consumer confidence indicator grew significantly in November.

The Board of Directors thinks that the expansionary monetary policy has made a persistent decrease in the interest rates for deposits and securities possible and that the current level of the benchmark rate continues to stimulate economic growth in an environment typical of a healthy financial system. Consequently, it was agreed to keep the Bank's benchmark rate unchanged at the current levels.

3. POLICY DECISION

The Board of Directors agreed to keep the Banco de la Republica's benchmark rate unchanged at 3.5%.

Bogotá, D. C., Colombia
December 30, 2009