Minutes of a Meeting of the Board of Directors of the Central Bank of Colombia on January 30, 2009

A regular meeting of the Board of Directors of the Central Bank of Colombia was held in the city of Bogotá on January 30, 2009.

Present:
Mr. Óscar Iván Zuluaga, Minister of Finance and Public Credit
Mr. José Darío Uribe, Governor of the Central Bank of Colombia

Full-time Directors:
Mr. Carlos Gustavo Cano
Mr. Juan José Echavarría
Mr. Juan Mario Laserna
Mr. Fernando Tenjo
Mr. Leonardo Villar

Conditions surrounding inflation and economic growth, and their prospects for the future were discussed, and decisions were reached on monetary policy. The following is a summary of the principal topics addressed during the meeting.

1. BACKGROUND

a. Recent Developments in Inflation

Annual consumer inflation was 7.67% in December, having fallen by 6 bp compared to November. By the end of the year, inflation was over the target set for 2008. The performance of various core inflation indicators during December was mixed.

Food inflation went from 13% in November to 13.2% in December. Both processed and perishable foods can be credited with the rise food prices at the end of the year.

Regulated prices registered an annual increase of 9.45% in December, which is below the 10.9% annual increase observed in November. The decline in prices for gasoline and residential natural gas services represents a high point in this sense.

Non-tradable inflation, excluding food and regulated prices, was 5.25%, as opposed to 5.2% in November. Rentals (5.21%) were an important factor, having exhibited a tendency to rise in the last four months. Tradable inflation, excluding food and regulated prices, went from 2.2% in November to 2.4% in December.

The various inflation-expectation indicators measured on the basis of local government bonds (at 1, 5 and 10 years) declined, but were still above the inflation targets set by the Board of Directors.

The annual variation in producer prices (PPI) declined from 10.9% in November to 9% in December.

b. <u>Internal Growth</u>

The slowdown in local economic activity during the second half of 2008 occurred faster than the Central Bank's technical team had expected. In December, DANE released the third-quarter growth rate (3.1%) and revised the figure for the second quarter from 3.7% to 3.8%. As a result, growth during the first three quarters came to 3.8%, which is less than the figure for 2007 (7.5%).

The figures for the third quarter show that private consumption continues to weaken, especially in the case of durable goods. There has been quite a slowdown in exports in real pesos, largely due to smaller volumes of coffee and coal and fewer non-traditional exports (textiles, garments, plastics and machinery), primary to the United States and Venezuela. Less growth during the third quarter, compared to the second, is explained by the poor performance of both these aggregates. On the other hand, investment growth remained high, even more so than during the first half of the year, thanks to the recovery in civil works. Investment in buildings also saw significant growth, somewhat similar to the increase in other private investments. This is judging by the extent to which imports of capital goods had increased by that time (23.9% in dollars).

Available indicators for the third quarter show that performance did not live up to expectations and tended to decline. Industry is the most obvious case in point, having experienced a sharp slowdown during October and November compared to the same months in 2007 (7.5% and 13.3% respectively). Transport material and textiles and garments were the sectors that reported the largest reductions, due to less internal and external (Venezuela) demand. As to commerce, the drop in retail sales during November (2.9%) was associated largely with vehicles.

Business opinion surveys confirm the economic slowdown that is reflected in the sector indicators. These surveys also show that businessmen are quite pessimistic about how they expect their sectors to perform during the first six months of 2009.

As to the external sector, imports were still growing at a decent pace by November 2008, thanks largely to imports of capital goods. That same month, imports of raw materials declined sharply in value for the first time during the year, while imports of consumer goods continued to lose speed. However, they were still at historically high levels.

Total exports continued to deteriorate in October 2008, but with annual growth rates that remained high. Prices for oil and other mining products have been falling since mid-2008; this has cut into the monthly sales value of these exports. The monthly value of non-traditional exports was less during August and September, but increased again in October, mainly due to the rise in sales to Venezuela and Ecuador.

The latest employment figures show a loss in jobs, but higher "self-employment" numbers took some of the edge off that situation. Nevertheless, growth in self-employment has slowed since mid-2008. Although the labor supply has declined, the number of employed persons has declined even more, which means higher unemployment.

c. The External Context

The depth of the international financial crisis and the recession in the United States and Europe was confirmed in December. Tax and monetary policies adopted by the developed countries during the fourth quarter have not prevented the mortgage and financial crisis from infecting non-household consumption and investment. Employment has been seriously impacted as well. By December, unemployment in the United States was 7.2%

Industrial production in Europe and Asia dropped sharply during October and November. Although some countries in these areas have announced rescue packages to deal with the crisis, there is a great deal of uncertainty about what tax incentives can do to help the economy. The United States is a case in point.

Signs of economic slowdown in Latin America were more evident during the last month and a half. Industrial production and retail sales indicators show contraction in the November figures for countries such as Brazil, Chile, Colombia and Mexico.

All of this translates into less international trade. For example, in the United States, the dollar value of exports fell by 1.6% yr/yr in November. The decline in the European economies fluctuated between 15% and 20% yr/yr. As to economies such as Japan and China, it was 14% in November and 2% yr/yr in December, respectively. In Latin America, the export sectors in most countries are now feeling the effects of the worldwide slowdown.

The financial crisis in the developed economies has yet to be contained. The problems Bank of America and the British banks faced in January are proof of that. Although liquidity on interbank markets has improved, they are still under financial stress.

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Up until early January, the situation for emerging economies was more encouraging. The deterioration in risk indicators (EMBI and CDS) was brought to an end, but at higher levels than those in September. At the start of January, Brazil, Colombia and Mexico managed to borrow in dollars - at not overly high rates - through bond issues on demand, which suggests the capital markets remain open for emerging sovereign issuers.

On the exchange market, the recent upward movement in the exchange rate is associated with growing international risk aversion and the prospect of lower benchmark interest rates throughout the region

The decline in world demand and the drop in commodity prices have been accompanied by a quick reduction in inflation in the developed economies and in a number of emerging markets. The central banks in several

Latin American and emerging market economies, including Colombia, have responded by beginning to lower their benchmark rates.

As a result, the growth estimates for our trading partners are also lower. In 2009, growth is expected to be somewhere between -1.6% and -2.5% in the United States, between -1.3% and -2.3% in Europe, and between 0% and 2.5% in Venezuela.

Commodity price projections have fallen on par with the lower forecasts for world growth. The price of WTI crude is expected to be somewhere between US$35 and US$50 a barrel.

d. Financial Variables

The main monetary aggregates accelerated during the last two months. By January 23, the annual increase in base money was 15.3%, while M3 was up by 17.6%.

The total gross loan portfolio continued to lose speed, registering an annual increase of 16.7% by January 23. The commercial loan portfolio showed the best momentum, with 20.2% annual growth. Mortgage loans were up by 15.2% and consumer loans by 11.6%.

Between November and so far in January, the productive and financial sectors have issued an important amount of debt securities and bonds at rates slightly above those for government bonds.

In the last two months, the TIB has averaged 50 bp below the policy rate. This occurred in a context where the Central Bank of Colombia was temporarily a net debtor of the financial system.

On January 23, the weighted average lending rate (the Bank's method) was 15.9%, showing a monthly reduction of 93 bp. There were no reductions in consumer, home and micro-lending rates. The average interest rate on certificates of deposit (CD) was 10.1%, which is 8 bp less than what it was the month before.

The real DTF averaged 4.8%, and average interest on lending (the Bank's method) was 12%. These are similar to the historic averages calculated since 1986, and above those registered since 2001.

2. DISCUSSION AND POLICY OPTIONS

The Board emphasized the following points in its deliberations:

- i The pace of price hikes continues to exceed the inflation targets.
- ii International prices for food, raw materials and oil continue to fall. This could have a major impact on total inflation in the next few months, depending on the exchange rate and the country's trade policy, particularly with respect to food imports.
- iii The annual change in regulated prices has begun to decline, even though the drop in oil prices on the international market has not been passed on to local gasoline prices.
- iv Economic activity continues to weaken faster than the Bank's technical team had anticipated.
- v Companies still face high production costs, despite the sharp slowdown in PPI growth last month.
- vi Poor performance of the world economy and that of Colombia's major export markets, particularly the United States, Venezuela and Ecuador.
- vii The effect of the exchange rate on inflation and growth in the tradable sectors.
- viii Intermediate and long-term expectations for inflation, which are still above the targets set by the Board of Directors.

The main points of discussion among Board members centered on: (i) the effect of monetary-policy measures, given the time it takes them to work through to the economy; (ii) the elements that affect inflation forecasts for 2009 and 2010; (iii) how the behavior of inflation in the short term might affect prices and wages in 2009; (iv) the fact that some core inflation indicators have not declined; (v) projections on the current account deficit; (vi) the uncertainty the world financial crisis has generated in international markets and how it affects the Colombian economy; (vii) depreciation of the peso against the dollar in the last few weeks; (viii) the improvement in the region's access to external financing in recent weeks, the decline in long-term interest rates, and the momentum in the loan portfolio held by the financial system; (ix) the balance of risk between growth and inflation in a context where inflation expectations are still above target and the slowdown in economic activity has been more than expected; and (x) the need to bolster the monetary authority's credibility and to anchor inflation expectations.

Although consumer inflation was 7.67% in December of last year, which is over the target set by the Board of Directors for 2008, it was emphasized that weak local and external demand and falling international commodity prices should mean less inflationary pressure throughout 2009. The Board is confident that consumer inflation this year will be within the target range (5% +/- half a percentage point) and continue to decline towards the medium and long-term objective (3% +/- 1 percentage point).

The members of the Board also noted that world economic performance remains negative, despite the strong expansive policies adopted by countries. Most of the developed economies are seeing less growth, while the emerging economies are experiencing what is, in some cases, a dramatic slowdown. If the rate of world economic growth is below its long-term tendency and international commodity prices fall, world inflation will be much less in 2009. If the exchange rate remains stable and an appropriate commercial policy is applied, this expected decline in international inflation should pass through relatively quickly to consumer prices in Colombia.

There are new figures that confirm productive activity in Colombia has weakened. The latest information on industry and commerce shows more of a decline than what the Board anticipated at its last meeting. Added to this situation are the effects the world economic slowdown has on production, via lower exports and terms of trade, less confidence and most expensive capital flows.

The Board of Directors believes the time is right to continue to lower the intervention rate and to consolidate the steps initiated in the final quarter of 2008 to change the stance of Colombia's monetary policy. The opportunity and speed at which our monetary policy can be relaxed during 2009 will depend on whether inflation behaves as forecast. It also will hinge on expectations with respect to the targets.

Most of the Board felt that lowering the Bank's intervention interest rate at a time of financial market instability at home and abroad must be done in a way that aims for credibility and confidence among economic agents. This will ensure the monetary authority can continue to use the policy tools at its disposal in a countercyclical way. Caution is particularly important for several reasons; namely, core inflation has been reluctant to decline; the drop in food and regulated prices on the local market has been less than what would be consistent with the performance of international markets; and there have been some particularly pronounced increases in the exchange rate during the last two weeks, which could generate less confidence in the Colombian peso. A 50 bp cut was considered adequate in this context.

A minority of the Board members felt that macroeconomic conditions allow and call for a more ambitious cut in the intervention interest rate, without risking the Board's targets for inflation. A cut of 100 bp would send a loud signal to the productive sector at a time when expectations for growth and inflation are low.

Finally, the Board reiterated the need to continue to monitor the international financial situation, so as to be ready to adopt whatever monetary-policy measures might be required to deal with its impact.

3. POLICY DECISION

The Board of Directors agreed, by majority vote, to lower the Central Bank's intervention interest rate by 50 bp, placing it at 9%.

Bogotá, Colombia
February 13, 2009