Minutes of Banco de la Republica (Central Bank of Colombia)
Board of Directors' Meeting of 30th January 2012

On 30th January 2012, in the city of Bogota, the ordinary meeting of Banco de la Republica's Board of Directors was held with the presence of the Minister of Finance and Public Credit Mr. Juan Carlos Echeverry, the Governor and Managing Director 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, as well as the perspectives for both situations are discussed, and decisions relating with the monetary policy are adopted. The following is a summary of the major subjects addressed at this meeting.

1. BACKGROUND

a. Recent developments in inflation:

Annual consumer inflation in December was 3.73% (0.42% monthly), which means 23 basic points (bp) less than in November. This value exceeded 3%, the central point of the long-term target range defined by the Bank's Board of Directors (3%+/-1 percentage point). In addition, it was above the expectations, and increased 46 bp with respect to the figure recorded a year before.

The fall of inflation during the month is mainly explained by deceleration in the variation in food prices. On its side, the GDP without foods stood at 3.13%, which means 10 bp more than in November and 31 bp above December's GDP in the previous year. This was the result of a rise in tradable and non-tradable basket prices after the exclusion of foods and regulated items.

With respect to the food CPI, annual variation shifted from 6.4% in November to 5.3% in December. Just like in the previous month, what contributed the most to this drop was price variation in perishable foods, with potatoes and fruits exhibiting absolute price falls. This behavior suggests that non-processed food supply conditions have continued to return to normal after the shocks suffered from the bad weather conditions. Since the processed food GDP was slightly diminished, peso depreciation over the previous months and international prices would not have generated significant upward pressures. The variation in prices of eating away from home remained stable, but nonetheless above the target range ceiling; this might be due to the dynamism of internal demand.

Within the GDP without foods, the increase in the annual variation in the tradable-item GDP (without regulated items) to 0.80% in December stands out. Since September 2011, this indicator has been going up; this fact is likely to be associated to the exchange rate depreciation between September and December and the internal demand boom as well.

Likewise, in December, increases were seen in the annual variation in non-tradable without foods and regulated items. This indicator has increased in the past six months; this might be the result of the dynamism of internal demand and the broadening of the product gap. Particularly, most increases are concentrated on health-service items and leases.

The variation in the regulated items GDP remained at 5.8%. However, the record continues to be high as propelled by the price of gasoline and public transportation.

Base inflation continued to go up in December for the forth consecutive month. The average of the three indicators monitored by Banco de la Republica stood at 3.41%, i.e. 7 bp more than in the previous month.

Inflation expectations grew in early January 2012, upon the announcement of December data; those obtained from the 12-month monthly survey stand at 3.56% as compared with 4.44% of the past month. In the same survey, inflation is expected to be 3.55% in December 2012. Measurements deriving from different-term public debt certificates “TES” did also increase.

With respect to salaries, no significant pressures had been generated at year end on consumer prices, since adjustment reports stand around 4% for both industry and commerce, and construction. All the above suggests that production costs would not have been a source of significant pressures on consumer prices in the fourth quarter of 2011. Nevertheless, this situation is unlikely to remain unchanged for 2012 due to the narrowness of the labor market, and the fact that the minimum wage 5.8% adjustment was higher by 2.8 percentage points than the 3% long-term target.

b. <u>Growth</u>

According to the, the National Administrative Department of Statistics - DANE, the Colombian GDP grew 7.7% in annual terms in the third quarter of 2011 (1.7% on a quarterly basis). This expansion rate, together with that registered in the forth quarter of 2006, is the highest seen since 1979.

Unlike the previous quarters, the largest contribution to growth by type of expenditure came from investment in fixed capital or “FBKF” (gross fixed capital formation), where the investment contribution destined for industry was important. The annual increase of the “FBKF” was 20%, and it displaced household consumption as the main engine of growth. However, household performance was significant too (7.3%).

A deceleration from 24.9% in June down to 18.8% was experienced in the third quarter. Despite this lower rhythm, the real import level is historically high. Exports rebounded and were able to record, again, a two-digit growth rate (10.5%).

On the supply side, the sectors with higher growth rates were mining (18.4%) and construction (18.1%). Financial services expanded by 6.6%, but contributed in a significant way to GDP dynamics given their importance in the total. In the third quarter, positive annual growth rates were registered by all sectors.

For the fourth quarter, the most recent information suggests that Colombian economy continued to show good dynamism by growing at a rate even higher than the one registered in the first quarter of the year.

By type of expenditure, growth continues to be propelled by household consumption; this can be inferred from the dynamic behavior of commerce sales (annual variation of 3.7% on average as of November) and imports of consumer goods in dollars in October and November (annual 17% on average), as well as from portfolio and interest rate data addressed to this item (in the fourth quarter, the annual growth in the consumer credit balance was nearly 22%).

In addition, it can be anticipated that private consumption in the fourth quarter may have been favored by the continuous fall registered in the unemployment rate. This reduction was fundamentally due to the increase experienced in labor demand and the dynamic increment of the number of occupied individuals at both the national level and the 13 metropolitan areas. In the fourth quarter, one-single-digit unemployment rates were seen, similar and even lower than those observed in 2007.

The conjunction of the above-mentioned factors along with improved expectations favored a recovery in consumer confidence at the end of 2011. According to Fedesarrollo, consumer confidence grew significantly in December and stood not only above the series average, but also at the highest level for the whole year.

With respect to investment, and despite having less information, the scenario might have been favorable as well. In the first place, imports of capital goods in dollars grew 40.5% on average in October and November and, secondly, because cement production in November maintained a dynamic behavior with annual growths higher than 10%.

On the supply side, the behavior of industrial production stood out. In November, the GDP grew at a 6.5% annual rate. Information available with respect to orders and stocks suggests that the sector might grow in December at rates similar to those observed in the past three months (5.5%).

Colombia's external sales kept on growing. In November, total exports in dollars grew 42.5% per year, this fact mainly explained by an increase of 52.1% in the foreign sales of the main products of mining origin (oil, coal, gold, ferronickel). Likewise, industrial exports increased 31.5% and 31.5% those of agricultural origin. By destinations, industrial exports grew 69.1% to Venezuela, 28.1% to Ecuador, and 26.9% to the rest of the ALADI countries.

Generally, in 2011, significant household consumption growth would have been possible (by duplicating its growth average in the past decade), and a strong acceleration in investment growth. In the external sector, exports in real terms would have registered the highest expansion rate in twenty years (close to 11%). Also imports would have exhibited a high growth rate (22.1%) and offset foreign sale dynamics. In this case, the external demand contribution to GDP growth would be negative. The best behaved sectors in 2011 would have been mining, transport, and commerce/trade. The above information may indicate that growth for 2011 might be higher than 5.5%.

For 2012, information available suggests an interval for the product's growth rate between 4.0% and 6.0%.

c. Financial variables

Total credit in national currency ["*moneda nacional*"] (MN) and foreign currency ["*moneda extranjera*"] ("ME") is kept at high growth rates with a slight moderation in December. All credit modalities for both households and enterprises continue to exhibit much higher growths than those of the economic activity. This has occurred in a context of historically low real interest rates.

As of December, total credit growth (MN and ME) registered an annual rate of 21.1%, lower by 22 bp than the rate observed in November with a moderation in all of its modalities. Growth rates were: 25.0% for consumer credit, 19.5% for commercial credit, and 17.2% for mortgage credit.

In December, real interest rates (excluding CPI without foods) for consumer, mortgage and ordinary commercial credits stood at 15.4%, 9.6% and 8.2%, respectively, this figures being lower than the averages observed since 1998 (with the exception of the mortgage credit rate, the average of which is being estimated since May 2002).

d. External context

For the last 2011 quarter, the world's economic activity figures show that global economy has been weakening as a result of the Eurozone recession symptoms having forced a downward revision of world growth for the full year 2012.

In the Eurozone, private bank public debt and funding solvency problems have affected the economic activity and greatly deteriorated entrepreneur and consumer confidence in the region. Added to the threatening contagion of the sovereign debt crises of Greece and Ireland to countries like Spain and Italy, there is the not yet dissipated risk of Greece not paying its debt. Should no agreement be reached in the negotiations among the financial sector, the European authorities and Greece, the likelihood of a financial crisis is high, given the significant exposure of some European banks to the Greek debt. Despite the measures adopted by the Central European Bank to avoid credit restriction, no revitalization signs are visible in the granting of credit by the private banking.

The European authorities have continued to advance in matters such as public spending reduction, fiscal integration, and the reinvigoration of the financial system to confront the crisis. Notwithstanding, the measures adopted seem to be insufficient to solve the region's unbalances in terms of economic growth and competitiveness. All this has been reflecting in the volatile behavior of financial markets, while there is an increasing likelihood of an economic recession in the Eurozone that might have begun in the last quarter of 2011 and would extend over the first semester of 2012.

In the United States, a likely contagion of the external situation seem to be limited, and the economy continues to exhibit positive dynamism as supported on a recovery of both consumption and the manufacturing activity. Last unemployment figures were better than those estimated by the market average, and the industry continued to show rehabilitation signs. With inflation at low levels, housing and labor markets continue to be the FED's worst concerns; at its meeting of last Wednesday 25th January, it announced that it would keep its intervention interest rates near zero until 2014. According to the analysts, this announcement is expected to maintain long-term rates at low levels to reduce the cost of mortgage debt. Despite the recent positive data, the United States growth is likely to be moderate in the next quarters as a consequence of the still prevailing structural difficulties.

In Japan, the supply chain seems to show a high recovery percentage after the 2011 natural disaster. However, the economy has started to evidence weakening symptoms particularly in its exports, as a result of reduction in global demand.

The major emerging economies have continued to decelerate in line with the previous report's forecasts. In China, the most recent economic growth and industrial activity figures suggest a slight decrease in growth, while the weakening of the housing market implies an additional risk to the fall in global demand. Last announcements from the Chinese authorities suggest higher fiscal and monetary encouragements in the months to come. For the Latin American economies, the trend is growth moderation. In the case of Brazil, for example, fiscal and monetary stimulus measures are being introduced in order to mitigate external shocks.

Both lower global economic growth and low inflationary pressures would give way to a looser or more comfortable monetary policy worldwide. For this reason, no interest rate increases are expected in advanced economies. On the contrary, the monetary policy will continue to be expansive, and additional rounds of liquidity injections in Europe are not been ruled out. On the other hand, in most emerging economies, interest rate stability or reductions are expected.

The international prices of basic goods have decreased from its maximums attained in the first semester of 2011, but they still remain at historically high levels. For 2012, international quotations of the main basic goods exported by Colombia are expected to keep relatively high levels despite the predictable lower growth in global demand. In the case of oil, projections have increased compared to three months ago due to diverse geopolitical tensions. Therefore, the level of the terms of trade would remain high and continue to propel national income.

The last balance of exchange data for Colombia reflects the fact that foreign direct investment is still dynamic, particularly as directed towards mining. If the international situation does not deteriorate further, it can be predicted that this behavior may remain unchanged in the course of 2012.

To this date, the increment in risk premiums and the reduction in some European ratings have not had a significant effect on the Colombian risk premiums. In fact, in the year-to-date, the exchange rate has been appreciated after having recorded an upward trend by the end of 2011.

Despite the external overview deterioration, the good results of internal growth, external sales, foreign investment and consumer and investor confidence show that no contagion of the international situation is observed in the Colombian economy.

2. DISCUSSION AND POLICY OPTIONS

The Board of Directors has unanimously expressed the convenience of increasing the intervention interest rates.

The Board has considered that, on the external front, the following must be taken into account: (i) In Europe, the public debt crises of some countries in the region and doubts arising on the solvency of certain banks continue to affect household and entrepreneur confidence. Recession in Europe is likely to be worse than anticipated months ago. (ii) The United States economy in 2012 is expected to grow at a positive - but slightly below its potential - rate. (iii) The international prices of basic products remain at high levels and encourage the national income of the producing countries. (iv) The worst risk of core growth forecasts continues to be a disorderly adjustment in Europe. Should this risk materialize, world economy would grow considerably less than expected, the international prices of basic goods may fall, and global risk aversion may be exacerbated, all of which would have adverse effects on the Colombian economy.

In the internal context, the following has to be taken into account: (i) In Colombia, as of the third quarter of 2011, the annual growth of the GDP was 7.7%, thus a historically high and above than expected figure. The annual growth of domestic demand (9.4%) was explained by the sharp increase of both investment and household consumption. (ii) Most recent information suggests that Colombian economy continued to show strong dynamism in the fourth quarter. In the external balance, both exports and imports kept on growing at high rates in November. Based on all the above, the technical team has estimated for 2011 an economic growth higher than 55.5%. For 2012, the forecast interval remained between 4% and 6%. (iii) Bank credit continued to increase at high rates. The consumption credit behavior suggests that households are increasing their degree of indebtedness in a significant manner. (iv) The average of base inflation measures went up again, and most of them exceed 3%. Inflation expectations grew. (v) Consumer confidence remains at high levels. (iv) Employment predictions foresee increasing pressures at the labor market for 2012. (vii) The impact of the exchange rate on inflation and growth projections. (viii) The different interest rate levels, except those for credit cards, stand at values below the past 15 years' averages. (ix) The main risk on inflation comes from excessive expansions in demand or increases in costs above those expected, with hard and lasting effects on monetary policy expectations and credibility. In longer time horizon, excessive credit growth and the persistence of low real interest rates might become a source of financial unbalances with negative effects on the sustainability of economic growth.

A Board Member deemed appropriate to supplement the rate increase with some king of macro-prudential measure aimed at accelerating the interest rate transmission on consumer credit dynamics.

3. POLICY DECISION

According to the assessment of the current balance of these risks which lend more weight to the internal conditions of the economy, the Board of Directors has decided to increase Banco de la Republica intervention interest rate by 25 basic points.

The Board will continue to carefully monitor the international situation, inflation behavior and projections, and growth, as well as the active markets performance; and it restates that monetary policy will depend upon the new information available.

Bogotá D.C., February 10 2012