Minutes of the Banco de la Republica Board of Director's meeting on October 29, 2010

On October 29, 2010 the regular meeting of the Board of Directors of the Banco de la Republica was held in the city of Bogota.

Present were:
Juan Carlos Echeverry, Minister of the Treasury and Public Credit
Jose Dario Uribe, Governor of Banco de la Republica

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

The inflationary and economic growth situations 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 September was at 2.28% (monthly was -0.14%) which was 3 basis points (bp) lower than in August.

The lower percentage registered with respect to August was due to the downward pressure from perishables, non-tradable excluding food and regulated prices and from regulated prices. The annual change in the prices for food went from 1.8% in August to 1.72% in September. This was driven by perishable food which registered an annual inflation of 4.43% in September compared to 6.24% in August. The annual change in the prices for non-tradable goods and services excluding food and regulated prices also dropped from 3.69% in August to 3.58% in September. Last of all, the prices for regulated goods registered an annual increase of 5.62% in September which was lower than the 5.69% registered for August.

The annual change in the prices for tradable goods excluding food and regulated prices, in turn, went from -0.77% in August to -0.62% in September.

With respect to the indicators for core inflation, these have remained practically stable for the last month and were below 3% for the second consecutive month. The lowest record, which is 1.67% annually, is still seen in the CPI excluding food and regulated prices.

Using the data for October, the inflation expectations derived from the negotiations for the 1-, 5- and 10-year public debt were at 0.8%, 3.5%, and 3.8% with variations of -174 bp, -14 bp, and -27 bp respectively. This data is below the average from the previous month.

The inflation expectations from the quarterly and monthly surveys done by the Banco de la Republica at the beginning of October continue to show declines and are within the long term target range fixed by the Board of Directors.

The pressure from non-salary costs remain at low levels. Significant pressures are not seen on that front in spite of the increase registered in the last month. The annual change in the producer prices (PPI) was 2.3% compared to the 2.0% registered in August.

b. Growth

The information from the third quarter suggests that, in general terms, the domestic demand continued to follow the trend seen in the first half of the year, which was characterized by the strength of household consumption and the sustained recovery of investment.

For the third quarter, the supply indicators available have had mixed performances and suggest that the economic growth in various branches such as industry, electricity, gas and water, and transportation could become more moderate. According to the latest information from DANE, the industry would have shown an annual expansion rate of 4.4% in August.

However, other sectors are showing a more outstanding performance as in the case of commerce, which according to DANE, expanded at an annual rate of 12.7% in August. This last figure agrees with the positive performance shown in the consumer confidence indicators for the third quarter.

With respect to the labor market, the unemployment rate was at 10.6% in September for the national total and 11.5% for the 13 cities. These figures are lower than those seen last year.

Investment is expected to rise in the third quarter. This prediction is based on the upswing in imports of capital goods, the positive performance of direct foreign investment and the local production of machinery and equipment. Likewise, the rise in construction permits and the strength of mortgage loans also support better performance in construction.

With respect to foreign trade, using data as of August, total exports in dollars showed an annual variation of 22.3% that is mainly driven by the mining sector with an annual change of 30.4%. These figures are higher than those registered for the months of July and June. The total imports in dollars, in turn, showed an upsurge in August with an annual, 12-month accumulated 5.0% rate of growth compared to the -0.5% that had been registered a month before. The surge was seen in the three groups: consumption, raw materials and capital goods.

c. Foreign context

The latest information available regarding the panorama abroad suggests a worldwide economic recovery that could occur more slowly and unequally than what the market has expected.

Our main trading partner, the United States in particular, is showing more marked signs of slowdown than was expected by the market. In the second quarter of 2010, it grew 1.6% (a/q) after having grown at a rate of 3.7% (a/q) at the beginning of the year. This is confirmed by the third quarter indicators such as: the new data on the labor market, industry sentiment, retail sales, consumer credit, and housing starts. Together, the slowdown in this economy, the strong monetary injection and expectations of larger stimuli to the economy on the part of the Federal Reserve have continued weakening the dollar with respect to the majority of the currencies.

The most recent information from Europe, in turn, continues to show a slow recovery in spite of the surge seen in Germany and France in the first and second quarters. The Asian countries, however, are maintaining positive rates of growth and are expected to continue down that road.

In this region's emerging economies, with the exception of Venezuela, the monetary policies and fiscal measures, levels of debt, capital flows, terms of trade and confidence continue to favor growth, especially that of domestic demand. This, together with the future outlook, has led the central banks in some of the countries (Peru, Brazil and Chile) to begin normalizing their monetary policies by raising their interest rates.

In the case of Venezuela, several analysts are projecting a fall in the GDP of close to 2% for this year. This is in line with what was registered in the second quarter (-1.9%) and a recovery for 2011 that is barely starting.

In spite of the lower growth of some industrialized countries, the terms of trade are expected to remain at historically high levels.

d. Financial variables

In September, the average for the nominal rates of the consumer and ordinary loans were at 17.5% and 9.7% respectively and had declined 3 bp and 10 bp with respect to the month before. The rates for mortgage loans remained stable at 12.9%. As a result, the interest rates for loans to households and to businesses are at historically low levels.

In September, the annual growth of the total average gross portfolio was 9.3% while the previous month it was 6.6%. The strongest portfolios are still mortgages which have an annual variation of 22.5% and the consumer portfolio which has an annual variation 12.3%. These figures are 300 bp above the data registered in August for the mortgage portfolio and 182 bp above the data for the consumer portfolio. In September, the annual growth for the commercial portfolio jumped 353 bp with respect to August and hit 6.1%.

Between September 30 and October 29, 2010 the rates for the public debt securities registered falls of 20 bp and 28 bp for the 1- and 5-year securities. On the same day, the 10-year securities were at 7.49% which was 40 bp less than what had been registered at the close of the previous month.

2. DISCUSSION AND POLICY OPTIONS

The following points were highlighted in the discussion: (i) the result of the inflation up to September, (ii) the indicators for core inflation, (iii) inflation expectations, (iv) the information available on the growth of the economy, (v) the producer and consumer confidence indicators, (vi) the growth of the financial system portfolio in legal currency, (vii) the performance of the market interest rates in response to the Bank's benchmark rate, (viii) the recent development in the exchange rate, its effect on inflation and the productive sectors, (ix) the performance of the public debt securities, and (x) data on the growth of the global economy.

The Board members' main points of analysis centered around the following aspects: (i) the inflation predictions for 2010 and 2011, (ii) the change in the prices for tradable goods, (iii) the lagged effect of the monetary policy measures on production and prices, (iv) the forecasted growth of the economy and employment for 2010 and 2011 which suggests a growth that is similar to what was seen in 2010, (v) the rise in consumer confidence and the performance of investment, (vi) the recent momentum in the financial system portfolio, (vii) the increase in the prices for financial assets and for housing, (viii) the drop in inflation expectations, (ix) the recent trend in capital flows, (x) the performance of public debt securities that show appreciation in all of the tranches, (xi) the balance of risk between growth and inflation in a context of a recovering economy and an inflation that is in the lower half of the long term target range, and (xii) the need to maintain the credibility of the monetary authority and anchor inflation expectations around the long term target.

The Board of Directors highlighted the following aspects of the inflation trend during the month: (i) annual consumer inflation in August was 2.28% which was lower than what the market and the technical team at the Banco de la Republica had expected, (ii) the indicators for core inflation continue to show low, stable levels, (iii) inflation expectations remain at low levels, and (iv) the result of inflation during the latest month is in line with the predictions made by the technical team. These shows, with a high degree of confidence, that inflation will be in the lower half of the long term target range in 2010 and 2011.

The Board emphasized that the information that has been received indicates that the Colombian economy is growing at the pace predicted a couple of months ago without causing inflationary pressure. The economy is still being boosted by consumer confidence, the high terms of trade, the strengthening of business investment and the recovery of the financial system portfolio.

In Europe and the United States, the outlook for growth in the short term is still modest. In contrast, Asia and Latin America are showing a better pace and outlook for growth.

The Board believes that the expansionary monetary policy that was adopted contributes to the growth of the economy without putting compliance with the inflation target at risk.

3. POLICY DECISION

The Board of Directors agreed to keep the benchmark rate of the Banco de la Republica unchanged and it will remain at 3%.

Bogota, DC, November 12, 2010