Minutes of a Meeting of the Board of Directors of Banco de la República on June 20, 2008

A regular meeting of the Board of Directors of Banco de la República was held in the city of Bogotá on June 20, 2008.

Present:

Mr. Óscar Iván Zuluaga, Minister of Finance and Public Credit

Mr. José Darío Uribe, Governor, Banco de la República

Permanent Board Members:
Mr. Fernando Tenjo
Mr. Carlos Gustavo Cano
Mr. Juan José Echavarría
Mr. Juan Mario Laserna
Mr. Leonardo Villar

Inflation, economic growth and their prospects for the future were discussed and monetary-policy decisions were reached. The following is a summary of the main topics addressed at the meeting.

1. Background

a. Recent Developments in Inflation

Annual consumer inflation was 6.39% in May, which is 66 b.p. more than in April, after having declined during the two previous months. Accumulated inflation in the first five months of the year was 5.1%. This is 70 b.p. above the figure for the same period in 2007. All core inflation indicators were up in May and some remain above target.

The build-up in inflation during May is explained largely by the way food prices behaved (up 9.7% in May compared to 7.8% in April), especially prices for perishables (potatoes and other vegetables and tubers) and imported foods.

Non-food inflation was 4.8%, which is slightly above the rate in April (4.7%). The increase is attributed to 5.25% inflation in non-tradables, excluding food and regulated prices, compared to 5.05% in April. Annual rental inflation (4.7%) stayed close to the rate observed in May, while banking services experienced a new hike.

Regulated price inflation went from 8.1% in April to 8.3% in May. Inflation in this basket of goods and services has been on the rise since September of last year, as a result of higher prices for fuel and public utilities.

Tradables, excluding food and regulated prices, were the only group to experience less inflation, which went from 2.4% in April to 2.2% in May. The reduction in vehicle prices (-4.6% annual inflation) was a high point in this respect. Prices for consumer durables in general have declined, probably due to the impact of accumulated appreciation.

Expectations of inflation at one year, based on analysts' surveys and the price of internal debt paper, rose to above 5.5%.

Annual PPI inflation was up from 3.8% in April to 5.4% in May.

b. Local Economic Growth

The available figures on production, aggregate demand and income reflect the following:

- The household confidence indicator from the Fedesarrollo survey declined between January and May, compared to 2007. However, it is still relatively high.

- The annual increase in industrial production, excluding coffee processing, was 9.8% by April, following a 9.4% drop in March, which was explained, at the time, as primarily the result of fewer working days in March and the Cerromatoso strike. Annual growth during March-April was -0.2%. During the course of the year up to April, it was 3.5%.

- The figures released by DANE show retail sales rose 1.2% in April. This exceeds the rate in March, but is low compared to the increase observed at the end of 2007 and the beginning of 2008. With respect to sectors, the poorest performance was in food sales (-3.5%). Other sectors such as footwear and textiles also reported negative figures.

- Exports, in dollars, saw continued momentum during first quarter of 2008. Total accumulated exports at 12 months were up by nearly 30%. This is similar to the rate observed at the start of the year and more than the increase during 2007.

- Higher prices for a number of raw material exports, coupled with an increase in exported volume, explain the build-up in traditional exports so far this year (34% by March for the 12-month accumulated increase in dollars).

- By March, there was a 25% increase in non-traditional exports. Exports to Venezuela slowed during the past month, possibly due to the border restrictions imposed in March and the Easter holiday that same month. However, the reduction in growth was offset, in part, by an increase in non-traditional exports to the United States.

- Imports recovered in April compared to their performance in March. This suggests the Easter holiday in March may have had a statistical impact. The accumulated increase in total imports for 12 months remained at around 24%, which is similar to the rates observed since 2006. There was a bit less growth in imports of consumer goods, particularly durables.

- The DANE indicator of investment in civil works shows an annual drop of 30% in relation to the first quarter of 2007. More than expected, this slump may have been due to the turnover in local government administrations.

- The reduced figures for growth in industry, commerce and civil works during the first quarter would have been offset, in part, by better performance in the agricultural, mining and financial sectors.

- The figures from the Household Survey in April show the decline in unemployment continues in every area, but was less pronounced than in recent months. Quarterly unemployment rates were 11.3% for the nationwide total and 12.1% in the 13 principal urban areas, reflecting respective declines of 0.5 pp. and 0.3 pp. compared to the same quarter in 2007.

- The reduction in unemployment is explained by more job creation in comparison to the labor supply, given that the number of employed persons nationwide increased at an annual rate of 4.5%.

c. The International Situation

Indicators of economic activity in the United States during April and May show performance was better than international analysts had expected. This was particularly true in industry and services. Exports bolstered by a weak dollar could explain part of this outcome.

Although the monetary and fiscal stimulus policies being applied in the United States have begun to cushion the slump in that nation's economy, household consumption continues to be affected by tight credit, a weak job market, the impact of energy prices on available income, and the drop in housing prices.

Inflation in the United States remains high and probably will continue to climb, given the recent hikes in international oil prices. Higher inflation has raised agents' expectations, which increased considerably during the last two months.

International analysts expect the US economy to grow by 0.8% during the remainder of the year and by 1.2% in 2009, which is below the historical average.

Higher inflation and increased expectations of inflation were evident not only in the United States, but also in a number of emerging economies and several developed ones, particularly the euro zone. As a result, various central banks were prompted to raise interest rates or to announce possible rate hikes in the future, even though prospects for growth have slackened.

d. Financial Variables

The growth in broader monetary aggregates continued to slow during May. The annual increase in M3 was 13.5%, which is less than what it was in April

(13.9%). Liabilities subject to reserve requirements (LSR) performed similarly. The last two months continued to see a shift in LSR towards certificates of deposit (CDT).

So far this year, the loan portfolio in the financial system has grown at an annual rate of nearly 20%. The peso portfolio continues to exhibit the most momentum, despite a nearly year-long tendency to decelerate.

The retail loan portfolio continued to experience more of a decline in growth than the commercial and mortgage loan portfolios. By May, it had increased at an annual rate of 22.4%. The increase in commercial and mortgage loans throughout the year has been more stable, with respective rates of around 20.5% and 16.4%.

Nominal interest rates were down in May. The sharpest decline was in lending rates, primarily those for retail (92 b.p.), preferred (72 b.p.) and ordinary credit (49 b.p.). Deposit rates, including the DTF, fell by about 20 b.p.

The downturn in rates was somewhat more in real terms, given the increase in non-food inflation during May. The real average rate was slightly below its historic average (since 1986). The real retail lending rate was below this average, and less than the average registered since 2001.

Average appreciation in January-May of this year was 14% compared to the same period in 2007. The sizeable influx of foreign capital continued, particularly in the oil and mining sectors.

2. Discussion and Policy Options

The Board emphasized the following points in its deliberations:

- i Continued price increases at rates that exceed the targets set by the Board of Directors;
- ii The considerable weight food brings to bear on prices in an international scenario marked by upward pressures;
- iii Uncertainty about how regulated prices will behave in the future, given the indexation mechanisms used to determine those rates and non-tradable inflation;

iv The sizeable increase in production costs for companies in terms of raw materials and labor;
v Uncertainty about the future of the world economy and Colombia's principal export markets, particularly Venezuela;
vi How revaluation of the peso has affected inflation and prospects for growth in the tradable sectors;
vii The course of inflation expectations, which continue to exceed the targets set by the Board of Directors.
viii The sharp impact on first-quarter GDP growth occasioned by the drop in investments in civil works and the uncertainty about its possible effect on future growth.

The Board believes the intervention interest rate hikes instituted as of April 2006 and the change in reserve requirements midway through 2007 have affected lending and deposit rates, and have helped to slow the increase in loans and local demand, as was intended. The behavior of core inflation indicators and expectations of inflation confirm that growth in demand needs to be curbed to reduce inflationary pressures and to prevent unsustainable economic growth.

The main points of discussion among the 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 influence inflation forecasts for 2008 and 2009; (iii) the advisability of adopting monetary policy measures in a scenario of rising international prices for food and fuel; (iv) the continued upward trend in non-tradable inflation, excluding food and regulated prices; (v) a current account deficit that reflect more growth in local demand compared to the increase in national production; (vi) the effects of appreciation in the exchange rate; (vii) the possibility that developments on the international scene, in a situation with a current account deficit, might lead to future exchange rate adjustments; (viii) the uncertainty created by highly volatile international markets and how that volatility might affect the Colombian economy; (ix) the difficulty in assessing available data in a situation where there is a break in the cycle of sustained growth; (x) the risk balance between growth and inflation in a context of rising inflation expectations and a slowdown in the economy; and (xi) the need to bolster the monetary authority's credibility as a way to anchor inflation expectations, given the possible side-effects of international food and fuel prices;

The Board underscored the persistence of inflationary pressures worldwide, and stressed the importance of anchoring inflation and expectations of inflation to the targets, given the inflation forecasts for the coming months. Although external conditions continue to favor economic growth, the indicators available in May suggest that growth in local demand and output has slowed considerably. Consequently, the Board members believe intervention interest rates at their current level are doing what is required to curb the increase in demand and, therefore, consider it prudent to maintain the current monetary policy stance.

The Board of Directors unanimously agreed to hold Banco de la Republica's intervention interest rate at 9.75% and emphasized the importance of continuing to monitor the possible impact the international economic situation might have on growth, as well as the effect of inflationary pressures originating with international prices for food and fuel.

It also agreed to step up the accumulation of international reserves during the remainder of 2008, so as to deal with any eventual deterioration in the international environment. This measure takes advantage of the fact that the exchange rate is now below sustainable levels. To counter the monetary effects of that measure, the Board decided to modify reserve requirements as of September 1 by eliminating the marginal reserve requirement and establishing an average ordinary reserve requirement of 10% (11.5% for checking and savings accounts and 6% for time certificates of deposit). If necessary, the Bank also will open its contraction windows.

3. Policy Decision

The Board of Directors unanimously agreed to hold Banco de la República's intervention interest rate steady at 9.75%.

Bogotá D.C., Colombia
July 4, 2008