Minutes of a Meeting of the Board of Directors of the Central Bank of Colombia on September 25, 2009

A regular meeting of the Board of Directors of the Central Bank of Colombia was held in the city of Bogotá on September 25, 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 Board Members in Attendance:
Mr. Carlos Gustavo Cano
Mr. Juan José Echavarría
Mr. Fernando Tenjo
Mr. Cesar Vallejo
Mr. Juan Pablo Zárate

The inflationary situation and economic growth as well as the prospects for the future were discussed in the meeting and decisions were made regarding monetary policy. Below is a summary of the main topics that were dealt with in this meeting.

1. BACKGROUND

a. <u>Recent Developments in Inflation</u>

Annual consumer inflation in August was 3.13% having fallen for the 10th consecutive month. Over the course of the year up to August, the accumulated inflation was 2.23% which is well below inflation for the same period last year (6.74%). Indicators for core inflation have continued declining.

The annual variation in food prices fell from 1.5% in July to 1.46% in August.

The annual upswing in prices for regulated goods declined from 4.7% in July to

3.5% in August due to the performance of all of their components (fuel, public utilities and transportation).

The annual variation in prices for non-tradable goods excluding food and regulated goods rose from 4.7% in July to 4.9% in August. The items with low-indexing and rentals went from 4.4% to 4.6%. The annual variation in prices for items high-indexing stayed at levels of 7%.

The annual rise in prices for tradable goods excluding food and regulated goods fell from 3% in June to 2.8% in August.

The inflation expectation indicators based on local government bonds (TES) rose and are between 2.4% (one-year TES) and 4.58% (10-year TES). The latter one is above the long range goal announced by the Board (2% - 4%).
The annual variation for producer prices (PPI) declined from 1.4% in July to 1% in August.

b. Growth

The annual growth of the GDP for the second quarter of the year was -0.5%. Compared to the first quarter, the second posted an increase of 0.7%.

The annual tightening in the second quarter was mainly due to a downswing in domestic demand (2.1% annually). Net exports in real pesos (exports minus imports) made a positive contribution.

The investment in public works was the most dynamic component of domestic demand (annual growth of 40.6%) while the investment in machinery and equipment plunged (-18.4%). Household consumption fell more than it did in the first quarter due to the effect of the consumption of durable goods (-7.2%) and non-durable goods (-2.0%). Public consumption grew 0.9%.

The sectors that contributed the most to annual GDP growth in the second quarter were the financial (4.3%), mining (10.2%) and public works construction (40.5%). Industry was the sector that shrank the most (-10.2%) thus completing a year of consecutive, negative, annual growth. Other sectors that contributed to the dropping GDP were commerce (the annual variation for this was -3.9%), construction of buildings (-9.9%) and, to a lesser degree, transportation (-1.2%) and agriculture (-1.8%).
With regards to the third quarter, the available sector indicators show the

following:

- The DANE figures for industrial production as of July indicate an annual fall of 6.5% which was significantly associated with the iron and steel subsector.

- According to the Fedesarrollo Business Opinion Survey (EOE) for industry, activity continues to be weak. Nevertheless, industrial confidence continued to recover due to higher production expectations for the next three months.

- According to DANE, annual retail sales in July were down 3.7% compared to a decline of 4.5% for the previous month.

- The Fenalco survey in August continued to reflect shrinking sales but with expectations of an upswing in six months.

- The demand for non-regulated energy grew at an annual rate of 1% in August.

- The Fedesarrollo Consumer Confidence Indicator in August improved for the 4th consecutive month and was at levels similar to those seen towards the end of 2008 and beginning of 2009.

- Building permits for the month of August, for both housing and other purposes, continued to show annual downswings of more than 25%. Cement production had an annual drop of 12.5% during the same month. However, this indicator has tightened less than it did in the first and second quarters (17.4% and 14.2% respectively).

Total exports as of June fell 10% annually compared to the previous 12 months. Although over the course of the year (January-July) they have plunged 19.2% annually, the levels are above those for the same period in 2007. For the same period of time (January-July), the dollar value of exports for all of the sectors (farming and animal husbandry, mining and industry) dropped in annual terms while, in volume, the farming and animal husbandry as well as mining sectors registered annual growth. The largest downswing for our exports was in the US market.

For the 12 month period as of July, 2009, the total imports declined by 3.2% (in annual terms) and over the course of the year (January-July), 16.2% (annual). The latter percent is due to the imports of intermediate goods (-27%). The dollar value of the total imports for the month July (US $3.178 million) was higher than that of the previous month (US $2.486 million) but less than that seen in July, 2008 (US $3.447 million).

The value of exports and imports for 2009 may end up similar to that which was posted in 2007. This would imply a 20% reduction in total exports and 17% in imports with respect to the levels reached in 2008. The former is consistent with the 20% annual plunge in exports to Venezuela.

For the moving average ending in July, the upswing in the unemployment rate on the national level occurred in the context of an increasing participation rate (which rose 2.8pp) which was greater than the increase in employment rate (which rose 2.1pp). Thus unemployment was 11.9%, 0.5pp above the same period in 2008.

According to the General Integrated Household Survey (GIHS) employment grew 6.4% on the national level and 4.2% in the 13 metropolitan areas in July compared to the same period of the previous year. Based on branches of activity, a strengthening of employment in construction and transportation was seen during the second quarter, a fact that could be associated with the momentum of the public works.

c. Foreign context

The results of the main developed economies has caused analysts to expect that there will be a slow world recovery better than that projected in the second half of 2009 and in 2010. This improvement in growth made it possible for the international prices of some commodities continue with the recovery that started three months ago.

The automobile industry, which is supported by state subsidies, has been the driving behind the recovery. Japan, Germany and France registered positive growth in the second quarter while in the United States, the indicators point to the stabilization of its economy. In regards to the emerging economies, the signals are mixed: some Asian countries have recovered in the last quarter while countries in Eastern Europe and Latin America continue shrinking.

A correction in the structural macroeconomic imbalances in the developed economies is necessary to reestablish a sustained growth momentum in these countries and in the world. As long as this does not happen, the greater financing needs of the industrialized economies could generate a rise in world interest rates. Along the same line, it is doubtful that in the medium range, world trade will return to the levels posted prior to the crisis.

d. Financial Variables

There was a slowdown in the growth of the M3 but it has shown annual increases that are above the rise in the nominal GDP estimated for this year.

Between June 19 and September 4, the growth rate for the peso loan portfolio dropped from 15,6% to 9.9% due to the performance of commercial loans. Between the same dates, the growth rate of commercial loans tumbled from 21.2% to 12.4%. Bond placement has compensated for this fall with an rise over the course of the year of $1.8 trillion.

Loans to households show a slowdown for the consumer loan portfolio and good performance in mortgages. On September 4, the annual rate of growth of the consumer loan portfolio was 0.3% while a month ago it moved at a pace of 1.8%. The mortgage portfolio went from a 12.4% annual growth to 13.2% annually between August 7 and September 4 respectively.
In the last few weeks the falling trend in all of the interest rates halted. Since the last part of July, DTF deposit taking has been around 5%. Consumer interest rates were set at 22%, credit cards at 28% and those for housing loans at 14.5%. The pause in the rates was also seen in the treasury loans, a group that has a rate of around 8.5%. As of September 4, the rates for ordinary and preferential loans have risen slightly with values of 12.5% and 9.4% respectively.

The TES curve registered a rise of 27 bp and 6 bp on the short and medium segment of the curve while there was decline of 22 bp on the long segment.

2. DISCUSSION AND POLICY OPTIONS

The following points were highlighted in the discussion:

i) The pace of price growth and its sustained downward trend;
ii) The fall in the annual growth of food prices;
iii) The effect on total inflation that the international prices for food, raw materials and petroleum could cause;
iv) The continuing improvement in producer and consumer confidence;
v) The financial system's peso loan portfolio that showed a slowdown

although its growth continues to be above the nominal GDP;
vi) The issuing of bonds which has complemented the financing of the productive sector;
vii) The performance of the market interest rates in response to the reduction of the Bank's benchmark rate;
viii) The negative growth in the United States and the lower growth in Venezuela, Ecuador and other trading partners;
ix) The effect of the exchange rate on inflation and the growth of tradable sectors;
x) The performance of the interest rates for government bonds; and
xi) The pattern of medium and long term inflation expectations.

The main points of analysis among the members of the Board were focused on the following aspects: i) the elements that affect the inflation projections for 2009 and 2010, especially an eventual recovery in food and regulated prices; ii) the lagged effect of the monetary policy measures on production and prices; iii) the results of the GDP for the second quarter, especially the domestic demand that was weaker than what was projected; iv) the effect of trade restrictions imposed on Colombian products; v) the performance of the exchange rate in the last few weeks; vi) the recent downtrend in the momentum of the financial system's loan portfolio; vii) the risk balance between growth and inflation in a context of a slowing economy and falling inflation; viii) the pertinence of continuing to reduce the intervention rate in view of the latest available information; and ix) the need to strengthen the credibility of the monetary authority and anchor inflation expectations around the long term goal.

The members of the Board emphasized the fall in annual consumer inflation for the 10th consecutive month and the possible effects of trade restrictions and the revaluation of the peso on inflation and growth projections. At the same time, they point out the weakening of the demand for credit.

In order to support economic recovery and reduce the possible negative effects of the restrictions that have occurred in trade as well as the appreciation of the peso, the Board of Directors unanimously agreed to reduce the intervention rate by 50 basis points. The members of the Corporation expect the intervention rate to be stable in the near future.

This reduction in the benchmark rate continues the expansionary monetary policy that has been in place since the end of last year and which has allowed a persistent reduction in the interest rates for deposits and bond offers. The Board of

Directors hope that this trend will continue to stimulate economic growth in an environment characterized by a healthy financial system along with the improvement in the confidence indicators of consumers and businessmen.

3. POLICY DECISION

The Board of Directors agreed to cut the Central Bank’s intervention interest rate by 50 b.p., placing the intervention rate at 4%.

Bogota, D.C., Colombia
October 9, 2009