



Minutes of a Meeting of the Board of Directors of the Central Bank of Colombia on August 20, 2009

A regular meeting of the Board of Directors of the Central Bank of Colombia was held in the city of Bogotá on August 20, 2010.

Present:

Mr. Juan Carlos Echeverry, 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

Inflation and the economic situation were discussed with respect to growth and prospects for the future, and monetary-policy decisions were reached. The following is a summary of the principal topics addressed during the meeting.

1. BACKGROUND

a. Recent Developments in Inflation

Annual consumer inflation in July was 2.24%, which is 1 bp less than in June. Monthly inflation was -0.04% and the core inflation indicators declined once again.

The annual variation in food prices went from 1.5% in June to 1.71% in July, basically due the price of perishables.

The annual increase in the price of regulated items went from 5.1% in June to 5.23% in July, due to the adjustments in electricity rates.

The annual variation in prices for non-tradables, excluding food and regulated items, declined from 3.8% in June to 3.78% in July.

The annual increase in prices for tradable goods, excluding food and regulated items, went from -0.5% in June to -0.77% in July.

With the preliminary data for July, inflation expectations derived from trading in government bonds at one, five and 10 years were at 1.12%, 3.81% and 4.33%, with respective variations of -51 bp, -4 bp and +2 bp compared to the average the month before.

The inflation expectations detected in the quarterly and monthly surveys conducted by the Central Bank at the beginning of July continue to show declines and are situated within the long-term target range set by the Board of Directors.

Annual producer price inflation (PPI) in July was 1.8% as opposed to 2.1% in June.

b. Growth

The indicators at hand show the momentum in local demand witnessed at the start of the year continued during the second quarter and, although less evident, in the third.

The indicators of the evolution in household consumption and its determinants suggest continued expansion. The second-quarter average for the Consumer Confidence Index shows household consumption was still growing at a good pace. Moreover, imports of consumer goods, especially durables, continue to illustrate the build-up in household spending on this item, bolstered by low international prices and developments in the exchange rate. The indicators of commercial activity point in the same direction. In June, the Business Opinion Survey (EOE in Spanish) also registered signs of a

recovery in commerce. This was confirmed by a 15.4% annual increase in retail sales, according to the latest report released by DANE.

The behavior of employment also contributed to the way consumption performed. During the second quarter, employment rose again, both in annual terms and compared to the first quarter. The increase was primarily in urban salaried jobs.

Two aspects stand out with respect to the latest information on investments. The first is the slow but steady recovery in imports of capital goods, particularly for industry. The second is the build-up in the amount of area licensed in May, which indicates construction, apart from civil works, is again on the rise.

As for supply, the pace of expansion in industry activity is good, even if somewhat slower than expected. For June, DANE reported 8.5% annual growth in industrial activity, which is less than was forecast by the Bank's technical team (9.8%).

The information from the opinion polls is favorable as well. Fedesarrollo's Business Opinion Survey for June shows industrial orders continued to improve, while expectations for production three months out have stabilized at high levels.

The figures for the third quarter are limited. Among the few available indicators is the one for consumer confidence, which was still relatively high in July. As a result, the pace of consumption observed in the second quarter is expected to continue. The same survey shows the willingness to purchase housing and durable goods remains higher than at the start of the year. Vehicle sales confirm that perception, having continued to rise at an important pace during July.

The new data at June show a slowdown in exports in dollars. By June, the annual increase in total exports was 11.7%, as opposed to 30% the month before. This decline in growth was observed in the major categories, according to product origin. The country's leading exports (coffee, coal, oil, nickel and by-products thereof) were up 30% in June, which is 24.9 pp less than the figure in May. Agricultural exports posted an annual increase of 0.8%, while growth in industrial exports, excluding the leading products, came

to -19.7% in annual terms. Respectively, these figures are 0.5 pp and 18 pp less than those registered in May.

c. The External Context

The latest information on the external scene suggests the world economy might not recover as quickly as the market expects, given the slowdown in the United States, which is Colombia's major trading partner. The U.S. economy grew 2.4% (a/q) during the second quarter of 2010, following an increase of 3.7% (a/q) early in the year. The biggest surprise was in household consumption; its first -quarter growth was revised downward and the second quarter saw even less of an increase. The new numbers for the job market, consumer confidence, retail sales, consumer lending and housing starts continue to reflect the weakness of internal demand in the United States.

The most recent information for Europe continues to show a slow recovery, despite the build-up in Germany and England. In contrast, the Asian countries maintain good growth rates and are expected to continue to do so.

With the exception of Venezuela, the build-up in the economies of Colombia's major trading partners in Latin America continues. Peru, Brazil and Chile are a case in point, having posted considerable growth. Feasibly, this momentum could continue during the remainder of the year, and 2011 could see even more of an increase in GDP.

In the case of Venezuela, annual growth during the first quarter (-5.8%) and the forecast for 2010 as a whole reflect an economy in recession that has cut back drastically on its imports. Other factors such as devaluation of the "strong bolívar" and the loss of confidence in the Venezuela market among Colombian exporters make it difficult to be optimistic about an increase in exports should trade relations be reestablished fully.

Despite less growth in some of the industrialized countries, terms of trade are expected to remain at their present levels, which can be considered favorable.

d. Financial Variables

In July, nominal rates on consumer and ordinary lending averaged 17.9% and 12.9% respectively, having declined 31 bp and 18 bp, in that order,

compared to the month before. Mortgage lending rates remained stable at 12.9%. Consequently, interest rates on household loans and corporate lending are historically low.

The annual increase in the average total gross loan portfolio was 5.4% by July, compared to 4.6% a month earlier. Mortgage and consumer lending are still the most dynamic, with respective annual increases of 18.8% and 9.3%. These figures are 90 bp and 170 bp higher, in that order, than the ones on record for June. The annual increase in the commercial loan portfolio rose by 60 bp in July to 1.4%.

Between July 23 and August 18, the rates on government bonds posted negative variations of 5bp, 27bp and 35bp in the short, medium and long tranches, respectively.

2. DISCUSSION AND POLICY OPTIONS

The following points were emphasized by the Board of Directors during its deliberations:

- i The outcome for inflation at July, which was lower than expected by the market and by the Central Bank's technical team and within the range set by the Board of Directors
- ii The continued drop in core inflation indicators, which also are within the target range established by the Board
- iii The continued decline in inflation expectations
- iv Available figures that still suggest a quick and sustained economic recovery
- v Improved business and consumer expectations
- vi Growth in the peso-denominated loan portfolio held by the financial system at levels similar to the estimated increase in nominal GDP for 2010
- vii Market interest rate performance in response to the Central Bank's benchmark rate cut
- viii The impact of the exchange rate on inflation and on growth in output in the tradable sectors
- ix Interest rates on government bonds, which dropped during the month
- x The possibility that recovery of the global economy might be slower than expected

The main points analyzed by the members of the Board centered on the following aspects:

- (i) Inflation forecasts for 2010 and 2011
- (ii) Less variation in the price of tradable goods due to peso appreciation with respect to the dollar
- (iii) The delayed effect of monetary policy measures on production and prices
- (iv) Economic growth forecasts for 2010, which suggest the recovery will be faster than anticipated and prompted the technical team to raise its forecast for the year
- (v) The recent increase in the loan portfolio held by the financial system and how asset prices performed
- (vi) The decline in inflation expectations
- (vii) The recent developments in capital flows
- (viii) The risk balance between growth and inflation in the context of a recovering economy and inflation that is within the long-term target range
- (ix) The need to preserve the monetary authority's credibility and to anchor inflation expectations around the long-term target

The Board of Directors highlighted the following with respect to the behavior of inflation during the month:

- (i) Annual consumer inflation in July was 2.24%, which is less than anticipated by the market and by Central Bank's technical team.
- (ii) The core inflation indicators fell again and remain in the lower part of the long-term range for inflation set by the Board of Directors.
- (iii) Inflation expectations are still at low levels
- (iv) Inflation last month was consistent with the technical team's forecasts, which show – with a high degree of certainty – that inflation will be within the long-term target range during 2010 and 2011.

It was emphasized by the Board that the information received during the last few weeks continues to indicate the Colombian economy is growing faster than expected, without bringing inflationary pressure to bear. The increase in consumer and producer confidence, the momentum in a number of leading indicators and the soundness of the financial system confirm the build-up in the Colombian economy.

The world economy continued to grow, but not as quickly as during the first half of the year. This was due to the slowdown in the United States. However, one sees an increasing amount of recovery in the Latin American economies. The international markets stabilized after the financial crisis in Europe.

The Board of Directors believes the Colombian economy during the remainder of this year and in early 2011 will see favorable terms of trade, larger capital flows, low international interest rates and a weak recovery in external demand for the country's non-traditional products.

The Board also believes the expansive monetary policy adopted by the Central Bank contributes to economic growth.

3. POLICY DECISION

The Board of Directors agreed to make no change in the Central Bank's intervention rate, leaving it at 3%.

Bogotá, Colombia
September 3, 2010