Minutes of a Meeting of the Board of Directors of Banco de la República on January 25, 2008

A regular meeting of the Board of Directors of Banco de la República was held in the city of Bogotá on January 25, 2008.

Present:

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

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

Full-time Associate Directors:
Mr. Carlos Gustavo Cano
Mr. Juan José Echavarría
Mr. Juan Mario Laserna
Mr. Leonardo Villar
Mr. Fernando Tenjo was not present.

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

1. Background

a. Recent Developments in Inflation

Consumer inflation ended the year at 5.69%. This is 119 b.p. above the top of the target range set by the Board of Directors of Banco de la República and 121 b.p. more than the figure registered in December 2006.

The rise in inflation during December was due essentially to the behavior of food and regulated prices. Annual inflation in non-tradables, excluding food and regulated prices, saw no increase that month and was 5.2%, having declined for the fourth month in a row after reaching a high of 5.57% in August.

The core inflation indicators averaged around 5% by the end of the year. Non-food inflation in particular was 4.4% in December 2007, which is similar to what it was in November.

Several factors explain the annual variation in food prices (8.51%). On the one hand, weather conditions such as El Niño in the early months of 2007 and La Niña in the second half affected the supply of vegetables, fruits and tubers. On the other, increased bio-fuel demand and production brought pressure to bear on international prices for certain foods and agricultural supplies, while high oil prices raised transport rates and prices for a number of chemicals used in agriculture. This situation also prompted a change in the use of agricultural raw materials; some of those previously used for food are now going to produce bio-fuels. The growing demand for certain foodstuffs in Venezuela and the strength of local demand pushed up prices as well.

b. Growth, the External Context and Financial Variables

Local economic growth remained strong. The reported annual increase in GDP during the third quarter of 2007 was 6.6%. This new information confirms that growth for the year as a whole will be around 7.0%.

A slowdown is expected this year, the extent of which will depend on the international situation. Even so, technical studies done by the Bank show GDP growth will remain vigorous in 2008, near the average for the last five years.

The foregoing is consistent with the good performance of exports, which continue to grow at a healthy pace, along with investment and the momentum in employment. As to employment in commerce, a sector survey shows an annual increase of 6.7% by November, rounding out two consecutive years of annual growth above 5%. Although it has not risen as much, industrial employment also completed six quarters with growth rates above 2%, having registered 2.5% annual growth in November.

c. The International Context

A number of indicators confirm the slowdown in the U.S. economy. The housing market shows no signs of recovery, the restrictions on credit have increased, and sales, building permits and the execution of new housing projects continue to decline. Consequently, the coming months are expected to see a further drop in housing prices and major implications for financial soundness in the United States and other developed countries. Moreover, unemployment was up from 4.7% to 5% by December, and the number of jobs being created slowed considerably, which has not happened since the previous recession in 2001. Industrial production expectations detected in surveys are down to levels not witnessed since 2001. Household consumption, which was very sound until only recently, could be feeling the pinch judging by the decline in retail sales during December (-4.3% annualized monthly) and by the drift in consumer surveys.

These doubts about the US economy have enhanced fears of a slowdown in other developed and developing economies. Added to this is the emergence of new inflation pressure originating with high oil and food prices and uncertainty about the future of Colombian exports to Venezuela.

d. Financial Variables

The increase in base money was 19.4% by the end of the year, as opposed to 15.3% in November and 10.9% one quarter earlier. The trend in this variable is associated with the recovery in the demand for cash and the increased demand for bank reserves after the marginal reserve requirement was raised midway through 2007. M3 registered 17.8% annual growth in December, which also is more than in past months. An increase in the share of certificates of deposit (CDT – Spanish acronym) to the detriment of saving accounts was another highlight.

Loan portfolio growth in the financial system continued to slow during that period and was up by 23.6% at December. Commercial credit is showing signs of more momentum, as confirmed by larger disbursements. Part of this increase could be due to a shift from external credit to local loans due to the reinstatement of deposits required for external borrowing. Annual growth in retail loans and the total loan portfolio declined.

Savings rates tended to decline in December, with the exception of the DTF. This was also the case with rates on retail, commercial and micro-credit and with the average lending rate. With this development in nominal rates and the rise in inflation during recent months, real rates tended to decline during the fourth quarter, ending the upward trend witnessed since early 2007.

2. Discussion and Policy Options

The following points were emphasized during the discussion:

(i) Price increases that continue to exceed the targets set by the Board of Directors.
(ii) The considerable weight of food on inflation in 2008 and 2009 amid an international context marked by rising pressures
(iii) The behavior of non-tradable inflation, excluding food and regulated prices, which continued to decline but is still above levels compatible with the targets
(iv) Available indicators suggesting the momentum in aggregate demand remains high compared to production, but is showing signs of moderation
(v) The uncertainty about the future of the world economy and that of our major export markets, particularly Venezuela
(vi) The monetary-policy implications of the Board's inflation targets and developments in inflation expectations, which rose last month due to inflation in 2007.

The Board believes the indicators show the benchmark rate hikes and the change in reserve requirements have had an impact on lending and savings rates and have been effective in helping to curb the momentum in credit. In any case, the credit growth rate is still high. Although declining, the increase in local demand continues to exceed the growth in national production.

The discussion among Board members focused on: (i) the effect of monetary-policy measures, given the lag in their impact; (ii) the elements that shape inflation forecasts for 2008; (iii) the widening current account deficit, which shows local demand is growing faster than national production; (iv) the fact that international developments, in the context of a current account deficit, might lead to future adjustments in the exchange rate; (v) the uncertainty sparked by the extreme volatility on international markets and how it might affect the Colombian economy; and (vi) the need for the monetary authority to enhance its credibility as a strategy for anchoring inflation expectations, given the upward price trends countries face.

The Board members were unanimous in stressing that the current environment is one of considerable uncertainty. Given the possible implications that less growth in the world economy could have for Colombia's economic growth, they advised waiting for new information before making a decision on benchmark interest rates. In effect, less growth in the world economy could affect economic performance in Colombia, which would depend on the extent of the slowdown in those countries and its impact on exports, commodity prices, capital flows and remittances.

Some of the members emphasized that inflation remains on a troubling upward course that is distancing it from the long-term target defined at the last meeting. This is manifest by the change in expectations. At the same time, they did not rule out the need for additional hikes in the benchmark rate at some point in the future, if the figures suggest hikes are advisable to ensure that inflation targets are met and to maximize the sustainable economic growth rate.

Other members reiterated that the current interest rate is consistent with a contractionist monetary policy and said that available information does not suggest the need for future benchmark rate hikes. They believe the country's monetary policy is fulfilling its objectives in terms of curbing growth and credit and anchoring expectations to meet the inflation targets. In their opinion, it would be possible to return to a more neutral stance, depending on how external conditions develop and the trend in local price and employment levels.

The Board unanimously decided to hold its benchmark rate at 9.50%. It also agreed on the importance of continuing to monitor the impact the international economic situation could have on growth, as well as the effect of inflation pressures brought to bear by international food and fuel prices.

3. Policy Decision

The Board of Directors unanimously agreed not to modify Banco de la República's benchmark rates.

Bogotá D.C., Colombia, February 8, 2008