Minutes of a Meeting of the Board of Directors of Banco de la República Held on April 29, 2011

A regular meeting of Banco de la República's Board of Directors was held in the city of Bogotá on April 29, 2011.

Present:

Mr. Juan Carlos Echeverry, Minister of Finance and Public Credit
Mr. José Darío Uribe, Governor, Banco de la República

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 situation with respect to inflation and economic growth was discussed, as were their prospects for the future, and decisions on monetary policy were reached. The following is a summary of the main topics addressed during the meeting.

1. BACKGROUND

a. Recent Developments in Inflation

Annual consumer inflation in March was 3.19% (0.27% for the month). This is two basis points (bp) more than in February.

Upward pressure was brought to bear by the annual change in regulated prices, with 6.9% inflation at March compared to 6.2% in February, and by tradables, excluding food and regulated prices, with -0.2% in March as opposed to -0.3% in February. Downward pressure came from the annual variation in food prices, which was 3.9% in March versus 4.4% in February. In this group, the main contribution to the slowdown originated with perishable foods, reversing part of the upward shock caused by the first wave of winter weather. The annual variation in prices for non-tradables, excluding food and regulated goods, remained virtually stable at 3.4% (with a two bp reduction in March compared to February)

As for the annual core inflation indicators, their average rose from 2.59% in February to 2.65% in March. At 1.8%, the lowest indicator was still the CPI excluding food and regulated items. The change in producer prices (PPI) was 4.9% by March, which is more than in February (4.6%). In terms of the make-up of the PPI, there was an increase in the annual variation in the imported component and in the component related to produced and consumed goods.

Banco de la República's monthly expectation survey with data at March points to 3.3% inflation by the end of 2011, which is less than what was anticipated the month before (3.5%). For expectations further out (five and 10 years), which are based on government bonds, the reduction was clearer, but they are still above the ceiling of the target range (4%).

b. Growth

GDP rose 4.6% in the fourth quarter of 2010. As a result, the increase in GDP for all of 2010 came to 4.3%. When analyzed by type of expenditure, the largest contribution to this growth came from household consumption, especially durable and semi-durable goods. Government consumption and investment also contributed to the increase. All the components in this last aggregate posted positive annual growth; investment in buildings was the only exception. Consequently, the rate of investment to GDP in 2010 was 25.6%, in real terms. On the other hand, net exports contributed negatively to GDP growth during 2010.

Available data for the first quarter of 2011 suggest strong economic growth fueled by the expansion in internal demand. Private consumption continues to benefit from interest rates (on consumer and credit card lending) that are still below their historic averages, plus a hefty rise in household lending and an increase in better-quality jobs. This improved outlook on household consumption is supported by the information on retail sales measured by

DANE. They were up 13.2% in February, bolstered by vehicle sales (when excluding this factor, the growth in retail sales was 5.5%). These favorable conditions appear to be reflected in consumer confidence, as illustrated by the upswing in the Fedesarrollo consumer confidence index.

As for investment, the trend in imports of machinery and equipment by February suggests a good deal of continued momentum. The figures on building permits point in the same direction. They exhibited important growth at the end of last year, fueled largely by low-income housing. This information is consistent with the high rates of growth in the real mortgage loan portfolio at March (15%).

On the supply side, annual industrial growth was 2.4% by February 2011. This rate, which is low compared to the one observed in January and to what was anticipated by Banco de la República's technical team, is explained by the drop in iron and steel production resulting from a partial closure at Cerro Matoso, which is expected to continue until August. Performance in most of the other branches is good and coincides with the favorable development of other indicators associated with the sector (orders, inventories, demand for unregulated energy, lending and production expectations).

With regard to foreign trade, total exports in dollars at February reflected an annual variation of 37.2%, bolstered primarily by the mining and coffee sector, with an annual increase of 49.8%. The cumulative 12-month rise in total exports comes to 23.6%. Total imports in dollars posted 35.1% annual growth at February. The cumulative 12-month increase in total exports is 29.2%.

Banco de la República's technical team raised the growth forecast for 2011 by 50bp to a range of 4.0% to 6.0%. This estimate takes into account the negative impact the resurgence of severe winter weather could have on the country's economic activity. With these forecasts, it is more likely output during the second quarter will be closer to its potential.

c. Financial Variables

In March, nominal interest rates on consumer and ordinary borrowing averaged 17.6% and 10 % respectively, with consumer lending up by 5 bp and ordinary lending by 25 bp compared to the month before. The mortgage lending rate was 12.5%, which is 15 bp higher than in February

Annual growth in the total gross loan portfolio in domestic currency came to 16% in March, having been 15.5% the month before. The consumer and mortgage loan portfolios were still the most dynamic, posting respective annual variations of 18.4% and 19%. By March, the annual increase in the commercial loan portfolio came to 13.8%.

During April, interest rates on one-year government bonds rose by 5 bp, while those on five and ten-year bonds declined by 31 bp and 15 bp, respectively.

d. The external context

During the first quarter of 2011, the indicators for the real sector in the developed economies were mixed. On the one hand, US economic performance has been relatively good, despite 1.8% growth in the first quarter of 2011 (which was less than expected). On the other hand, the recovery in the Euro Zone remains modest, led primarily by Germany, while the recovery of the Japanese economy is threatened in the short term by the natural disaster and nuclear emergency in that country.

The positive results for the US economy are based on internal and external factors, which can be summarized in a better job market, growing household consumption and dynamic foreign trade, with exports at pre-crisis levels. Nevertheless, there are still latent risks to the US economy, which may delay its short and mid-term recovery. As the Fed warned, recovery is proceeding at a “moderate pace” because of the difficulties that have emerged. Among them are: i) a huge fiscal deficit that limits action on the part of the federal government, ii) higher oil and food prices, which could hamper the country’s growth and that of the rest of the world, iii) less than robust job creation, and, iv) a continued lag in the housing market, although the latest figures have been favorable.

Therefore and considering inflation expectations have not increased, despite international price hikes, the Fed decided at its meeting on Wednesday, April 27, to leave the benchmark interest rate unchanged. Likewise, it maintained its policy to purchase Treasury bonds (US$600 billion) up until the end of the second quarter of 2011, as had been announced initially. In contrast, annual inflation in the Euro Zone has accelerated and is still above target, due to higher international prices and good growth in the major European economies. This is partly what prompted the European Central Bank to raise the intervention interest rate by 25 bp at its meeting in April.

The markets' nervousness about the sustainability of the debt of peripheral European economies increased again in recent weeks, due to the political instability in Portugal, the lack of credibility surrounding some of the fiscal austerity programs and the possible restructuring of government debt in Portugal and Greece. Even so, analysts have upgraded their Euro zone growth forecasts for this year. For example, the IMF raised its forecast from 1.5% to 1.6%.

The emerging countries are preserving good momentum and ended 2010 with important growth. The figures available up to the first quarter of 2011 suggest growth will continue throughout the year, but at a more moderate pace. Higher international prices have begun to affect inflation in some countries, particularly the Asian economies and Brazil, prompting most monetary authorities to raise their intervention rates. This strategy is expected to continue during the rest of the year, given inflationary pressures and the decline in output gaps.

Thanks to good performance by the economies in the region, their low risk premiums and low interest rates in the developed countries, the flow of capital towards Latin America continues. As a result, its currencies have appreciated.

International commodity prices are expected to remain high during 2011. Good performance by the emerging economies and various supply problems have bolstered Colombia's terms of trade to record high levels, which would support exports and an improvement in income for Colombians.

2. DISCUSSION AND POLICY OPTIONS

The members of the Board weighted the possibility of an intervention interest rate hike at this meeting, as part of a continuing effort to gradually reduce the monetary stimulus.

The following points were underscored:
(i) Interest rates are at record low levels in real and nominal terms.

(ii) All the lending components continue to grow at important rates, coupled with low real interest rates on loans and a build-up in household borrowing.
(iii) The 4.3% GDP increase in 2010 was more than expected and the figures for the first quarter of this year suggest the economy still is growing.
(iv) The country's terms of trade continue to improve and are now at record high levels, contributing to the growth in national income.
(v) Consumer expectations have increased and investment in machinery and equipment remains vigorous. The situation with respect to civil works is believed to be similar.
(vi) Banco de la República's technical team raised its growth forecast for 2011 by 50bp to a range of 4.0% to 6.0%. The lower part of this range takes into account the negative impact the resurgence of severe winter weather could have on the country's economic activity.
(vii) The job market indicators have improved.
(viii) Output is more likely to be closer to its potential during the second half of the year.
(ix) Housing price indicators continue to rise and are now near record highs.
(x) The recent appreciation in the peso was considered as well.

In terms of risks, the following was observed:
(i) International commodity prices rose in recent months, including those for oil and food, due to strong growth in demand in the emerging economies and negative supply shocks.
(ii) Inflationary pressures increased in many countries and some central banks in Latin America have raised interest rates, as did the European Central Bank.
(iii) Extremely low interest rates for too long a period of time ultimately can pose a risk to financial stability, the sustainability of growth and future inflation.
(iv) An exceptionally low interest rate may be inconsistent with near potential growth anticipated for 2011 and 2012 and inflation forecast close to the mid-point of the long-term target range.
(v) Inflation expectations at more than one year are above target.

Considering all these factors and the time it takes monetary policy to exert an impact on aggregate spending and inflation, the Board of Directors felt the move towards a less expansive policy must continue. Banco de la República's new interest rate still supports short-term growth in output and employment.

The intervention rate hikes will help to keep inflation within the target range for this year and the next, and to avoid future financial imbalances. Moreover, the anticipated monetary policy actions, coupled with an austere fiscal stance, should reduce the extent to which the intervention interest rate would have to be raised in relation to the levels witnessed in previous economic cycles.

3. POLICY DECISION

The Board of Directors agreed to increase Banco de la República's intervention rate by 25 bp, placing it at 3.75%.

Bogotá, Colombia
May 13, 2011