Minutes of the Banco de la Republica Board of Director's meeting on December 17, 2010

On December 17, 2010, the regular meeting of the Board of Directors of the Banco de la Republica was held in the city of Bogota.

Present were:
Juan Carlos Echeverry, Minister of the Treasury and Public Credit
Jose Dario Uribe, Governor of Banco de la Republica

Full-time Board members present:
Carlos Gustavo Cano
Juan Jose Echavarria
Fernando Tenjo
Cesar Vallejo and
Juan Pablo Zarate

The inflationary and economic growth situations as well as the outlook for both were discussed and decisions were made in relation to monetary policy. Below is a summary of the main topics dealt with in this meeting.

1. BACKGROUND

a. Recent Developments in Inflation

Annual consumer inflation in November was 2.59% (monthly was 0.19%) which is 26 basis points (bp) higher than in October. Thus, the accumulated inflation is 2.51%

The higher percentage with respect to October was due to the upward pressure from food and regulated goods and services. The annual change in the prices for regulated goods and services went from 5.94% in October to 6.29% in November driven by utilities. The annual change in the prices for food went from

1.69% in October to 2.4% in November. This increase in prices was seen for both processed and perishable food items.

The annual change in the prices for non-tradable goods and services excluding food and regulated prices rose marginally after having completed four consecutive months of declines and was at 3.54% in November compared to 3.52% in October. Meanwhile, the prices for tradable goods excluding food and regulated prices showed a slight upswing of 3 bp as it went from -0.57% in October to -0.54% in November.

With respect to the indicators for core inflation, the average went from 2.34% in October to 2.41% in November. The lowest amount registered is still appearing in the CPI excluding food and regulated prices with 1.69% annually.

Based on the data available as of December 14, 2010, the inflation expectations derived from the trading in 1-, 5-, and 10-year public debt were at 2.4%, 3.9% and 4.2% having seen increments of 68 bp, 28 bp and 24 bp respectively compared to the average from the previous month.

The inflation expectations from the monthly survey done by the Banco de la Republica at the beginning of December were within the long term target range set by Board of Directors.

The annual variation in producer prices (PPI) was 3.7% in November compared to the 2.7% that had been registered in October. The monthly change was 1.2%.

b. Growth

The information for the third and fourth quarters suggests that domestic demand has declined in strength and that its growth for the last quarters of the year will be lower than what was seen in the first half of 2010. Household consumption remains high but investment was negatively affected by both private and public construction.

Consumer confidence indicators remain high and explain the performance of consumption. This fact is reflected in the performance of the DANE indicators for trade and consumer imports. However, the confidence indicators based on the FEDESARROLLO survey have retreated.

Investment, in turn, showed a mixed trend during the third quarter. Up to the third quarter, imports of capital goods showed high expansion rates which implied the favorable performance of the investment in transportation equipment, machinery and equipment. Construction registered a 17.7% slowdown in the DANE indicators for public works projects and limited momentum in buildings with the exception of that allocated for investment in low-income housing.

With respect to foreign trade, total exports in dollars showed an annual change of 20.3% as of October, which was mainly stimulated by energy-related mining sector and coffee, which had an annual change of 29.7%. For the 12 month accumulation, the growth in total exports is 20.5%. Total imports in dollars showed an annual change of 22.2% in October. For the 12 month accumulation, the growth in total imports was 15.8%.

For the third quarter, the available supply indicators have seen mixed performances and suggest that the economic growth in several branches such as industry, electricity, gas and water as well as transportation could moderate. In contrast, the information from the FEDESARROLLO business opinion survey shows that orders remain at high levels and that inventory has fallen. Both of these indicators are associated with favorable performance in industry.

In the labor market, the unemployment rate showed a declining trend in October, especially in the national total. The data as of October show strong job creation, especially non-salaried jobs, in both the thirteen metropolitan areas and the national total.

c. Financial variables

In November, the average of the nominal interest rates for consumer and regular loans was at 16.8% and 9.2% respectively with downswings of 13 bp and 21 bp (in that order) compared to the month before. The rate for mortgages was at 12.2% which is 7 bp lower than what was registered in October. As a result, the interest rates for loans to households and businesses are at historically low levels.

The annual growth in November of the total gross loan portfolio in legal currency was 11.9% while its growth was 10.7% a month previously. The strongest portfolios are still mortgages with an annual change of 20.0% and the consumer portfolio with an annual change of 14.5%. The annual growth of the commercial portfolio was 9.6% in November.

Between November 30 and December 16, 2010, the rates for public debt securities jumped 56 bp and 31 bp for the one and five year securities. In the same period, the 10-year securities were at 8.25%, which is 4 bp more than what was registered as of November 30.

d. Foreign context

In the foreign context, the upswing in the perception of risk as a result of the fiscal and financial problems in Europe stands out. This has been passed on to higher risk premiums in Greece, Ireland, Portugal, Spain and, to a lesser degree, Italy. In Europe, a marked slowdown in economic activity has been seen with a growth of 1.5% (a/q) for the third quarter, a record that is much lower than the 3.9% (a/q) for the second quarter. However, the performance is varied with Germany and France showing economic activity that is recovering.

In the United States, information on economic activity continues to give off mixed signals. Although growth has been revised upwards to 2.5% (a/q) for the third quarter of 2010 with favorable performance from consumption, there are signs of weakness since the unemployment rate has remained high for more than a year.

The emerging economies in the region also felt the effects of the increase in risk and some of their currencies have devalued with respect to the dollar. The positive economic performance, the risk premiums that are still low and the favorable level of prices for some commodities will probably continue to contribute to the inflow of capital into these countries.

2. DISCUSSION AND POLICY OPTIONS

The board members' main points of discussion and analysis focused on the following aspects: (i) inflation projections for 2010 and 2011, (ii) the change in the prices for tradable goods, (iii) the lagged effect of the monetary policy measures on production and prices, (iv) the growth projections for the economy and employment for 2010 and 2011, (v) the trend of consumer confidence and the performance of investment, (vi) the recent strength in the financial system portfolio, (vii) the rise in the prices of financial assets and housing, (viii) inflation expectations, (ix) the recent trend for capital flows, (x) the performance of public debt securities, (xi) the balance of risk between growth and an inflation that is in the lower half of the long term target range, (xii) the need to uphold the credibility of the monetary authority and anchor inflation expectations around the long term target and (xiii) the growth data and projections for the global economy.

The Board of Directors emphasized the following aspects of the inflation trend during the month: (i) annual consumer inflation was 2.59% in November, which is higher than what was seen a month ago and above what had been expected by the Bank's technical team and the market, (ii) the core inflation indicators (which exclude the prices of the most volatile products such as food) rose slightly and remain close to or below the mid-point of the target range, (iii) inflation expectations followed a similar trend and (iv) the upswing in inflation, which was primarily due to the increase in the prices for food as a consequence of the weather patterns, will be transitory.

The Board emphasized that the Colombia economy is still being driven by the strength of domestic demand and the favorable terms of trade. The high levels of confidence, a labor market that is recovering, the strength of credit and real interest rates that are at historically low levels have had a favorable impact on the recovery of household consumption and on investment. In spite of this, an indicator of public works projects that is significantly lower than expected and the weather patterns could bring the data on economic activity down to a lower rate than the 4.5% which was anticipated a month ago.

Over the last month, the estimates for global growth for 2010 did not change significantly. Nevertheless, on average, the market analysts and some multilateral entities are still predicting a slowdown in the world economy in 2011. In addition, the risk perception in Europe remains at high levels and has affected the performance of the market and depreciated their currencies with respect to the dollar.

The international prices for commodities that are the most relevant for Colombia are still at historically high levels. Meanwhile, the index for the Colombian Stock Market, which had dropped partly because of the increase in the perception of global risk, has returned to its growth trend.

The Board of Directors believes that the monetary policy posture has contributed to the growth of the economy without putting compliance with the inflation target at risk.

3. POLICY DECISION

The Board of Directors agreed to keep the benchmark rate of the Banco de la Republica unchanged and it will remain at 3%.

Bogota DC, December 30, 2010