Minutes of a Meeting of the Board of Directors of the Central Bank of Colombia on February 27, 2009

A regular meeting of the Board of Directors of the Central Bank of Colombia was held in the city of Bogotá on February 27, 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 Directors:
Mr. Carlos Gustavo Cano
Mr. Juan José Echavarría
Mr. Juan Mario Laserna
Mr. Fernando Tenjo
Mr. Leonardo Villar

Circumstances surrounding inflation and economic growth, and their prospects for the future were discussed, 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 was 7.18% in January. This is 49 b.p. less than in December and represents a decline for the third month in a row. Most of the core inflation indicators declined during January.

Food inflation went from 13.2% in December to 12. 2% in January. Perishables and certain imported foods are credited with the drop.

The annual increase in regulated prices was 8.5% in January, which is less than in December (9.45%) The decline in prices for public utilities (gas and water), transportation and fuel is a high point in that respect.

Non-tradable inflation, without food and regulated prices, went from 5.25% in December to 5.1% in January. Rentals were an important item and have exhibited an upward tendency in the last five months, largely due to the clauses in rental contracts to compensate for the effects of inflation. For its part, tradable inflation, without food and regulated prices, registered no change and remained at 2.4%.

The various inflation-expectation indicators measured on the basis of local government bonds at 5 and 10 years fell below 5%, while those measured with one-year TES were at 5.6%, which is slightly over the top of the target range set by the Board of Directors.

The annual variation in producer prices (PPI) declined for the third month in a row, having gone from 9% in December to 6.2% in January. The monthly variation was -1.5%, which is the largest monthly drop in the history of the series since 1970.

b. <u>Internal Growth</u>

Local economic activity continued to slow faster than the Central Bank's technical team had anticipated. The available figures show annual industrial growth was -9.2% in December. For its part, DANE announced a drop of 3.4% in total commercial retail sales in December compared to the same month in 2007.

The few available indicators for the start of the year show the economy continues to lose momentum:

- By January, the demand for energy in the industrial sector was down by 9.5%, which is more than the drop in December.

- The Fenalco retail sales indicator, which discounts seasonality in commerce, showed a drop in January with respect to November and December.

- The total demand for energy for consumption and production was up by only 1% in January compared to the same month in 2008.

- The Fedesarrollo indicator of consumer sentiment rose somewhat in January, but is still below the levels observed during the last five years.

As to the external sector, total exports in dollars rose at an annual rate of 30.8% between January and November 2008, with traditional exports outdoing non-traditional exports (48.3% versus 9.0% growth). In the case of non-traditional exports, sales to Venezuela were up by 17.2% during the year to November, showing less momentum than in 2007. The annual increase in exports to Ecuador was 15.4%, while exports to the United States dropped (0.6% in January-November, excluding gold), with a decline in export value over the last three months. Non-traditional exports to the rest of the world rose by 5.3% during the same period.

The period between January and December 2008 saw considerable import growth (20.6%). However, there is evidence of less momentum in purchases outside the country, primarily imports of consumer goods, which went from an annual increase of nearly 25.1% for the year to February to 11.5% for the entire year. At the same time, capital goods, which were up 20.6% by December, reflected a slower rate of growth compared to their high in February, when they rose by 35.4%.

The latest employment figures show important annual increases in the unemployment rate, which was 14.2% nationwide. This was due primarily to an increase in the labor force participation rate compared to the same month the year before, while the rate of occupation remained relatively stable.

c. The External Context

The speed at which the world economy has deteriorated in recent months is faster and greater than expected. The decline in demand that began in the United States and in several European economies spread to other regions of the globe. By February, a sharp contraction in economic activity in Japan, the European Union and a number of Eastern European and Asian countries was patently obvious, while emerging economies such as China and India reflected a sharp slowdown.

The impact is evident in Latin America as well. The Mexican economy saw its GDP decline 1.6% during the fourth quarter (in annual terms). Other countries, such as Brazil and Chile, also reported reductions in annual industrial production by December: 15.5% and 5.6%, respectively.

World trade has contracted quickly in response to the sharp setback in demand. In December, Europe's developed economies reported annual reductions in nominal exports in dollars ranging from 15% to 20%, while the reduction in the United States was 9%.

The declining confidence in financial markets and the freeze on credit continue to affect the developed countries the most. In the emerging economies, particularly Colombia and other Latin American countries such as Peru, Chile and Brazil, the banks remain solvent and there is still an open credit channel. In those countries, the international crisis is being felt mainly in the form of reduced capital flows and less foreign trade.

On the other hand, weak demand worldwide and falling prices for raw materials have been accompanied by significantly less inflationary pressures in the developed and emerging economies. In response to this scenario, the Latin American central banks decided to lower their reference rates in an effort to stimulate the economy.

Exchange rates throughout the region depreciated during the past month. This tendency was most pronounced in Colombia and Mexico; the loss in the value of their currencies during the four weeks ended on February 20 came to 14.5% and 7.8%, respectively.

d. Financial Variables

Monetary aggregates registered a slowdown in the last two weeks, after showing an upward trend in December and January.

The total loan portfolio in the financial system grew at an annual rate of 16.6% in January compared to the 18.4% increase registered three months earlier (isolating the effect of the exchange rate on the loan portfolio in dollars). The drop in the portfolio level includes both foreign currency (- US$ 615 m since October) and local currency (-Col$2.4 t in the last eight weeks).

Growth in the portfolio in local currency continues to decline. The commercial loan portfolio registered an annual increase of 18% at the start of February, following nearly 22% at the end of December. Consumer loan growth went from 11.6% in December to 10% in the first week of February.

Loan portfolio quality indicators declined, particularly for consumer loans. In fact, by December, the non-performing consumer loan portfolio increased to 7.2% compared to a low of 4.2% at the end of 2004. The non-performing portfolio with respect to leasing and micro-loans was up as well.

In recent weeks, the banking system has earmarked funds acquired through deposits and repos for investment in local and foreign currency, as opposed to expanding the portfolio. The productive sector, for its part, continued to market securities as a way to finance its activities.

In January, the interbank interest rate (TIB) and the Bank Reference Indicator were in line with the policy rate for the first time since late October. This occurred in a context where the Central Bank again became a net lender to the financial system. As to the other interest rates in the market, those on CDs and the DTF have declined respectively by 131b.p. and 125 b.p. since December 19, when the Board of Directors began the current reference-rate reduction process. Moreover, all interest on commercial loans has declined during the last two months, as has the credit card rate. However, in the case of credit card lending, the reduction would be related to the decline in the usury rate.

2. DISCUSSION AND POLICY OPTIONS

The following points were emphasized during the course of the Board's deliberations:

i The increase in prices continues to exceed the targets for inflation set by the Board, but has slowed.

ii International prices for food, raw materials and oil continue to fall, which could have an important impact on total inflation, depending on how the exchange rate behaves and on the country's trade policy.

iii The annual variation in regulated prices continues to decline, even though local gasoline prices have yet to be affected by the drop in oil prices on the international market.

iv Economic activity continues to weaken faster than the Bank's technical team had anticipated.

v The total loan portfolio in the financial system continued to lose momentum during the past month.

vi Poor economic performance worldwide and in Colombia's major export markets, particularly the United States, Venezuela and Ecuador.

vii The effect of the exchange rate on inflation and growth in the tradable sectors.

viii Intermediate and long-term expectations for inflation are within the target range set by the Board of Directors.

The discussion among Board members centered primarily on: (i) the effect of monetary-policy measures, given the time it takes them to work through to the economy; (ii) the elements that affect inflation forecasts for 2009 and 2010; (iii) how inflation in the short term might affect prices and wages in 2009; (iv) projections on the current account deficit; (v) the uncertainty the world financial crisis has sparked on international markets and how it affects the Colombian economy; (vi) depreciation of the peso against the dollar in recent weeks; (vii) the region's access to external financing, the decline in long-term interest rates, and the reduced momentum in the loan portfolio held by the financial system; (viii) the risk balance between growth and inflation in a context where the economy is slowing faster than expected; and (ix) the need to bolster the monetary authority's credibility and to anchor inflation expectations.

The Board highlighted the fact that consumer inflation declined for the third month in a row. The drop was more than expected and included most of the items in the family market basket, particularly the food group. The core inflation indicators also were down in February, and inflation expectations were within the target range set by the Board (5%+/- 1/2 percentage point).

The decline in inflation and expectations of inflation confirms the fact that weak internal and external demand and the drop in international commodity prices are translating into less inflationary pressure. The Board is now more confident that annual inflation will continue to decline in the coming months and will be within the target range by the end of the year.

Available figures show the outlook for the world economy remains negative, despite the sharply expansive policies countries have adopted. The figures also confirm that productive activity in Colombia has slowed. The latest data on industry and commerce continue to show major reductions. Added to this is the impact further deterioration in economic activity worldwide has had on productive activity through fewer exports and lower terms of trade, declining confidence and more costly capital flows.

Given the current situation, which is characterized by declining inflation and fewer expectations of inflation, the Board of Directors believes the time is right to lower the intervention rate at a faster pace than the one adopted in the past two months, without affecting the credibility of the Central Bank's monetary policy. It emphasized that the loss of momentum in productive activity, which is reflected in higher unemployment, is greater than expected and that other central banks in the region also are adopting more expansive monetary policies to support demand and future growth in their economies.

Although they agreed to a reduction in the intervention interest rate, several members warned about the risks associated with a faster change in the policy rate than was agreed on at previous Board meetings. Given the instability of international and local financial markets, they believe the Bank's intervention interest rate should be cut in a way that focuses on credibility and the confidence of agents in the economy. An interest rate cut that is not credible can affect the exchange market, the government bond market and future expectations of inflation, all of which could make it difficult for the Board to continue to pursue an anti-cyclical monetary policy.

Nevertheless, the members of the Board agreed, by consensus, to reduce the intervention rate at a faster pace than the one adopted at previous meetings, but without this implying similar cuts in the future. Therefore, monetary policy and peso devaluation will help to support demand and future economic growth to the extent that they do not jeopardize the inflation targets.

Lastly, the Board reiterated the need to continue to monitor the international financial situation in order to ensure that whatever monetary policy measures might be needed to address its impact can be adopted at the proper time.

3. POLICY DECISION

The Board of Directors agreed to cut the Central Bank’s intervention interest rates by 100 b.p. This places its intervention rate at 8%.

Bogotá D.C., Colombia
March 13, 2009