Minutes of a Meeting of the Board of Directors of the Central Bank of Colombia on February 26, 2010

A regular meeting of the Board of Directors of the Central Bank of Colombia was held in the city of Bogotá on February 26, 2010.

Present:
Mr. Oscar Iván Zuluaga, 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 predominant issues addressed during the meeting.

1. BACKGROUND

a. Recent Developments in Inflation

Annual consumer inflation in January was 2.1%, which is 10 bp more than in December. Monthly inflation was 0.69%, and the annual core inflation indicators rose for the first time since early 2009.

The annual variation in food prices went from -0.3% in December to -0.5% in January. Although prices for perishables were higher, the increase was more than offset by the performance of non-perishables and food outside the home.

The annual increase in regulated prices went from 2.6% in December to 3.9% in January, owing to higher prices on all the goods and services in this sub-basket, but especially natural gas for residential use and public transportation.

The annual variation in non-tradables, excluding food and regulated prices, remained stable at 4.4%. The monthly variation in rentals was a significant factor; they were up 0.4%, which is more than the increases registered during the same month in past years.

The annual increase in tradables, excluding food and regulated goods, declined from 1.4% in December to 1.2% in January. This reflects accumulated appreciation in the exchange rate during recent months and international price stability for industrial products.

Given the preliminary data for February, inflation expectations derived from trading in government bonds at 1, 5 and 10 years came to 4.26%, 4.89% and 5.05%, respectively, with 57 bp, 64 bp and 65 bp variations compared to the averages for January.

The inflation expectations revealed in the Central Bank's monthly survey at the beginning of February were up slightly, but remained within the long-term target range defined by the Board of Directors.

Annual inflation in the producer price index (PPI) was 0.5% compared to -2.2% the month before.

b. Growth

Available figures on production in December and January indicate the momentum in economic recovery is weak, having been affected by the plunge in sales to Venezuela. Although the consumption indicators denote a slight recovery, those for industry and commerce show no clear trend.

The following are some of the relevant indicators:

- According to DANE, industrial production rose 2.0% in December, which is better than the Central Bank's technical team had expected.

- As for the December FEDESARROLLO Business Opinion Survey, the response to the questions on orders and inventory suggest it will take time for industry to return to the extent of economic activity witnessed prior to the crisis, since the momentum exhibited by these indicators - when statistically refined - is low.

- January saw an annual decline of 2.6% in the demand for unregulated industrial energy, halting the recovery observed in the fourth quarter of last year.

- The expectations for industrial activity, as noted in the FEDESARROLLO Business Opinion Survey for November and December, are optimistic. Particularly during the final two months of 2009, expectations for production three months out demonstrate a growing trend, with levels above those witnessed in 2008 and during the first half of 2009.

- The Business Opinion Survey for commerce, with data at December, indicates entrepreneurs anticipate an economic recovery at the start of 2010. The FENALCO survey, with information up to January, forecasts low growth in sales compared to past years.

- The total demand for energy rose 2.5% in annual terms, which is less than the increase posted during the previous two months.

- According to estimates by the National Federation of Colombian Coffee Growers, coffee production was down 40% in January compared to the same month in 2009.

Available indicators on the demand side, with data at January, denote a moderate recovery in private consumption.

- With January data, the FEDESARROLLO Consumer Confidence Index (CCI) shows the levels of confidence reached during the third and fourth quarters of 2009 continue. Given the high correlation between this indicator and total household consumption, the figure for January suggests this demand still continues to grow at a rate below the historic average.

- The Colombian Automotive Committee and the firm Econometría reported an annual increase of 6.8% in vehicle sales during January. As measured by DANE in the national accounts, there was a high correlation between motor vehicle sales and durable goods consumption.

Total exports in dollars came to US32, 849 million in 2009. This includes an annual reduction of 12.7%, primarily as a result of fewer sales to the United States (-8.2%) and Venezuela (-33.5%). In terms of value, all the sectors experienced reductions (industry -20.3%, mining -3.4% and agriculture -2.5%); as for volume, the industrial sector was the only one to post a decline (-17.6%).

Total exports were up 7.6% in December 2009 with respect to the same month in 2008, largely because of a 51.7% increase in mining exports. However, agricultural and industrial exports in dollars registered annual declines: 12.8% and 13.4%, respectively.

December 2009 witnessed an important rise in exports to the United States (50.9% in annual terms), thanks largely to the sale of oil and petroleum by-products. On the other hand, monthly exports to Venezuela dropped 77.6% in annual terms.

Imports (CIF) in 2009 came to US$ 32,897 m, having fallen at an annual rate of 17.1%. The most important reduction was in imports of intermediate goods (-25.4%), followed by imports of consumer goods (-11.9%) and capital goods (-9.62%). As for volume, all the country's imports were down, accumulating a 6.6% reduction in total. In monthly terms, the total value of imports at December was similar to what it was in December 2008 (0.1% less).

c. <u>The External Context</u>

The world economy was still in the midst of recovery at the end of 2009, even though performance was not consistent or uniform across all countries. At the start of 2010, the figures at hand show this recovery is ongoing. In fact, industrial production in the United States continued to expand and the figures for annual growth are positive. Business sentiment in most countries improved moderately during December and January, and remains at levels indicative of an increase in economic activity.

However, despite this favorable environment, the past month witnessed difficulties associated with government debt problems in Greece. The result has been an increase in risk perception with respect to that country and others with huge debts, such as Spain, Portugal and Ireland, as reflected in larger spreads on their sovereign bonds. This situation has brought pressure to bear on the euro, weakening it against the dollar and undermining investor confidence and stock market performance in the developed economies.

As for the emerging economies, the impact of the government debt problems in Europe has been low. Although the countries in the region saw their risk premiums go up slightly last month, this situation was reversed somewhat during the past week. A number of currencies, including the Colombian peso, remained stable and others, such as the Brazilian real and the Chilean peso depreciated, 7% between January and the first week of February.

With respect to growth, several countries in the region, such as Brazil and Chile, already show clear signs of recovery, as manifest in their industrial production and export indicators. In general, the developing countries have a more favorable mid-term outlook than the developed countries.

d. Financial Variables

Annual growth in the primary monetary aggregates stabilized during the past nine weeks at rates between 5.0% and 8.0%. In the case of M3, the stability in the growth rate was the result of a build-up in savings and a slowdown in term deposits.

The nominal annual increase in the total gross loan portfolio came to 5.8% by early February, which is a little more than at the end of 2009 (4.9%). Although consumer lending was up slightly (2.3% nominal), disbursements continued to gain momentum, posting an annual increase of 26.6%. With respect to mortgages, growth in the outstanding balance was much higher (18.1%) and disbursements were up 48%. The commercial loan portfolio increased 4.5% as opposed to 3.5% by the end of 2009, while disbursements weakened in January, especially those for builders to finance home construction. The last three months have seen an upsurge in mortgage and consumer lending.

The interbank rates (IBR and BRI) in January and early February were close to the policy rate. The generalized decline in all other interest rates, characteristic of the fourth quarter of 2009, continued up until mid-January, but was interrupted during the last two weeks of that month, with the exception of interest rates on treasury loans. In real terms, all average interest rates were down in January.

Government bond performance in January was mixed, with depreciation in mid-term bonds (24 bp), valuation in short-term bonds (-35 bp) and stability in long-term bonds (2 bp).

2. DISCUSSION AND POLICY OPTIONS

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

- i The January figure for inflation, which was less than the rate forecast by the Central Bank's technical team, mainly because of good performance with respect to food prices
- ii The increase in core inflation indicators
- iii The temporary effect El Niño weather could have on higher prices
- iv The optimism reflected in producer and consumer confidence indicators
- v The increase in monetary aggregates at rates between 5% and 8%
- vi The financial system's peso loan portfolio, which continues to grow in excess of nominal GDP
- vii How market interest rates performed in response to the decline in the Central Bank's benchmark rate
- 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 showed mixed performance for the different tranches.

The main points analyzed by the Board members centered on: (i) the elements that affect inflation forecasts for 2010, particularly an eventual temporary surge in food and regulated prices due to El Niño weather; (ii) the lag between monetary policy measures and their impact on production and prices; (iii) forecasts for economic growth in 2010; (iv) the sharp drop anticipated in exports to Venezuela; (v) the performance of monetary aggregates and how it might affect economic recovery; (vi) the recent momentum in the financial system's commercial and mortgage loan portfolio; (vii) the increase in expectations of inflation (viii) the risk balance between growth and inflation in the context of an economy that continues to demonstrate weak growth and a level of inflation that is within the long-term range set by the Board of Directors; and (ix) the need to bolster the monetary authority's credibility and to anchor expectations for inflation close to the long-term target.

The Board of Directors emphasized the following with respect to the performance of inflation during the month: (i) annual consumer inflation in January was 2.1%, having been 2% at the end of December;(ii) core inflation indicators were up slightly, while expectations for inflation one-year out increased, but remain within the target range set by the Board of Directors, which coincides with the long-term range (between 2% y 4%); (iii) annual inflation in January was due fundamentally to higher prices for regulated goods; (iv) in spite of El Niño weather, the decline in food prices continued; (v) although perishables experienced price hikes, they were more than offset by non-perishables and food outside the home; (vi) the Central Bank's inflation forecasts include temporary increases in the price of food as a result of El Niño weather, but they are expected to be reversed during the second half of the year.

The U.S. economy, which is Colombia's leading export market, demonstrated more growth during the fourth quarter of 2009 and so far this year than international analysts had expected. The mid-term and long-range prospects for the region's economies and for other emerging markets remain favorable.

According to the figures at hand, the slow recovery in quarterly GDP levels continues. Expectations within the business community have improved, and there is more growth in private consumption.

The Board of Directors believes the Central Bank's expansive monetary policy has permitted a steady decline in interest rates on deposits and lending. It also is of the opinion that the benchmark rate, as it now stands, continues to kindle economic growth in an environment that is characterized by a healthy financial system. Therefore, it decided to hold the Central Bank’s intervention rate at the current levels.

3. POLICY DECISION

The Board of Directors agreed to make no change in the Central Bank’s intervention rate, leaving it at 3.5%.

Bogotá, Colombia
March 12, 2010