MINUTES OF A MEETING OF THE BOARD OF DIRECTORS OF THE CENTRAL BANK OF COLOMBIA ON JANUARY 29, 2010

A regular meeting of the Board of Directors of the Central Bank of Colombia was held in the city of Bogotá on January 29, 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 December was 2%, which is 37 bp less than in November. Monthly inflation (0.08%) was positive for the first time in three months. The drop in core inflation indicators continued.

The annual variation in food prices declined from 0.7% in November to -0.3% in December.

The annual increase in prices for regulated goods and services went from 1.5% in November to 2.6% in December, owing to higher public utility rates.

Annual inflation in non-tradables, excluding food and regulated prices, declined from 4.5% in November to 4.4% in December. Annual inflation in rentals was an important factor, having gone from 4.2% to 3.9% in December. Annual inflation in the price of highly indexed goods and services remained at 6.8%, while annual inflation in the price of items with less indexing went from 3.8% in November to 3.7% in December.

The annual increase in the price of tradables, excluding food and regulated goods and services, dropped from 1.9% in November to 1.4% in December.

Inflation expectations derived from trading in government bonds at one, five and ten years were 3.07%, 4.17% and 4.47%, respectively, with variations of 111 bp, 69 bp and 33 bp compared to the average figures for December.

Annual producer-price inflation (PPI) was -2.2% as opposed to -3-9% the month before.

b. Growth

At the end of December, DANE announced the figure for annual GDP growth in the third quarter of 2009, which was -0.2%. Compared to the second quarter of that year, third-quarter GDP rose 0.2%, thereby completing three consecutive periods of slow quarterly GDP growth.

As for annual variations, the decline in GDP during the third quarter of 2009 was related to fewer investments. DANE reported a decline in gross capital formation, due to a sharp reduction in investments other than those in civil works. The other component of internal demand, consumption (government and private consumption combined), contributed positively to the annual variation in GDP during that period. Private consumption saw no annual growth; however, this represents an improvement compared to the reductions witnessed during the two previous quarters and, in terms of level, it is slightly better than the situation observed during those periods. Government consumption in the third quarter posted the largest annual increase for the year to date.

With respect to external demand, exports declined in annual terms, owing to fewer coffee sales as a result of less coffee production and the drop in exports to Venezuela. The slump in external demand, due to the international crisis, was a factor as well. Once again, imports experienced more of a decline than exports. As a result, external demand made a positive contribution to annual GDP growth.

As to the various branches of economic activity, the sectors that explained the annual drop in GDP were industry, commerce, building construction and transportation, in that order. Civil works and mining were the sectors that contributed the most, in a positive sense, to the annual variation in GDP during the third quarter.

Most of the indicators at hand for the fourth quarter of 2009 show more economic activity in terms of annual growth.

- By November, the annual variation in the Industrial Production Index (IPI), excluding coffee processing, was 2.0%, according to DANE. This is the best figure on record for annual growth in one month since April 2008.

- From September to November, there were signs of recovery in almost half of the industrial branches, including chemical substances, furniture, tobacco and metallic products. However, other branches such as wearing apparel, paper, petroleum by-products, glass, cement and electrical appliances, among others, continued to show no signs of recovery. Some of these industries probably have been affected as a result of the trade restrictions imposed by Venezuela.

- The overall demand for energy (regulated and non-regulated) increased at an annual rate of 3.4% in December and 2.6% during the entire last quarter, which was the largest expansion witnessed since the end of 2007.

- The Fedesarrollo consumer confidence index (CCI), which has quarterly data, rose during the fourth quarter despite the drop in the monthly figure for December.

- Retail sales posted an annual increase of 2.0% during November. With respect to levels, seasonally adjusted sales rose compared to previous months, with the exception of food and beverages.

- Unlike consumption, investment (at least investment that does not include civil works or building construction) sustained stable growth at the end of 2009.

The balance of payments up to the third quarter of 2009 shows a current account deficit of US$3.456 billion (b) (2.1% of GDP). This is US$737 million (m) less than the deficit posted during the same period in 2008. That reduction originated with the decline in current outlays (-US$7.019 b), which exceeded the drop in current income (-US$6.282 b).

The aforementioned deficit was financed with US$4.894 b in capital inflows (3 % of GDP), mainly US$6.165 b in resources from the public sector (including Ecopetrol). The capital and financial account surplus is US$ 2.166 b less than it was during the same period in 2008. This is due to a decline in net capital flows for foreign direct investment (-US$ 2.410 b), larger debt payments and Colombian investment abroad.

Total exports in dollars saw 25.9% annual growth in November 2009, largely because exports to the United States were up 61.6%. Most of this performance is due to a base effect, given the low level of exports in November 2008 (slightly more than US$2 billion). During the same month, exports to Venezuela fell 71.5% in annual terms.

Although total exports in dollars declined at an annual rate of 14.4% between January and November 2009, the levels are higher than they were during the same period in 2007 (US$29.660 b in 2009 versus US$ 26.815 b in 2007). During this period, the accumulated drop in exports came to 12.7% in the case of the United States, 28.2% in the case of Venezuela and 17% with respect to Ecuador. All export sectors experienced a decline in value (industrial -21%, mining -7.2% and agriculture -1.6%). However, the industrial sector was the only one to report less volume (-19.4%).

During the year to November 2009, imports (CIF) came to US$29.836 b, having fallen 18.5% in annual terms. Imports of intermediate goods were down by -27.6%, consumer goods -12.5% and capital goods -10.2%. Total imports also declined with respect to volume: specifically, 7.6% in the amount accumulated by November. In monthly terms, the value of imports in November 2009 was less than in November 2008 (-14.2%), primarily because of imports of capital goods were down 21.6%.

The Comprehensive Household Survey (GEIH in Spanish) shows employment in the 13 major urban areas rose at an annual rate of 4.3% during the September-November 2009 moving quarter. When analyzing the seasonally adjusted series, one sees an increase in employment levels during the second half of 2009 compared to the first six months. However, it was concentrated in non-salaried workers, since salaried employment remained at a standstill throughout the year.

c. The External Situation

The world economy continued to recover during the fourth quarter of 2009, thanks to economic growth in the Asian counties. An increase in international trade as of mid-year, which reached levels in some countries similar to those witnessed in 2007, was a reflection of that revival. The principal analysts believe the world economy in 2010 will continue to be lead by Asia. This, in turn, will favor the terms of trade in Colombia and in other countries of the region. Even so, the risks in the developed economies remain high, which is why recovery in 2010 still is expected to be slow. For that reason, the forecasts for growth were raised only slightly, particularly for the United States.

As to prices, although the industrialized countries witnessed an increase in annual inflation during the last few months, it was due to the effects of a lower base in the second half of 2008 (owing to the drop in energy prices). However, core inflation remained stable and, in some cases, has declined. In view of that fact and the weak forecast for growth, no major inflationary pressure is anticipated for the coming quarters. Analysts forecast 2.1% inflation in the United States during 2010 and 2% in 2011.

The economic recovery in the emerging markets has been led by the Asian countries, particularly China and India. China reported 10.7% annual growth in the fourth quarter and, as a result, its economy grew 8.7% during 2009. Several countries in Latin America, such as Brazil and Chile, showed clear signs of recovery and, during the third quarter, a number of countries in the region achieved the GDP levels registered in 2008.

Most of the region's currencies appreciated during the final quarter of 2009. However, performance was mixed during the four weeks prior to January 25. While Brazil and Chile saw their currencies depreciate, Colombia and Peru reported appreciation in the price of their currencies. The government in Venezuela decreed a sharp devaluation of the bolívar.

Risk premiums have remained stable and are at the levels witnessed prior to the collapse of Lehman Brothers.

d. Financial Variables

The annual increase in M3 went from 16.4% in July 2009 to 10.3% in September of the same year and to 7.3% by January 15, 2010. Most of the slowdown in M3 is due to liabilities subject to reserve requirements (LSR), especially CDs. Even so, the increase in M3 continues to outpace economic growth, and the M3/GDP ratio is at the highest level calculated since December 1989.

There are indications of stabilization in the lending market, both in terms of data and expectations about how the total gross portfolio will evolve. Certain types of lending, such as mortgage and consumer loans, are showing signs of recovery. In the case of commercial loans, the slowdown has been offset by the increase in the placement of bonds issued by large companies.

The annual increase in the total gross loan portfolio was 8.1% in September, 4.9% in December and 5.3% for the year to date in January. A look at the different types of loans shows mortgage lending was the most dynamic, having gone from 14.6% annual growth in September to an annual rate of 18.3% for the year to date in January. On those same dates, the annual increase in consumer lending went from 0.6% to 1.5% and from 9.3% to 4% for commercial loans.

A portion of the slowdown in the commercial loan portfolio is due to corporate bond issues. When corporate bonds are added to the commercial loan portfolio, the outstanding balance remained stable in the final quarter of 2009, with 5.3% nominal growth and 2.9% real growth, respectively.

As to the availability of credit, the latest Central Bank quarterly survey of businessmen, merchants, transport service suppliers, financial analysts, academics and labor unions shows it is perceived as being high, a tendency that has been growing since the first quarter of 2009. On the credit supply side, the preference for granting loans gained ground, especially loans to companies that produce for the local market and to companies with foreign investment. The same survey showed the financial system is more willing to accommodate loan applications and does not contemplate increasing loan requirements. In fact, they might even be reduced.

One-day interest rates on the interbank market were near the Central Bank's benchmark rate and those on lending and deposits continued to decline. By January 22, the DTF benchmark rate was 4.10%, having been 4.14% and 4.45% four and thirteen weeks earlier. As for commercial lending, the interest rate on January 15 was 10.56% for ordinary loans, 7.63% for preferred loans and 7.12% for treasury loans. These rates were 4 bp, 15 bp and 2 bp less than those in December, in that order. During the third quarter, and in the same order, the reductions came to 60 bp, 57 bp and 67 bp. Interest rates on household loans declined as well. As for consumer lending, the rates observed on October 16, December 11 and January 15 were 21.20%, 20.43% and 19.98%, respectively. On those same dates, the interest rates on home loans were 14.14%, 13.84% and 13.66%.

Between December 21 and January 26, the TES yield curve shifted upward by 63 bp, 91 bp and 34 bp in the short, medium and long segments, respectively.

2. DISCUSSION AND POLICY OPTIONS

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

i Inflation at the end of the year and the slowdown in price hikes during the month, which was generalized once again
ii The decline in core inflation indicators.
iii The temporary effect El Niño weather could have on price hikes
iv The rise in consumer and business confidence indicators, which have improved
v The situation with M3 and liabilities subject to reserve requirements
vi The financial system's peso loan portfolio, which continues to grow more than nominal GDP
vii Bond issues that have supplemented financing for the productive sector
viii How market interest rates have performed in response to the decline in the Central Bank's benchmark rate
ix The impact of the exchange rate on inflation and on growth in output in the tradable sectors
x The performance of interest rates on government bonds

The main points analyzed by the Board members centered on: i) the elements that affect the inflation forecasts for 2010, particularly an eventual temporary rebound in food and regulated prices due to El Niño weather; ii) the time it takes monetary policy measures to affect production and prices; iii) economic growth forecasts for 2010; iv) the sharp drop in exports to Venezuela during recent months and the decline in that country's output; v) the performance of monetary aggregates and how it might affect economic recovery; vii) the recent momentum in the commercial loan portfolio held by the financial system; viii) the risk balance between growth and inflation in a context of economic slowdown and falling inflation; and x) the need to bolster the monetary authority's credibility and to anchor expectations for inflation to the long-term target.

With respect to the way inflation performed during the month, the Board of Directors emphasized the following: i) annual consumer inflation ended the year at 2%.; ii) the indicators of core inflation (which does not include prices of the most volatile items such as food) continued to decline, while expectations for inflation one year out remain within the target range set by the Board of Directors, which coincides with the long-term range (between 2% and 4%); and iii) December witnessed another generalized price decline for the various items in the basket, thereby encompassing a wide variety of goods and services.

The world economy continued to recover, thanks largely to growth in the Asian countries. The rise in international trade and higher commodity prices are a reflection of that revival and prompted an increase in the growth forecasts for 2010. The medium and long-term outlook for the region's economies and for other emerging countries remains favorable. However, the growth forecasts for Venezuela were revised downward once again.

According to the information at hand, quarterly GDP levels continue to recover. There also are signs that aggregate demand is on the mend. These indications include the improvement in the confidence indicator for consumers and the industrial sector associated with the construction of civil works, stabilization of the indicators for installed capacity, and the recovery in raw material imports.

The Board of Directors thinks the expansive monetary policy has allowed for a steady decline in interest rates on deposits and lending, and believes the benchmark rate, as it now stands, continues to stimulate economic growth in an environment characterized by a stable financial system. Consequently, it decided to keep the Central Bank's intervention rate at its current level.

3. POLICY DECISION

The Board of Directors agreed to hold the Central Bank's intervention rate steady at 3.5%.

Bogotá, Colombia
February 12, 2010